

INTERNATIONAL MONETARY FUND



# **Staff Country Reports**

**Cambodia: 2002 Article IV Consultation and Sixth Review Under the Poverty Reduction and Growth Facility—Staff Report; Public Information Notice and Press Release on the Executive Board Discussion; and Statement by the Executive Director for Cambodia**

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of a combined discussion of the 2002 Article IV consultation with Cambodia and sixth review under the Poverty Reduction and Growth Facility, the following documents have been released and are included in this package:

- the staff report for the combined 2002 Article IV Consultation and sixth review under the Poverty Reduction and Growth Facility, prepared by a staff team of the IMF, following discussions that ended on November 22, 2002, with the officials of Cambodia on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on February 3, 2003. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- a Public Information Notice (PIN) and Press Release, summarizing the views of the Executive Board as expressed during its February 20, 2003, discussion of the staff report on issues related to the Article IV consultation and the IMF arrangement, respectively.
- a statement by the Executive Director for Cambodia.

The document(s) listed below have been or will be separately released.

Joint Staff Assessment of the Poverty Reduction Strategy Paper  
Letter of Intent sent to the IMF by the authorities of Cambodia\*  
Memorandum of Economic and Financial Policies by the authorities of Cambodia\*  
Poverty Reduction Strategy Paper  
Selected Issues Paper and Statistical Annex/Appendix

\*May also be included in Staff Report

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

To assist the IMF in evaluating the publication policy, reader comments are invited and may be sent by e-mail to [publicationpolicy@imf.org](mailto:publicationpolicy@imf.org).

Copies of this report are available to the public from

International Monetary Fund • Publication Services  
700 19<sup>th</sup> Street, N.W. • Washington, D.C. 20431  
Telephone: (202) 623-7430 • Telefax: (202) 623-7201  
E-mail: [publications@imf.org](mailto:publications@imf.org) Internet: <http://www.imf.org>

Price: \$15.00 a copy

**International Monetary Fund  
Washington, D.C.**

INTERNATIONAL MONETARY FUND

CAMBODIA

**Staff Report for the 2002 Article IV Consultation and Sixth Review  
Under the Poverty Reduction and Growth Facility**

Prepared by the Asia and Pacific Department

(In consultation with the Fiscal Affairs, Legal, Monetary and Exchange Affairs, Policy Development and Review, Statistics, and Treasurer's Departments)

Approved by R. Anthony Elson and Matthew Fisher

February 3, 2003

- A staff team visited Phnom Penh during November 7-22 to conduct discussions for the 2002 Article IV consultation and the sixth review under the PRGF arrangement. The team consisted of Messrs. Lee (Head), Doi, Marciniak, and López-Mejía (all APD), Mr. Ishikawa (PDR), Ms. Eulate (APD, staff assistant), and was assisted by Mr. Hagemann (Resident Representative). Ms. Indrawati and Mr. Segara (OED) attended the policy meetings.
- The mission met with Senior Minister of Economy and Finance Keat Chhon, Senior Minister of the Council of Ministers Sok An, Governor Chea Chanto of the National Bank of Cambodia, Minister of Commerce Cham Prasidh, and other senior officials. It also met with representatives from the labor union, business community, and NGOs.
- The authorities have expressed interest in continued Fund support through a successor PRGF arrangement. To help maintain economic reform momentum until a possible successor arrangement is put in place, understandings were reached on a macroeconomic framework for 2003 and on supporting structural reforms as elaborated in the attached MEFP (Attachment).
- Cambodia accepted the obligations of Article VIII, Section 2, 3, and 4 in January 2002, and has maintained an exchange system that is free of restrictions on payments and transfers for current international transactions.
- Disbursement of the second tranche of the World Bank Structural Adjustment Credit is being delayed mainly due to problems in the forestry sector. These relate to (i) the government's decision to terminate the role of Global Witness as an independent monitor, which could weaken the forestry monitoring system, and (ii) a delay in the government's review process of existing concession contracts and agreement on any actions required following the outcome of the review.
- The government has agreed to the publication of the staff report, MEFP, National Poverty Reduction Strategy (i.e., the PRSP), and Joint Staff Assessment in line with Cambodia's past practice under the PRGF.

Contents	Page
Executive Summary.....	4
I. Introduction.....	5
II. Stocktaking of Performance Since 1998.....	5
III. Report on the Discussions.....	13
A. Medium-Term Prospects and Challenges.....	15
B. Outlook and Policies for 2003.....	20
IV. Staff Appraisal.....	24
<b>Text Boxes</b>	
1. Structural Conditionality.....	6
2. Competitiveness.....	8
3. Government Contracts and Their Revenue Implications.....	10
4. Governance and Corruption.....	12
5. How Do Policy Recommendations Affect the Poor?.....	14
6. Financial Intermediation.....	17
<b>Figures</b>	
1. Selected Economic Indicators, 1997-2002.....	27
2. Indicators of Program Performance, 1998-2002.....	28
<b>Tables</b>	
1. Selected Economic Indicators, 1998-2003.....	29
2. Balance of Payments, 2000-2007.....	30
3. Monetary Survey, 2000-2003.....	31
4. Summary Accounts of the National Bank of Cambodia, 2000-2003.....	32
5. General Government Operations, 2001-2003.....	33
6. Quantitative Performance Criteria and Benchmarks, June-December 2002.....	34
7. Structural Policy Actions for the Sixth PRGF Review.....	35
8. Medium-Term Macroeconomic Framework, 1999-2007.....	36
9. Indicators of Fund Credit, 2000-2011.....	37

## Annexes

I.	Key Achievements Under the PRGF-Supported Program .....	38
II.	Technical Cooperation Action Plan (TCAP).....	39
III.	Public and External Debt Sustainability.....	41
IV.	Fund Relations.....	46
V.	World Bank Policy Dialogue and Its Relation with the IMF .....	48
VI.	Relations with the Asian Development Bank.....	53
VII.	Statistical Issues.....	54
VIII.	Socio-Demographic Indicators, 1990-2000.....	56
IX.	Summary of Technical Assistance Provided by the Fund, 1998-December 2002 .....	57

## Attachment

Letter of Intent .....	58
Memorandum of Economic and Financial Policies for 2003 .....	59

### **Executive Summary**

- **After decades of unrest, political and social stability was regained in late 1998**, when a coalition government headed by Prime Minister Hun Sen (Cambodian People's Party) was formed. The first-ever commune elections were held in February 2002 where the CPP gained a significant majority. National elections are slated for end-July 2003.
- **Supported by inflows of development aid, economic activity regained vitality in 1999.** The government's macroeconomic strategy, which was supported by a PRGF arrangement, yielded positive results. Real GDP growth averaged 7 percent per annum during 1999-2001, and inflation was subdued. Some progress was also made in strengthening customs and tax administration, restructuring the banking system, and introducing various legislative changes; however, deep-rooted governance problems and human resource constraints hampered progress in judiciary reform and capacity building.
- **Economic performance in 2002 was broadly satisfactory.** Real GDP is estimated to have slowed to 4½ percent due to adverse weather conditions. Government revenue is expected to have fallen short of earlier expectations, but larger external financing allowed a net repayment to the National Bank. Gross international reserves increased steadily to about US\$665 million (equivalent to 3½ months of imports) by year-end. All end-September quantitative performance criteria and the structural performance criterion for end-October were observed. Progress in structural reforms has been broadly satisfactory, albeit with some delays.
- **Real GDP growth could reach 6-7 percent over the medium term.** However, the foundations to support such growth still remain weak. Cambodia's wages are relatively high, infrastructure is poor, and the regulatory environment is unpredictable. Decisive efforts are needed to strengthen governance and public administration. Strengthening fiscal revenue performance will be key for the government to be able to afford competitive civil service wages, and thereby upgrade the quality of public services, as well as to raise social spending. Establishing a sound judiciary will also be essential.
- **The main near-term policy issue, including for the sixth review, is to reverse the erosion of the revenue base and improve customs and tax administration.** In particular, measures are needed to meet the 2003 fiscal revenue target of 12¾ percent of GDP, which is consistent with the medium-term framework. Limits need to be placed on government spending, especially in light of the national elections slated for July, to avoid recourse to bank financing.

## I. INTRODUCTION

1. **A coalition government, formed in 1993 following UN-sponsored free elections, provided a brief period of economic stability for the first time in more than three decades.** But with growing tension among the ruling parties and poor governance, economic performance deteriorated in the second half of the 1990s. As a result, the mid-term review of the second annual PRGF arrangement (1994-97) was not completed, and the Fund's resident representative office was closed in October 1997, owing to governance issues relating to illegal logging. Political stability was regained in late 1998 when a new coalition government was formed, headed by Prime Minister Hun Sen (Cambodian People's Party (CPP)). Cambodia's first-ever commune elections were held in February 2002, where the CPP gained a significant majority. National elections are slated for July 2003.

2. **A three-year PRGF arrangement for SDR 58.5 million (67 percent of quota) was approved by the Executive Board on October 22, 1999.** The fifth review was concluded on July 22, 2002. An Interim Poverty Reduction Strategy Paper (I-PRSP) was endorsed by the World Bank and Fund Executive Boards in January 2001. As of November 30, 2002, total Fund credit and loans outstanding to Cambodia amounted to SDR 71 million (81 percent of quota). Upon completion of the current (and final) review, a disbursement of SDR 8.4 million would become available. In accordance with the Fund's safeguards policy, the National Bank of Cambodia (NBC) published in September 2002 its audited financial statements and related audit opinion for 2001, as it did with its 2000 accounts.

3. **In concluding the 2001 Article IV consultation (together with the fourth PRGF review) on February 6, 2002,** Directors commended the authorities for the maintenance of macroeconomic stability, but stressed the need to press ahead with the reform program, particularly in view of an uncertain global economic environment. They emphasized the importance of stronger tax administration and expenditure management, bank restructuring, forestry policy, and civil service reform. These recommendations, which overlapped with program conditionality under the PRGF arrangement, were broadly observed (Box 1 and Annex I). With support provided under the Technical Cooperation Action Plan (TCAP), some progress was made in strengthening the capacity of various departments of the Ministry of Economy and Finance (MEF), although the remaining agenda is still large (Annex II). In the area of bank restructuring, significant progress was made.

## II. STOCKTAKING OF PERFORMANCE SINCE 1998

4. **A decade long civil war in Cambodia and political upheaval destroyed the basic building blocks of the economy.** Physical infrastructure was severely damaged by the civil war.<sup>1</sup> Government capacity was diminished and remains very limited owing to the lack of adequate institutions, the low skills of civil servants, and financing constraints. In addition, the

---

<sup>1</sup> For example, only about 7,000 miles of roads have been rehabilitated (with earth fill and laterite surfacing) since the rebuilding efforts began in the first half of 1990s, yielding about a third of a mile of rural road per 1,000 hectares.

## **Box 1. Cambodia: Structural Conditionality**

### **1. Evolution of coverage under the PRGF-supported program**

The structural conditions under the PRGF-supported program during 1999-2002 have focused on: (i) improving tax and customs administration and public sector accounting and expenditure management; (ii) reforming management of forestry resources; (iii) completing the bank restructuring program, including reforming the state-owned Foreign Trade Bank (FTB), and developing a modern payments system; (iv) promoting trade reform; and (v) establishing sound governance. These reforms are viewed as essential for maintaining financial stability and enhancing prospects for sustained growth and poverty reduction.

Consistent with the guidelines for streamlining conditionality, structural conditions since the fourth review have been designed to focus on those measures most critical to the near-term macroeconomic outlook, and to avoid duplication with the World Bank. As a result, the restructuring of forestry concessions was retained for the fourth review as a structural benchmark, owing to the declining share of forestry in overall government revenue. Structural benchmarks on formulating a strategy for civil service reform and preparing for the full implementation of the military demobilization program, where the World Bank is taking the lead, were included owing to their importance for the medium-term macroeconomic objectives.

### **2. Status of structural conditionality from earlier programs**

Since the inception of the PRGF-supported program in October 1999, all structural performance criteria have been observed, with the exception of one structural performance criterion on the completion of an unqualified audit for the FTB. A waiver was granted at the time of the fifth review on the grounds that the audit was qualified because of provisions made in 2001 for losses that should have been recorded in earlier years.

There have been significant delays in the implementation of some structural benchmarks. Some of these delays were relatively minor, reflecting time needed to design reforms in the context of a very heavy agenda. The main areas that experienced considerable delays were military demobilization program, civil service reform, revisions to the Law on Investment, and the privatization of the FTB. Nevertheless, delayed reforms subsequently have moved forward or have been completed. The preparation of two pieces of legislation on secure transactions and insolvency were excluded from the formal structural conditionality at the time of the fourth review because they were not critical to the short-term macroeconomic outlook. However, completion of this legislation is under way with donor support, as a requirement for Cambodia's membership application to the World Trade Organization (WTO).

### **3. Structural areas covered by the World Bank and the Asian Development Bank (AsDB)**

The current World Bank SAC program, approved in February 2000, aims at improving natural resource and public sector management, as well as enhancing governance and fighting corruption. It has conditionality in the areas of forestry policy, the pilot military demobilization program, public expenditure management, and the investment regime. Due to lack of progress in forestry issues, the release of the second tranche is being delayed. The World Bank is also supporting the full military demobilization program through a demobilization and reintegration project approved by the World Bank's Board in August 2001, and forestry policy through a Learning and Innovation Loan (LIL) approved in June 2000. Civil service reform and the Governance Action Plan are being addressed through an Economic and Public Sector Capacity Building project, and a Policy and Human Resource Development Grant. In support of the full PRSP, an updated Country Assistance Strategy and a Poverty Reduction Support Credit (PRSC) are expected to be in place in 2003. The World Bank also has a Legal and Judicial Reform Project and a Land Management Project.

Other priority areas with active involvement of the AsDB and other donors include natural resource management, land reform, public sector management, financial reform, and legal and judicial reform. Public expenditure management is an overlapping area of assistance involving the Bank, AsDB, WHO, bilateral donors, and the Fund, and has required careful coordination to ensure that assistance is complementary.



business environment is unpredictable given the weak legal framework and uneven application of the law, and corruption is pervasive. Reflecting the early stage of economic rehabilitation, poverty in Cambodia continues to be widespread, with 36 percent of the population (1999) by one measure living below the poverty line of half a dollar a day (see page 49 of the Second Socio-Economic Development Plan (SEDP-II)).<sup>2</sup>

5. **The authorities have long regarded raising real GDP growth as crucial for reducing poverty.** Accordingly, since 1999, they have focused on maintaining macroeconomic stability, rebuilding institutions and addressing governance/corruption problems to reduce the impediments to economic development. With PRGF support, the authorities' strategy was aimed at: (i) strengthening revenue and implementing administrative reforms to improve social services and support an increase in public investment, while reducing military spending; (ii) improving bank soundness and financial intermediation; (iii) strengthening natural resource management, particularly forestry, to preserve valuable long-term sources of growth; and (iv) building a modern legal and judiciary framework and economic institutions.

6. **This reform strategy has been broadly successful, especially on the macroeconomic front.** With the booming garment sector and tourist-related activities, real GDP growth averaged 7 percent during 1999-2001. This compares with 3 percent growth during 1997-98 when political instability depressed economic activity. Growth in 2002 is expected to have slowed to 4½ percent due to the impact of a drought followed by flooding on agricultural output (Table 1). The rebound of garment exports after an initial slowdown in early 2002 (related to quota reallocation and worker strikes) helped to reduce the external current account deficit to about 10¼ percent of GDP (Table 2). Inflation has remained well below 5 percent since 1999, largely owing to the maintenance of fiscal discipline. Financial deepening has continued (Tables 3 and 4), partly facilitated by regained public confidence in the banking system, following the successful completion of bank relicensing in March 2002. Nevertheless, private credit expansion remains weak as banks regard lending to local businesses as high credit risk.<sup>3</sup> Increased demand for local currency helped boost international reserves. The exchange rate against the U.S. dollar has remained broadly stable during 1999-02, while gross international reserves rose from US\$390 million at end-1998 to about US\$665 million at end-December 2002 (equivalent to 3½ months of imports).

7. **The authorities' reform efforts have been also supported by favorable external developments and significant aid inflows.** Merchandise exports rose from only 29 percent of GDP in 1998 to about 40 percent of GDP in 2002, essentially reflecting an increase in garment exports to the United States under the Normal Trade Relations (NTR) status that was granted in 1996. Indeed, NTR status appears to have allowed Cambodia to expand its exports in an increasingly competitive environment (Box 2). Cambodia's historic heritage also attracted

---

<sup>2</sup> The UNDP in its Human Development Report (2001) indicated that between 40-45 percent of the population subsists below the poverty line.

<sup>3</sup> Reflecting this risk, interest rate spreads remain high at 13-14 percent, even though the domestic market is liquid.

## Box 2. Cambodia: Competitiveness

Competitiveness is a concern both with respect to the garment and the non-garment sectors.

**The garment sector is heavily affected by external factors, in particular U.S. textile and apparel quota policy.** The dramatic increase in garment exports from US\$1 million in 1996 to US\$516 million in 1999 was made possible by the United States granting Cambodia quota-free status for garment beginning in 1996, together with Normal Trade Relations (NTR) status. Accordingly, the average US tariff rate for garments produced in Cambodia was reduced from 50-70 percent to 10-20 percent. Foreign garment producers, who faced quota restrictions in their home countries, were attracted to Cambodia. In 1999, the U.S. imposed quotas on 13 categories of textile and apparels under the US-Cambodia textile agreement, with the average tariff rate kept unchanged. Since then, garment exports subject to quota have been limited to an annual quota increase of about 15 percent. The increase hinges on adherence to fair labor laws and regulations.

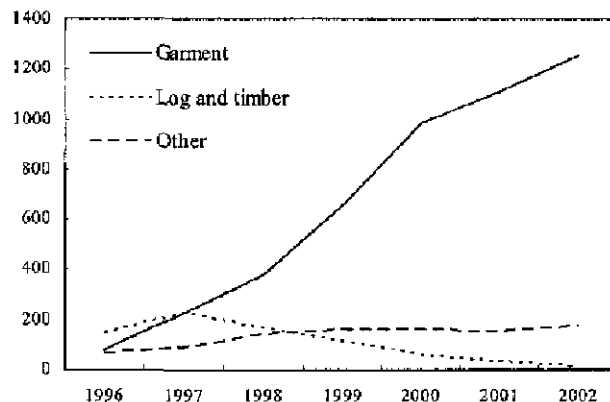
**Exports of textile and apparel outside the quota categories increased by about 120 percent on average per year during 1999-2001, but have slowed markedly since early 2002.** The sharp decline reflects strengthened export competition from other countries, including Vietnam (when its bilateral trade agreement with the United States came into effect), China, and Mexico. U.S. textile and apparel quota policy has protected Cambodia's garment sector from its competitors, and there is a significant risk that Cambodia's garment exports could drop sharply once the quota on textile and apparels are phased out in 2005 for all WTO members.

**Non-garment exports have declined since 1999.** Excluding exports of log and timber, which have declined sharply since 1999 due to the forestry reform program, non-garment exports rose only marginally by 3 percent, highlighting a serious competitiveness problem for the reasons noted below and difficulties in accessing the global market.

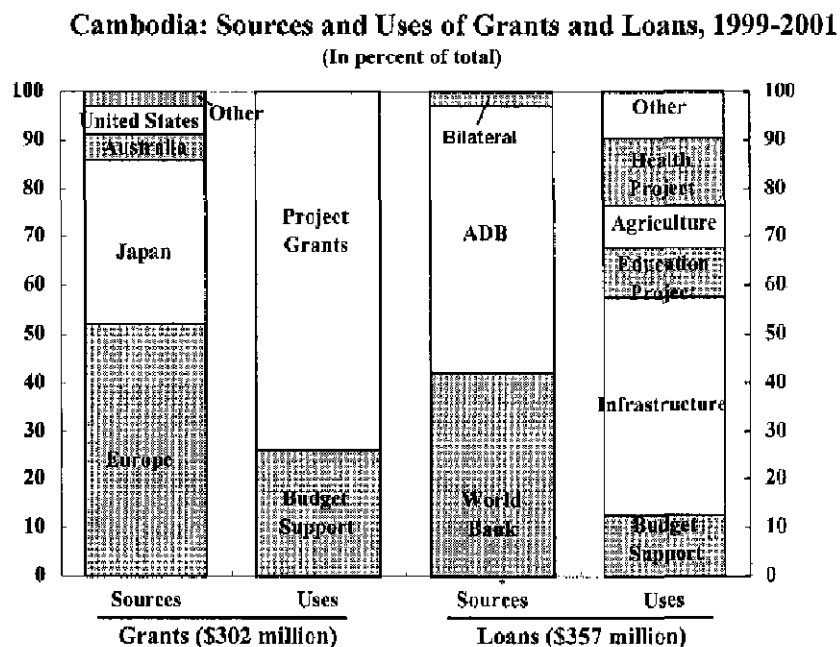
**Cambodia's business community noted that they needed to cut their costs by about 15-20 percent to compete with China.** Cambodia also needs to finalize its accession to the WTO. Since Cambodia is highly dollarized, there is little scope for cost reduction through the exchange rate policy. Key domestic cost components include:

- **Wages:** At a minimum wage of US\$45 per month and an average of US\$61 per month in the garment sector, for example, Cambodia's wages are higher than in several neighboring countries including Vietnam, India, and Sri Lanka. Moreover, Cambodia has generous labor benefits, such as 100 percent supplementary pay for overtime, long annual leaves, and about 26 paid official holidays per year.
- **Operating expenses:** (i) **Electricity:** Although international comparison is difficult, Cambodia's electricity tariff is regarded as relatively high: the tariff for commercial and industrial consumers ranges from US\$0.12 to US\$0.16 per kilowatt hour, while electricity tariffs for other ASEAN countries, such as Thailand, Malaysia, the Lao P.D.R., and Vietnam, range from US\$0.04/kWh to US\$0.08/kWh. (ii) **Roads:** Paved roads account for only 16.2 percent of the total road network in Cambodia, compared with 22.4 percent in China with a huge land mass, 97.5 percent in Thailand, and 25.1 percent in Vietnam. (iii) **Telecommunications:** Cambodia has just 2 telephone mainlines per 1000 people, while China has 112, Lao has 8, Thailand has 92, and Vietnam has 32.
- **Facilitation fees:** Since most investors receive various tax breaks, complaints have focused on the informal facilitation fees and the unpredictability of the regulatory environment.

Cambodia: Exports by Category of Goods, 1996-2002  
(In millions of US dollars)



visitors during this period, and tourism receipts rose from US\$66 million to US\$294 million during the same period (equivalent to about 8 percent of GDP in 2002). Aid inflows (grants and highly concessional loans) amounted annually to about 12-13 percent of GDP during 1999-2001. These inflows were predominantly used to rebuild infrastructure and support budgetary outlays.<sup>4</sup> Foreign direct investment inflows, however, have remained at around \$100 million in recent years, well below the peak of \$300 million in 1996, when foreign garment producers rushed into Cambodia to take advantage of the NTR status with the United States.



Source: Data provided by the Cambodian authorities.

8. **Government revenue** strengthened from 8.3 percent of GDP in 1998 to 11.7 percent of GDP in 2001, contributing to the maintenance of the current budget surplus at above 1¼ percent of GDP. Over the same period, defense spending declined by one percentage point of GDP, enabling the government to reallocate more resources to social spending. In 2002, however, with a projected revenue shortfall of 1¼ percent of GDP relative to the budget target, the current fiscal surplus (excluding grants) is estimated to have fallen below 1 percent of GDP (Table 5). Weak revenue performance reflected a drop in trade taxes in spite of recent efforts to strengthen customs administration and increases in excises on beer and selected petroleum products. Moreover, there has been an erosion of the tax base arising from widespread tax exemptions and the signing of contracts with private firms (to provide certain government services), which reduced transfers to the Treasury (Box 3). Nonwage current expenditure was accordingly compressed. There was no recourse to domestic bank financing of the budget last year because larger-than-expected foreign financing, i.e., bilateral project loans equivalent to about 1 percentage points of GDP, more than fully offset the shortfall in revenue and foreign budgetary support.

9. **Progress has been made on some structural fronts.** Early in the reform process, a Financial Institutions Law was passed, which was instrumental in providing the legal basis for successful bank relicensing, and, more recently, the banking and payments systems were restructured. Since 2001, governance issues have been partly addressed in the context of the Governance Action Plan (GAP). While the GAP has integrated cross-cutting public sector

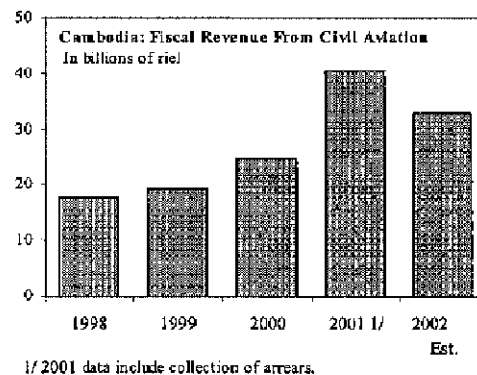
<sup>4</sup> Only about two-thirds of total official transfers are channeled through the central government. The remainder comprise inflows to foreign NGOs operating in Cambodia, and infrastructure projects implemented directly by donors.

### Box 3. Cambodia: Government Contracts and Their Revenue Implications

Two of Cambodia's major challenges are to improve its infrastructure and provide adequate public services to support the private sector. As the government lacks the financial and administrative resources to provide these basic needs, Cambodia has relied on the private sector by contracting out public or semi-public activities in return for sharing the revenue with the private operators.

To the extent that an appropriate regulatory framework is provided and a fair revenue-sharing agreement is in place, such contracting out could be a useful option. In Cambodia, government contracts in the areas of civil aviation and telecommunications have provided important sources of revenue and delivered needed services. However, the amount of revenue transferred to the budget has been below expectations when viewed against the rapid increase in activity in these areas, raising doubt about the appropriateness of the financial terms of these contracts.

**Civil Aviation.** Until recently, Cambodia had relied on neighboring countries to provide air traffic control services. In 2001, the government decided to take direct control, and signed a contract with a foreign company to build, operate, and eventually transfer (BOT) to the government the facilities necessary for providing air traffic control. Under this BOT, the government receives a portion of the fees collected from aircraft using Cambodian airspace. However, notwithstanding the collection of arrears in 2001, revenue in 2002 from civil aviation is estimated to have declined following the agreement. In addition, the financial terms of the contract have not been disclosed, and it is unclear whether a detailed financial analysis of the contract, comparing the initial capital outlays and operating expenses with the "foregone" revenue, had been conducted.



**Airport in Phnom Penh.** The government awarded a BOT contract to a foreign company in 1995 to build and operate the airport, providing generous tax exemptions. The contract included a revenue-sharing agreement, whereby the government receives 9 percent of the landing and passenger service charges but none of the departure fees. This contract was awarded even though grant funding was offered by a donor to build the airport.

**Telecommunications.** Following the expiration of a contract with a foreign operator providing international telecommunication services in 2000, the Ministry of Post and Telecommunications (MPTC) took over the equipment and facilities and began to provide these services. Revenue from this operation has remained relatively stable. At the same time, the MPTC signed a new contract with a different operator to cope with an increasing demand for such services. However, profit transferred to the budget from the new contract is only about one-fifth of that of the former contract.

To ensure that an appropriate amount of revenue is transferred to the budget, the government should consider taking the following steps when entering into a contract with a private company:

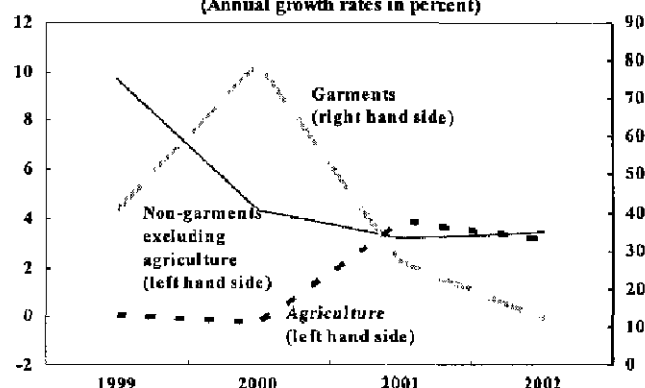
- Transparent procurement procedures, including appropriate use of competitive bidding should be adopted, and all contracts should be reviewed and signed by the Minister of Economy and Finance. All bidding information should be made public after the contract has been awarded.
- Financial terms of the contracts should be disclosed to the public.
- The National Audit Authority should audit government contracts, assess their appropriateness, and disclose its findings.
- External audit of the operation of the contractors should be conducted periodically by international auditors, and the results should be made public.

reform issues under a unified framework, progress under the GAP has been mixed (Box 4). Widespread illegal logging activity was formally banned, and several forestry concessions were cancelled. Key laws were introduced, including the Land Law and the Forestry Law. Draft commercial laws are being prepared to pave the way for WTO accession, and amendments to the investment law, which should help make the investment regime more transparent, are being discussed by the National Assembly.

10. **Implementation of structural reforms in several key areas has been slow, reflecting severe human resource constraints and entrenched governance problems.** Delivery of public services remains weak and responsibilities of economic institutions remain fragmented. Improvements in basic budgetary processes, such as cash management and revenue forecasting, have been slow due to inadequate intra-ministerial coordination. On the forestry front, there is still no effective system in place for monitoring logging activity and sustainable logging plans have yet to be worked out. In addition, the regulation of community forestry has not yet been finalized. Progress has been particularly slow in legal and judiciary reform, undermining the business environment, and the passage of an anti-corruption law is now expected to be further delayed.

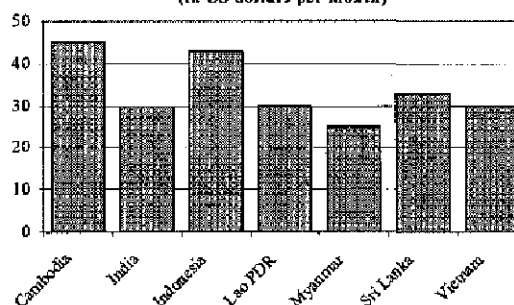
11. **Notwithstanding the achievements to date, the foundation for growth remains weak.** Growth has been narrowly-based on the garment sector, which employs only a small fraction of Cambodia's population of 13 million and on tourism-related activities that are geographically concentrated in a few small areas. Moreover, agricultural production, which accounts for about 40 percent of GDP, has grown very slowly, as the irrigation system is under-developed and crops are chronically affected by drought and/or flooding.

**Cambodia: GDP by Sector, 1999-2002**  
(Annual growth rates in percent)



12. **Cambodia's competitiveness has not improved, and attracting investors will be difficult.** First, labor costs are higher in Cambodia than in neighboring countries, in part reflecting the erosion of competitiveness since the Asian crisis. The currencies of its neighboring countries depreciated or remained broadly unchanged in real effective terms, while the riel appreciated by more than 10 percent by the same measure. In addition, institutional rigidities in the labor market, coupled with the fact that most prices in the formal sector are denominated in U.S. dollars, prevented downward adjustment of wages in US dollar terms. Second, poor infrastructure raises the cost of transportation and other operational

**Minimum Wages in the Garment Industry**  
(In US dollars per month)



Sources: Integration and Competitiveness Study; The Garment Manufacturers Association in Cambodia; and staff estimates.

### **Box 4. Cambodia: Governance and Corruption**

The Cambodian government has recognized that weak governance and pervasive corruption are major impediments to inclusive and private sector-led growth. The government's agenda for addressing these problems is spelled out in the Governance Action Plan (GAP I) adopted in April 2001. While the government has made progress in three key areas (i.e., public finance, military demobilization, and land management), it still has to take decisive steps in the other areas (especially in legal and judicial reform, public administration, forestry management, and anticorruption). Low civil service salaries, corruption, and vested interests remain major impediments to improving governance. Below is a summary of progress in key areas under GAP I.

#### **1. Public finance management**

- An amendment to the Law of Investment was recently submitted to the National Assembly. While it will enhance transparency, exemptions nevertheless remain excessive.
- Budget allocations to social sectors have increased, but a smoother disbursement pattern needs to be achieved to avoid year-end bunching.
- As part of procurement reform, competitive bidding on selected goods and services has been introduced in four ministries, but it needs to be expanded to other ministries and its coverage extended to include capital goods.
- The National Audit Authority (NAA) is now operational and a first audit on the implementation of the 2001 budget has been completed. However, the NAA still has to demonstrate the effectiveness of its operations.

**2. Public administration:** New job classification and remuneration regimes have been introduced in 2002 and priority mission groups are expected to be launched in early 2003. Implementation of other key aspects of civil service reform (CSR), however, has been postponed until after the 2003 national elections. The government will formulate a medium-term CSR after completing additional World Bank-funded studies on functional analysis, the labor market, and the safety net.

**3. Demobilization of the armed forces:** The full-scale demobilization program was launched in late 2001, with 15,000 soldiers discharged. A final group of 15,000 soldiers is expected to be discharged during 2003.

**4. Decentralization and local governance:** The first-ever commune elections were held in February 2002. Key laws and regulations have been adopted as part of the development of the legal framework for implementing decentralization and establishing transparency and accountability in Commune Councils. Strengthening local governance and service delivery, however, is largely contingent upon ensuring adequate and timely financing of local government outlays.

**5. Legal and judicial framework:** Progress in establishing a modern legal and judiciary framework has been limited. The School of Magistracy has been established, but it still needs to become fully operational. Finalization of the civil code and penal law are among the highest priorities in this area. Twelve commercial laws are expected to be adopted by the next WTO working group scheduled for April 2003.

**6. Anti-corruption:** The government has delayed the adoption of the Anti-Corruption Law until an adequate legal and judiciary framework is in place. Adoption of the Law is now tentatively slated for mid-2003.

**7. Gender equity:** Actions are under way to increase gender awareness among government officials. A decree enforcing the law against trafficking in women and children was adopted in 2002.

#### **8. Natural resource management:**

- The Land Law was enacted in 2001, and a comprehensive program to review land tenure and title issues is under way.
- The Forestry Law was enacted in mid-2002. An Independent forest crime monitoring has been established, but it has been ineffective. Logging and log transportation have been suspended. Concession contracts are being reviewed.
- The Fisheries Law and master plan are still pending. The scope of fisheries concessions has been reduced and new fisheries communities established.

#### **Other governance issues**

The government is preparing an enhanced governance strategy (GAP II) focusing on social and corruption issues. The government also intends to continue complying with the provisions under the IMF Safeguards assessment and has recently issued regulations on the reporting of anti-money laundering activities.

expenses. Third, due to poor public administration, regulations are enforced on an ad hoc basis, exacerbating the uncertainty of the business environment. The low quality of public services is largely attributed to low civil service wages, which average only US\$28 a month (even after a 35 percent increase in 2002) or only one-third of the average private sector wages in the formal sector (or slightly higher than half the wages paid to low-skilled garment workers). Low wages force civil servants to hold several jobs, seriously undermining the quality of public services.

13. **Program objectives in 2002 under the PRGF were broadly achieved.** All end-September quantitative performance criteria and the structural performance criterion for end-October were observed (Table 6). Three out of six structural benchmarks were met, and substantial progress was made in treasury reform (Table 7). A public notice announcing the government's intention to privatize the Foreign Trade Bank was issued in January 2003 (two months behind the target date), and the unweighted average tariff rate will be reduced to below 15 percent by end-June 2003 from the current rate of 16½ percent. This delay was partly related to the conversion of national tariff lines to the ASEAN Harmonized Tariff Nomenclature.

14. **The Government has continued to make efforts to resolve outstanding debt issues with the Russian Federation and the United States.** Discussions were held with the Russian authorities in June and September 2002. An understanding was reached on the broad terms for the pre-cut-off date debt, but further negotiations are needed for the post-cut-off date debt. On the U.S. debt, there have been a number of exchanges between the two sides since April 2002 to determine the precise amount of debt that is subject to rescheduling. The staff has provided technical support in carrying the debt negotiations forward.

15. **The National Poverty Reduction Strategy Paper (NPRS) was completed in December 2002, two years after the I-PRSP.** This gap arose as the authorities first concentrated on the preparation of the SEDP-II (2001-2005), which then became the basis of the NPRS in 2002. The NPRS has operationalized SEDP-II with more specific policy actions, addressed some of the key cross-cutting issues (e.g., governance and private sector development) in more depth, and developed detailed indicators to monitor progress in poverty reduction. Macroeconomic and key structural policies in the PRGF-supported program have been consistent with the policy agenda as spelled out in the I-PRSP and the newly released NPRS, especially with regard to fiscal and financial reform, governance, military demobilization and civil service reform.

### III. REPORT ON THE DISCUSSIONS

16. **The Article IV consultation discussions focused on the medium-term policy requirements that could generate sustainable growth aimed at reducing Cambodia's widespread poverty.** Strengthening government capacity was seen as a key element under the government's medium-term strategy, especially with a view to facilitating private sector development. The implications of policy recommendations on the poor (Box 5) were also examined, which are more extensively elaborated in the NPRS. Within the medium-term framework, discussions for the sixth PRGF review also focused on specific policies for 2003.

**Box 5. Cambodia: How Do Policy Recommendations Affect the Poor?**

Key policy reforms discussed with the authorities in the 2002 Article IV consultation can potentially affect the relative welfare of three income groups: Group 1—the poor (urban and rural), Group 2—the middle income group (employed mostly in the formal sector), and Group 3—the high income group (the business community).

Policy reform	Implication	Potential Impact
<b>1. Fiscal reform</b>		
<b>1.1 Strengthen revenue collection:</b> Raise fiscal revenue in the next few years.	Increase in social spending and government saving.	Potential redistribution of assets (income) from Group 3 (mostly taxpayers) to other groups (i.e., through higher social spending). Income effect: If properly spent, could promote growth (benefits all groups).
<b>1.1a. Tax revenue:</b> Address staff integrity, strengthen enforcement measures, and tighten control on smuggling.	Reduces inefficiency and corruption—strengthens revenue collection.	Same as 1.1 Income effect: Could promote investment as informal facilitation fees are reduced (benefits all groups), through more transparent investment regime.
<b>1.1b. Nontax revenue:</b> Review recent contracts and ensure that all future contracts are approved by the Minister of Economy and Finance.	Ensures proper transfer of profit to the budget—strengthens the revenue base.	Same as 1.1 Price effect: Could reduce monopoly pricing of concessionaires (benefits all groups).
<b>1.2 Tax policy:</b> Reduce the scope of exemptions and compensate by lower tax rates.	Reduces discretion and corruption—revenue neutral.	Income effect: Attracts investment and could foster more broad-based growth (benefits all groups).
<b>1.3 Expenditure re-orientation:</b> Raise social spending, and ensure allocation of capital spending in rural area.	Larger health and education spending; better roads and provision of utilities in rural areas.	Better access to health and education by Group 1. Income effect: Allows Group 1 easier access to markets and, more generally, economic opportunities.
<b>1.4 Civil service reform:</b> Reallocate a large portion to education ministry, raise civil service wages within overall medium-term expenditure framework.	Improves the quality of public services and provides more teachers.	Better access to public services (benefits all groups). Income effect: Better business environment. Employment effect: Could lead to redundancies in civil services in the short term.
<b>2. Monetary and external policies</b>		
<b>2.1 Low inflation:</b> Maintain low inflation.	Also ensures less volatility in the exchange rate.	Protects the value of Group 1 assets which are more likely to be denominated in riels. Price effect: Will protect price of local agricultural produce relative to imported goods.
<b>3. Banking sector reform</b>		
<b>3.1 Promote financial intermediation:</b> Strengthen legal framework.	Facilitates enforcement of financial contracts.	Easier access to bank credit by Group 2 and 3. Income effect: Promotes more broad-based growth (benefits all groups).
<b>3.2 Strengthen bank supervision:</b> Conduct on site inspection and monitor implementation of new chart of accounts.	Prevents banking crisis and limits banking system risks.	Protects the value of financial assets of Group 2 and 3. Price effect: Reduces cost of borrowing. Income effect: Promotes growth (benefits all groups).
<b>4. Other reforms</b>		
<b>4.1 Suspend logging activities:</b> until sustainable management plans, as agreed with stakeholders, and a monitoring system are in place.	Protects the environment and ensures a source of sustainable growth.	Income effect: Provides sources of sustainable growth for all groups. Protects a source of asset income for Group 1.
<b>4.2 Strengthen governance:</b> Implement Government Action Plan II.	Promotes transparency and reduces corruption.	Income effect: Promotes investment. Access to better government services by all groups.



### **A. Medium-Term Prospects and Challenges**

17. **To reduce poverty, the authorities' strategy as elaborated in the NPRS calls for real GDP growth of 6-7 percent in the medium term.** The authorities agreed that, given the limited domestic capital and skill base, the achievement of such a growth rate would require significant inflows of foreign direct investment (FDI) and continued donor support with foreign savings representing about 3-4 percent of GDP, consistent with an external current account deficit (excluding grants) of about 10-11 percent of GDP (Table 8). On this basis, Cambodia is expected to be able to continue servicing its obligations to the Fund in a timely manner (Table 9).

18. **The authorities have identified several potential sources of growth that have not yet been fully tapped, especially in the agricultural sector.** Large areas of land remained under-utilized; new varieties of rice could contribute to significant increases in yields and strengthen food security and develop rice exports; increased irrigation could alleviate the impact of flooding and drought, and allow an additional crop each year. Agro-processing and fish farming were also considered promising sources for future growth. The mission expressed concern, however, that in some areas natural resources were being depleted due to over-exploitation, e.g., forestry and fisheries. Adoption of sustainable plans is urgently needed to ensure that these valuable resources are not lost.<sup>5</sup>

19. **In view of the remaining challenges, the achievement of sustained strong economic growth would require substantial efforts.** The mission noted that to attract FDI and foster private sector activity competitiveness needed to be strengthened by reducing costs, including labor, utilities and transportation. Tapping other sources of growth would require upgrading basic infrastructure and sustainable plans in forestry and fishing. However, under the Labor Law, which currently sets a minimum wage of \$45/month, 100 percent supplementary payments for overtime and generous leave plans, the scope for reducing the cost of labor appeared very limited. Changing the Labor Law was considered to be politically difficult, given the presence of strong labor unions which are supported by international NGOs. In addition, improving labor skills and lowering operating costs through building infrastructure would take a long time. Accordingly, it was agreed that priority in the short term should be given to ensuring the predictability of the business environment and a more supportive public administration; over the medium term, emphasis should be given to increasing labor market flexibility, upgrading skills, and rebuilding infrastructure.

20. **It was also recognized that efforts would be needed to further simplify the investment regime.** The current system of tax preferences not only undermines revenue collection, but promotes rent-seeking activities and demands for informal facilitation fees. Indeed, during 1998-2001, about 50 percent of all imports were exempted from import duties, mostly under the 1994 Law on Investment. Given Cambodia's weak public administration, the staff suggested that a simpler tax system with low rates and strictly limited exemptions would

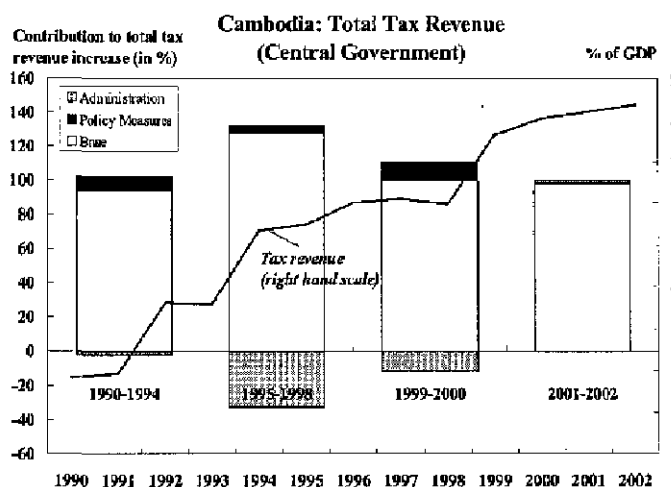
---

<sup>5</sup> The Land Law, which was promulgated in mid-2001, the forthcoming Fisheries Law, and the recently submitted forestry concessions and management plans are all aimed at establishing sustainable management of natural resources, while safeguarding access by local communities.

ensure a more transparent and predictable business environment. The authorities argued, however, that the scope of investment tax exemptions was to a certain extent pre-determined, because they needed to align their system with that of neighboring countries.

21. **To facilitate a more broad-based private sector development, bank credit will need to be made more widely accessible, especially to local investors and farmers (Box 6).** NBC staff concurred that improvements in financial intermediation would require changes to the legal framework aimed at increasing the enforceability of financial contracts. Although the draft Insolvency Law has recently been completed, various other commercial laws, including those related to the provision of collateral and the protection of creditor rights—which are essential to promote banking activities—are still in the drafting stage.

22. **To upgrade the quality of the civil service and rebuild the infrastructure will require improvements in revenue collection.** In the short run, improvements in fiscal revenue could be expected from the collection of arrears and the tightening of leakages through addressing staff integrity issues. The anticipated increase in revenue over the medium term was predicated on: (i) containing further the erosion of the revenue base and (ii) strengthened administrative capacity, which would only be possible if decisive actions were taken. Neither of these objectives would be easily accomplished, as the tax base is being eroded by increases in tax incentives, as discussed above, and the signing of contracts that had reduced transfers to the Treasury. While clearing the backlog of applications for tax exemptions helped to improve transparency, it had seriously undermined the revenue base, more than halving the projected profit tax in 2003. Furthermore, the analysis of past records indicated that the contribution from administrative improvements had been negative. Only during 2002, with support under the TCAP, had administration improvements been made for the first time with a positive contribution to revenue.



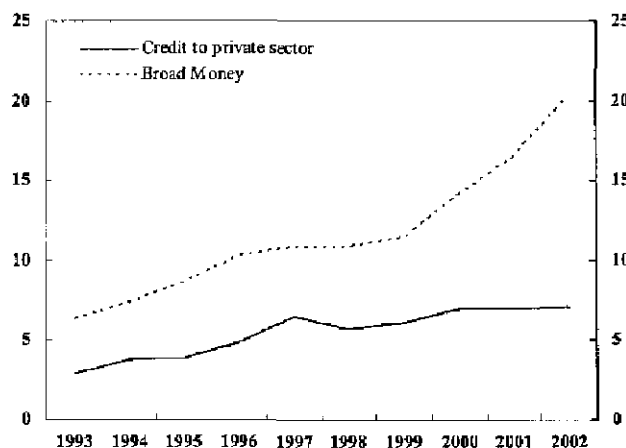
23. **Even if the revenue target could be achieved, a tight reign on expenditure will be required to meet the deficit targets.** To retain public debt sustainability, the primary deficit (including grants) would need to be reduced from 3 percent of GDP in 2002 to below 2¼ of GDP over the medium term. On the basis of the mission's baseline external scenario (Annex III), debt service payments would increase by about 1 percent of GDP, largely reflecting the expected resolution of outstanding debt with the Russian Federation and the United States. This projection implies that about 70 percent of the expected increase in revenue would be needed just to meet additional debt service obligations and to facilitate the planned reduction of the primary deficit. Any increase in interest rates would further reduce the scope for an increase in social spending. Accordingly, there is only limited scope for raising the wage bill, while non-interest expenditure on non-priority sectors would probably have to be reduced as a percent of GDP.

### Box 6. Cambodia: Financial Intermediation

The size of the banking system in Cambodia, in terms of the deposit base, grew from 4 percent of GDP in the early 1990s to 12 percent by the end of the decade largely due to the repatriation of financial wealth by residents. But banks played only a limited role in facilitating economic development, and despite their limited role, the number of banks proliferated under a weak regulatory framework.

The recent re-licensing program implemented by the National Bank of Cambodia (NBC) has successfully revamped the banking system. The number of banks was reduced from 31 to 17. In response, public confidence in the banking system appears to be gradually improving, as reflected in the 22 percent increase in the deposit base during the first 10 months of 2002. Nonetheless, lending activities of the banks continue to stagnate and the spread between loan and deposit rates continues to be around 13-14 percent, making it very costly for local businesses to borrow.

Cambodia: Credit to Private Sector and Broad Money, 1993-2002  
(In percent of GDP)



Demand for credit by high credit quality borrowers, such as multinational corporations, is limited, causing some prominent foreign banks to pull out of Cambodia in response to higher minimum capital requirement. By contrast, demand by lower quality borrowers, consisting mainly of local SMEs, seems to be relatively strong. However, there are various factors impeding credit growth, including:

- **Lack of legal infrastructure to support the enforceability of financial contracts.** The present collateral registration system is not reliable due mostly to the absence of a legal basis for secure transactions. Lack of a proper collateral valuation system also inhibits lending.
- **Lack of reliable borrower information.** Few firms produce financial statements, and no common accounting standards are in place, making cash flow-based lending difficult. Lack of borrower information, together with the small size of loans leads to high administrative costs, and thus high spreads.
- **Lack of banks' focus on local businesses.** Most banks in Cambodia are foreign-owned and tend to focus on providing financial services to their home-country customers operating in Cambodia. In addition, there are no financial institutions outside major cities, except for some micro-finance institutions.
- **Highly conservative quantitative prudential regulations.** The minimum capital adequacy ratio is set at 20 percent, potentially constraining the lending activities of some of the active banks. There is scope to relax these regulations once supervisory capacity is sufficiently upgraded and more effective on-site and off-site banking supervision is put in place.
- **Lack of human resources.** The open door policy has attracted foreign banks, but most banks have difficulty finding qualified working-level staff.

Creating an enabling environment for financial intermediation remains a major challenge. Providing a legal infrastructure addressing, inter alia, the above factors, should be at the center of any future reform. In parallel, the NBC's supervisory capacity based on prudential regulation, as well as the creation of an interbank market, will become increasingly important as private credit picks up.

**While the mission supported the government's civil service reform objectives, this reform would need to be incorporated within the Medium-Term Expenditure Framework (MTEF).<sup>6</sup>** The staff welcomed the initiation of a first phase of pay reform, financed partly by savings from military demobilization. Looking ahead, the government planned to: (i) increase gradually the remuneration of all civil servants during the 2002-2006 period to a level equivalent to the minimum wage paid in the garment sector; and (ii) convert about 15,000 out of 63,000 non-teacher positions to additional teaching slots, while maintaining the overall size of civil service at about 163,000. The mission agreed that the comparatively higher skills required for most public sector work would require commensurately higher pay than the private sector minimum wage in order to attract and retain qualified workers.

24. **The staff questioned whether the government's current civil service reform plan could be achieved.<sup>7</sup>** In particular, the mission noted that recruiting new teachers on the scale envisaged would be difficult and would require time and a large investment in teacher training. The authorities indicated that they would revisit their civil service reform plan once government studies on the staffing of line ministries and the labor market were completed. Meanwhile, the mission recommended that the overall government wage bill, including military and security personnel, should not exceed 5 percent of GDP given other priority spending needs. On a related matter, the implementation of the Priority Mission Group Program (PMG), which would provide temporary pay supplements to a small percentage (roughly 1.5 percent) of civil servants for special assignments, should help ensure quality public service in high priority areas.<sup>8</sup>

25. **While economic and structural reform policies envisaged as part of the government's medium-term strategy do not appear to place a heavy burden on the poor, efforts would need to be made to ensure that all income groups benefit from the country's economic development.** Spending on education, for example, which is essential for boosting productivity in the long run, should be provided equally to the population living in rural areas to allow them access to better economic opportunities. In the same vein, capital spending, which is needed to rebuild infrastructure to reduce operating costs of businesses, should also be allocated to rural roads to give better market access. The authorities noted that they would address poverty issues in the context of further refining their policies contained in the NPRS.

---

<sup>6</sup> The AsDB is taking the lead in formulating the MTEF. The MTEF, which in turn is part of a broad budgetary reform led by the World Bank (in the context of the IFAPER), is in an early stage of development. The MTEF still needs to incorporate the government's strategy on civil service reform, the public investment program, and external financing issues.

<sup>7</sup> Civil service reform is discussed in more detail in the Selected Issues paper accompanying this report.

<sup>8</sup> PMGs involve selected groups of skilled civil servants expected to carry out performance-based tasks in return for improved remuneration incentives and working conditions. PMGs are expected to be launched in 2003 involving up to 1,000 staff, and reach a maximum of 2,500 staff by 2005.

26. **Acknowledging the weak administrative capacity and the major challenges ahead, the authorities emphasized that continued technical assistance would be required.** The staff agreed that achieving the government's economic objectives will require continued broad-based technical assistance efforts, as provided under the TCAP, but noted that the next phase of assistance should focus more on institution-building, rather than relying on external advisors to fill key functions.

27. **In the discussions, a number of risks to the success of the medium-term strategy were identified, reflecting particular areas of vulnerability for Cambodia.** First, failure to improve institutional capacity (including from the lack of progress in civil service reform) and governance will continue to discourage new investment. Second, inability to adhere to the fiscal and monetary targets established in the government's reform strategy, could threaten investor confidence, as well as donor support. In particular, projected revenues may not materialize if gains in collection efforts were undermined by a further erosion of the tax base arising from tax exemptions and non-transparent contracts for government services. Failure to deal with these issues could heighten the uncertainty of the business environment and weaken confidence in financial institutions, which in turn could lead to a reversal of the recent financial deepening.

28. **An improvement in the business environment was seen as particularly important for achieving the authorities' growth objectives.** In the absence of new investment, garment exports would most likely decline over the medium term in the face of stronger competition from neighboring countries (see text table). More importantly, the scheduled phasing-out of the textile

Cambodia: Baseline and Non-adjustment Scenarios, 2002-2007  
(In percent of GDP, unless otherwise indicated)

		Projection				
	2002	2003	2004	2005	2006	2007
<b>Baseline scenario</b>						
Real GDP growth (percent change)	4.5	5.0	6.0	6.0	6.3	6.5
Of which: Garment (percent change)	14.1	10.0	10.0	8.0	8.0	8.0
Government revenue	12.1	12.7	13.4	13.9	14.3	14.5
Current Expenditure, of which	11.1	11.4	11.9	12.2	12.6	13.1
Wages	3.9	4.0	4.1	4.3	4.4	4.6
Other	7.2	7.5	7.8	7.9	8.2	8.5
Memo item: Social spending 1/	3.6	3.8	4.3	4.4	4.5	4.5
Primary deficit	3.1	2.9	2.2	2.0	1.9	2.1
Garment export (in US\$ million)	1,254	1,376	1,481	1,596	1,724	1,862
Current account balance, excluding official transfers (in US\$ million)	-391	-405	-431	-470	-481	-493
Gross international reserves (in US\$ million)	642	696	742	810	904	1,011
<b>Non-adjustment scenario</b>						
Real GDP growth (percent change)	4.5	2.8	3.1	1.9	1.7	1.7
Of which: Garment (percent change)	14.1	6.7	2.6	-6.7	-11.0	-13.3
Government revenue	12.1	12.3	12.5	12.5	12.6	12.5
Current Expenditure, of which	11.1	11.1	11.0	10.9	11.0	11.1
Wages	3.9	3.9	3.8	3.6	3.6	3.6
Other	7.2	7.2	7.2	7.3	7.4	7.5
Memo item: Social spending 1/	3.6	3.6	3.6	3.6	3.6	3.6
Primary deficit	3.1	2.9	2.2	2.0	1.9	2.1
Garment export (in US\$ million)	1,254	1,351	1,400	1,320	1,188	1,041
Current account balance, excluding official transfers (in US\$ million)	-391	-430	-509	-603	-636	-734
Gross international reserves (in US\$ million)	642	670	640	574	514	379

Source: Fund staff estimates.

1/ Includes components of wages paid in the social sectors.

and apparel quotas under the WTO Agreement on Textile and Clothing in 2005 could lead to a sharp drop of quota-based garment exports. Such an outturn would lead to a fall in real annual GDP growth to below 2 percent, i.e., below population growth. Moreover, depending on how quickly consumers were to adjust to lower export receipts, gross reserves could drop rapidly to below 1½ months of imports.

## **B. Outlook and Policies for 2003**

29. **The mission discussed a policy framework for 2003 that could start to address the medium-term challenges and to make up for the slippages under the PRGF-supported program.** Emphasis was placed on the need for further progress in raising fiscal revenue, improving the quality of public services, and reforming the legal system, forestry policy, and the banking system. With appropriate policies in these areas, real GDP growth could be expected to reach 5 percent, inflation contained to below 4 percent, and the external current account deficit maintained at about 10½ percent of GDP. To reach a gross reserve target equivalent to about 3¼ months of imports, an external financing gap of about US\$30 million would arise in 2003, and one of US\$66 million for the next three year period (including 2003).

### **Fiscal issues**

30. **The mission noted that the government revenue target of 13¼ percent of GDP in the 2003 budget would be very difficult to achieve.** The erosion in the revenue base in 2002 would continue under the amended investment law as further incentives were likely to be provided.<sup>9</sup> Thus, even achieving a revenue target of 12¾ percent of GDP, which was estimated by the staff to be a realistic target, would require substantial efforts, including strengthening collection enforcement. The authorities agreed with the mission's projection and indicated that they would carefully execute the 2003 budget, with cutbacks in spending, as needed, to avoid recourse to domestic bank financing. At the same time, the authorities agreed, as detailed in the attached Memorandum of Economic and Financial Policies (MEFP), to implement measures to strengthen tax and non-tax collection, including those needed to offset the revenue loss from the expected tariff reduction in June 2003.<sup>10</sup>

31. **Given the lower revenue target, the mission noted that current expenditure should be curtailed.** At the same time, expenditure should be reallocated to make room for military demobilization and an increase in debt service payments following completion of the bilateral

---

<sup>9</sup> The MEF had delayed granting exemptions because of budgetary concerns, causing a long queue of outstanding requests. The amended Investment Law now requires a decision by the MEF on requests for exemptions within a period of 31 working days.

<sup>10</sup> The authorities are considering either (i) a reduction in the current maximum tariff rate from 35 percent to 30 percent while raising the excise tax rate by 5 percentage points to offset the revenue loss; or (ii) a reduction in the tariff rate of a group of products from the maximum rate to 15 percent that will have only a limited impact on revenue.

debt negotiations.<sup>11</sup> The mission proposed expenditure cuts in non-social spending equivalent to ½ percent of GDP, involving a scaling-back of operating expenditure and net transfers to local government in line with historic trends. Even after these adjustments, a financing gap of about CR 80 billion (½ percent of GDP) would be expected in 2003, which was expected to be financed by multilateral concessional loans. The authorities agreed with these proposals, but indicated that the magnitude of expenditure cut would be revisited once the debt negotiations have been completed.

32. **In parallel with revenue collection efforts, the staff recommended a further strengthening of budget management to avoid cash shortages and ease the year-end bunching of spending.** In this regard, the staff welcomed the progress made in centralizing government accounts at the National Treasury. Efforts to centralize government accounts could be expanded to cover accounts held in line ministries, and the use of the banking system for government financial transactions could be increased, while ensuring that the treasury accounts are held with the NBC. The authorities indicated that improvements in budgetary management would be made with the introduction of standardized accounting procedures for government transactions.

#### **Monetary and external sector policies**

33. **The authorities' monetary framework for 2003 is consistent with the growth and inflation objectives noted earlier.** Broad money is projected to increase by 20½ percent, reflecting some moderation in the decline in velocity observed to date. The effectiveness of monetary policy, notwithstanding the lack of market-based monetary policy tools, is limited due to the highly dollarized environment.<sup>12</sup> Accordingly, the authorities recognized that macroeconomic stability was contingent on meeting the fiscal objective of avoiding any recourse to domestic bank financing. It was agreed that reducing the role played by the U.S. dollar in the economy should be a long-term objective, which could only be achieved through maintaining macroeconomic stability over time. While the recent increase in the amount of riel circulation was an encouraging development, the authorities recognized that rapid de-dollarization is unlikely to occur in the next few years. In the meantime, the government could assist the process by gradually expanding the use of riel for its transactions.

34. **The mission supported the authorities' intention to maintain a flexible exchange rate in the context of the current intervention policy aimed at increasing gradually the level of international reserves.** NBC officials indicated that they would continue to use any increase in demand for riel to bolster international reserves and avoid resisting downward pressure on the exchange rate, except to dampen excessive short-term variations of the exchange rate. In view of the limited scope to improve competitiveness through the use of exchange rate policy, the authorities agreed that productivity increases through training and the creation of a favorable

---

<sup>11</sup> For illustrative purpose, staff assumed the rescheduling agreement to take place in mid-2003 on the same terms underlying the baseline scenario presented in Annex III.

<sup>12</sup> About 95 percent of banks' assets and liabilities are denominated in U.S. dollars.

business environment (as noted earlier) through better governance needed to be emphasized. Prices for goods and services are routinely quoted in U.S. dollars, and most transactions in urban areas are settled in dollars. The riel is used for small cash transactions only, and is injected into circulation primarily through government payments for goods and services (including civil servants salaries). Although foreign currency cash holding is difficult to measure, according to a recent study,<sup>13</sup> it is estimated to account for around 95 percent of broad money defined to include cash dollars in circulation. Accordingly, any attempt to devalue the exchange rate would be offset immediately by an equivalent price increase in riel terms, which would adversely affect the rural poor and civil servants who are paid in riel.

### **Banking sector**

35. **The mission welcomed the successful completion of the relicensing of commercial banks and the restoration of banking sector soundness.** Banks now have an adequate capital base and ample liquidity from a large increase in deposits, reflecting improved public confidence in the banking system. However, the mission emphasized that strengthening bank supervision capability remained a priority, especially in view of the limited role of the NBC as a lender of last resort. NBC officials indicated that successful introduction of a new chart of accounts by mid-2003 and a substantial strengthening of on-site inspection activities were priorities for this year. It was also expected that the government's announcement of its intention to privatize the Foreign Trade Bank would reduce the extent of policy-based lending.

36. **Looking ahead, the authorities shared the mission's concern that the existing banks were heavily concentrated in urban areas.** NBC officials noted that it was commercially not viable for commercial banks to provide financial services to the rural poor who are mostly engaged in agriculture. The cost of handling small scale loans to farmers, and the associated credit risks were too high for banks. Accordingly, the role of micro-finance institutions was expected to continue to increase, requiring increased attention from the NBC for prudential purposes. In this regard, the staff welcomed plans to reactivate NBC branches in selected provinces which could facilitate banking activities, including the operations of micro-finance institutions.

### **Other structural reforms**

37. **The authorities highlighted the significant progress made on trade reform that had enabled Cambodia to come closer to joining the WTO.** The third WTO Working Party meeting in November 2002 was successful, paving the way for Cambodia to become a full member by September 2003. WTO accession is critical for Cambodia to level the playing field for foreign investors, especially in view of the scheduled phasing out in 2005 of textile and apparel quotas under the WTO agreement. The authorities noted that the conversion of the tariff classification to the ASEAN Harmonized Tariff Nomenclature was under way and that discussions on the reduction of ASEAN Free Trade Area (AFTA) tariff rates had already started

---

<sup>13</sup> See "Macroeconomic Adjustment in a Highly Dollarized Economy: The Case of Cambodia" by Mario de Zamaroczy and Sopanha Sa, IMF Working Paper WP/02/92.



in 2001.<sup>14</sup> This reduction could help attract foreign investment that would support exports to non-ASEAN markets.

38. **The mission strongly urged that the suspension on logging activity be maintained until the management plans and agreements on restructured concessions were approved in a transparent manner.** Monitoring of log transportation and overall forest crime has proven difficult. Despite the ban on logging introduced on January 1, 2002, enforcement was made difficult in large part because of the absence of an effective scheme for ensuring that transported logs had in fact been felled prior to end-2001. In addition, it could not always be confirmed that royalty payments had been paid to the government on logs for which transport permits were requested. To address these problems, the government began to suspend log transportation in May 2002. The recent suspension of donor support to the Forest Crime Monitoring Unit (FCMU), however, has reduced the credibility of the forest crime monitoring process;<sup>15</sup> and the disclosure process of the newly-prepared forestry concession management plans raised concerns among local communities, donors, and NGOs. The situation was further complicated in December 2002 when, after months of mounting tensions between the government and Global Witness (an NGO that served as an independent monitor of forestry activity in Cambodia since early 2000), the government announced its intention to identify a new independent monitor. This issue has affected the tranche release conditions for the second disbursement of the World Bank Structural Adjustment Credit (equivalent to about US\$15 million).<sup>16</sup>

39. **The mission supported the government's commitment to continue pursuing its governance and anti-corruption agenda.** The second GAP, which is under preparation, is expected to focus more directly on corruption and social issues as these are areas where least progress was made under the first GAP. Unfortunately, slow progress in establishing a modern legal and judiciary system has held back reforms in other areas, especially the adoption of an anti-corruption law. The authorities explained that introducing the anti-corruption law without setting up minimum safeguards against corruption in the judicial system would only raise the cost of "buying" a court ruling and fuel further corruption in the judiciary. Accordingly, the government is giving priority to making the Council for Legal and Judiciary Reform and the School for Magistracy fully operational, and to ensuring an effective functioning of the National Audit Authority. The mission recommended that legal documents be made more easily accessible

---

<sup>14</sup> The current tariff schedule has four rates of 0, 7, 15, and 35 percent; the unweighted average is 16.5 percent. Cambodia is rated 6 under the Fund's Trade Restrictions rating.

<sup>15</sup> The FCMU was created in 1999 with donor support to monitor illegal logging. The FCMU, however, has never been in a position to operate effectively, owing to inadequate staffing and continued conflicts between the management of the Department of Forestry and the foreign advisors (FAO) assigned to the FCMU. In October 2002, donors suspended support to the FCMU, pending completion of a review of FCMU's operation.

<sup>16</sup> The delay in the SAC disbursement is not expected to create additional financing gap in 2003 because of the carry-over of foreign financing of similar amount from 2002 owing to larger-than-expected foreign inflows.

to the general public at a minimum cost, and stressed the need to develop a framework for monitoring progress in governance in the second GAP, that includes indicative targets and benchmarks.

40. **The mission welcomed the ongoing efforts to upgrade the statistical framework, with support from the Fund's resident multi-sector statistical advisor under the TCAP,** as well as the submission of the new Law on Statistics aimed at ensuring the independence and coordinating role of the National Institute of Statistics (Annex VII). Despite significant shortcomings in some areas, core data are generally adequate for program design and monitoring, and are provided on a timely basis. Nevertheless, it was recognized that further efforts were needed to improve the reliability of macroeconomic data, especially the national accounts, balance of payments, and government finance statistics. The mission stressed that allocations should be made in the budget for funding planned improvements in the compilation of statistics.

41. **The mission commended the authorities for their efforts in preparing a fully participatory NPRS.** The NPRS will serve as the government's blueprint for addressing poverty reduction in Cambodia in consultation with development partners, civil society, and NGOs. The authorities recognized that the NPRS was only a first step in implementing a broad-based poverty reduction strategy over the medium term, and thus needed to be updated on a continuous basis in light of the recommendations in the Joint Staff Assessment and as new information becomes available.<sup>17</sup>

#### IV. STAFF APPRAISAL

42. **Cambodia's economy has visibly strengthened since political stability was restored in 1998 and economic reform was resumed.** The authorities' efforts were supported by donors through financial and technical assistance. Favorable external factors, including the bilateral trade agreement with the United States, also helped Cambodia to achieve a record of strong growth, driven by exports. Inflation remained low, reflecting fiscal discipline. However, notwithstanding these efforts, poverty is still widespread, especially in rural areas.

43. **Strong and sustained growth over the medium term will be needed to achieve meaningful poverty reduction, but there are considerable challenges.** In spite of the progress made in recent years, decades of instability have left the country with weak foundations for growth. Also, the robust economic performance of the recent past will be difficult to replicate if growth remains narrowly based on garment manufacturing and, to a lesser extent, tourism. In this regard, external competitiveness is a key concern, reflecting the relatively high costs of doing business in Cambodia. However, even with an improvement in competitiveness, widespread

---

<sup>17</sup> A more in-depth Poverty and Social Impact Analysis (PSIA) is expected to be undertaken by the World Bank on land reform, where policy changes will have a direct impact on poverty in rural areas. The ability to carry out more extensive PSIA is constrained by the poor quality of survey data. The UNDP is assessing the impact of macroeconomic policies on the poor more broadly in a regional context.

complaints about the burden of informal facilitation fees and uncertainties in the regulatory framework discourage foreign investment.

44. **The staff considers that a major strengthening in government capacity is essential in the period ahead.** Rebuilding government institutions and upgrading the quality of the civil service, supported by improved revenue collection, should enable Cambodia to establish a sound regulatory framework. In addition, a simple and transparent investment regime with lower tax rates is needed to replace the current system of incentives which provides for large exemptions. Progress in these areas will encourage continued donor support, which is essential to supplement limited domestic resources in rebuilding economic infrastructure, and create a more favorable business environment.

45. **The staff welcomes the progress that has been made in reorienting government expenditure to social spending and military demobilization.** However, continued efforts are needed in the context of a medium-term expenditure framework to reorient spending, especially as the expected completion of debt negotiations with the United States and the Russian Federation will raise public debt service. In particular, civil service reform, which will inevitably entail higher civil service pay, is required to contain the government wage bill so as to protect other priority spending.

46. **Lasting improvements in tax collection enforcement are required to prevent a further erosion of the revenue base.** In particular, tax and customs administration needs strengthening to meet the government revenue targets for 2003 and the medium term. It will also be important to examine government contracts with service providers to ensure that appropriate fees are being transferred to the Treasury. All future contracts should be handled under a proper bidding process, and be authorized by the Minister of Economy and Finance and made public.

47. **Parallel efforts should be made to strengthen budget management.** The staff welcomes the progress made in centralizing government accounts at the National Treasury and the plan to introduce standardized accounting procedures for government transactions. Further efforts should be made to enhance coordination among government agencies to improve cash management.

48. **The staff supports the maintenance of a flexible exchange rate regime** in the context of the current intervention policy aimed at further strengthening the official reserve position. De-dollarization should be a long-term objective consistent with the promotion of sustainable growth. In the meantime, the government could support this objective by gradually expanding the use of riel for its transactions.

49. **The staff commends the authorities for the successful completion of the relicensing of commercial banks and the restoration of banking sector soundness.** Nevertheless, lending activity remains weak, especially with respect to local businesses. There is a need to strengthen the regulatory framework, especially as regards the provision of collateral and the protection of creditor rights, to reduce lending risks faced by banks. The staff also urges the government to follow through on its plans to privatize the Foreign Trade Bank.

50. **There is an urgent need to strengthen the monitoring of logging activities.** The staff is concerned by the government's announcement to replace the current independent monitor, and urges the authorities to ensure that this interruption be kept to a minimum. Progress in this area will be an important indicator of the government's commitment to improved governance. The recent decision to collect public comments on the government's sustainable forestry management plans is a welcome development. Until sustainable management plans are in place, the suspension of logging activities by concessionaires and the ban on log transportation should be retained.

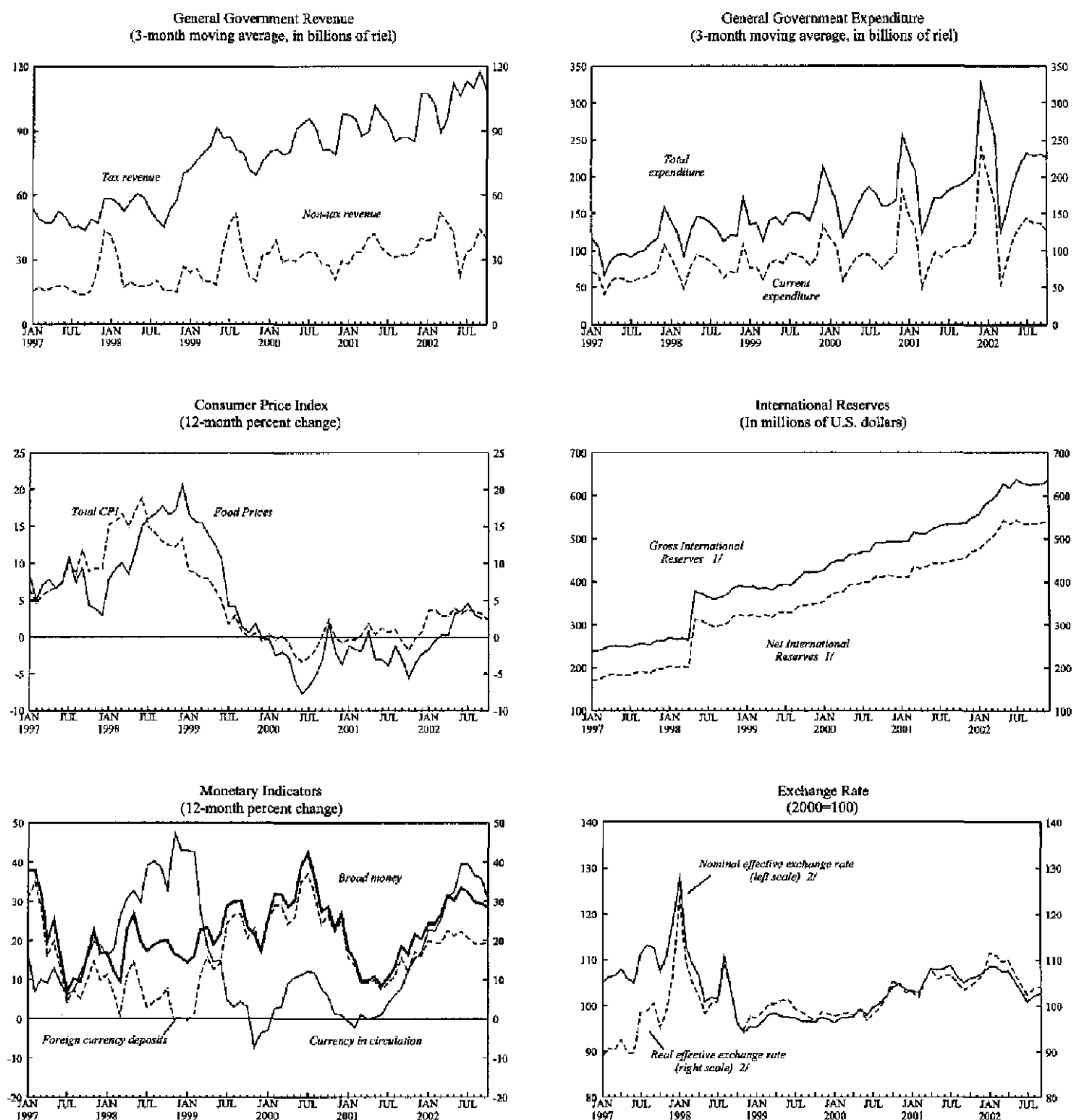
51. **Urgent efforts are needed to improve governance during the next phase of reform.** In this respect, the staff welcomes the preparation of the second Governance Action Plan, which is expected to focus more directly on corruption and social issues. In particular, the authorities should make the Council for Legal and Judiciary Reform and the School for Magistracy fully operational to strengthen the judicial system. At the same time, efforts need to be made to adopt the Anti-Corruption Law by mid-2003, as pledged by the Government at the June 2002 Consultative Group meeting in Phnom Penh.

52. **The staff sees a strong need for continued support under the Technical Cooperation Action Plan to build government capacity.** To date, positive results from the TCAP in tax and customs administration and statistics are evident. Efforts to build a sound statistical base should continue as economic analysis and program monitoring is still hampered by data weaknesses. In all areas in which technical assistance is provided, however, the authorities need to demonstrate greater ownership.

53. **On the basis of Cambodia's performance under the third-year program and the government's commitments to achieve the objectives of the program for 2003, the staff recommends completion of the sixth review under the PRGF arrangement.** The staff commends the authorities for their efforts in preparing a fully participatory National Poverty Reduction Strategy Paper and looks forward to the implementation of the policies contained therein.

54. **It is expected that the next Article IV consultation with Cambodia be held in accordance with the provisions of the decision on consultation cycles approved on July 15, 2002.**

**Figure 1. Cambodia: Selected Economic Indicators, 1997-2002**

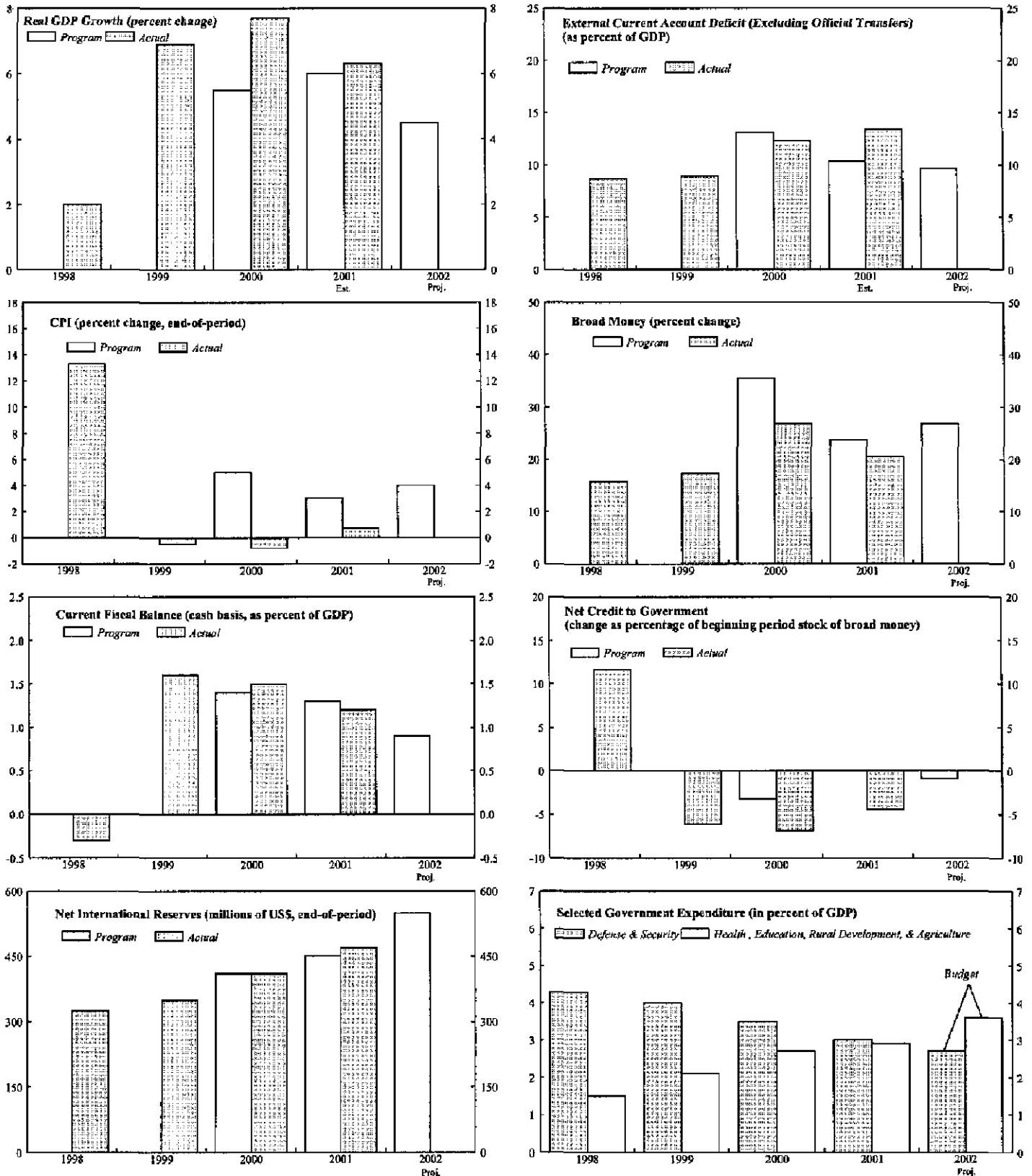


Source: Data provided by the Cambodian authorities.

1/ Includes US\$117 million associated with the return in 1998 of Cambodian gold previously held by the BIS.

2/ Based on the official exchange rate; an upward movement indicates an appreciation of the exchange rate.

Figure 2. Cambodia: Indicators of Program Performance, 1998-2002



Sources: Data provided by the Cambodian authorities; and Fund staff estimates.

Table 1. Cambodia: Selected Economic Indicators, 1998-2003

Nominal GDP (2001):	\$3,404 million						
Population (2001):	13 million						
GDP per capita (2001):	\$259						
Fund Quota:	SDR\$7.5 million						
	1998	1999	2000	2001	2002	2003	
					Proj.	Proj.	Proj.
(Percent change)							
Real economy							
Real GDP	2.1	6.9	7.7	6.3	4.5	4.5	5.0
GDP deflator	13.8	3.7	-4.6	-2.9	3.0	3.0	3.7
Consumer prices (end of period)	13.3	-0.5	-0.8	0.7	3.0	3.7	3.7
(annual average)	14.8	4.0	-0.8	0.2	1.4	3.2	3.2
(In percent of GDP)							
Domestic investment	11.3	15.9	13.5	17.9	16.2	16.6	16.9
Government investment	5.3	5.7	6.7	7.2	7.2	7.7	7.1
Nongovernment investment	6.1	10.2	6.8	10.7	9.0	8.9	9.8
Of which: change in inventories	-0.9	1.4	-1.7	2.0	...	...	...
National saving	9.1	13.6	9.2	12.7	13.8	13.7	13.9
Government saving	-0.3	1.6	1.5	1.2	1.3	0.9	1.1
Nongovernment saving	9.4	12.0	7.7	11.5	12.5	12.8	12.8
(Percentage change, unless otherwise indicated)							
Money and credit							
Broad money	15.7	17.3	26.9	20.4	22.4	26.8	20.5
Of which: rise in circulation	43.0	-3.8	1.0	16.8	20.2	28.7	22.0
Net credit to the government 1/	11.7	-6.1	-6.9	-4.3	0.0	-0.9	0
Velocity of money 2/	10.3	9.3	7.3	6.6	5.8	5.6	5.1
(In percent of GDP)							
Government budget							
Revenue (incl. capital revenue)	8.3	10.6	11.2	11.7	12.8	12.1	12.7
Of which: Tax revenue	6.0	7.7	8.2	8.4	8.9	8.5	8.5
Nontax revenue	2.0	2.8	2.8	3.2	3.7	3.5	3.6
Additional revenue	...	...	...	...	...	...	0.4
Expenditure	13.8	14.7	16.4	17.7	18.7	18.9	19.0
Current expenditure 3/	8.3	8.9	9.5	10.4	11.3	11.1	11.4
Capital expenditure	5.5	5.8	6.9	7.3	7.4	7.8	7.3
Current budget balance	-0.3	1.6	1.5	1.2	1.3	0.9	1.1
Overall budget balance	-5.5	-4.0	-5.2	-6.0	-5.9	-6.8	-6.3
Overall budget balance (incl. grants)	-2.5	-1.3	-2.3	-3.1	-2.6	-3.3	-3.4
Foreign financing 4/	4.5	4.4	5.5	5.7	6.2	7.1	6.5
Domestic financing	1.0	-0.6	-0.1	0.1	-0.3	-0.3	-0.2
Outstanding operations 5/	0.1	0.3	-0.2	0.2	0.0	0.0	0.0
(In millions of U.S. dollars; unless otherwise indicated)							
Balance of payments							
Exports 6/	685	921	1,206	1,295	1,358	1,434	1,571
Imports 6/	-954	-1,219	-1,664	-1,777	-1,752	-1,880	-2,041
Current account (excl. official transfers)	-261	-295	-412	-456	-356	-391	-405
(in percent of GDP)	-8.7	-8.9	-12.3	-13.4	-9.6	-10.7	-10.4
Current account (incl. official transfers)	-67	-75	-144	-180	-87	-106	-118
(in percent of GDP)	-2.2	-2.3	-4.3	-5.3	-2.4	-2.9	-3.0
Capital account	-38	-18	86	200	116	157	133
Overall balance	-105	-93	-58	20	28	51	14
Financing gap	...	...	...	...	...	...	31
Gross official reserves 7/	390	422	485	550	629	642	696
(In months of imports of goods and services)	3.6	3.2	2.8	2.9	3.4	3.3	3.3
Net official reserves 7/	323	349	411	470	537	549	604
Public external debt 8/	2,044	2,269	2,265	2,254	1,552	2,403	1,370
(in percent of GDP)	67.9	68.7	67.6	66.2	42.1	65.6	35.2
Public debt service (actual basis)	124	125	129	54	20	56	54
(In percent of domestic exports of goods and services)	14.4	11.1	8.5	3.3	1.1	3.0	2.6
Memorandum items:							
Nominal GDP (in billions of riels)	11,364	12,587	12,932	13,357	14,377	14,377	15,650
(in millions of U.S. dollars)	3,011	3,300	3,351	3,404	3,686	3,663	3,891
Exchange rate (riels per dollar; end of period)	3,780	3,775	3,910	3,900	3,900	3,935	4,095

Sources: Data provided by the Cambodian authorities; and Fund staff estimates and projections.

1/ Contributions to 12-month percent change of broad money.

2/ Ratio of nominal GDP to average stock of broad money.

3/ Excludes cash adjustments in 2003.

4/ Includes disbursements for the financing gap in 2003.

5/ Includes expenditure committed but not yet allocated to the accounts of the government agencies that execute the budget, and exchange rate adjustments.

6/ Excludes re-exports.

7/ Projection based on data available through mid-November. Actual gross and net international reserves at end-December 2002 were US\$ 665 and US\$ 569 million, respectively.

8/ A Paris Club rescheduling under Naples terms (67 percent NPV reduction) is assumed in mid 2003.

Table 2. Cambodia: Balance of Payments, 2000-2007  
(In millions of U.S. dollars)

	2000	2001	2002	2003	2004	2005	2006	2007
			Rev. Prog.	Proj.		Projections		
Current account (excluding official transfers)	-412	-456	-356	-391	-405	-431	-470	-493
Current account (including official transfers)	-144	-180	-87	-106	-118	-135	-158	-165
Trade balance: 1/	-452	-476	-389	-441	-465	-513	-592	-643
Exports	1,394	1,475	1,529	1,605	1,745	1,901	2,093	2,517
Domestic exports	1,206	1,295	1,358	1,434	1,571	1,723	1,911	2,328
Of which: GDP (incl. garments)	1,013	1,147	1,221	1,294	1,416	1,528	1,649	1,977
Forestry	39	33	12	11	20	49	106	163
Re-exports	188	180	171	171	174	178	182	189
Imports, f.o.b.	-1,846	-1,951	-1,918	-2,046	-2,210	-2,415	-2,638	-3,160
Retained imports, f.o.b.	-1,664	-1,777	-1,732	-1,880	-2,041	-2,242	-2,462	-2,977
Garments sector	-590	-663	-730	-692	-744	-785	-829	-929
Petroleum	-300	-295	-292	-320	-334	-318	-330	-356
Other retained imports	-775	-820	-729	-868	-964	-1,139	-1,303	-1,691
Imports for re-export, f.o.b.	-182	-174	-166	-166	-169	-172	-176	-183
Services and income (net)	-30	-53	-43	-28	-22	-6	-16	52
Services (net)	52	66	102	117	135	169	167	251
Of which: Tourism (credit)	199	235	282	294	306	384	440	569
Income (net)	-82	-119	-145	-145	-157	-175	-183	-200
Of which: Interest (debit)	-12	-12	-18	-19	-27	-34	-35	-39
Private transfers (net)	70	73	77	78	82	88	91	98
Official transfers (net)	268	276	268	284	286	296	315	327
Capital and financial account	86	200	116	157	133	153	197	264
Medium- and long-term loans	-23	79	137	101	91	98	120	164
Disbursements	91	113	172	136	128	137	160	205
Amortization	-114	-35	-35	-35	-37	-39	-40	-41
Foreign direct investment	135	95	75	98	101	110	120	144
Short-term flows and errors and omissions	-26	26	-96	-42	-59	-56	-43	-44
Overall balance	-58	20	28	51	14	17	41	99
Financing	58	-20	-28	-51	-14	-17	-41	-99
Change in gross official reserves	-63	-63	-78	-93	-83	-47	-67	-107
Use of Fund credit	4	9	9	9	-1	-9	-7	-8
Purchases/disbursements	11	21	21	22	11	0	0	0
Repurchases/repayments	7	12	12	12	12	9	7	8
Debt restructuring: 2/	0	16	1,435	0	1,462	19	19	16
Debt forgiveness	0	15	800	0	815	19	19	16
Debt rescheduling	0	1	636	0	647	0	0	0
Change in arrears (- = reduction)	117	20	-1,395	32	-1,453	0	0	6
Financing (top)	...	...	...	...	31	20	15	0
Memorandum items:								
Trade balance (in percent of GDP)	-13.5	-14.0	-10.6	-12.0	-11.9	-12.5	-12.5	-13.0
Current account balance								
Excluding official transfers (in percent of GDP)	-12.3	-13.4	-9.6	-10.7	-10.4	-10.5	-10.8	-10.0
Including official transfers (in percent of GDP)	-4.3	-5.3	-2.4	-2.9	-3.0	-3.3	-3.6	-3.3
Gross official reserves: 3/	485	550	629	642	696	742	810	904
In months of imports of goods & services	2.8	2.8	3.4	3.3	3.3	3.2	3.2	3.4
In months of core imports of goods & services: 4/	4.6	5.4	6.0	5.4	5.3	5.1	5.0	5.0
Net international reserves	411	470	537	549	604	659	734	810
Public debt service (cash basis)	12	19	21	21	42	59	60	68
Public debt service ratio (cash basis): 5/	0.8	1.1	1.2	1.1	2.1	2.6	2.4	2.3
Nominal GDP (in millions of U.S. dollars)	3,351	3,404	3,686	3,663	3,891	4,111	4,337	4,933

Sources: Data provided by the Cambodian authorities; and Fund staff estimates and projections.

1/ Includes estimates for unrecorded trade, such as forestry exports and unrecorded petroleum imports. Data on exports and imports have been revised from earlier estimates based on improved statistics.

2/ Assumes a Paris Club rescheduling under Naples terms (57 percent NPV reduction) in mid-2003. Bilateral rescheduling agreements were reached in principle with the Czech and Slovak Republics in 2001.

3/ Includes \$117 million associated with the return of Cambodian gold holdings by the BIS in 1998.

4/ Imports excluding imports for re-export and imports for the garment sector.

5/ Ratio of debt service to domestic exports of goods and services.



Table 3. Cambodia: Monetary Survey, 2000-2003

	2000	2001	2002						2003				
	Dec.	Dec.	Mar.	Jun.	Sept.		Oct.	Dec.		Mar.	Jun.	Sept.	Dec.
					Prog.	Act.		Prog.	Proj.	Projection			
(In billions of riels; end of period)													
Net foreign assets	2,588	3,081	3,366	3,614	3,483	3,693	3,642	3,518	3,779	3,884	3,991	4,099	4,199
National Bank	2,102	2,429	2,680	2,964	2,759	3,117	3,067	2,769	3,188	3,297	3,398	3,501	3,596
Deposit money banks	486	651	686	649	725	577	575	749	582	587	592	598	603
Net domestic assets	-758	-877	-959	-965	-876	-956	-948	-821	-976	-960	-925	-890	-833
Domestic credit	904	868	829	767	950	854	852	1,006	877	893	929	965	1,022
Government (net)	3	-75	-152	-165	-95	-106	-129	-75	-95	-115	-115	-115	-95
Public enterprises	3	7	5	4	4	3	3	4	4	4	4	4	4
Private sector	398	926	976	928	1,041	958	978	1,077	968	1,004	1,040	1,076	1,113
Other items (net)	-1,662	-1,744	-1,788	-1,732	-1,826	-1,810	-1,800	-1,827	-1,852	-1,853	-1,854	-1,853	-1,855
Of which: capital	-1,791	-1,959	-1,971	-1,886	...	-1,918	-1,913	...	...	...	...	...	...
National Bank	-1,000	-1,035	-1,067	-1,095	...	-1,115	-1,103	...	...	...	...	...	...
Deposit money banks	-791	-924	-904	-791	...	-803	-809	...	...	...	...	...	...
Broad money	1,831	2,204	2,408	2,648	2,608	2,737	2,694	2,697	2,794	2,924	3,066	3,209	3,366
Narrow money	540	610	676	748	710	771	757	741	791	834	877	921	964
Currency in circulation	493	578	641	711	665	727	713	694	744	785	825	866	907
Demand deposits	45	32	35	37	45	44	44	47	47	49	52	54	57
Quasi-money	1,291	1,594	1,731	1,901	1,898	1,966	1,938	1,956	2,003	2,090	2,189	2,289	2,402
Time deposits	46	56	62	69	64	75	75	67	83	88	92	96	100
Foreign currency deposits	1,245	1,539	1,670	1,831	1,833	1,891	1,864	1,888	1,920	2,002	2,097	2,192	2,302
(12 - month percent change)													
Net foreign assets	28.2	19.0	23.2	28.7	18.0	25.2	24.2	14.2	22.4	15.4	10.4	11.0	11.4
Net domestic assets (+ decrease)	31.5	15.7	14.9	17.5	5.8	15.6	13.2	-6.3	11.3	0.1	-4.2	-6.9	-14.6
Private sector	17.7	4.2	7.9	-2.1	5.0	-3.5	-0.5	15.0	3.4	2.9	12.1	12.4	15.0
Broad money	26.9	20.4	26.8	33.4	22.8	28.9	28.5	22.4	26.8	21.4	15.8	17.2	20.5
Of which: currency in circulation	1.0	16.8	25.6	39.6	24.3	36.0	30.8	20.2	28.7	22.3	16.1	19.1	22.0
(Contribution to annual growth of broad money; in percent)													
Net foreign assets	39.5	26.9	33.3	40.6	25.1	35.0	33.8	19.9	31.3	21.5	14.2	14.8	15.4
Net domestic assets	-12.6	-6.5	-6.6	-7.2	-2.3	-6.1	-5.3	2.5	-4.5	0.0	1.5	2.4	5.1
Domestic credit	2.0	-2.0	-0.4	-5.0	1.1	-3.4	-3.7	6.3	0.4	2.6	6.1	4.1	5.2
Government (net)	-6.9	-4.3	-4.4	-4.2	-1.0	-1.6	-3.2	0.0	-0.9	1.5	1.9	-0.3	0.0
Private sector	9.4	2.1	3.7	-1.0	2.3	-1.6	-0.2	6.4	1.4	1.2	4.3	4.3	5.2
Other items (net)	-14.5	-4.5	-6.1	-2.3	-3.4	-2.7	-1.6	-3.7	-4.9	-2.7	-4.6	-1.6	-0.1
Memorandum items:													
Foreign currency deposits (in millions of dollars)	318	395	428	467	470	479	473	484	486	502	521	540	562
Foreign currency deposits (in percent of broad money)	68	70	69	69	70	69	69	70	69	68	68	68	68
Real component of broad money	586	665	738	817	774	846	830	809	874	922	969	1,017	1,064
(in percent of broad money)	32	30 #	31	31	30	31	31	30	31	32	32	32	32
Credit to the private sector (in millions of dollars)	230	240	250	237	267	242	248	276	245	252	259	265	272
Velocity 1/	7.3	6.6	6.3	6.0	6.0	5.7	5.7	5.8	5.6	5.4	5.3	5.2	5.1

Source: Data provided by the Cambodian authorities; and Fund staff projections.

1/ Nominal GDP divided by the average stock of broad money.

Table 4. Cambodia: Summary Accounts of the National Bank of Cambodia, 2000-2003

	2000	2001	2002						2003			
	Dec.	Dec.	Mar.	Jun.	Sept.	Oct.	Dec.		Mar.	Jun.	Sept.	Dec.
					Prog.	Act.	Prog.	Proj.			Projection	
(In billions of riel; end of period)												
Net foreign assets	2,102	2,429	2,680	2,964	2,759	3,117	3,067	2,769	3,188	3,297	3,398	3,501
Foreign assets	2,389	2,740	3,016	3,315	3,120	3,497	3,443	3,121	3,548	3,699	3,792	3,883
Foreign liabilities	-286	-311	-335	-350	-361	-380	-376	-352	-360	-402	-394	-382
Net domestic assets	-941	-1,070	-1,180	-1,213	-1,117	-1,218	-1,210	-1,099	-1,221	-1,241	-1,243	-1,245
Claims on central government (net)	4	-75	-152	-165	-95	-147	-169	-75	-135	-155	-155	-135
Claims	272	271	269	269	...	269	269	...	...	...	...	...
Deposits	268	346	421	434	...	416	439	...	...	...	...	...
Claims on deposit money banks (net)	-69	-85	-82	-86	-85	-94	-78	-87	-99	-100	-101	-102
Claims on public enterprises (net)	0	0	0	0	0	0	0	0	0	0	0	0
Claims on private sector (net)	0	0	0	0	0	0	0	0	0	0	0	0
Other items (net)	-877	-910	-947	-962	-937	-977	-962	-937	-986	-986	-987	-988
Assets	124	126	168	181	...	186	190	...	...	...	...	...
Liabilities	1,000	1,035	1,115	1,143	...	1,163	1,152	...	...	...	...	...
Of which: capital	-1,000	-1,035	-1,067	-1,095	...	-1,115	-1,103	...	...	...	...	...
Reserve money	1,161	1,360	1,500	1,752	1,642	1,899	1,857	1,670	1,968	2,056	2,155	2,256
Currency outside banks	495	578	641	711	665	727	713	694	744	785	825	866
Currency in banks	34	36	34	45	48	37	38	52	37	38	38	39
Reserve deposits	633	746	824	996	929	1,134	1,106	924	1,187	1,234	1,292	1,351
(12 - month percent change)												
Net foreign assets	27.5	15.5	20.2	31.3	19.3	34.8	33.1	14.0	31.2	23.0	14.6	12.3
Net domestic assets (+ decrease)	31.0	13.6	20.0	15.2	3.0	12.3	13.7	2.8	14.1	5.1	2.5	2.2
Reserve money	24.9	17.1	20.3	45.4	33.7	54.5	49.7	22.8	44.7	37.1	23.0	18.8
Of which: currency outside banks	1.0	16.8	25.8	39.6	24.3	36.0	30.8	20.2	28.7	22.3	16.1	19.1
(Contribution to annual reserve money growth, in percent)												
Net foreign assets	48.8	28.1	36.0	58.7	36.3	65.4	61.5	25.0	55.8	41.1	24.8	20.2
Net domestic assets	-23.9	-11.0	-15.8	-13.3	-2.6	-10.9	-11.8	-2.2	-11.1	-4.0	-1.7	-1.4
Net credit to government	-11.1	-6.8	-5.6	-6.9	-1.8	-6.0	-9.0	0.0	-4.4	-0.2	0.6	-0.4
Net claims on banks	0.9	-1.4	0.4	-1.4	-0.7	-1.5	0.0	-0.6	-1.0	-1.2	-0.9	-0.4
Other items (net)	-13.7	-2.8	-10.5	-5.0	-0.1	-3.4	-2.7	-2.0	-5.7	-2.6	-1.4	-0.6
Memorandum items:												
Money multiplier (Broad Money/Reserve Money)	1.6	1.6	1.6	1.5	1.6	1.4	1.5	1.6	1.4	1.4	1.4	1.4

Sources: Data provided by the Cambodian authorities; and Fund staff projections.

Table S. Cambodia: General Government Operations, 2001-2003

	2001	2002		2003		2001	2002		2003				
	Est.	Budget	Prog.	Proj.	Budget	Proj.	Est.	Budget	Prog.	Proj.	Budget	Proj.	
		(In billion of riels)						(In percent of GDP)					
Total revenue	1,561	1,860	1,824	1,758	2,074	1,982	11.7	13.4	12.8	12.1	13.2	12.7	
Of which: central government	1,520	1,816	1,790	1,699	2,022	1,931	11.4	13.0	12.5	11.8	12.9	12.3	
Tax revenue	1,128	1,285	1,279	1,219	1,431	1,333	8.4	9.2	8.9	8.5	9.1	8.5	
Direct taxes	140	138	127	130	139	90	1.0	1.0	0.9	0.9	1.0	0.6	
Of which: Profit taxes	113	108	96	92	129	69	0.8	0.8	0.7	0.6	0.8	0.4	
Indirect taxes	571	681	686	642	746	731	4.3	4.9	4.8	4.5	4.8	4.7	
Of which: Excise taxes	115	165	220	205	256	241	1.2	1.2	1.5	1.4	1.6	1.5	
Domestic	20	35	35	30	41	41	0.2	0.3	0.2	0.2	0.3	0.3	
Import	135	130	185	176	215	200	1.0	0.9	1.3	1.2	1.4	1.3	
VAT (net VAT refunds)	400	502	452	423	479	480	3.0	3.6	3.1	2.9	3.1	3.1	
Domestic	85	112	112	100	134	134	0.6	0.8	0.8	0.7	0.9	0.9	
Import	327	390	370	343	366	366	2.4	2.8	2.6	2.4	2.3	2.3	
Refund (-)	-9	...	-30	-20	-20	-20	...	...	-0.2	-0.1	-0.1	-0.1	
Others	13	14	14	14	11	10	0.1	0.0	0.1	0.1	...	0.1	
Trade taxes	376	430	430	412	484	470	2.8	3.1	3.0	2.9	3.1	3.0	
Tax revenue from provinces	41	36	36	36	42	42	0.3	0.3	0.3	0.3	0.3	0.3	
Non-tax revenue	424	550	530	502	617	569	3.2	4.0	3.7	3.5	3.9	3.6	
Of which: Timber royalties	29	46	20	11	30	20	0.2	0.3	0.1	0.1	0.2	0.1	
Enterprises and immobile leases	28	36	36	26	38	38	0.2	0.3	0.3	0.2	0.2	0.2	
Civil aviation	38	40	42	34	47	30	0.3	0.3	0.3	0.2	0.3	0.2	
Tourism income	14	27	27	21	44	28	0.1	0.2	0.2	0.1	0.3	0.2	
Casino royalties	22	31	31	33	38	38	0.2	0.2	0.2	0.2	0.2	0.2	
PTT	122	133	130	133	145	145	0.9	1.0	0.9	0.9	0.9	0.9	
Passports and visas	36	43	43	38	68	45	0.3	0.3	0.3	0.3	0.4	0.3	
Quota auction	32	35	75	64	45	72	0.2	0.3	0.5	0.4	0.3	0.5	
Garment licenses	39	45	45	40	45	52	0.3	0.3	0.3	0.3	0.3	0.3	
Others	38	84	52	101	97	101	0.3	0.6	0.4	0.7	0.6	0.6	
Capital revenue	9	25	25	16	25	25	0.1	0.2	0.2	0.1	0.2	0.2	
Additional revenue	...	...	...	...	...	55	...	...	...	...	...	0.4	
Total expenditure 1/	2,367	2,655	2,682	2,713	2,874	2,974	17.7	19.1	18.7	18.9	18.4	19.0	
Current expenditure	1,391	1,620	1,620	1,537	1,814	1,778	10.4	11.6	11.3	10.7	11.6	11.4	
Wages	438	524	524	580	619	619	3.3	3.8	3.6	3.9	4.0	4.0	
Civil administration	214	259	259	289	336	336	1.6	1.9	1.8	2.0	2.1	2.1	
Defense and security	274	265	265	271	283	283	2.1	1.9	1.8	1.9	1.8	1.8	
Nonwage	856	1,052	1,052	943	1,106	1,107	6.5	7.6	7.3	6.6	7.1	7.1	
Of which: Operating expenditure	682	676	676	676	737	700	4.5	4.9	4.7	4.7	4.7	4.5	
Economic transfers	30	42	42	42	34	34	0.2	0.3	0.3	0.3	0.2	0.2	
Social transfers	109	121	121	121	125	125	0.8	0.9	0.8	0.8	0.8	0.8	
Interest	22	25	25	25	25	74	0.2	0.2	0.2	0.2	0.2	0.5	
Other nonwage	38	77	78	73	130	120	0.3	0.6	0.5	0.5	0.8	0.8	
Reserve funds (Chapter 40)	63	111	110	5	55	55	0.5	0.8	0.8	0.0	0.3	0.4	
Of which: Elections	...	...	10	...	25	25	...	...	0.1	...	0.2	0.2	
Civil service reform	...	...	30	...	...	0	...	...	0.2	...	...	0.0	
Demobilization	...	...	14	...	...	14	...	...	0.1	...	...	0.1	
Provincial expenditure (net subsidy)	37	44	44	34	89	52	0.3	0.3	0.3	0.2	0.6	0.3	
Capital expenditure	975	1,035	1,062	1,116	1,060	1,135	7.3	7.4	7.4	7.8	6.8	7.3	
Locally financed	283	335	362	290	360	360	2.1	2.4	2.5	2.0	2.3	2.3	
Externally financed 2/	692	700	700	826	700	775	5.2	5.0	4.9	5.7	4.5	5.0	
Cash adjustments 3/	...	...	...	-60	...	-60	...	...	...	-0.4	...	-0.4	
Current balance	160	215	189	125	235	179	1.2	1.5	1.3	0.9	1.5	1.1	
Overall balance	-806	-795	-848	-974	-800	-992	-6.0	-5.7	-5.9	-6.8	-5.1	-6.3	
Overall balance (including grants)	-410	-395	-369	-474	-400	-526	-3.1	-2.8	-2.6	-3.3	-2.6	-3.4	
Financing	806	795	848	974	800	911	6.0	5.7	5.9	6.8	5.1	5.8	
Foreign financing (net)	763	808	894	1,024	800	941	5.7	5.8	6.2	7.1	5.1	6.0	
Budget support (grant)	36	0	79	100	0	66	0.3	0.0	0.5	0.7	0.0	0.4	
Budget support (loans)	18	120	124	66	125	140	0.1	0.9	0.9	0.5	0.8	0.9	
Project grants	360	400	400	400	400	400	2.7	2.9	2.8	2.8	2.5	2.6	
Project loans 2/	383	300	300	467	360	375	2.6	2.2	2.1	3.2	1.9	2.4	
Amortization	-4	-12	-9	-9	-25	-40	0.0	-0.1	-0.1	-0.1	-0.2	-0.3	
Domestic financing (net)	13	-12	-46	-50	0	-30	0.1	-0.1	-0.3	-0.3	0.0	-0.2	
Of which: Bank financing (net)	-18	-5	0	-20	...	0	-0.6	0.0	0.0	-0.1	...	0.0	
Private sector accounts	73	-8	-46	-30	...	-30	0.5	-0.1	-0.3	-0.2	...	-0.2	
Outstanding operations 4/	32	0	0	0	0	0	0.2	0.0	0.0	0.0	0.0	0.0	
Financing gap	...	...	...	...	...	80	...	...	...	...	...	0.5	
Memorandum items:													
Defense and security outlays	400	390	390	390	409	390	3.0	2.8	2.7	2.7	2.6	2.6	
Health, education, rural development, and agriculture	382	518	518	518	589	589	2.9	3.7	3.6	3.6	3.8	3.8	
Tax department revenue (excluding VAT refunds)	259	299	288	274	345	276	1.9	2.1	2.0	1.9	2.2	1.8	
Customs department revenue	138	950	985	930	1,065	1,036	6.3	6.8	6.9	6.5	6.8	6.6	
GDP	13,157	13,919	14,377	14,377	15,651	15,651	...	...	...	...	...	...	

Sources: Data provided by the Cambodian authorities; and Fund staff estimates and projections.

1/ Cash basis.

2/ Projections for 2002 and 2003 include CR 100 billion and CR 75 billion from bilaterals, respectively.

3/ Reflects the cash impact of expenditure committed at end-2001.

4/ Includes expenditure committed but not yet allocated to the accounts of the government agencies that execute the budget.

Table 6. Cambodia: Quantitative Performance Criteria and Benchmarks, June-December, 2002

	2001	2002						
	End-Dec. Actual	Rev. Prog.	End-June Adj. Prog.	Actual	Rev. Prog.	End-Sept. 1/ Adj. Prog.	Actual	Dec. Rev. Prog.
(Cumulative change from beginning of year)								
Net domestic assets of the central bank (in billions of riels) 2/3/	-1070	-45	-67	-133	-47	-21	-123	-29
Net credit to the government from the banking system (in billions of riels) 3/4/	-75	-20	-42	-90	-20	6	-31	0
Net domestic financing of the budget (in billions of riels) 3/	13	-62	-83	-172	-81	-55	-169	-46
Contracting or guaranteeing of external debt by the public sector 4/								
Up to one-year maturity 5/	0	0	0	0	0	0	0	0
1-5 year's maturity	0	0	0	0	0	0	0	0
Medium-and long-term nonconcessional debt 6/	0	0	0	0	0	0	0	0
External payments arrears 7/	0	0	0	0	0	0	0	0
(Cumulative change from beginning of year)								
Net official international reserves (in millions of U.S. dollars) 8/	470	54	58	63	65	55	64	67
<i>Memorandum items:</i>								
(Cumulative flows from beginning of year)								
Foreign currency budget / BOP support (in millions of U.S. dollars)	5	13	17	17	27	17	17	32
Total nonproject budget support (in billions of riels)	54	116	138	138	175	149	149	203
(Stock at end of period)								
Net domestic assets of the central bank (in billions of riels)	-1,070	-1,115	-1,137	-1,202	-1,117	-1,091	-1,193	-1,099
Net credit to the government from the banking system (in billions of riels)	-75	-95	-117	-165	-95	-69	-106	-75
Net official international reserves (in millions of U.S. dollars)	470	524	528	533	535	525	534	537
(At end of period)								
Exchange rate (riels per U.S. dollar, end of period)	3,900	3,900	3,920	3,920	3,900	3,950	3,950	3,900

Sources: Data provided by the Cambodian authorities; and Fund staff estimates.

1/ Performance criteria.

2/ Net domestic assets are defined as reserve money minus net foreign assets of the central bank, adjusted for valuation changes arising from the difference between program and actual exchange rates.

3/ For purposes of verifying compliance with the program, the ceiling for net domestic assets, net credit to the government from the banking system, and net domestic financing of the budget will be adjusted upward (downward) by any shortfall (excess) in total nonproject budget support from the program estimates. The adjustments for shortfalls in total nonproject budget support will not exceed \$10 million. The adjusted program in June was adjusted downwards by CR 22 billion reflecting an excess in total nonproject budget support, while in September 2002 it was adjusted upwards by CR 26 billion reflecting a shortfall in total nonproject budget support.

4/ Maturity based on original contract.

5/ Ceiling applies to amount outstanding. Excludes normal import-related credit and any borrowing associated with debt rescheduling.

6/ Excludes amounts contracted under the government loan agreement with China dated July 26, 2000 for a maximum loan amount equivalent to \$12 million.

7/ Continuous performance criterion.

8/ For purposes of verifying compliance with the program, the floor on net official international reserves will be adjusted downward (upward) by any shortfalls (excess) in external nonproject budget support from the program estimates. The adjustments for shortfalls in budget support will not exceed \$10 million. Valuation effects on the stock of gold holdings are excluded, and gold holdings in 2001 and 2002 are evaluated at the end-December 2001 gold price. In June 2002, the floor on net international reserves has been adjusted upwards by \$4.1 million. In September 2002, the floor on international reserves has been adjusted downwards by US\$9.8 million.

Table 7. Cambodia: Structural Policy Actions for the Sixth PRGF Review

Policy Action	Program Monitoring	Status
1. Identify the 100 largest accounts in the tax department that are in arrears, complete an analysis of the arrears, and establish an action plan with collection targets and reports on performance. The first report to be completed by end-July 2002.	Structural benchmark	Observed. To date CR 16 billion tax arrears have been collected out of CR 84 billion identified in the July report.
2. Pursue further centralization of accounting in the National Treasury by end-October as defined in the technical memorandum of understanding.	Structural benchmark	Partly observed. The centralization of the accounts held by the Foreign Currency Unit has been met; the coverage needs to be expanded to include accounts held by line ministries and the Department of Investment and Cooperation.
3. Finalize a new chart of accounts for fully licensed commercial banks based on international standards and begin implementation by end-July 2002.	Structural benchmark	Observed with delay. The chart of accounts was finalized by the NBC in August, and discussions have been initiated with commercial banks to complete implementation by July 2003.
4. Issue final report of the working group in the National Treasury on standardized accounting procedures and methodology for the public sector in line with international standards by October 2002.	Structural performance criterion	Observed. The final report was issued in French on October 15, 2002.
5. Taking into account technical assistance recommendations, complete proposal for the next stage of tariff restructuring to reduce the unweighted average rate to below 15 percent by end-October 2002.	Structural benchmark	Delayed. Based on technical assistance provided in October 2002, further tariff restructuring is expected to be completed by June 30, 2003.
6. Initiate privatization of the Foreign Trade Bank by issuing a public notice by end-November 2002.	Structural benchmark	Observed with delay. A public notice was issued in January, 2003.
7. Suspend all logging activity by concessionaires with effect from January 1, 2002 until sustainable management plans have been approved.	Structural benchmark (continuous)	Observed. The suspension remains in place, but enforcement and monitoring need to be strengthened.

Table 8. Cambodia: Medium-Term Macroeconomic Framework, 1999–2007  
(In percent of GDP, unless otherwise indicated)

	1999	2000	2001	2002	2003	2004	2005	2006	2007
	Projections								
<b>Real sector</b>									
Real GDP (percent change)	6.9	7.7	6.3	4.5	5.0	6.0	6.0	6.3	6.5
Real Per capita GDP (in riel; percent change)	4.2	5.0	3.7	2.5	2.9	3.9	2.9	3.2	3.4
CPI Inflation (average; percent change)	4.0	-0.8	0.2	3.3	3.8	3.5	3.5	3.5	3.5
<b>National saving</b>	13.6	9.2	12.7	13.7	13.9	14.1	14.1	14.4	14.6
Government saving	1.6	1.5	1.2	0.9	1.1	1.3	1.3	1.3	1.2
Private saving	12.0	7.7	11.5	12.8	12.8	12.8	12.8	13.1	13.5
<b>Domestic investment</b>	15.9	13.5	17.9	16.6	16.9	17.4	17.7	17.8	18.0
Government investment	5.7	6.7	7.2	7.7	7.1	7.0	6.9	6.8	6.8
Private investment	10.2	6.8	10.7	8.9	9.8	10.4	10.8	11.0	11.2
Of which: change in inventories	1.4	-1.7	2.0	...	...	...	...	...	...
<b>Fiscal sector</b>									
<b>Revenue</b>	10.6	11.2	11.7	12.1	12.7	13.4	13.9	14.3	14.5
Tax revenue	7.7	8.2	8.4	8.5	8.5	8.7	8.8	8.8	8.6
Of which: Domestic Taxes	1.1	1.8	1.8	1.9	1.8	1.8	1.8	1.8	1.8
International Taxes	6.3	6.2	6.3	6.5	6.6	6.8	6.8	6.8	6.7
Non-tax revenue	2.8	2.8	3.2	3.5	3.6	3.6	3.4	3.5	3.6
Of which: quota auctions	0.7	0.2	0.3	0.4	0.5	0.5	0.0	0.0	0.0
Capital Revenue	0.1	0.2	0.1	0.1	0.2	0.2	0.3	0.3	0.3
Revenue Measures	...	...	...	...	0.4	0.8	1.4	1.7	2.0
<b>Expenditure (cash basis)</b>	14.7	16.4	17.7	18.9	19.0	19.1	19.4	19.7	20.2
Current	8.9	9.5	10.4	11.1	11.4	11.9	12.2	12.6	13.1
Wages	4.2	4.0	3.7	3.9	4.0	4.1	4.3	4.4	4.6
Civil administration	1.5	1.6	1.6	2.0	2.1	2.5	2.7	2.9	3.0
Defense and security	2.6	2.3	2.1	1.9	1.8	1.6	1.6	1.5	1.5
Interest payments	0.1	0.1	0.2	0.2	0.5	0.7	0.7	0.7	0.7
Other	4.6	5.4	6.6	7.0	7.0	7.1	7.2	7.5	7.8
Memo item: Social spending 1/	2.0	2.3	2.9	3.6	3.8	4.3	4.4	4.5	4.5
Capital	5.8	6.9	7.3	7.8	7.3	7.2	7.1	7.1	7.1
Current balance	1.6	1.5	1.2	0.9	1.1	1.3	1.3	1.3	1.2
Overall balance	-4.0	-5.2	-6.0	-6.8	-6.3	-5.7	-5.5	-5.5	-5.6
Overall balance (including grants)	-1.3	-2.3	-3.1	-3.3	-3.4	-2.9	-2.7	-2.6	-2.8
Domestic financing	-0.3	-0.1	0.1	-0.3	-0.2	0.0	0.0	0.0	0.0
External financing 2/	4.4	5.3	5.9	7.1	6.5	5.7	5.5	5.5	5.5
Disbursements	4.4	5.3	6.0	7.2	6.8	6.0	6.0	6.0	6.0
Amortizations	0.0	0.0	0.0	0.1	0.3	0.3	0.5	0.5	0.5
<b>External sector</b>									
Domestic exports (percent change)	34.5	30.9	7.4	10.7	9.6	9.7	10.9	10.3	10.5
Retained imports (percent change)	27.7	36.5	6.8	5.8	8.6	9.8	9.8	9.9	10.1
Retained imports (excl. garments, percent change)	16.8	29.8	3.8	6.6	9.2	12.3	12.1	11.9	12.1
Current account balance (excluding transfers)	-9.0	-12.3	-13.4	-10.7	-10.4	-10.5	-10.8	-10.4	-10.0
Current account balance (including transfers)	-2.3	-4.3	-5.2	-2.9	-3.0	-3.3	-3.6	-3.4	-3.4
Foreign direct investment (in millions of US\$)	146	135	95	98	101	110	120	131	144
Overall balance	-2.8	-1.7	0.6	1.4	0.4	0.4	0.9	1.8	2.0
Gross official reserves (in millions of US\$)	422	485	550	642	696	742	810	904	1,011
(in months of imports of goods and services)	3.2	2.8	2.9	3.3	3.3	3.2	3.2	3.3	3.4
Net capital flows 3/	8.5	10.8	11.9	10.6	11.4	10.2	10.1	10.1	9.6
Financing gap (in millions of US\$)	0	0	0	0	31	20	15	0	0
<b>External debt 4/</b>	68.7	67.6	66.2	65.6	35.2	36.0	37.0	38.3	39.4
External debt (NPV) 4/	56.1	56.0	55.5	52.9	21.8	22.0	22.2	23.0	21.6
External public debt-service ratio, accrual basis 5/	11.1	8.5	3.3	3.0	2.6	2.6	2.4	2.2	2.3
External public debt-service ratio, cash basis 6/	0.7	0.8	1.1	1.1	2.1	2.6	2.4	2.2	2.3

Sources: Data provided by Cambodian authorities; and Fund staff estimates and projections.

1/ Includes components of wages paid in the social sectors.

2/ Includes disbursements for the financing gap in 2003.

3/ Net official disbursement, exceptional financing, and official transfers.

4/ Figures include bilateral debt with the Russian Federation and the United States and reflect the impact of completing rescheduling agreements on Naples terms with these creditors in mid-2003.

5/ As percent of domestic exports of goods and services. The declines in 2000 and 2001 reflect the tailing off of payments to the Russian Federation.

6/ As percent of domestic exports of goods and services.

Table 9. Cambodia: Indicators of Fund Credit, 2000–2011

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
	Projections											
	(In millions of SDRs)											
Outstanding Fund Credit	56.2	63.6	70.8	69.7	62.7	56.9	52.7	45.2	33.5	20.1	8.4	-0.8
GRA	3.1	2.1	1.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
SAF/PRGF	53.1	61.4	69.7	69.7	62.7	56.8	52.6	45.1	33.4	20.0	8.3	-0.9
PRGF loan disbursements	8.4	16.7	16.7	8.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total debt service to the Fund	5.7	9.7	10.1	10.1	7.6	6.5	4.8	8.0	12.2	13.8	12.1	9.6
Repurchases of GRA	1.0	1.0	1.0	1.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Repayments of SAF/PRGF	4.2	8.4	8.4	8.4	7.0	5.9	4.2	7.5	11.7	13.4	11.7	9.2
Charges	0.4	0.3	0.7	0.7	0.6	0.6	0.6	0.5	0.5	0.4	0.4	0.4
	(In percent)											
Fund credit outstanding												
In percent of total public external debt	3.3	3.6	3.8	6.7	5.6	4.7	4.0	3.1	2.1	1.2	0.5	0.0
In percent of quota	64.3	72.6	80.9	79.7	71.7	65.0	60.2	51.6	38.3	23.0	9.6	-0.9
Debt service to the Fund												
In percent of total public external debt service	60.8	66.4	63.4	27.2	17.1	14.3	10.5	15.6	20.6	19.5	15.3	12.5
In percent of exports of goods and services	0.5	0.7	0.7	0.7	0.4	0.3	0.2	0.4	0.5	0.5	0.4	0.3
	(In millions of SDRs; unless otherwise indicated)											
Memorandum items:												
Cambodia's quota in the Fund	87.5	87.5	87.5	87.5	87.5	87.5	87.5	87.5	87.5	87.5	87.5	87.5
Total public external debt	1,717	1,771	1,857	1,034	1,115	1,212	1,330	1,459	1,583	1,670	1,780	1,888
Total public external debt service	9	15	16	37	44	45	45	51	59	71	79	77
Total exports of goods and services	1,147	1,303	1,434	1,541	1,696	1,852	2,050	2,275	2,506	2,720	2,955	3,208
Total public debt-service ratio, cash basis (in percent of exports of goods and services)	0.8	1.1	1.1	2.4	2.6	2.4	2.2	2.3	2.4	2.6	2.7	2.4

Sources: IMF Treasurer's Department; and Fund staff estimates and projections.

### Cambodia: Key Achievements Under the PRGF-Supported Program

This annex provides a summary of Cambodia's achievements against program objectives under the PRGF since its inception in October 1999. Program conditionality overlapped with recommendations provided under the 2000 and 2001 Article IV consultations.

Policy Areas	Program and Implementation Status
<b>Macroeconomic objectives</b>	Macroeconomic objectives have been largely achieved. Real GDP growth averaged 6½ percent per annum during 1999-02. However, partial data indicate that little change was made to poverty during that short duration. Inflation has been consistently contained below the 5 percent targeted under the program, largely owing to fiscal restraint. The exchange rate has been stable in real effective terms, and official reserves rose by about \$220 million during this period, in line with program targets (3½ months of imports).
<b>Fiscal policy</b>	Key fiscal objectives have been broadly met even though revenue fell short. The current fiscal surplus was maintained at about 1-1½ percent of GDP, while the overall budget deficit (excluding grants) was contained to 5-7 percent of GDP. The overall deficit was fully financed through external concessional resources and no recourse was made to domestic banks. But revenue fell below the 2002 program target by ¾ percent of GDP and Cambodia still has one of the lowest revenue to GDP ratio. As envisaged, defense and security spending declined by about 2 percentage points of GDP, allowing for an equivalent increase in priority social outlays.
<b>Fiscal structural measures</b>	Tax reform has been protracted, especially with respect to customs enforcement and collection of nontax revenue. On the expenditure side, performance has also been short of expectations, owing to the lack of effective budget and cash management, and enforcement of government procurement regulations. Reforms in public accounting, auditing, control, and in budget and treasury management are under way with TCAP and donor support.
<b>Military demobilization</b>	The World Bank has taken the lead in this area. The military demobilization program has moved forward only after considerable delays, due to problems with the design and funding of the compensation packages. A pilot program involving the discharge of 1,500 soldiers was successfully completed in 2001; 15,000 soldiers were discharged in 2002 under the first phase of the full demobilization program; and an additional 15,000 soldiers are expected to be discharged in the first half of 2003.
<b>Civil service reform</b>	Civil service reform (which is being mainly monitored by the World Bank) has also been delayed, although progress was made in eliminating ghost workers, establishing a computerized payroll, converting some positions to teachers and establishing a new remuneration grid. The authorities, however, have avoided any retrenchment, creating tension between fiscal sustainability and the need to increase wages and enlarge wage differentials among civil servants with different skills and experience, as recommended by Bank and Fund staffs.
<b>Forestry policy</b>	In spite of strong political resistance due to vested interests, strong actions have been taken, including canceling several forestry concessions, banning logging activity in December 2001, and log transportation in May 2002. Monitoring of forest crime remains weak, although illegal logging is reported to be well below the level prevailing during 1996-98. The fundamental objective of establishing a sound forestry concession system based on sustainable practice, while safeguarding the livelihood of local communities, has been only partially met as management and environment plans were only submitted in November 2002 for review by the authorities and the international community.
<b>Governance and corruption</b>	The implementation of the governance agenda has been mixed. While the government has achieved some of the goals spelled out in the 2001 Governance Action Plan (GAP1), especially public finance, military demobilization, and land management, further efforts are urgently needed in the areas of judicial reform, administrative reform, anticorruption, and forestry (see above).
<b>Financial system</b>	Financial sector reform is the area where implementation has been most in line with the original program. The establishment of a sound legal framework under the Financial Institutions Law was instrumental in ensuring successful completion of bank relicensing, which led to the closing of 15 banks. Although progress was made toward restructuring the state-owned Foreign Trade Bank, its privatization—originally targeted for end-2001—is still a pending issue. The government has recently publicly announced its intention to privatize FTB. Progress has also been made toward establishing a modern payment system. The implementation of a new Chart of Accounts for banks in mid-2003 is also expected to pave the way for strengthened bank supervision.



### Cambodia: Technical Cooperation Action Plan (TCAP)

The TCAP aims to assist the Government strengthen its overall capacity to formulate and implement sound macroeconomic policies and to manage public finances more effectively. Through advisory services, training and introduction of essential IT systems, the program aims at strengthening the institutional capacities of six key government departments and agencies –the tax, customs and excise, and budget departments and the treasury, in the Ministry of Economy and Finance (MEF), the National Bank of Cambodia (NBC), and the National Institute of Statistics (NIS). The program, implemented jointly with UNDP and co-financed by Japan, the Netherlands, and the United Kingdom, was approved in May 2001 and is scheduled to be concluded by end 2003. There are currently five resident advisors in place (in budget management, customs administration, tax administration, banking system, and economic statistics) each at different stages of their assignment. The TCAP has provided valuable support to the PRGF program: it has helped to prioritize reforms in several areas, providing the basis of program conditionality, and has contributed to program implementation, including through a strengthening of government capacity. The program represents a substantial commitment of Fund technical assistance (including through peripatetic TA missions) and bilateral donor financial resources.

Achievements	Impediments to implementation	Remaining agenda
<b>Customs administration</b>		
A new customs law was drafted that fully complies with the WTO. The operation of the Pre-shipment Inspection (PSI) program was strengthened. Phase one of the tariff restructuring in July 2001 was implemented. Detailed reviews of existing procedures and improvements have been conducted. Significant improvements have also been made in anti-smuggling operations, particularly in inter-agency co-operation.	The slow progress in customs computerization remains a major bottleneck to modernizing and streamlining customs procedures. The automation project has been put out for tender and proposals received. Other important impediments includes the widespread practice of informal "facilitation fees" demanded by many customs officers, their corrupt practices, and their lack of commitment to the reform program.	Ongoing assistance include: (i) developing regulations and related policies and procedures required under the new customs law; (ii) automating project planning and implementation; (iii) preparing for accession to the World Trade Organization and to meet ASEAN obligations; (iv) strengthening the anti-smuggling program, and developing a customs fraud investigation capacity; and (v) strengthening the PSI program.
<b>Tax administration</b>		
Significant progress was made with the largest gains in expanding the real regime (which covers incorporated businesses) to an additional five provinces, creating and operationalizing the Large Taxpayer Unit (LTU) and the Medium Taxpayer Unit (MTU), and strengthening collection compliance and enforcement tasks. To a lesser degree, there has been progress in computerization and audit policy, and VAT compliance.	The main difficulties encountered have been the limited ownership shown by officials and the low level of capacity of staff. Moreover, there is lack of ability or willingness to make decisions regarding the functional organizational structure and delegation of power, and changes in the work flow (work technology system).	Remaining tasks where assistance is required are: (i) establishing collection enforcement activities in the LTU and MTU and testing and operationalizing enforcement actions; (ii) deciding on management information and program measurement systems; and (iii) fine tuning the operations and developing enhanced operational procedures in taxpayer services, collections, audit and returns processing.
<b>Treasury management</b>		
A Cash Management Committee (CMC) has been established to improve cash management and coordination among the National Treasury (NT) and budget management departments. The restructuring of government deposit accounts into the NBC started in March	Public revenue management does not totally conform to the legal budget process and international accounting standards due to the various budgeting procedures, the fragmentation of accounting systems, and the absence of fiscal surveillance by the NT.	Remaining work consists of: (i) strengthening the role of the CMC to reduce bunching of spending at year-end; (ii) further consolidating government accounts under the NT; (iii) implementing the recommendations contained in the

2002 and a stock-taking of domestic public debt was completed for the first semester of 2002. A working group was established to streamline accounting procedures and to revise the current chart of accounts. A draft report on standardized accounting procedures, in line with international standards, was issued in October.	Moreover, some ministries do not adhere to the legal framework on budgetary process in Cambodia.	standardized accounting procedures in tandem with the World Bank's recommendations under the Integrated Fiduciary Assessment and Public Expenditure Review.
<b>Budget management</b>		
Various materials on systematic approaches to progressively increasing delegation of financial management were prepared and presented in workshops. As a result, the MEF is finalizing a strategy to delegate financial management responsibilities to spending agencies, including the 2003 pilot model for endorsement by the Minister. Budget execution/cash management for 2003 is being strengthened by expanding the focus of the Cash Management Committee's task.	Progress in budget system reform is hampered by the lack of trained staff and the highly concentrated work load on limited, existing staff. There is no underlying institutional structure to guide the development of a comprehensive and coordinated budget system reform program and to steer its implementation. Special institutional arrangements are needed because a properly articulated program cuts across a number of departments and impacts across the whole of the administration.	There is a considerable amount of work yet to be done on (i) the design and implementation of the pilot model that increases financial management responsibilities in the Health and Education ministries, (ii) the reorganization of the Budget and Financial Affairs Department, (iii) the implementation of a proactive budget/cash planning and monitoring system, and (iv) the need to resolve the split of capital and current budget responsibilities between two ministries.
<b>Banking system</b>		
The TCAP advisor's main contribution focused on banking supervision, implementation of a bank restructuring program, training of NBC agents to off-site and on-site supervision, and assisting the creation of reporting format following a new bank chart of accounts.	The main difficulties were reorienting technical assistance from donors towards priorities NBC had defined, reluctance from banks to implement the new chart of accounts, inability to give full-time assistance to on-site supervisors, making draft regulations homogeneous (such as anti-money-laundering), insufficient modernization of NBC's internal management (esp. IT and human resources), and a difficult working relationship between NBC and the MEF.	Much remains to be done, especially as regards: (i) implementation of the new charts of accounts, (ii) overseeing the implementation of new regulations (esp. anti-money laundering); (iii) helping the on-site bank supervision department to organize its work properly; and (iv) advising in the modernisation of the bank (internal regulation of branch network, and setting up a rational information circulation network).
<b>Economic statistics</b>		
Assistance was provided in drafting the statistics law and sub-decrees on statistical functions, roles and obligations. Progress was made in improving coordination and data sharing arrangements within the government. GDDS framework for official statistics, including short- and medium-term plans to improve the production and dissemination of official statistics was introduced.	Progress in improvements in statistics is hampered by various factors, including weak institutional foundations, lack of coordination, low priority placed on data collection by government agencies, no budgetary allocations, and the heavy reliance on donors' technical and financial assistance.	Remaining agenda include: (i) enacting statistics law and implementing sub-decrees and regulations; (ii) reaching formal coordination agreements among government agencies and work program for MEF and NBC; (iii) disseminating official statistics and concepts, sources and methods; (iv) providing training on prices and government finance statistics; and (v) strengthening economic survey activities.

## Cambodia: Public And External Debt Sustainability

1. This Annex provides an overview of Cambodia's current debt situation and compares the staff's baseline projection for Cambodia's public and external debt against scenarios based on maintaining historical averages for key underlying macroeconomic variables. The sensitivity of the debt dynamics to a number of shocks is also considered. The shocks are applied as temporary deviations from the baseline and with magnitudes based on the historical deviations over the past six to ten years (depending on data availability).

### A. The Current Situation

2. **More than 70 percent (or 80 percent in NPV terms) of Cambodia's sovereign debt is owed to the United States and the Russian Federation.**<sup>1</sup> Accordingly, Cambodia's debt servicing capacity will depend heavily on the terms of the ongoing debt restructuring with these two countries. As described in EBS/02/13 (January 2002), Cambodia underwent a Paris Club rescheduling operation on Naples terms for maturities falling due during 1995-97. The bilateral agreement with the United States has not yet been signed due to the lack of documentation on the total stock of debt. Cambodia is also continuing discussions with the Russian Federation on the rescheduling of its ruble-denominated debt.

Cambodia: External Debt Outstanding at End-2002

	Principal	Arrears	Total	
	US\$ mn.	US\$ mn.	US\$ mn.	Percent of total
Nominal debt stock	1,046	1,359	2,405	100
Multilateral	709	0	709	29
Official bilateral	337	1,359	1,696	71
NPV of debt stock	608	1,359	1,967	100
Multilateral	353	0	353	18
Official bilateral creditors	255	1,359	1,614	82

Sources: Cambodian authorities; and Fund staff estimates and projections.

### B. Public Debt Sustainability

3. **Positive medium-term debt dynamics are contingent on solid growth, enhanced revenue mobilization, and continued assistance from donor countries.** On the assumption that outstanding bilateral rescheduling agreements are resolved in 2003, the baseline projection implies an increase in the public debt ratio from 37½ percent of GDP in 2003 to 41¼ in 2007.<sup>2</sup> The accumulation of public debt comes largely from the persistence of a

<sup>1</sup> The NPV of total debt was about 106 percent of exports and 423 percent of government revenue at end-2002.

<sup>2</sup> The baseline scenario assumes concessional rescheduling in mid-2003 under Naples terms with a 40-year maturity (16 year grace period) and the original interest rate of 3 percent for the U.S. debt, and a DSR option with a flow operation under Naples terms on pre-cut-off date Russian debt and a nonconcessional deferral with a 15 year maturity (5 year grace period) for the post-cut-off date Russian debt. The large drop in the outstanding debt in 2003 is due to the assumed up-front discount that is based on the memorandum of understanding between

(continued)

primary deficit. The projected primary deficit through 2007 is based on a sustained increase in grants and enhanced revenue mobilization, which reflects further strengthening of tax and customs administration.

**4. The fiscal implications of an eventual rescheduling would be substantial.** Indeed, Cambodia's fiscal position would be marginally sustainable under different assumptions on the consolidation period and/or treatment of the pre- and post-cut-off date Russia debt. After the debt rescheduling with the two countries, Cambodia's primary deficit (including grants) would be only about 0.2 percent of GDP below the deficit threshold required to maintain the

Cambodia: Indicators of Debt Sustainability  
(Percent of GDP; unless otherwise indicated)

	2001	2002	2003	Projections			
				2004	2005	2006	2007
Public-debt stabilizing primary deficit 1/	2.2	2.2	2.2	2.2	2.2	2.2	2.2
Primary deficit							
including grants	2.8	3.1	2.9	2.2	2.0	1.9	2.1
excluding grants	5.8	6.6	5.9	5.0	4.8	4.8	4.9
Public external debt outstanding	66.2	65.6	35.2	36.0	37.0	38.3	39.4
Public external debt service (cash basis)							
in percent of revenue	1.8	2.0	5.7	7.5	8.6	8.4	8.4
in percent of exports of goods and services	1.1	1.1	2.1	2.6	2.4	2.2	2.3
<i>Memorandum item:</i>							
Public external debt service (accrual basis)							
in percent of exports of goods and services	3.3	3.0	2.6	2.6	2.4	2.2	2.3

Source: Cambodian authorities and IMF staff estimates.

1/ Assumes 2.5 percent interest rate and 6.5 percent annual GDP growth.

2002 debt-to-GDP ratio stable. Moreover, since the ratio of debt service to government revenue would average 7¼ percent of GDP over 2003-07, a fundamental adjustment in expenditure priorities would be required to meet debt service obligations. In particular, achieving the government's objective of increasing social spending in line with other low-income countries would require a possible reduction (in percent of GDP) of non-interest operational expenditures on non-priority sectors and an annual wage bill of less than 5 percent.

**5. The analysis of shocks to the baseline scenario indicates that the debt dynamics are mainly sensitive to the recognition of any implicit or contingent liabilities, should they arise in the future.<sup>3</sup>** Indeed, recognition of implicit or contingent liabilities, assumed to

the Russian Federation and the Paris Club in September 1997. For a discussion of other possible rescheduling scenarios, see EBS/02/13.

<sup>3</sup> The other standard stress test relating to real depreciation is not presented as this shock would not be relevant in Cambodia where the economy is highly dollarized.

be on the order of 10 percent of GDP, would increase the public debt ratio to about 48 percent of GDP (see stress test 6 in the attached table). Stress tests 2 and 5 show that a two standard deviation increase in real interest rates would raise the debt ratio by 5 and 10 percentage points, respectively. However, the two standard deviations used in the sensitivity analysis may be too large relative to a likely magnitude of a shock in the future as the former is calculated on the basis of an unstable economic environment during 1995-98. The size of shocks related to the primary deficit and GDP growth (stress tests 3 and 4) are perhaps more relevant to the current stable environment. These shocks suggest that the public debt ratio would be only slightly higher than the debt ratio in the baseline scenario.

### C. External Debt Sustainability

6. **The sustainability of external debt in the medium term depends on strong export performance, solid GDP growth, and continued assistance from donor countries.** After the possible resolution of outstanding bilateral agreements with Russia and the United States in 2003, the accumulation of external debt would mainly reflect continuing current account deficits, partly offset by non-debt creating capital inflows. The projected current account deficits through 2007, which assume that exports would increase to 65 percent of GDP in 2007, are expected to be financed by rising foreign direct investment and official transfers of about 7 percent of GDP per annum.

7. **The analysis of shocks to the baseline projection suggests that the debt dynamics are sensitive to the size of the non-interest current account deficit.** Stress tests 4 and 6 suggest that the debt ratio is highly sensitive to the assumed shock in the U.S. dollar GDP deflator. However, due to the unstable macroeconomic situation during most of the 1990s, the two standard deviations in the measurement of the U.S. dollar GDP deflator assumed for the sensitivity analysis may be too large viewed against Cambodia's recent experience. Lastly, stress test 5 highlights the importance of strong export performance and sustained donor's assistance as the assumed two standard deviations shock to the non-interest current account deficit would raise the debt ratio to 47 percent (or 24 percent in NPV terms) by 2007.

Table A1. Cambodia: Public Sector Debt Sustainability Framework, 1998-2007  
(In percent of GDP; unless otherwise indicated)

	Actual				Projections					
	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
<b>I. Baseline Medium-Term Projections</b>										
Public Debt/Revenue	850.2	661.3	633.0	580.5	562.0	296.5	285.2	281.0	281.7	283.4
Public debt 1/	70.5	70.3	70.6	67.8	67.9	37.6	38.1	39.0	40.2	41.2
Of which: foreign-currency denominated	68.0	68.0	68.5	65.8	66.0	35.8	36.5	37.6	38.8	40.0
Change in public debt	-4.0	-0.2	0.3	-2.7	0.1	-30.3	0.6	0.9	1.1	1.0
Identified debt-creating flows (5+8)	-7.6	-4.7	0.7	0.7	-1.5	-2.2	-0.3	-0.5	-0.8	-0.8
Primary deficit	2.4	1.9	2.4	2.8	3.1	2.9	2.2	1.9	1.9	2.1
Revenue and grants	11.3	12.6	13.8	14.8	15.6	15.6	16.2	16.8	17.1	17.4
Primary (noninterest) expenditure	13.7	14.5	16.2	17.5	18.7	18.5	18.3	18.7	19.0	19.5
Automatic debt dynamics: $(r-g-(\pi+gr)) \times (1+g+\pi+gr) \times \text{debt}/\text{GDP}$ (lines 10/9) 2/	-10.0	-6.6	-1.6	-2.0	-4.6	-5.1	-2.4	-2.5	-2.7	-2.8
Denominator: $1+g+\pi+gr$	1.2	1.1	1.0	1.0	1.1	1.1	1.1	1.1	1.1	1.1
$(r-g-(\pi+gr)) \times \text{debt}/\text{GDP}$ (lines 11+12+13)	-11.6	-7.4	-1.7	-2.1	-5.0	-5.5	-2.7	-2.7	-2.9	-3.1
Contribution from nominal interest rate: $r$ times debt/GDP	0.5	0.2	0.2	0.2	0.2	0.5	0.8	0.8	0.8	0.8
Contribution from real GDP growth: minus $g$ times debt/GDP	-1.6	-4.8	-5.4	-4.5	-3.1	-3.4	-2.3	-2.3	-2.5	-2.6
Contribution from price changes: minus $(\pi+gr)$ times debt/GDP	-10.5	-2.8	3.5	2.2	-2.1	-2.6	-1.2	-1.2	-1.2	-1.3
Residual, including asset changes and valuation changes in external debt/GDP (2-3)	3.6	4.5	-0.4	-3.5	1.6	-28.2	0.8	1.4	1.9	1.8
Memorandum items: Key Macroeconomic and Fiscal Assumptions										
Real GDP growth (in percent)	2.1	6.9	7.7	6.3	4.5	5.0	6.0	6.0	6.3	6.5
Average nominal interest rate on public debt (in percent) 3/	0.7	0.3	0.3	0.3	0.3	0.8	2.1	2.0	2.0	1.9
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	-13.1	-3.3	4.9	3.2	-2.7	-2.9	-0.9	-1.0	-1.0	-1.1
Nominal appreciation (increase in US dollar value of local currency, in percent)	-8.7	0.1	-3.5	0.3	-2.5	-2.3	-2.9	-2.9	-2.9	-2.9
Inflation rate (GDP deflator, in percent)	13.8	3.7	-4.6	-2.9	3.0	3.7	3.0	3.0	3.0	3.0
Growth of real primary spending (deflated by GDP deflator, in percent)	9.4	13.1	20.5	15.0	11.3	4.0	5.0	8.1	8.1	9.1
<b>II. Stress Tests for Public Debt Ratio</b>										
1. Real GDP growth, real interest rate, and primary balance are at historical averages in 2003-2007					67.9	36.2	36.0	36.4	37.3	37.9
2. Real interest rate is at historical average plus two standard deviations in 2003 and 2004					67.9	45.7	50.4	50.5	50.9	51.1
3. Real GDP growth is at historical average minus two standard deviations in 2003 and 2004					67.9	39.5	41.5	42.3	43.4	44.3
4. Primary balance is at historical average minus two standard deviations in 2003 and 2004					67.9	38.0	39.7	40.5	41.6	42.5
5. Combination of 2-4 using one standard deviation shocks					67.9	42.2	45.5	45.4	45.5	45.6
6. 10 percent of GDP increase in other debt-creating flows in 2003					67.9	47.6	47.5	47.8	48.3	48.8
Memorandum items:										
Primary deficit (percent of GDP, average of past 8 years)					1.7	1.7	1.7	1.7	1.7	1.7
Primary deficit (percent of GDP, standard deviation of past 8 years)					0.8	0.8	0.8	0.8	0.8	0.8
Nominal interest rate (average of past 6 years)					0.9	0.9	0.9	0.9	0.9	0.9
Nominal interest rate (standard deviation of past 6 years)					0.7	0.7	0.7	0.7	0.7	0.7
Real interest rate (average of past 6 years)					-2.5	-2.5	-2.5	-2.5	-2.5	-2.5
Real interest rate (standard deviation of past 6 years)					6.3	6.3	6.3	6.3	6.3	6.3
Real GDP growth rate (average of past 10 years)					5.7	5.7	5.7	5.7	5.7	5.7
Real GDP growth rate (standard deviation of past 10 years)					1.8	1.8	1.8	1.8	1.8	1.8
GDP deflator (average of past 10 years)					21.2	21.2	21.2	21.2	21.2	21.2
GDP deflator (standard deviation of past 10 years)					38.3	38.3	38.3	38.3	38.3	38.3

1/ General government gross debt.

2/ Defined as:  $r$  = interest rate;  $\pi$  = change in GDP deflator;  $g$  = real GDP growth rate.

3/ Derived as nominal interest expenditure (accrual basis) divided by previous period debt stock.

Table A2. Cambodia: External Debt Sustainability Framework, 1998-2007  
(In percent of GDP; unless otherwise indicated)

	Actual				Projections					
	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
<b>I. Baseline Medium-Term Projections</b>										
1 External debt	68.0	68.0	68.5	65.8	66.0	35.8	36.5	37.6	38.8	40.0
2 Change in external debt	6.2	6.1	0.4	-2.7	0.2	-30.1	0.7	1.0	1.3	1.2
3 Identified external debt-creating flows (4+8+11)	4.5	-8.1	-0.7	1.5	-4.4	-3.4	-1.3	-1.2	-1.6	-2.0
4 Current account deficit, excluding interest payments	1.6	1.9	4.9	5.0	2.4	2.4	2.5	2.7	2.6	2.5
5 Deficit in balance of goods and services	9.1	8.7	12.1	12.0	8.8	8.4	8.3	8.6	8.3	7.9
6 Exports	34.6	39.2	51.4	53.7	55.0	56.6	58.7	60.4	62.6	64.9
7 Imports	43.7	47.9	63.5	65.6	63.8	65.0	67.1	69.0	70.9	72.8
8 Net non-debt creating capital inflows (negative)	-4.0	-4.4	-4.1	-2.8	-2.7	-2.6	-2.7	-2.7	-2.8	-2.9
9 Net foreign direct investment, equity	4.0	4.4	4.1	2.8	2.7	2.6	2.7	2.7	2.8	2.9
10 Net portfolio investment, equity	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
11 Automatic debt dynamics: $[(r-g-p(1+g))/(1+g+p+gp)]$ times debt/GDP (13/12)/1	6.9	-5.6	-0.7	-0.7	-4.2	-3.3	-1.1	-1.2	-1.4	-1.6
12 Denominator: $1+g+p+gp$	0.9	1.1	1.0	1.0	1.1	1.1	1.1	1.1	1.1	1.1
13 $(r-g-p(1+g))$ debt/GDP (14+15+16)	6.3	-6.1	-0.7	-0.7	-4.5	-3.5	-1.1	-1.3	-1.5	-1.7
14 Contribution from nominal interest rate: $r$ times (debt/GDP)	0.5	0.4	0.4	0.4	0.5	0.6	0.9	0.9	0.9	0.8
15 Contribution from real GDP growth: $g$ times (debt/GDP)	-1.3	-4.7	-5.2	-4.3	-3.0	-3.3	-2.2	-2.2	-2.4	-2.5
16 Contribution from price and exchange rate changes: $(-p(1+g))$ times debt/GDP	7.1	-1.9	4.2	3.3	-2.0	-0.8	0.1	0.0	0.0	0.0
17 Residual, incl. change in gross foreign assets (2-3)	1.7	8.1	1.2	-4.1	4.6	-26.7	2.0	2.3	2.9	3.1
<b>Key Macroeconomic and External Assumptions</b>										
Real GDP growth (in percent)	2.1	6.9	7.7	6.3	4.5	5.0	6.0	6.0	6.3	6.5
Exchange rate appreciation (US dollar value of local currency, change in percent)	-21.9	-1.0	-1.2	-1.7	0.0	-2.4	-3.2	-2.9	-2.9	-2.9
GDP deflator in US dollars (change in percent)	-11.2	2.6	-5.7	-4.5	3.0	1.2	-0.3	0.0	0.0	0.0
Nominal external interest rate (in percent)	0.9	0.6	0.5	0.5	0.8	0.9	2.5	2.4	2.3	2.2
Growth of exports (US dollar terms, in percent)	6.5	25.6	30.0	8.1	10.2	9.4	9.7	9.0	10.2	10.4
Growth of imports (US dollar terms, in percent)	6.3	21.4	31.6	7.0	4.5	8.3	9.0	9.1	9.2	9.4
<b>II. Stress Tests for External Debt Ratio</b>										
1. Real GDP growth, nominal interest rate, dollar deflator, non-interest current account, and non-debt inflows are at historical average in 2003-2007	66.0	35.5	35.1	35.0	35.6	36.3				
2. Nominal interest rate is at historical average plus two standard deviations in 2003 and 2004	66.0	37.4	38.3	39.3	40.5	41.6				
3. Real GDP growth is at historical average minus two standard deviations in 2003 and 2004	66.0	37.7	39.7	40.7	41.8	42.9				
4. Change in US dollar GDP deflator is at historical average minus two standard deviations in 2003 and 2004	66.0	49.8	59.9	60.1	60.5	60.8				
5. Non-interest current account is at historical average minus two standard deviations in 2003 and 2004	66.0	39.8	44.4	45.1	46.1	47.0				
6. Combination of 2-5 using one standard deviation shocks	66.0	46.3	53.7	54.2	54.8	55.3				
<b>Memorandum items:</b>										
Current account deficit, excluding interest payments (percent of GDP, average of past 10 years)	2.9	2.9	2.9	2.9	2.9	2.9				
Current account deficit, excluding interest payments (percent of GDP, standard deviation of past 10 years)	1.8	1.8	1.8	1.8	1.8	1.8				
Net non-debt creating capital inflows (percent of GDP, average of past 10 years)	3.7	3.7	3.7	3.7	3.7	3.7				
Net non-debt creating capital inflows (percent of GDP, standard deviation of past 10 years)	2.5	2.5	2.5	2.5	2.5	2.5				
Nominal external interest rate (percent, average of past 6 years)	1.3	1.3	1.3	1.3	1.3	1.3				
Nominal external interest rate (percent, standard deviation of past 6 years)	1.0	1.0	1.0	1.0	1.0	1.0				
Real GDP growth (in percent, average of past 10 years)	5.7	5.7	5.7	5.7	5.7	5.7				
Real GDP growth (in percent, standard deviation of past 10 years)	1.8	1.8	1.8	1.8	1.8	1.8				
GDP deflator in US dollars (change in percent, average of past 10 years)	0.3	0.3	0.3	0.3	0.3	0.3				
GDP deflator in US dollars (change in percent, standard deviation of past 10 years)	8.8	8.8	8.8	8.8	8.8	8.8				

1/ Derived as  $r$  = nominal effective interest rate on external debt;  $p$  = change in domestic GDP deflator in US dollar terms, and  $g$  = real GDP growth rate.

2/ Defined as current account deficit plus amortization on medium- and long-term debt.

**Cambodia: Fund Relations<sup>1</sup>**  
As of November 30, 2002

**I. Membership Status:** Joined: 12/31/1969; Article VIII

<b>II. General Resources Account:</b>	<b>SDR Million</b>	<b>Percent Quota</b>
Quota	87.50	100.0
Fund Holdings of Currency	88.54	101.2
<b>III. SDR Department:</b>	<b>SDR Million</b>	<b>Percent Allocation</b>
Net cumulative allocation	15.42	100.0
Holdings	0.58	3.8
<b>IV. Outstanding Purchases and Loans:</b>	<b>SDR Million</b>	<b>Percent Quota</b>
Systemic Transformation	1.04	1.2
PRGF arrangements	69.74	79.7

**V. Financial Arrangements:**

Type	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
ESAF/PRGF	10/22/1999	02/28/2003	58.50	50.14
ESAF	05/06/1994	08/31/1997	84.00	42.00

**VI. Projected Obligations to Fund:** (SDR Million; based on existing use of resources and present holdings of SDRs):

	Overdue <u>12/31/2001</u>	Forthcoming				
		<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>
Principal	--	--	9.4	7.0	5.9	4.2
Charges/Interest	--	0.2	0.6	0.6	0.6	0.5
Total	--	0.2	10.0	7.6	6.5	4.7

**VII. Safeguards Assessment:**

Under its current arrangement with the Fund, Cambodia is subject to the transitional procedures governing safeguards assessments, which require a review of the external audit mechanism of the National Bank of Cambodia (NBC). Staff reviewed the documentation provided by the central bank and concluded that NBC has made considerable progress in updating its external audit mechanism and financial reporting framework in the past year. In particular, the NBC appointed

<sup>1</sup> Prepared by the staff of the IMF. Contact person: Mr. Alejandro López-Mejía, Economist, Division 7, Asia and Pacific Department, phone (202) 623-4334.



a high quality international accounting firm to audit its financial statements in accordance with International Standards on Auditing and adopted International Accounting Standards. In addition, staff identified certain weaknesses in other areas of the safeguards framework, notably in NBC's financial reporting framework. Following staff advice, the NBC has agreed to the following measures: (i) the contract of the external auditor has been extended for another five years; (ii) the monitoring of the external audit mechanism (by the Fund) will be adhered to for the duration of the Fund arrangement; and (iii) NBC staff will provide periodic updates to the Fund on the status of the other recommendations made by the auditor. An external audit of NBC's 2001 accounts was recently completed. As in the case of the 2000 accounts, the NBC published its audited financial statements and related audit opinion for 2001 in its September 2002 bulletin, in accordance with safeguards policy.

#### **VIII. Exchange Rate Arrangement:**

Since November 8, 1992, the exchange rate arrangement for the riel has consisted of the following two rates. First, the official exchange rate, which is expressed in riels per U.S. dollar, applies to all official external transactions conducted by the government and state enterprises. Second, the market rate, which is determined through interactions of foreign exchange traders in the private sector, applies to all other transactions. The official exchange rate is adjusted so as to limit the spread between the official rate and the market rate to no more than 1 percent on a daily basis. On November 30, 2002, the official exchange rate was CR 3,935 per U.S. dollar and the market rate CR 3,944 per U.S. dollar. Cambodia accepted the obligations of Article VIII, Sections 2, 3, and 4 on January 1, 2002. Cambodia maintains an exchange system that is free of restrictions on payments and transfers for current international transactions.

#### **IX. Article IV Consultation:**

Cambodia is subject to the provisions on consultation cycles approved on July 15, 2002. The Executive Board concluded the last Article IV consultation on February 6, 2002 (EBS/02/13, 01/24/02).

#### **X. Technical Assistance:**

Following discussions between the Government, the IMF, UNDP, and other interested multilateral and bilateral donors, a comprehensive Technical Cooperation Action Plan (TCAP) was adopted in May 2001. The TCAP calls for an annual review to assess the progress of implementation and, where needed, to adjust planned activities to reflect changed government priorities. With the agreement of the government and participating donors a revised program document, incorporating these changes and related budget adjustments, was completed in June 2002. An update of recent technical assistance missions is contained in Annex VII.

#### **XI. Resident Representative:**

The resident representative office was closed in October 1997, but it was re-opened at end-October 1999. Mr. Hagemann is currently the Resident Representative.

## **Cambodia: World Bank Policy Dialogue and Its Relation with the IMF <sup>1</sup>**

### **World Bank Policy Dialogue**

The World Bank has a wide-ranging policy dialogue in Cambodia, covering diverse areas such as poverty reduction strategy, public sector management, forestry management, private sector development, governance and anti-corruption, legal and judicial reform, and military demobilization. This Annex focuses on areas within the Bank's policy dialogue and operations which are complementary to the Fund's activities in Cambodia.

**Poverty Reduction Strategy.** The PRSP completed in December 2002 provides a credible framework for guiding the implementation of actions to reduce poverty in Cambodia. However, shortcomings and challenges remain, in particular in improving governance and combating corruption, addressing weaknesses in costing and prioritization, and further elaborating rural and infrastructure development strategies. The Bank has been providing assistance to relevant ministries by closely aligning its economic and sector work with the PRSP, in addition to the targeted assistance provided to the Government under an Institutional Development Facility (IDF) grant for poverty reduction strategy formulation. The Bank is providing analytical support for assessing the incidence of public spending in health, education, agriculture, and transport. The Bank is planning to assist the Government with a poverty and social impact analysis on land policies to be carried out in 2003. The Bank is also assisting the Government in the process of securing a poverty reduction strategy trust fund.

**Public Sector Management Issues.** While the Fund is in the lead in developing fiscal policy and overall fiscal targets, the Bank takes the lead on civil service reform and public expenditure and financial management. Though the Government has been engaged in a public sector reform program for a number of years, and while the program has yielded results in several areas, further fundamental reforms are needed, principally in the areas of civil service reform and public expenditure and financial management to improve the capacity of the public sector to deliver pro-poor services and improve fiduciary accountability. Both civil service reform and public expenditure and financial management constitute the core thematic focus of the Bank's on-going Integrated Fiduciary Assessment and Public Expenditure Review (IFAPER), scheduled to be completed by mid-2003, and will continue to be part of the dialogue with the RGC over the short and medium term. Grant funding has been mobilized to support technical assistance on key IFAPER recommended reforms in these areas in 2003-2004.

**(a) Civil Service Reform.** The RGC, Bank, and Fund have agreed to the following civil service reform objectives: (i) constraining the wage bill within a sustainable macroeconomic and fiscal framework; (ii) enhancing and decompressing civil service salaries in the context of fiscal sustainability; (iii) redeploying civil servants to priority

---

<sup>1</sup> Contact person on this note: Mr. Su-Yong Song, World Bank (458-0498)

sectors; and (iv) using normal attrition to offset hiring of additional priority sector civil servants. However, there has been no explicit agreement on: (i) further retrenchment; (ii) the overall wage bill ceiling; and (iii) details of civil service reform implementation. The Bank and Fund have acknowledged the Government's position that no major reforms would take place until after the election to be held in July 2003. The Bank and Government have agreed to a set of analytical studies to lay the groundwork for the reforms to be undertaken by the next administration, including: (i) labor market wage analysis; (ii) pay and employment sustainability analysis; (iii) reallocation and retrenchment analysis; (iv) development of a functional analysis methodology and its application to select ministries; and (v) preparation for an establishment register for select ministries. Funding for the studies has been secured by the Bank and the work is about to commence and is to be completed by September 2003. Based on the outcome of these studies, the Government is to formulate a credible civil service reform strategy. The Bank considers this as an integral part of possible future policy-based lending.

***(b) Public Expenditure and Financial Management.*** Another principal public sector management concern is the effectiveness of the Government's expenditure and financial management system, which is characterized by: (i) a weak treasury system, resulting in misallocation of resources across government and over time, and (ii) the lack of effective controls over cash management. Observations so far also indicate problems at the level of the provincial treasuries, which is worrisome given that they are slated to play an important role under the decentralization program in commune level financial management. These problems undermine the capacity of the planning and budgeting system to deliver resources to the Government's priority services. While the social sectors receive priority over other sectors in the budget, this is countervailed both by poorer actual expenditures (vis-à-vis the budget) and higher back-loading of expenditures throughout the year. Future policy-based lending would feature key public expenditure and financial management reforms.

***Forestry Management.*** Developments in the forestry sector are problematic. While some progress has been made on the legislative front, serious problems have recently arisen in consultations with affected communities and in maintaining and increasing transparency in the sector through arrangements for independent monitoring of forest crime monitoring. *First*, management plans and environmental and social impact assessments have been submitted and decisions on permit approvals are awaiting review and subsequent filings. Following public disclosure of these submissions, tensions have arisen over the conduct and quality of community consultations and response to comments from stakeholders and observers. These have boiled over into incidents and dispute with the Government's independent monitor, Global Witness. The Government has moved to terminate its arrangement with Global Witness and has requested assistance from external partners in the identification of an alternative monitor. *Second*, increased attention is needed on the role of economic land concessions in forestry. In addition to serious concerns about adverse social and environmental impacts, fellings associated with land development activities constitute a potentially important source of revenue loss and of corruption. The introduction of reforms in concession forestry has also not been well sequenced or coordinated with changes in community forestry or with development of

other arrangements for production forestry. Finalization of the Sub-Decree on Community Forestry seems to have stalled after considerable consultative and technical work.

The Bank is pursuing progress on these issues through investment support and dialogue with the Government over concession policy reform and forest law enforcement in relation to the Structural Adjustment Credit (SAC). The Bank-financed Forest Concession Management and Reform Pilot Project is currently rated as unsatisfactory and supervision attention focuses on the strength of Government's efforts to enhance the technical quality of forest management. A credible action plan is needed to restore the performance of the project. The continuity of arrangements for independent monitoring of illegal logging and the continuation of the overall forest policy reform process are the main issues facing release of the second tranche of the SAC.

***Private Sector Development.*** While there is broad appreciation for efforts to improve the foreign investment regime, develop a pro-poor trade strategy, and create a Private Sector Forum to facilitate a reform dialogue with the private sector, the Government needs to place a higher priority on structural reforms to support sustainable, private-led growth. Potential investments which would diversify the export base are discouraged by a high-risk and high-cost business environment, characterized by an underdeveloped commercial legal system, inadequate infrastructure, a shallow financial structure, high administrative costs of doing business, weak private sector capacity and poor linkages between the foreign and domestic private sector. In light of these, the Bank is focusing its efforts on PSD in three areas: (i) developing a cross-cutting, multi-sectoral approach to increasing the efficiency of private provision of public services, supporting the introduction of transparency, competition and accountability into public-private partnerships, in particular a prohibition on closed, opaque concession transactions; (ii) improving the investment climate, including rural business environment to address pervasive informality, overlapping authority, and discretionary processes by carrying out an Investment Climate Survey in the first half of 2003; and (iii) supporting export diversification, regional integration, and FDI facilitation.

***Governance and Anti-corruption.*** The Government adopted a Governance Action Plan (GAP) in 2001 that integrated about a hundred reform actions in the areas of legal and judicial reform, public finance, public administration, decentralization, anti-corruption, gender equity, demobilization, and natural resource management. While the Government made progress in implementing GAP in 2001-02 (in areas such as demobilization, land, public finance, gender, decentralization), politically sensitive areas such as legal and judicial reform and anti-corruption experienced major delays. Following up on previous assistance on the governance and corruption diagnostic report and GAP implementation, the Bank's future assistance includes: (i) providing training on anti-corruption awareness and prevention as well as public procurement under the Economic and Public Sector Capacity Building project which is expected to become effective in February 2003; (ii) providing technical assistance for potential studies on institutional arrangements for implementing an anti-corruption law and mechanisms of citizen protection and feedback

in enhancing service delivery. Governance/anti-corruption would be a key component of possible future policy-based lending.

***Legal and Judicial Reform.*** While the Government is undertaking some measures, including (i) drafting modern Civil and Penal Codes and Codes of Civil and Criminal Procedure and (ii) launching a School for Judicial Training, much remains to be done. The Bank has been supporting Government efforts to devise a Legal and Judicial Reform Strategy and Plan of Action. Since the dissemination of the draft Legal and Judicial Reform (LJR) Strategy in June 2002, little progress appears to have been made in finalizing this strategy and in ensuring its broad endorsement. The Bank aims to assist the Government's efforts with the proposed Legal and Judicial Reform Project which includes, among others: (i) building capacity to plan and prioritize its LJR reform agenda and action plans; (ii) streamlining the law-making process; (iii) creating a self-financing institution for the effective and timely publication and dissemination of all legal norms; (iv) improving the efficiency and effectiveness of judicial work; and (v) training judges.

***Military Demobilization.*** The Government has undertaken the discharge and reinsertion phase for the first 15,000 soldiers of the full scale demobilization program using budgets from several donors as well as their own budget. The IDA credit in support of demobilization became effective in July 2002 and is funding the reintegration phases. The second food distribution for the first 15,000 soldiers took place in the second half of 2002, and distribution of the reintegration packages started toward the end of the year. It is now widely accepted, based on a growing body of evidence, that there were irregularities in the 1999 registration of military personnel and establishment of a database. A comprehensive monitoring initiative has been developed and is being implemented, to ensure that the final database of demobilized soldiers will be accurate. It also includes studies to assess the impact of the reintegration packages on the livelihoods of the soldiers and their families. The length of time taken to register old and disabled soldiers for pensions is of some concern and will be addressed by additional technical assistance.

### **World Bank-IMF Collaboration**

Bank-Fund collaboration in Cambodia takes place at two levels: (i) through the policy-based lending program; and (ii) through analytical and advisory services.

***Lending programs and conditionalities.*** There is a close coordination between the Fund's PRGF program and the World Bank's SAC. The Fund's PGRF program mainly focuses on the fiscal and banking sector issues while the SAC focuses on issues relating to forestry, civil service reform/governance, public expenditure management, and military demobilization. The Bank and Fund teams have been in close coordination, and as such, the two programs have been designed to complement each other.

***Analytical and advisory activities.*** The Bank's recent analytical and advisory activities include the IFAPER, the Governance and Corruption Diagnostic Report, the Integration and Competitiveness Study, and the Poverty Assessment. The Bank aims to support

Government efforts with forthcoming analytical work on, among others, sources of growth, private sector development strategy, investment climate assessment, rural sector strategy, and a legal and judicial reform strategy.

**World Bank's Main Non-Lending Services**  
(recently completed and ongoing)

<b>Issue</b>	<b>Instrument</b>
Poverty Reduction	Poverty Assessment (2000), PRSP/JSA (February 2003), IDf grant on poverty reduction (ongoing), Rice Value Chain Study (2002), PSIA on land policies (to be completed by late 2003), Rural Sector Strategy (to be completed by late 2003), Sources of Growth (to be completed by mid-2003)
Public Expenditure Management	IFAPER (to be completed by mid-2003), Policy and Human Resource Development (PHRD) grant on public sector reform (ongoing)
Civil Service Reform	IFAPER (to be completed by mid-2003), PHRD grant on public sector reform (ongoing), IDf grant on civil service reform (2003)
Private Sector Development	FIAS report on FDI (2001), Private Sector Development Strategy (to be completed by mid-2003), Investment Climate Assessment (to be completed by mid-2003)
Governance	Governance and Corruption Diagnostic Report (2001), IDf grant on governance (2002), PHRD grant on public sector reform (ongoing)
Trade	Integration and Competitiveness Study (2002), Cost of implementing WTO requirements (to be completed by late 2003)
Legal and Judicial Reform	Legal and Judicial Reform Strategy (to be completed by early 2003)

**Lending Operations**

The goal of the World Bank's country assistance strategy under the current CAS is to assist Cambodia to build the foundations for sustainable development and poverty reduction through: (i) supporting good governance; (ii) building physical infrastructure; (iii) rebuilding human capital; and (iv) facilitating private sector development. Lending operations during the last three years have averaged \$75 million per year and focused on the CAS objectives mentioned above. The level and composition of the lending program for the next three years will be determined in the context of the forthcoming CAS, currently scheduled for December 2003.

### Cambodia: Relations with the Asian Development Bank

From 1992 through November 30, 2002, the AsDB approved \$649.7 million in low-interest loans to Cambodia to finance 20 projects and 4 structural reform programs. To date 3 projects, for a total of \$125.9 million, were completed: the Special Rehabilitation Assistance Project (approved in 1992), Power Rehabilitation Project (approved in 1994), and an Agriculture Sector Program (approved in 1996). Of the remaining loan projects, \$266.6 million were for economic infrastructure, \$158.0 million for social infrastructure, and \$99.2 million for agriculture and rural infrastructure.

The AsDB also designed and administered 93 technical assistance projects during this period. They were financed through grants from the AsDB (\$22.7 million), the Japanese Special Fund (\$30.7 million), and other sources (\$12.4 million).

The AsDB completed a new Country Operational Strategy in July 2000 emphasizing poverty reduction through interventions in four areas: rural economic development, social development, governance, and improvement of the conditions for private investment. The AsDB is very active in the areas of governance, including public expenditure management and medium-term planning. The AsDB will place particular emphasis on facilitating government leadership of sector development initiatives in water resource management, education and transportation. This will be accomplished through efforts to coordinate the activities of aid agencies, build local capacity to finance and manage development programs, and fund priority investments.

In October 2000, the AsDB conducted an assessment of the flood damage to prepare a proposal for loan assistance to meet Cambodia's rehabilitation requirements. In December 2000 an Emergency Flood Rehabilitation Project in the amount of \$55 million was approved. In 2001, the Financial Sector Development Program and Northwest Rural Development loans were approved. The Board also approved a loan to support structural reform in the education sector along with a complementary investment loan. In 2002, the AsDB approved 4 national loans: Tonle Sap Environmental Management, Health Sector Support, Financial Sector Program, and Commune Council Development Project.

AsDB: Loan Commitments and Disbursements to Cambodia, 1992-2002  
(In millions of U.S. dollars)  
as of November 30, 2002

	Loan Approvals	Contract Awards/ Commitments	Disbursements
1992	67.7	0.0	0.0
1993	0.0	4.4	5.4
1994	28.2	35.9	12.2
1995	45.1	28.1	35.9
1996	105.0	15.3	32.1
1997	0.0	41.5	10.7
1998	40.0	29.1	29.3
1999	88.0	17.0	26.2
2000	109.6	114.2	50.8
2001	75.2	40.7	48.3
2002	90.9	52.0	64.7
Total	649.7	378.2	315.6

### Cambodia—Statistical Issues

Extensive technical assistance from the Fund, the UNDP, the AsDB, and the World Bank has contributed to substantial improvements in macroeconomic statistics. In October 2001, a long-term IMF advisor was placed in the National Institute of Statistics (NIS) to assist the authorities in upgrading economic and financial statistics. An *IFS* page for Cambodia has been published since April 1996. In March 2002 Cambodia's metadata were posted on the General Data Dissemination System (GDDS) site of the Fund's Dissemination Standards Bulletin Board. Despite significant shortcomings in some areas, core data are generally adequate for program design and monitoring and are provided on a timely basis.

**National accounts.** Official GDP estimates are provided annually under peripatetic expert support from the AsDB. Revised national accounts series for 1993–2001 were officially released in May 2002. The quality of GDP estimates remains hampered by the lack of comprehensive and reliable sectoral information.

**Prices.** The NIS provides a monthly CPI with a five-week lag. NIS has recently updated the CPI for Phnom Penh with new expenditure weights (July–December, 2000 = 100). In addition, the NIS has compiled a monthly CPI for five major provincial cities since the second half of 2001. No producer or wholesale price indices are available yet.

**Government finance statistics.** The Ministry of Economy and Finance provides monthly fiscal data broadly based on GFS standards on a timely basis with a four-week lag. The authorities have provided monthly fiscal data for publication in *IFS* since 2001 and reported data on the *GFSM* 2001 format in 2002. These data, including any improvements to be made during a GFS mission scheduled in April, will be published in the 2003 GFSY. There are still weaknesses regarding the reliability of data sources, the coverage and the economic and functional classifications of expenditure and donor-specific data on investments financed by project aid are available only with considerable lags. Recent and envisaged measures to improve expenditure management, including a revision of public accounting to start being implemented on February 1, 2003, should significantly help in resolving some of these issues.

**Monetary statistics.** The NBC provides data on the monetary authorities and deposit money banks on a monthly basis with a four-week lag. An IMF mission in April 2002 assisted the authorities in strengthening the framework for compiling monetary statistics.

**External sector statistics.** The NBC is responsible for compiling balance of payments statistics. Customs data have substantial coverage and valuation problems arising from the nonrecording of nondutiable imports, under reporting of re-exports, and the weakness of customs controls. While there have been improvements in the quality of foreign direct investment data, private capital flows are believed to be large and not fully captured by official data. A range of international transactions by enterprises, such as payments for imported services, income payments, and portfolio investment abroad are not included in the data. Data on external debt are provided by the Ministry of Economy and Finance, but timely information on disbursements by bilateral donors is weak. The second of a series of three planned missions on balance of payments visited Cambodia in October–December 2002 to review and recommend improvements to the source data used for compiling the balance of payments. The authorities have not initiated compiling data on foreign currency liquidity in line with the data template on international reserve and foreign currency liquidity.



**Cambodia: Core Statistical Indicators as of January 8, 2003**

	Exchange Rates	International Reserves <sup>1</sup>	Central Bank Balance Sheet	Reserve/ Base Money	Broad Money	Interest Rates	Consumer Price Index	Exports/ Imports	Current Account Balance	Overall Government Balance <sup>2</sup>	GDP/GNP	External Public Debt/Debt Service
<i>Date of Latest Observation</i>	Jan. 8, 2003	Dec. 31, 2002	November 2002	November, 2002	November, 2002	November, 2002	November, 2002	September, 2002	June, 2002	November, 2002	2001	2001
<i>Date Received</i>	Jan. 8, 2003	Jan. 8, 2003	Jan. 8, 2003	Jan. 8, 2003	Jan. 8, 2003	Jan. 8, 2003	December, 2002	November, 2002	November, 2002	December, 2002	May, 2002	November, 2002
<i>Frequency of Data</i>	Daily	Daily	Monthly	Weekly	Monthly	Monthly	Monthly	Quarterly	Quarterly	Monthly	Annual	Annual
<i>Frequency of Reporting</i>	Daily	Daily one-week lag	Monthly five-week lag	Weekly one-week lag	Monthly five-week lag	Monthly five-week lag	Monthly five-week lag	During missions	During missions	Monthly one-month lag	Annual	During missions
<i>Source of Data</i>	NBC	NBC	NBC	NBC	NBC	NBC	NIS	NBC	NBC	MEF	NIS	MEF
<i>Mode of Reporting</i>	Fax or Email	Fax or Email	Fax or Email	Fax or Email	Fax or Email	Fax or Email	Fax or Email	During missions	During missions	Fax	During missions	During missions
<i>Confidentiality</i>	No	Yes	No	No	No	No	No	No	No	No	No	Yes
<i>Frequency of Publication</i>	Daily	N/A	Monthly	Monthly	Monthly	Monthly	Monthly	Annually	Annually	Annually	Annually	N/A

<sup>1</sup> Refers to gross and net international reserves.

<sup>2</sup> Refers to general government balance.

## Cambodia: Socio-Demographic Indicators, 1990-2000 1/

	1990 (or latest year available)	1995	2000	Same Region/Income Group 2/ East Asia and Pacific	Low- Income
Population					
Total population, mid-year (millions)	9.1	10.7	12.0	1,855	2,460
Growth rate (percent annual average)	3.2	3.1	2.5	1.1	2.0
Population density (people per sq. km)	54	61	67	115	73
Urban population (percent of population)	13	14	16	35	31
Total fertility rate (births per woman)	4.9	4.7	4.0	2.1	3.6
Life expectancy at birth (years)					
Total	50	53	54	69	59
Male	49	52	52	67	58
Female	52	54	55	71	60
Mortality					
Infant (per thousand live births)	122	108	88	35	76
Under 5 (per thousand live births)	..	147	120	44	115
Adult (15-59)					
Male (per 1,000 population)	392	349	364	184	288
Female (per 1,000 population)	319	303	315	141	258
Poverty (percent of population)					
National headcount index	..	36.1	35.9	..	..
Urban headcount index	..	21.1	..	..	..
Rural headcount index	..	40.1	40.1	..	..
Income					
GDP per capita (US\$; at current prices)	173	294	265	1,032	427
Consumer price inflation (annual change; in percent)	..	1.1	-0.8	4.0	4.1
Social Indicators					
Public expenditure					
Health (percent of GDP/GNI)	..	0.4	0.6	2.0	1.2
Education (percent of GDP/GNI)	..	1.0	1.4	2.9	3.4
Gross primary school enrollment rate (in percent of school-age population)					
Total	121	126	104	107	96
Male	..	138	110	106	103
Female	..	114	97	108	88
Adult illiteracy rate (in percent of population above 15)					
Total	69	66	32	14	38
Male	49	46	20	8	28
Female	85	83	43	21	47
Population per physician (number of people)					
	15,629	9,575	6,666	909	..
Immunization rate (percent of children under 12 months)					
Measles	38	79	55	85	57
DPT	34	75	49	85	57
Child malnutrition (percent of children under 5 years)					
	..	..	47	10	..
Access to safe water (percent of population)					
Total	..	..	30	75	76
Urban	..	..	53	..	..
Rural	..	..	25	..	..

Sources: 2001 World Development Indicators and Cambodia at a Glance, World Bank; and IMF staff estimates.

1/ The dimensions of poverty are analyzed in chapter 3 of Cambodia's National Poverty Reduction Strategy (NPRS).

2/ Data as of 2000.

**Cambodia—Summary of Technical Assistance Provided by the Fund, 1998–December 2002<sup>1</sup>**

Purpose	Assistance and Timing (person-months)
<p><b>Fiscal Reform</b></p> <ul style="list-style-type: none"> <li>• Tax policy and customs administration</li> <li>• Technical Cooperation Action Plan (TCAP) mission</li> <li>• Tax administration and policy</li> <li>• Public expenditure management</li> <li>• Long-term customs advisor</li> <li>• Long-term treasury advisor</li> <li>• Long-term tax advisor</li> <li>• Income tax changes regarding new Law on Investment</li> <li>• Review of draft customs law</li> <li>• Long-term budget advisor</li> <li>• Tariff restructuring</li> <li>• Regulations on taxation</li> </ul> <p><b>Monetary Policy and Central Bank Operations</b></p> <ul style="list-style-type: none"> <li>• Long-term advisor</li> <li>• Banking system restructuring</li> <li>• Banking system restructuring and payments system development</li> <li>• Law on negotiable instruments and payment transactions</li> <li>• Banking system restructuring and supervision</li> <li>• Foreign exchange management</li> </ul> <p><b>Statistics</b></p> <ul style="list-style-type: none"> <li>• Government Finance Statistics</li> <li>• Long-term multisector statistics advisor</li> <li>• General Data Dissemination System</li> <li>• Monetary Statistics</li> <li>• Balance of payments compilation</li> </ul> <p><b>Legal</b></p> <ul style="list-style-type: none"> <li>• Insolvency Law</li> <li>• Insolvency Law</li> <li>• Insolvency Law</li> </ul>	<p>September 1999; (2)</p> <p>March–April 2000; (3¼)</p> <p>March 2001; (1)</p> <p>April 2001; (1)</p> <p>April 2001; (21)</p> <p>August 2001; (14)</p> <p>October 2001; (14)</p> <p>April 2002; (½)</p> <p>May 2002; (¼)</p> <p>August 2002; (6)</p> <p>October 2002; (1)</p> <p>November/December 2002; (¾)</p> <p>January 1998; (60)</p> <p>April 2001; (1)</p> <p>August and November 2001; (2)</p> <p>March and May 2002; (½)</p> <p>July and December 2002; (2)</p> <p>September 2002; (¾)</p> <p>April 2001; (1)</p> <p>November 2001; (12)</p> <p>November–December, 2001; (1)</p> <p>March–April, 2002; (1)</p> <p>April/June, Oct./Dec., 2002; (6)</p> <p>November 2000; (½)</p> <p>July 2001; (½)</p> <p>February and December 2002; (1)</p>

<sup>1</sup> A detailed description of the Technical Cooperation Action Plan (TCAP) is contained in EBS/01/02 (01/04/01).

January 17, 2003

Mr. Horst Köhler  
Managing Director  
International Monetary Fund  
Washington D.C. 20431  
U.S.A.

Dear Mr. Köhler:

Economic performance in 2002 has been in line with program objectives and all quantitative performance criteria for end-September, 2002 and the structural performance criterion for end-October have been met. While structural benchmarks were largely met, some delays have occurred with respect to the centralization of accounting in the National Treasury, implementation of a new chart of accounts for fully licensed banks, and reducing the average tariff to below 15 percent.

On the basis of corrective actions being taken as detailed in the attached Memorandum of Economic and Financial Policies (MEFP) for 2003, we hereby request completion of the sixth review under the PRGF arrangement.

The government believes that the policies and measures described in the attached memorandum, complemented by a comprehensive Technical Cooperation Action Plan, are adequate to achieve the objectives of the program for 2003, and stands ready to take any additional measures beyond the current program that may become necessary for this purpose. During the remaining period of the current PRGF arrangement, the Government will consult with the Managing Director, at the initiative of either party, and will provide the IMF with such information as it requests on the progress made in policy implementation and the achievement of program objectives.

In continuing with our policy of transparency, we consent to the publication, including on the IMF's website, of the attached MEFP and the accompanying Executive Board documents prepared by the IMF staff. In addition, we will publish the audited accounts of the NBC for 2002, in compliance with the requirements under the IMF's Safeguards Assessment.

Sincerely yours,

/s/

/s/

Keat Chhon  
Senior Minister  
Ministry of Economy and Finance

Chea Chanto  
Governor  
National Bank of Cambodia

Attachment: Memorandum of Economic and Financial Policies

## **CAMBODIA**

### **Memorandum of Economic and Financial Policies for 2003**

January 17, 2003

**1. Cambodia's medium-term economic objectives remain broadly unchanged from those described in the Letter of Intent (and related MEFP) of June 21, 2002.** It aims to reduce poverty through sustainable growth. An annual growth target of 6-7 percent could be achieved in the medium term through capital deepening, upgrading of labor skills, and improving governance. Increasing fiscal revenue will be key, in addition to reorientation of spending, to provide adequate social spending and infrastructure while avoiding recourse to domestic bank financing, essential for maintaining macroeconomic stability. With decisive actions on tax and customs administration and tax policy aimed at broadening the tax base, government revenue could reach 14½ percent of GDP in 2006-07. The external current account deficit (excluding grants) is expected to marginally decline to around 10 percent of GDP, a level that is consistent with projected concessional financing and foreign direct investment, and maintaining gross international reserves at about 3-4 months of imports of goods and services.

#### **Policies for 2003**

**2. Despite a weak global economic outlook, real GDP growth is expected to pick up to about 5 percent while inflation could be kept under 4 percent, underpinned by fiscal discipline.** The current fiscal surplus is projected to increase to about 1 percent of GDP, and the overall deficit (excluding grants) to 6½ percent of GDP, financed largely by external concessional resources. The monetary targets are established on the basis of a declining money velocity in response to increased confidence in the banking system. The external current account deficit of 10½ percent of GDP and reserves equivalent to 3¼ of imports of goods and services are expected to remain broadly unchanged.

**3. On the basis of the lower-than-expected revenue collected in 2002, the 2003 revenue target will likely be missed by ½ percent of GDP.** Additional efforts will be made to collect tax arrears of CR 40 billion, and to improve tax and customs administration (CR 15 billion). These efforts will be built on a revenue base that include the collection of nontax arrears in 2002 consisting of: (i) collection of all outstanding forestry royalties identified in the June 2002 audit (CR 1.5 billion); and (ii) arrears from civil aviation (CR 8.5 billion). Progress will also be made in collecting arrears on leases of state assets. Together with higher-than-budgeted foreign financing, budgeted spending obligations could be met.

**4. The customs and tax departments, as well as the National Treasury (NT), will upgrade information systems and strengthen enforcement measures.** The internal audit function of the audit units of the customs and tax departments and the NT will be strengthened to address integrity issues within their respective agencies. Priority will be

given to automation of customs administration which so far has proved to be a serious bottleneck to enhancing the capacity of the customs department. Anti-smuggling operations will be further strengthened through making units in key border provinces fully operational. Penalties for offenders will be stiffened, including through seizure of goods at customs on importation and exportation. Regarding the tax department, priority will be given to increasing staff working on collection enforcement, and audit of tax payers. To substantiate tax department's resolve to strengthen enforcement measures especially against those with tax arrears, about five to ten bank accounts will be frozen, exportation/importation of goods will be held at the customs department until outstanding amounts are paid, and licenses cancelled in collaboration with the Ministry of Commerce. Efforts will be made to put in place an operational management information system in the tax department. In addition, all contracts involving the use of state assets will now require MEF approval.

**5. Expenditure management will be improved which will also help to ensure the effective reorientation of spending toward priority sectors.** Spending on priority social sectors will increase to 3¾ percent of GDP, and the second phase of demobilization involving discharging 15,000 additional soldiers is expected to be completed by the third quarter of 2003. To improve accounting and budget execution procedures, the government will finalize monthly revenue flow estimates and ministries' spending plans for 2003 for notification to ministries before January 1 to enable commitments to start flowing from as close to the beginning of the year as possible. At the same time, the government will endorse and start implementing the recommendations prepared by the Working Group at the National Treasury while efforts to centralize government accounts will continue, and increased use of the banking system will be made for government financial transactions.

**6. The monetary targets for 2003 are consistent with growth and inflation objectives.** The government will adhere to these targets (see paragraph 10) and maintain a flexible exchange rate policy, within the intervention policy aimed at building up official reserves. It will not contract or guarantee any nonconcessional debt and make best efforts toward resolving outstanding debt issues with the Russian Federation and the United States.

**7. Trade reform is moving forward and progress has been made toward joining the WTO.** The conversion of the tariff classification to the ASEAN Harmonized Tariff Nomenclature (AHTN) was completed by end-2002. The government will reduce the unweighted average tariff rate under the AHTN to about 15 percent under the AHTN (or below 15 percent under the old system), while offsetting revenue measures will be introduced to contain revenue loss to below CR 1 billion.

**8. The Government is maintaining the momentum of banking sector reform.** The National Bank of Cambodia (NBC) will allocate adequate staff resources to (i) start on-site inspection of banks with the objective of completing at least 6 banks in 2003 and thereafter all banks once a year, except for micro-financing institutions which could be on a longer cycle, and (ii) verify and guide, if needed, the full implementation of banks of the new chart of accounts according to which each bank should submit their monthly financial statement to NBC starting in July 2003. A public notice announcing the intention to privatize the Foreign

Trade Bank (FTB) was issued in December. FTB's reform committee will continue its work to make the bank commercially viable, but sell at any point of the restructuring process to a strategic investor offering an appropriate price.

9. **The suspension of logging activity will remain in place, but monitoring log transportation and overall forest crimes is a challenge.** Restructured concession agreements in line with sustainable practice have been delayed and are now expected to be completed by June 30, 2003. All log transportation by, or on behalf of, concessions will continue to be suspended until the management plans and agreements on restructured concessions are in place.

10. **To monitor economic and financial performance during 2003, the government has set up structural and quantitative indicative targets.** The structural indicative targets will focus primarily on improved revenue mobilization, budget implementation, and forestry reforms (Table 1). Quantitative indicative targets through end-December 2003 include (Table 2): (i) a ceiling on the net domestic assets of the NBC; (ii) a ceiling on net bank credit to the government; (iii) a ceiling on net domestic financing of the budget; (iv) a zero ceiling on publicly contracted or guaranteed nonconcessional foreign currency loans; (v) no accumulation of external arrears; and (vi) a floor on the net official international reserves of the NBC.

Table 1. Structural Policy Targets for 2003 Program

<u>Indicative Policy Targets</u>	<u>Completion date</u>
Collect	
<ul style="list-style-type: none"> <li>• Tax arrears of CR 40 billion (excluding penalties and late interest)</li> </ul>	During 2003
<ul style="list-style-type: none"> <li>• Remaining forestry royalties identified in the June 2002 audit of CR 1.5 billion</li> </ul>	December 31, 2002
<ul style="list-style-type: none"> <li>• Outstanding transfers from civil aviation of CR 8.5 billion</li> </ul>	December 31, 2002
<ul style="list-style-type: none"> <li>• Outstanding transfers from the Gateway II operation of US\$4.7 million</li> </ul>	December 31, 2002
<p>The Fiscal Reform Working Group (to be convened by mid-December) will discuss the selection of an IT system for the customs department and possible sources of financing. On the basis of the discussion, the government will set a timetable for implementation.</p>	December 31, 2002
<p>Adopt the recommendations contained in the report of the working group in the National Treasury on standardized accounting procedures and methodology that was finalized in October, after incorporating IMF staff's comments, and start implementation.</p>	February 1, 2003
<p>Reduce unweighted average tariff under the current tariff schedule containing 6,823 tariff lines to below 15 percent (which should be equivalent to about 15 percent under the ASEAN Harmonized Tariff Nomenclature), and implement offsetting revenue measures to contain revenue loss to below CR 1 billion.</p>	June 30, 2003
<p>Complete implementation of the new charts of accounts for all fully licensed commercial banks.</p>	July 31, 2003
<p>Maintain the suspension of logging activity until the management plans and agreements on restructured concessions are in place.</p>	Continuous



Table 2. Cambodia: Quantitative Indicative Targets, 2003

	2002	2003			
	End-Dec. Est.	End-Mar.	End-June Prog.	End-Sept.	End-Dec.
(Cumulative change from beginning of year)					
Net domestic assets of the central bank (in billions of riels) 1/2/	-1221	-20	-22	-24	-6
Net credit to the government from the banking system (in billions of riels) 2/	-95	-20	-20	-20	0
Net domestic financing of the budget (in billions of riels) 2/	-50	-40	-40	-40	-20
Contracting or guaranteeing of external debt by the public sector 3/					
Up to one-year maturity 4/	0	0	0	0	0
1-5 year's maturity	0	0	0	0	0
Medium and long-term nonconcessional debt 5/	0	0	0	0	0
External payments arrears 6/	0	0	0	0	0
(Cumulative change from beginning of year)					
Net official international reserves (in millions of U.S. dollars) 7/	549	14	27	40	50
<i>Memorandum items:</i>					
(Cumulative change from beginning of year)					
Foreign currency budget / BOP support (in millions of U.S. dollars)	17	20	25	30	55
Total nonproject budget support (in billions of riels)	185	83	126	169	289
(Stock at end of period)					
Net domestic assets of the central bank (in billions of riels)	-1,221	-1,241	-1,243	-1,245	-1,227
Net credit to the government from the banking system (in billions of riels)	-95	-115	-115	-115	-95
Net official international reserves (in millions of U.S. dollars)	549	563	576	589	600
(At end of period)					
Exchange rate (riels per U.S. dollar; end of period)	3,900	3,986	4,023	4,059	4,095

Sources: Data provided by the Cambodian authorities; and Fund staff estimates.

1/ Net domestic assets are defined as reserve money minus net foreign assets of the central bank, adjusted for valuation changes arising from the difference between projected and actual exchange rates.

2/ The ceiling for net domestic assets, net credit to the government from the banking system, and net domestic financing of the budget will be adjusted upward (downward) by any shortfall (excess) in total nonproject budget support from the indicative targets. The adjustments for shortfalls in nonproject budget support will not exceed \$10 million.

3/ Maturity based on original contract.

4/ Ceiling applies to amount outstanding. Excludes normal import-related credit and any borrowing associated with debt rescheduling.

5/ Excludes amounts contracted under the government loan agreement with China dated July 26, 2000 for a maximum loan amount equivalent to \$12 million.

6/ Continuous indicative target.

7/ The floor on net official international reserves will be adjusted downward (upward) by any shortfalls (excess) in external nonproject budget support from the indicative targets. The adjustments for shortfalls in budget support will not exceed \$10 million. Valuation effects on the stock of gold holdings are excluded, and gold holdings in 2002 and 2003 are evaluated at the end-December 2002 gold price.



INTERNATIONAL MONETARY FUND

*Public Information Notice*

EXTERNAL  
RELATIONS  
DEPARTMENT

Public Information Notice (PIN) No. 03/21  
FOR IMMEDIATE RELEASE  
February 28, 2003

International Monetary Fund  
700 19<sup>th</sup> Street, NW  
Washington, D. C. 20431 USA

## **IMF Concludes 2002 Article IV Consultation with Cambodia**

On February 20, 2003, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Cambodia.<sup>1</sup>

### **Background**

Since late 1998, the newly formed coalition government embarked on a comprehensive economic reform, which was supported by significant inflows of aid and a three-year arrangement under the Poverty Reduction and Growth Facility (PRGF) approved in October 1999. Recognizing that rapid growth was key to reduce widespread poverty in Cambodia, the authorities' strategy focused on providing a conducive environment for private sector development through maintaining macroeconomic stability, rebuilding institutions, and addressing governance problems.

The reform strategy has been broadly successful, especially on the macroeconomic front. Real GDP growth averaged 7 percent during 1999-2001, although it is expected to have slowed to 4½ percent in 2002, owing to adverse weather conditions. Inflation has been contained well below 5 percent since 1999, underpinned by fiscal discipline that was backed up by a strengthening of fiscal revenue from 8.3 percent of GDP in 1998 to 11.7 percent of GDP in 2001. At the same time, defense and security spending was reduced by one percentage point of GDP, helping the government to increase social spending. Revenue performance in 2002, however, suffered from a drop in trade taxes, an erosion of the tax base owing to clearing a

---

<sup>1</sup> Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

backlog of applications for tax exemptions and recently signed public contracts that have reduced transfers to the Treasury. The 2002 revenue shortfall was met through a compression of nonwage expenditure and larger-than-expected foreign financing. Financial deepening continued, but private credit expansion remained weak. The exchange rate against the U.S. dollar has remained broadly stable since 1999. International reserves have risen steadily from US\$390 million at end-1998 to about US\$665 million at end-2002 (equivalent to 3½ months of imports). Efforts are being made to reach a resolution of outstanding debt issues with the United States and the Russian Federation. Finally, program objectives in 2002 under the PRGF have been broadly achieved.

Cambodia has also made progress in implementing key structural reforms, although slippages have occurred in several areas. The capacity of fiscal departments has been strengthened and bank relicensing was successfully completed. The first phase of the military demobilization program was completed in late 2002. Trade liberalization has proceeded smoothly in the context of the ASEAN Free Trade Area and in preparation for World Trade Organization (WTO) membership. However, further implementation of civil service reform has been postponed until after the national elections. Moreover, while illegal logging has been curtailed and several forestry concessions were cancelled, there is still no effective system in place for monitoring logging activity and sustainable logging plans have yet to be worked out. The recent suspension of donor support to the Forest Crime Monitoring Unit and the government's announcement to terminate the activities of a foreign non-governmental organization (NGO) as an independent monitor have given rise for concern among donors. Cambodia lacks an adequate legal and judiciary framework for enforcing the rule of law, and recently adopted laws (e.g., Land Law and Forest Law) still remain to be implemented.

Notwithstanding recent achievements, the foundations for growth remain weak. Growth has been narrowly based on the garment sector and agricultural production has grown very slowly as the irrigation system is under-developed. Moreover, the high factor cost of production in Cambodia makes attracting foreign investment difficult. Furthermore, the slippages in structural reform, together with a weak government capacity, continue to hamper creation of an environment conducive to private sector activity.

### **Executive Board Assessment**

Executive Directors welcomed the maintenance of macroeconomic stability and the restoration of growth over the last few years, which were supported by donors through financial and technical assistance, and favorable external factors that facilitated a rapid expansion of exports. Notwithstanding these developments, however, Directors noted that poverty is still widespread and—with a narrow production base, continuing governance concerns, and a still low revenue-to-GDP ratio—the foundations for sustained growth in the future remain weak. Going forward, the main challenges facing the country will therefore be to rationalize expenditures and boost revenues, broaden the production base, and strengthen progress on key structural issues, particularly governance, fiscal reform, and forestry.

To reduce poverty, Directors stressed the importance of promoting broad-based economic growth through foreign investment and the encouragement of private sector activity. In this regard, they noted that removing impediments to business activity is essential. In particular,

complaints by foreign and domestic investors about the burden of informal facilitation fees and uncertainties in the regulatory framework and labor market rigidities need to be addressed with urgency. Poverty alleviation efforts would also need to focus on strengthening productivity in the agricultural sector, as most of the poor live in rural areas.

In the period ahead, Directors underscored the need for a major strengthening of government capacity, which will require rebuilding official institutions and an upgrading of the civil service in close consultation with the World Bank and other donors. In addition, Directors considered the current system of investment incentives, which provides for large exemptions, difficult to administer, and recommended replacing the system with a simple and transparent regime with low tax rates.

Directors welcomed the progress made in increasing fiscal revenue in recent years, but noted that a further increase in the tax ratio is required to provide resources for strengthening government capacity and spending on social services and infrastructure. In this regard, they urged the authorities to make effective use of technical assistance to further improve tax and customs administration and to prevent further erosion of the revenue base. Moreover, greater efforts should be made to ensure that appropriate fees from government contracts with service providers are transferred to the Treasury.

Directors commended the authorities for their initial efforts in redirecting expenditure from defense to priority sectors and encouraged the authorities to press ahead with these efforts, with more emphasis on health, education, and the agricultural sector. They also encouraged the authorities to enhance coordination among government agencies in order to strengthen budget and cash management.

Directors underscored the urgent need to improve governance during the next phase of reform, and welcomed the preparation of the Second Governance Action Plan, which is focused on corruption and social issues. In this connection, Directors urged the adoption of the Anti-Corruption Law as soon as possible and further progress in establishing a modern legal and judiciary system. Directors also highlighted the importance of effective monitoring of logging activities to ensure the sustainability of natural resources, and stressed that progress in this area would be an important indicator of the government's commitment to enhanced governance. Directors also underscored the importance of approving a medium-term plan for sustainable forestry management in a fully transparent manner.

Directors welcomed completion of the process of relicensing commercial banks, which has helped to restore banking sector soundness. In this connection, they urged the authorities to follow through on their plans to privatize the Foreign Trade Bank and stressed the importance of strengthening banks' lending activity. To reduce lending risks faced by banks, the regulatory framework, including laws related to the provision of collateral and the protection of creditors' rights, should be further enhanced. Directors encouraged the authorities to develop mechanisms to allow micro-finance institutions to play a larger role, in particular, in providing credit to rural areas. Incentives and appropriate policies to encourage de-dollarization were also seen as important steps to be taken.

Directors recommended the maintenance of a flexible exchange rate regime and noted the progress made in establishing a liberal trading system. In particular, Directors commended the authorities' efforts to pursue membership in the WTO, including the drafting of several commercial laws that would facilitate creation of a transparent trading environment.

Directors commended the authorities for completing a fully participatory National Poverty Reduction Strategy (NPRS). They encouraged the authorities to update the NPRS on a continuous basis in light of the recommendations in the Joint Staff Assessment and as new information becomes available.

Directors welcomed the authorities' efforts to search for and block the assets of terrorists, and urged continued attention to this issue.

While recognizing recent efforts to upgrade economic statistics, within the framework of the Technical Cooperation Action Plan for Cambodia, Directors indicated the need for further improvements in data compilation to enhance economic analysis and program monitoring.

***Public Information Notices (PINs)*** are issued, (i) at the request of a member country, following the conclusion of the Article IV consultation for countries seeking to make known the views of the IMF to the public. This action is intended to strengthen IMF surveillance over the economic policies of member countries by increasing the transparency of the IMF's assessment of these policies; and (ii) following policy discussions in the Executive Board at the decision of the Board.

**Cambodia: Selected Economic Indicators, 1998-2002**

	1998	1999	2000	2001	2002 Est
(Annual percent change)					
<b>Output and prices</b>					
Real GDP	2.1	6.9	7.7	6.3	4.5
GDP deflator	13.8	3.7	-4.6	-2.9	3.0
Consumer prices (end-period)	13.3	-0.5	-0.8	0.7	3.7
(In percent of GDP)					
<b>General government</b>					
Total revenue	8.3	10.6	11.2	11.7	12.1
Total expenditure	13.8	14.7	16.4	17.7	18.9
Of which: current expenditure	8.3	8.9	9.5	10.4	11.1
Current fiscal balance	-0.3	1.6	1.5	1.2	0.9
Overall fiscal balance (excluding grants)	-5.5	-4.0	-5.2	-6.0	-6.8
(Annual percent change)					
<b>Money and credit (end of period)</b>					
Broad money	15.7	17.3	26.9	20.4	26.8
Private sector credit	2.8	16.5	17.7	4.2	3.4
(In millions of U.S. dollars; unless otherwise indicated)					
<b>External sector 1/</b>					
Current account balance (excluding official transfers)	-261	-295	-412	-456	-391
(In percent of GDP)	-8.7	-8.9	-12.3	-13.4	-10.7
Domestic exports	685	921	1,206	1,295	1,434
Retained imports	-954	-1,219	-1,664	-1,777	-1,880
Gross official reserves	390	422	485	550	642
(In months of imports of goods and services)	3.6	3.2	2.8	2.9	3.3
External debt stock (in percent of GDP) 2/	67.9	68.7	67.6	66.2	65.6
Exchange rate (end of period; riels per U.S. dollar)	3,780	3,775	3,910	3,900	3,935

Sources: Data provided by the Cambodian authorities; and IMF staff estimates and projections.

1/ Data for 2002 are projections based on information through mid-November.

2/ Including debt owed to the former Council of Mutual Economic Assistance.



Press Release No. 03/19  
FOR IMMEDIATE RELEASE  
February 20, 2003

International Monetary Fund  
Washington, D.C. 20431 USA

## **IMF Completes Sixth Review of Cambodia's PRGF Program and Approves US\$12 Million Credit**

The Executive Board of the International Monetary Fund (IMF) today completed the sixth and final review of Cambodia's economic performance under the Poverty Reduction and Growth Facility (PRGF) arrangement (see [Press Release No. 99/51](#))<sup>1</sup>. This enables the immediate release of a further SDR 8.4 million (about US\$12 million) from the arrangement, which would bring total disbursements under the IMF-supported program to SDR 58.5 million (about US\$80 million).

After the IMF Executive Board's discussion, Shigemitsu Sugisaki, Deputy Managing Director and Acting Chairman, made the following statement:

"The Cambodian authorities have continued to make good progress in implementing their economic reform program. Performance under the PRGF arrangement was broadly satisfactory, as inflation remained low and sustained economic growth was maintained despite adverse weather conditions. While progress was also made in the implementation of structural reforms, efforts need to be strengthened in key areas, particularly revenue administration, expenditure management, civil service reform, and forestry and agricultural policy. In the area of forestry policy, it is especially important to minimize any possible disruption in forestry monitoring arising from the government's decision to replace the current internationally-recognized independent monitor.

"To ensure broad-based economic growth over the medium term, Cambodia needs to foster the development of private sector activity and attract foreign investment. Moreover, competitiveness

---

<sup>1</sup> The PRGF is the IMF's concessional facility for low-income countries. It is intended that PRGF-supported programs will in time be based on country-owned poverty reduction strategies adopted in a participatory process involving civil society and development partners, and articulated in a Poverty Reduction Strategy Paper (PRSP). This is intended to ensure that each PRGF-supported program is consistent with a comprehensive framework for macroeconomic, structural, and social policies to foster growth and reduce poverty. PRGF loans carry an annual interest rate of 0.5 percent, and are repayable over 10 years with a 5 ½-year grace period on principal payments.

will need to be improved through a reduction in costs, including that associated with informal facilitation fees, and enhanced predictability of the business environment. The replacement of the current system of investment incentives by a simple and transparent regime with lower tax rates will help to create such an environment. Further legal and judicial reform and improvements in governance, a key cross-cutting issue in Cambodia, will also be important for minimizing risks to the success of the government's medium-term development strategy.

"Additional increases in fiscal revenue will be needed to strengthen government institutions and upgrade the quality of the civil service. Improvements in revenue will require strong efforts to prevent a further erosion of the revenue base, collect tax and nontax arrears, and strengthen tax and customs administration. At the same time, improved cash management will be crucial for establishing effective budget execution and the continued avoidance of domestic financing of the budget through the banking system, which is essential for macroeconomic stability.

"The momentum of banking sector reform should be maintained, with a view to promoting financial intermediation. Bank supervision and the regulatory framework should continue to be strengthened, and the planned privatization of the Foreign Trade Bank should be carried out without delay.

"The recent completion of the National Poverty Reduction Strategy (NPRS) is a welcomed development. This strategy provides an adequate basis for implementing a broad-based poverty reduction strategy. It is now essential that the Cambodian government demonstrate full ownership of the implementation process.

"Strong and sustained growth over the medium term will continue to depend on the provision of broad-based technical assistance and financial donor support. In the latter regard, it is important for the authorities to step up their efforts to urgently resolve outstanding bilateral debt issues consistent with Cambodia's fiscal constraints. In addition, nonconcessional borrowing should continue to be avoided," Mr. Sugisaki stated.



**Statement by Sri Mulyani Indrawati, Executive Director for Cambodia**  
**February 19, 2003**

At the outset, I would like to convey the Cambodian authorities' appreciation to the Fund management and staff for their continuous support and advice. The extensive consultation and discussions during the Fund mission had provided a comprehensive assessment and valuable suggestions on the implementation of the reform measures under the Poverty Reduction and Growth Facility (PRGF) arrangement. As such, the three-year PRGF program was completed successfully, with both quantitative and structural performance criteria observed. Such an achievement required both domestic effort and support from international community. Hence, the Cambodian authorities would like to express their gratitude to their development partners and the donor community for their support.

Notwithstanding a very weak foundation for growth, including severely damaged infrastructure, weak institutional capacity and human resource constraints, the continuous implementation of cohesive macroeconomic policy and structural reform has led the Cambodian economy to a more sustainable economic growth path. The authorities also believe that the successful implementation of the program will not only establish a sound basis for further deepening the reform process, but will also put the Cambodian economy in a much better external position.

### **Recent Economic Developments**

Despite the global economic downturn, the Cambodian macroeconomic performance in 2002 was satisfactory and showed strong resilience. GDP was estimated to have grown by around 5.0 percent compared with 6.3 percent in 2001, due mainly to the slowdown of the global economy and the adverse impact of weather conditions on agriculture production. The annual inflation rate for 2002, based on 12-month average increased to 3.3 percent. The increase reflected the drought in some areas and insufficient rice stockpiling by farmers. Gross official foreign reserves increased steadily to US\$ 665 million at the end of 2002, equivalent to 3.4 months of imports. The current account deficit improved; the ratio of current account deficit to GDP declined from 13.4 percent to about 10-11 percent (excluding grants), reflecting strong export and tourism performance, as well as capital inflows. Cambodia continues to face enormous challenges, given the weak global economic recovery, shrinking export markets, and unfavorable climatic conditions, all of which have dominated the recent macroeconomic landscape in the country.

### **Fiscal Policy**

The Cambodian authorities have continued to implement fiscal reforms to ensure a fiscal position that would underpin macroeconomic stability. Under the PRGF-supported program, several structural measures have been implemented to strengthen tax and customs administration, including broadening the tax base and preventing leakages. Consequently, the overall fiscal performance in 2002 has been broadly satisfactory, as government revenue rose

to 12.1 percent of GDP. These improvements reflect the effectiveness of several revenue measures introduced during the past two years, including the revenue recovery from Post Telegraph and Telecommunication (PTT) and the lease of government assets. The revenue target for fiscal year 2003 has been set at 12.7 percent of GDP. Hence, the current budget surplus is expected to increase to 1.4 percent of GDP compared with 0.9 percent of GDP in 2002. To meet the revenue target for 2003, the government will continue to implement vigorously fiscal measures, focusing in particular on the collection of tax arrears, and the improvement of tax and customs administration.

On the expenditure side, the government has exercised prudence, putting in place significant expenditure restraints in order to provide scope for priority spending and budget reallocation. Budget management had been streamlined through reallocation of spending to the social and economic sector. In line with its commitment to a pro-poor fiscal policy, the Cambodian government will carry out the second phase of military demobilization to divert more resources from defense and security to the social sector, which is expected to be completed by the third quarter of 2003. As a result, defense and security spending is expected to decline from 2.8 percent to 2.5 percent of GDP in 2003, while social sector spending is budgeted to increase from 3.6 percent to 3.8 percent of GDP. Administrative procedures and public sector governance would also be enhanced to ensure that social sector spending targets are achieved. Moreover, to further strengthen budget management, the government accounts have been centralized at the National Treasury.

### **Monetary Policy and Financial Sector Reforms**

To facilitate economic development in Cambodia, maintaining price stability has been the main objective of the monetary policy framework. In addition, monetary policy remains tight to inhibit bank financing of the budget. However, the central bank's ability to use traditional monetary instruments in its conduct of monetary policy is limited, due to high dollarization in the economy. The Cambodian authorities agree with staff that de-dollarization should be a long-term objective through maintaining macroeconomic stability. With respect to the exchange rate policy, the National Bank of Cambodia (NBC) continues to pursue a managed float exchange rate regime. Over the past two years the Riel has been stable against the US dollar in real terms. The foreign exchange intervention policy adopted by the NBC is also aimed at strengthening the official foreign reserve position.

Turning to financial sector reform, the NBC has furthered its efforts to strengthen banking sector soundness, in accordance with the blueprint for financial sector development drawn up with the assistance of ADB. In 2002, the liquidation of ten insolvent banks was completed and unclaimed deposits were fully transferred for reimbursement. The NBC is now in the process of strengthening banking supervision and issuing uniform accounting and disclosure requirements for commercial banks and specialized banks. Consequently, the banking sector has regained public confidence and deposits have increased by around 22 percent in 2002. The need to enhance credit extensions by the banking sector and credit to the rural area by micro-finance institutions has also received priority attention from the NBC. Further, the establishment of an association of banks recently would help promote market

discipline, further strengthen the spirit of private-public sector partnership in the banking sector, and build up capacity.

### **Reform of Natural Resources Management**

The authorities believe that sustainable management of its natural resources and the protection of the environment are among the main elements of its strategy for combating poverty in Cambodia. Hence, the authorities have reaffirmed that they will not step backward, but will continue to be steadfast and remain committed to the reform of the forestry sector. In this regard, the authorities have temporarily banned logging until after the management plans and agreement on restructured concessions are approved. The authorities have also canceled several concessions, and ceased log transportation.

The latest developments in the forestry sector demonstrates that forest management is a very challenging task. Despite full efforts by the government to conduct consultations with public in a transparent manner, tensions have arisen, leading to a dispute between the government and the independent monitoring unit - Global Witness (GW). The Cambodian government has no intention whatsoever to suspend or cease the process and mechanism of forest crimes monitoring. They remain committed to ensuring the continuity of this mechanism and to the nationwide implementation of a strong, effective, credible and reliable system of forest monitoring. In this connection, the authorities fully recognize the importance of the role played by an independent monitoring unit. Against this background, the authorities have proposed a flexible, constructive and compromise solution to the external donor partners, and requested their assistance in the identification of an alternative monitoring unit.

A new approach of national resources management has also been introduced with the recognition that the authorities alone would not be able to control illegal logging activities, due to a very limited number of staff. Hence, the authorities have decided to allow 132 families in villages of Preah Vihear province to own and manage forested land. They will be granted the right to control the use of their land, so that they can manage the land and help curb illegal logging activities in this sanctuary.

### **National Poverty Reduction Strategy (NPRS)**

In January this year, the Cambodian government adopted the NPRS, which established a framework and policy direction for poverty and inequality reduction over the next three years. The macroeconomic and other key structural policies outlined in NPRS are based on I-PRSP and PRGF supported programs, in particular in the area of fiscal and financial reform, governance, military demobilization and civil service reform. In the implementation of the NPRS, the Cambodian authorities are aware of the risks and challenges including the risk of slower than expected growth. However, with extensive consultation with and participation of all government ministries and agencies, the donor community, NGOs, as well as with the poor, the Cambodian authorities believe that their efforts will be effective in reducing poverty.

## **Governance and Civil Service Reform**

With the recognition that good governance is a prerequisite for sustainable socio-economic development and social justice in Cambodia, the authorities continue to implement measures contained in the Governance Action Plan (GAP) that was disseminated in December 2001. While significant outcomes have already been achieved in many areas, in particular, public finance, military demobilization, and land management, greater vigilance will be needed in the areas of judicial reform, administrative reform, corruption and forestry. To complement this framework, the National Audit Authority (NAA) has been established and began operation in 2002.

Civil service reform under the three-year PRGF-supported program has also begun to bear fruit. The implementation of the nationwide computerized payroll system and the elimination of "ghost" workers have resulted in annual savings of US\$ 2.2 million. Significant progress was also made in the conversion of some officials to teachers, as well as the establishment of a new remuneration grid. The Cambodian authorities agree with staff that the low quality of public services is largely attributed to the low wages in the civil service, which is approximately only one-third of the average wage of private sector employees in the formal sector. In light of this, the authorities have increased salaries for civil servants commensurably with their skills, experience and responsibility, especially for teachers and health workers.

The military demobilization program, which is aimed at transferring demobilized soldiers into productive economic sectors, has been moving forward. The first phase of military demobilization program in 2002, which involve 15,000 soldiers was successful. The authorities will continue with the second phase in which another 15,000 soldiers are expected to be discharged in the first half of 2003.

## **Debt Resolution**

The Cambodian authorities have continued their efforts in seeking a resolution to its outstanding debts with bilateral creditors. With regard to the outstanding debt to Russia, dialogues with the Russian authorities were held twice in 2002, in Phnom Penh in June and in Washington DC in September. The agreement on rescheduling has been reached for pre-cut-off date debt which accounted for one-third of the total debt stock. This has marked significant progress in debt resolution efforts. Further negotiation will be needed for rescheduling of the post-cut-off date debt for the remaining two-thirds of the total amount. In this context, the Cambodian authorities have confirmed in written communication to the Russian authorities that they remain strongly committed to continuing negotiations to find an appropriate solution.

Regarding the outstanding debt to the US, efforts to determine the precise amount of debt have been ongoing. The Cambodian authorities look forward to further discussions on the reconciliation of the outstanding debt. At this stage, the Cambodia's servicing of their debt will severely affect their fiscal position and put pressure on resources needed to

implement their National Poverty Reduction Strategy. In this respect, the authorities would like to express their appreciation to staff for providing technical support in the debt negotiation.

## **Conclusion**

In conclusion, with continuous support from the international community, and the authorities' strong commitment to the program, Cambodia has made considerable progress under the three-year PRGF arrangement despite its prevailing capacity constraints and unfavorable external factors. Progress had been made in several key areas, namely, in fiscal and financial sector reforms. The authorities have expressed strong commitment to take steps to strengthen governance and build up institutional capacity, the absence of which they fully understand could undermine the investment and business climate in Cambodia. However, the success of economic reform will depend also on continued support from the international community.

With the successful implementation of the program over the past three years, the Cambodian authorities request the Executive Board's approval for the completion of the sixth review under the PRGF arrangement and the release of the seventh disbursement. Financial and technical assistance will be needed in the years ahead to support the authorities' ongoing efforts. The Cambodian authorities have also expressed their interest in continued Fund-support through a successor PRGF arrangement.

Finally, on behalf of the Cambodian authorities, I would like to reiterate our appreciation to the staff, management, and the Board for their continuous support for the reform program in Cambodia.