July 2006
IMF Country Report No. 06/264

Cambodia: 2006 Article IV Consultation—Staff Report; Public Information Notice 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 the 2006 Article IV consultation with Cambodia, the following documents have been released and are included in this package:

- the staff report for the 2006 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on May 11, 2006, 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 June 22, 2006. 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) summarizing the views of the Executive Board as expressed during its July 7, 2006 discussion of the staff report that concluded the Article IV consultation.

- a statement by the Executive Director for Cambodia.

The documents listed below have been or will be separately released.

Joint Staff Advisory Note on the Poverty Reduction Strategy Paper
Poverty Reduction Strategy Paper
Selected Issues Paper and Statistical Appendix

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.

Copies of this report are available to the public from

International Monetary Fund • Publication Services
700 19th Street, N.W. • Washington, D.C. 20431
Telephone: (202) 623-7430 • Telefax: (202) 623-7201
E-mail: 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 2006 Article IV Consultation

Prepared by the Staff Representatives for the 2006 Consultation with Cambodia

Approved by Masahiko Takeda and Adnan Mazarei

June 22, 2006

- The 2006 Article IV discussions took place in Phnom Penh April 27–May 11, 2006. The staff team comprised Messrs. Carter (Head), D'Hoore, Davies (all APD), Botman (FAD), and Joshi (PDR), and was assisted by Mr. Nelmes, the resident representative, and Mr. Mahar (APD). Ms. Phang (Executive Director) and Mr. Tola (OED Advisor) also participated in the discussions.
- Cambodia's last PRGF arrangement ended in February 2003, with access of 67 percent of quota fully drawn.
- The Executive Board concluded the 2004 Article IV consultation and discussed the Ex Post Assessment of Longer-Term Program Engagement in Cambodia on September 13, 2004. At that time, Directors stressed the need for broad-based growth and poverty reduction, emphasizing the importance of increasing the pace of reforms, particularly in the agricultural sector and in the area of governance. They also emphasized the importance of improved fiscal performance, a stable exchange rate, and a well-supervised financial system.
- Cambodia accepted the obligations of Article VIII, Sections 2, 3, and 4 in January 2002, and has maintained an exchange system that is free of restrictions on the making of payments and transfers for current international transactions.
- Despite significant shortcomings in some areas, core economic and financial data provided to the Fund are generally adequate for surveillance.

Contents Page

Executive Summary

- **Despite robust economic growth, rural poverty in Cambodia has remained stubbornly high.** Growth has averaged around 10 percent annually in recent years, supported by prudent macroeconomic policies, large aid inflows, and greater openness to trade. But much of this growth has been narrowly based on the garment and tourism sectors while conditions in the rural, mainly agricultural areas had not improved substantially by 2004. Cambodia has reduced overall income poverty but will need to accelerate progress if it is to meet its Millennium Development Goals.
- **Growth was very high in 2005 largely due to an excellent agricultural performance and continued strength in garment exports, tourism and construction.** Higher petroleum prices adversely affected the external position in 2005. Continued high oil prices would pose risks to the balance of payments and growth outlook, but have little direct fiscal impact given full pass-through.
- **Progress has been made in increasing fiscal revenue since late 2004, and debt is on a sustainable path**. Revenue collection increased with stepped-up arrears-collection efforts. The revenue-to-GDP ratio remains very low, however, and collection efforts need to be fortified to finance higher social spending and infrastructure development. Cambodia's debt, reduced by the recent MDRI relief, is on a sustainable path but risk of debt distress remains due to low revenue collections.
- **Monetary and exchange rate policies are expected to continue focusing on the government's aim of keeping inflation low and limiting volatility of the riel**, while allowing the exchange rate to reflect changes in fundamentals.
- **Structural reforms have advanced after lagging earlier.** Initial progress has been made in structural reform implementation, particularly in the fiscal and legal areas, though much needs to be done to enhance governance.
- **The recently approved National Strategic Development Plan (NSDP) seeks to achieve sustainable broad-based growth and poverty reduction**. The aspects of the strategy that have been discussed in the context of a possible PRGF arrangement focus on maintaining macroeconomic stability, strengthening the role and effectiveness of the government, and improving financial intermediation. Governance reforms, in particular establishing the rule of law and addressing corruption, are essential for maintaining fiscal integrity, improving competitiveness, and together with other structural reforms, in creating an environment more conducive to private sector activity.
- **The authorities and staff have reached understandings on the parameters for a successor PRGF arrangement**. Such an arrangement would support implementation of the NSDP. However, delays in resolving outstanding debt issues with official creditors prevent the progress of the proposed arrangement.
- **Risks to the government's strategy include** (i) difficulty in implementing reforms, reflecting entrenched interests within and outside the bureaucracy; and (ii) capacity constraints, reflecting Cambodia's level of economic development.

I. Background

1. **Cambodia has enjoyed a broad degree of macroeconomic stability in recent years, underpinned by prudent fiscal and monetary policies**. Growth has been very robust, averaging more than 10 percent annually over the last three years. The economy has successfully created new jobs to absorb the rising working age population, which has been growing at 3 percent annually, faster than the population. Inflation has remained under control. The economy has withstood pressures from high world oil prices, albeit with a small deterioration in the balance of payments. With the exchange rate broadly stable, the external debt burden has eased to 51 percent of GDP in 2005, from a peak of 60 percent in 2003.

2. **Nevertheless, the country remains poor and governance weaknesses limit both critical spending and the environment for broad-based development.** Growth has been narrowly based on garment exports and tourism and thus while the overall poverty rate has declined—from 47 percent in 1994 to 35 percent in 2004—rural poverty remains stubbornly high, and many Millennium Development Goals appear beyond reach (Box 1 and Table 6). Low revenue has led to development spending shortfalls while corruption has contributed to poor government operations and high costs of doing business. Cambodia ranks 130 (out of 158 countries) in Transparency International's Corruptions Perceptions Index.

Box 1—Poverty in Cambodia[1]

According to the 2004 Cambodia Socio-Economic Survey of households, 35 percent of the population lived below the national poverty line in that year.[2] This represents a significant decline from an estimated 47 percent in 1994, although data issues hamper a strict comparability with earlier surveys. Thus, midway into the 1993–2015 period set for reaching its Millennium Development Goals (MDG), Cambodia is well on its way to achieving its first MDG of halving the proportion of the poor.

Poverty remains a largely rural phenomenon—more than 90 percent of the poor live in rural areas. While poverty declined in all areas, the gains in urban areas were more significant than those in rural areas. Moreover, inequality has increased: the consumption Gini coefficient is estimated to have reached about 0.42 in 2004, one of the highest in the region.

The overall changes in incidence and distribution of poverty largely reflect the broad patterns of economic growth over the period. In the urban areas, poverty reduction was helped by rapid growth in garment manufacturing and tourism-related services. In rural areas, prospects were held back by weak growth in agricultural productivity, hampered by a range of structural impediments, including uneven access to land. Efforts to address this problem will need to confront recent adverse trends, with the proportion of landless rural households increasing from 13 percent in 1997, to 20 percent in 2004.

The spill-over of high urban growth into the rural economy appears to have been muted, reflecting weak rural-urban linkages. For example, only a small fraction of rural households receive remittances from family members working in cities. Sustained poverty reduction thus requires a deepening and broadening of economic growth to include the rural economy and strengthen urban-rural linkages (including through public spending). In this respect, the impressive growth in agriculture in 2005—about 17 percent—is a welcome development.

---

[1]See Chapter II of the Selected Issues Paper for a more detailed treatment, drawing on the Poverty Assessment prepared by the World Bank, and published in February 2006.

[2] The poverty line is defined using a regionally-adjusted per capita consumption threshold. The results give poverty line estimates, in 2004, ranging from about US$160 per capita in rural areas to a high of US$215 in Phnom Penh.

3. **The political environment is stable but still fragile.** Tensions over criminal proceedings against dissidents have eased recently. The opposition leader, Sam Rainsy, earlier convicted of criminal defamation and sentenced in absentia, was pardoned and returned to Cambodia to resume his seat in Parliament. Parliament voted to amend the Constitution to reduce the proportion of lawmakers required to form a government, giving Prime Minister Hun Sen's Cambodia People's Party the ability to form a government without the need for a coalition partner. However, the coalition continues in place although Prince Norodom Ranariddh, leader of the coalition party FUNCINPEC, resigned as President of the National Assembly.

4. **International support has remained strong despite concerns over the governance environment.** The Consultative Group meeting in March 2006 commended Cambodia's recent progress and donors pledged a combined US$600 million (10 percent of 2005 GDP) in support for 2006, much of it in grant form. For 2005, the comparable figure was US$500 million. The Fund also forgave 100 percent of its debt (about US$82 million) through the Multilateral Debt relief Initiative (MDRI).[1] However, the international community remains concerned over the quality of governance and is taking close interest in the recent suspension by the World Bank of three projects because of fraud concerns.[2] The World Bank's Country Assistance Strategy, discussed mid-2005, focuses on public financial management, private sector development, natural resource management and local governance. A Poverty Reduction Strategy Operation (PRSO) based on these issues is expected to be approved in the second half of 2006.

II. Recent Economic Developments

5. **Despite earlier pessimism, real GDP growth rose to 13½ percent in 2005 with all sectors contributing** (Table 1 and Box 2). In 2005, largely because of exceptionally favorable weather conditions, following a drought in 2004, agriculture output grew by around 17 percent. Contrary to previous staff expectations of a large negative impact of the termination of MFA quotas, with the introduction of safeguard restrictions put in place by the United States and European Union, garment exports continued to expand in 2005, albeit at a slower pace. To provide some relief, the government extended tax concessions to the sector while trade unions suggest that wages have been cut as increased pressure was felt on profit margins in the new environment. After increasing by 50 percent in 2004, tourist arrivals rose by 35 percent in 2005 to nearly 1½ million with a related increase in construction activity.

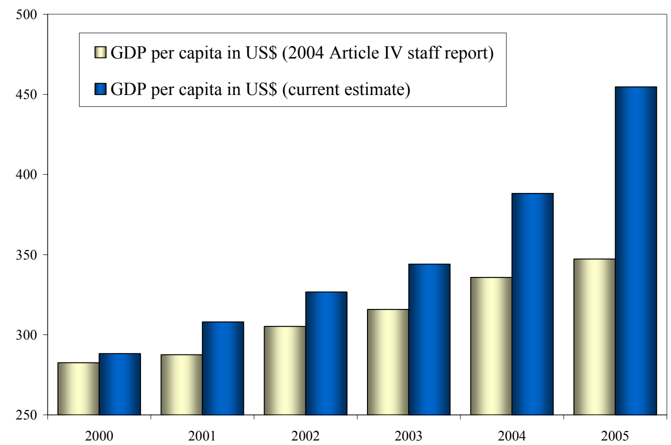
[1] The obligation of the National Bank of Cambodia NBC to the IMF was cancelled on January 6, 2006. The government received a one-off capital revenue transfer, improving the 2006 deficit position by around 1 percent of GDP, as spending of the proceeds (on rural irrigation projects) will occur mostly in subsequent years.

[2] These infrastructure projects have a total value of around US$70 million.

Box 2. A Changing Picture of Cambodian Incomes

Compared with estimates and projections at the time of the 2004 Article IV consultation, the Cambodian National Institute of Statistics' revised GDP estimates are sharply higher:

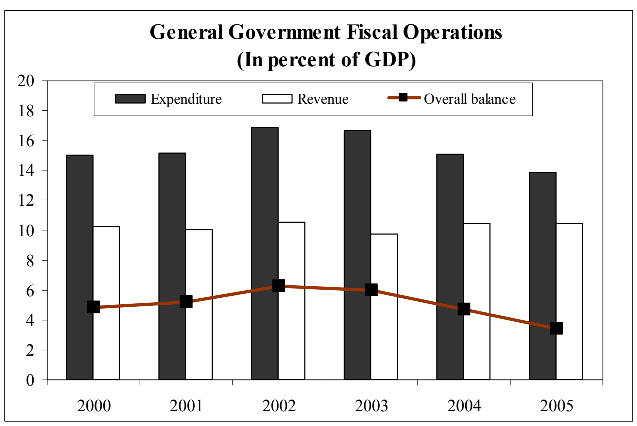
- the new estimates incorporate the results of the 2004 Cambodia Socio-Economic Survey, with much higher household final consumption expenditures (about 17 percent) than previously estimated,
- the coverage of the national accounts was broadened to include activities hitherto ignored, such as cash crops from commercial agricultural exploitation, gem and gold mining, insurance and micro-finance, and privately-provided education and health services.



Real growth in 2005 turned out to have been sharply higher than projected in a broad range of sectors, including agriculture, largely the result of unusually good weather; garments, as the anticipated negative shock following the lifting of MFA quotas did not materialize; and construction, boosted by tourism-related and donor-financed construction spending exceeding initial forecasts.

6. **Inflation remained under control, although rising to 6¾ percent at end-2005, mainly reflecting higher petroleum prices**. At end-April 2006, inflation had eased to below 5 percent as the effect of the 2004 drought on food prices and oil-price shock diminished.

7. **Fiscal policy was cautious, as expenditure restraint and slower donor project execution led to a decline in the overall deficit to 3½ percent of GDP in 2005, from 4¾ percent in 2004 (Table 2).** The deficit was again more than financed by external aid. Despite greater than budgeted tax revenues and one-off receipts from the privatization of the Foreign Trade Bank, the revenue to GDP ratio in 2005 was only 10½ percent. Expenditure declined as a share of GDP as capital spending continued its downward trend—in line with external financing—and current spending grew only moderately. As the current balance improved, the government was able to reduce the stock of outstanding payment orders in 2005.



8. **Revenue collection continued to grow in early 2006**. Collection of domestic taxes through April was in line with the revised 2006 projections. Nontax and trade taxes increased but are somewhat behind target. As earlier, weaknesses in management have meant that expenditure has been restrained in the early part of the year.

9. **Financial intermediation continued to expand, in the context of extremely high dollarization.** Broad money and bank deposits grew by about 16 percent (year-on-year) in 2005 (Table 3) and have picked up pace in early 2006. The banking system, however, remains relatively undeveloped and concentrated. In this context, the acquisition of the government-owned Foreign Trade Bank (FTB) by the owners of the largest private bank was particularly noteworthy; together the two banks account for around 40 percent of total deposits. The recent entry of ANZ Bank has introduced more modern banking practices and rapidly mobilized deposits. Although annual growth in bank credit to the private sector approached 30 percent, financial intermediation remains low—private sector credit averaged less than 10 percent of GDP in 2005, allocated mainly to the services and retail sectors. Only 4 percent of deposits in banks and 6 percent of bank loans are in riel. In this relatively thin market, the riel was fairly stable both in terms of dollars and partner country currencies with little evidence of intervention by the National Bank of Cambodia (NBC).

10. **External developments were mixed**. Robust tourism earnings and tourism have only partly offset higher petroleum prices and strong non-garment imports (Table 4). The current account deficit (excluding transfers) widened to 9½ percent of GDP in 2005, but this was financed by an upswing in foreign direct investment, concentrated in garment, tourism, and construction sectors. So far in 2006, reserve accumulation has been steady, due in part to increases in the value of NBC's gold holdings, with reserves reaching over US$1 billion in May (around 2½ months of imports).

11. **Progress has been made on the wide-ranging structural reform agenda.** The authorities are implementing their flagship public financial management (PFM) reform program. The program addresses the weaknesses discussed in the recent assessment of Cambodia's public expenditure management system made in the context of the MDRI.[3] In the financial sector, NBC certified all banks as compliant in implementing the new bank Chart of Accounts but much improvement is still required in banking supervision. In the area of land policy, the issuances of sub decrees on economic land concessions and on state land management were significant developments.

III. Policy Discussions

12. **Discussions took place in the context of a newly finalized PRSP—the National Strategic Development Plan 2006–10 (NSDP).** Reflecting the importance attached to it, the

[3] EBS/05/181. The broader assessment and the actions the reform program is putting in place to address PFM issues are summarized in Chapter IV of the Selected Issues paper.

NSDP was approved by the National Assembly in May 2006 despite a large backlog of legislation. It focuses on broadening growth, increasing access to social services, and promoting rural development through improved irrigation, land allocation and access to credit. In their discussions with staff, parliamentarians supported the Plan's emphasis on the sustainable broad-based growth and poverty reduction through ensuring macroeconomic stability, strengthening the role and effectiveness of the government, and enhancing financial intermediation and governance. NGOs also expressed support for the strategy but hoped to be more broadly involved in its implementation.

13. **The authorities have shown commitment to implementing this strategy, which they hope will soon be supported by a PRGF arrangement.** They have performed strongly over the last year against the quantitative and structural indicators previously agreed with staff for a possible arrangement in support of this strategy. As a resolution of long-outstanding arrears to official creditors (see Box 3 and Chapter V of the Selected Issues Paper) has not been reached, the authorities have not been able to request such an

Box 3. Debt Obligations to the Russian Federation and the United States

Cambodia's overdue obligations to the Russian Federation and the United States are tied to its tumultuous history. As Cambodia shifted its Cold War alliances, it received loans from each of the superpowers. In the unstable years that followed, these loans were unaccounted for and largely unpaid. At the Paris Club meeting of 1995, the government acknowledged its inheritance of these obligations.

Public Debt Outstanding, 2005
(In millions of U.S. dollars)

External debt	3,180
Multilaterals	1,149
IMF	81 1/
IDA	461
AsDB	568
Bilateral	2,031
Russia	1,525
United States	302
Domestic Debt	210
Total	3,391

1/ In January 2006, MDRI erased outstanding debt to the Fund of SDR56.8 million (valued at US$82 million at the time of transaction.)

The U.S. Debt

Obligations to the United States arise from commodity shipments during the latter stages of the Vietnam War to the then-incumbent Lon Nol regime. The United States provided documentation that it had for these loans, including proof of shipment, in 2005 (as no documentation survived in Cambodia), reducing its claims in the process. Following this, agreement was reached on an outstanding principal amount of US$162 million. A bilateral agreement to formalize this is currently being drafted. Outstanding interest payments are estimated at $155 million by the United States. The two sides have agreed that the overdue obligations will be further rescheduled in the context of the Paris Club, where terms of rescheduling will be agreed upon with other creditors.

The Russian Debt

Cambodia's obligations to the Russian Federation arise from transferable ruble trading balances incurred in the 1980s. Agreement has been reached on valuing the outstanding nominal debt stock at US$1.5 billion, which, with an agreed up-front discount, would be reduced to about US$457 million. However, there has been no agreement on the concessionality of the repayment terms for short-term debt and debt contracted after December 31, 1985. Discussions are ongoing—the last bilateral discussions were held in March 2006—though negotiations have not yet been concluded.

arrangement.[4] They hope to be in a position to do so soon, in line with the understandings reached in the context of the Article IV discussions.

A. Medium-Term Outlook

14. **Staff and authorities agreed upon a favorable medium-term macroeconomic framework.** It was accepted that, despite very strong recent growth, a degree of conservatism was appropriate for planning purposes. With strong nonagricultural growth tempered by a return to normal agricultural output trends, overall growth is expected to slow to 5 percent in 2006, but will average about 6 percent in the medium term (Table 5).

- Garment exports, construction, and tourism are expected to continue to underpin buoyant economic activity in the near term but decelerate in the medium term as the broader private sector begins to make a greater contribution.

- A return to more normal weather conditions is likely to lead to a fall in agricultural output in 2006. The authorities argued that their rural reforms, in particular increasing irrigation and land allocation, could lead to better agricultural performance in 2006. The agreed framework, however, anticipates this effect, though significant, to be felt more in the medium term.

Macroeconomic Framework

	2006	2007	2008	2009
	(Annual Percent Change)			
Real GDP	5.0	6.5	6.1	5.8
Consumer Price Inflation (average)	5.0	4.0	3.5	3.5
	(In Percent of GDP)			
Government Revenue	12.0	11.3	11.8	12.3
Public Sector Primary Balance (Incl. Grants)	-0.8	-2.2	-1.8	-1.4
Public Sector Current Balance	1.2	1.8	2.1	2.4
External Current Account Balance (Excl. Transfers)	-10.7	-11.3	-9.9	-9.3
	(In millions of U.S. Dollars)			
Gross International Reserves	1,050	1,161	1,331	1,502

- Inflation should ease slightly, to about 5 percent in the near term, as higher oil prices impede a more rapid decline. In the medium term, it is expected to decline to the level of trading partners (about 3 percent).

- High oil prices will dampen growth and contribute to a widening of the external current account deficit (excluding official transfers) in the near term before sustained growth in tourism and improved competitiveness allow it to narrow to 9¼ percent of GDP by 2009. With the anticipated increase in external assistance, international reserves are projected to recover to around 2¾ months of imports by 2009.

[4] Fund financing to a member is precluded when there are arrears to official bilateral creditors, unless such arrears are addressed consistent with Fund policy on non-toleration of arrears. The earlier PRGF arrangements were approved on the basis that Cambodia's arrears were being addressed within the Paris Club framework.

- Public debt will remain sustainable (see Annex II). Once debt-rescheduling agreements with the Russian Federation and the United States are concluded, and including IMF debt relief under the MDRI, public sector debt is projected to drop from 51 percent of GDP in 2005 to 34 percent in 2006 and decline further thereafter.

15. **There are, however, risks to the outlook:**

- A breakdown in the fragile political stability could affect confidence and growth.
- The phasing out of safeguards restrictions on China could adversely affect garment exports in the medium term, as could accession to the WTO of regional competitors.
- The banking sector is gaining strength, but remains a source of weakness.
- The economy is highly vulnerable to a domestic or regional outbreak of avian flu. Cambodia was one of the first countries where animal infection was reported, and more recently there have been cases of human infection and death. Compounding the risks, Cambodia's health facilities and epidemic control systems remain poor and no business continuity plans have yet been drawn up for the financial sector.

16. **The exploitation of recently discovered large offshore oil reserves is likely to boost the economy significantly, though mainly in the longer run**. Contracts have been awarded for four of six offshore blocks; one of these could contain around 700 million barrels of oil. Much uncertainty remains as to the scale and fiscal return of these projects but oil companies' initial estimates suggest that the oil could start flowing from 2010. Additional revenues annually accruing to the government within a few years could significantly exceed total fiscal revenue collected in 2005. The medium-term framework and the DSA will be updated in 2007 to reflect the expected impact of oil exploration and production as more information is forthcoming.

B. Fiscal Policy and Public Sector Reforms

17. **The Ministry of Economy and Finance (MEF)'s medium-term fiscal objectives are to enhance revenue collection to meet priority spending needs, while continuing to avoid domestic debt financing.** Although total revenue has grown substantially in nominal terms, it has struggled to keep pace with economic activity, remaining below 11 percent of GDP. This low revenue buoyancy reflects the fact that the most rapidly growing sectors (including informal agriculture and garments) are largely tax-exempt; governance problems also impede revenue collection. The authorities hope to reach the revenue target of around 12½ percent of GDP by 2009 by broadening the effective tax base through further improvements in administration and enforcement. Staff however emphasized the need to continue to refine and develop tax policy, particularly in the event that administrative measures were not sufficient to meet revenue targets.

18. **The fiscal developments thus far and the targets for 2006 are broadly consistent with these objectives.** The 2006 Budget, passed by the National Assembly in December 2005, is the basis for these targets, adjusted for anticipated higher revenues and donor aid, higher debt service, and the impact of MDRI.[5] A current surplus of around 1¼ percent of GDP is projected to occur, despite the sharp rise in interest costs as the U.S. and Russian debt begins to be serviced after rescheduling agreements are finalized. This, together with increased donor assistance, will allow capital spending to remain around 5½ percent of GDP. The overall deficit (after grants) is expected to increase from 1¼ percent of GDP in 2005 to around 2½ percent in 2007, but decline in the medium term.

Fiscal Program (excluding MDRI transactions)

	2005 Actual	2006 Proj.	2007 Proj.
(In percent of GDP)			
Total revenue	10.5	10.8	11.3
Tax revenue	7.7	8.3	8.6
Nontax revenue	2.3	2.2	2.4
Other capital revenue	0.5	0.3	0.1
Total expenditure	13.9	15.0	15.5
Current expenditure	8.2	9.3	9.4
Wages	2.8	3.1	3.0
Nonwage	5.4	6.2	6.3
Capital expenditure	5.6	5.6	5.9
Locally Financed	1.2	1.8	2.0
Current balance	1.6	1.2	1.8
Overall balance	-3.4	-4.1	-4.0
Overall balance (including grants)	-1.3	-2.3	-2.4
Foreign financing (net)	4.8	4.4	4.4
Domestic financing	-1.4	-0.3	-0.5

19. **The authorities place strong emphasis on improved revenue administration**. Staff supported this approach, encouraging the authorities to focus on full and equitable enforcement of the Law on Taxation. Key elements of the authorities' plans are capturing the rapidly growing informal sector in the tax base, including through strengthening audits of taxpayers, and re-organizing the tax department to enhance its efficiency. Customs modernization will focus on a major IT investment (ASYCUDA), updating the anti-smuggling plan—smuggling is a major source of revenue loss—and strengthening risk management. Staff noted that despite the growth in the non-tax revenue base, receipts from this source have been falling as a share of GDP in recent years and 2006 receipts have been below expectations. The authorities responded that privatization had reduced dividend receipts but stressed their commitment to more effective administration and were confident the budget target would be achieved. They explained new non-tax departments had been established within the MEF and efforts would be made to ensure all revenues collected by government agencies are promptly transferred to the Treasury. To address issues of government revenue loss from nontransparent sales, transfers, and contracts, a Prime Ministerial Order (PMO) was signed in 2005 requiring the cessation of swaps of public lands and initiating transparent bidding procedures for future concession contracts.

[5] Collection from domestic taxes is projected to build on the momentum achieved in 2005 and early 2006 with growth in the tax base, and efforts to collect outstanding tax arrears, including from telecommunications companies. As a result, the approved Budget target is expected to be exceeded by more than 20 percent—the provision for servicing the rescheduled U.S. and Russian debt would be authorized by the MEF once finalized.

20. **The MEF accepted that tax policy measures would need to be considered for the 2007 Budget and beyond**. Although it remains confident in the administrative measures outlined above, MEF will consider the policy measures proposed by 2003's FAD technical assistance mission during budget preparation. These include amending VAT rates and thresholds, increasing excise rates and re-considering property taxation in urban areas. Petroleum-sector taxation policy will also be clarified and strengthened with FAD support. MEF will further discuss the 2007 Budget with Fund staff in the autumn.

21. **The authorities committed not to grant tax exemptions beyond the provisions already allowed in law**. The Senior Minister of Commerce, nevertheless, expressed the view that further tax incentives are required to compete with neighboring countries, Vietnam in particular, in attracting foreign investment. Staff responded that although tax incentives could induce FDI at the margin, the current system was already generous and other factors were more important to Cambodia's competitiveness (see Chapter III of the Selected Issues Paper).

22. **Expenditure is being reoriented to support poverty reduction and achieve the MDGs**. Current expenditure is projected to increase by about 1¼ percent of GDP in 2006, somewhat below the envisaged revenue increase, to make room for financing a greater share of capital spending. Within this envelope, social spending (excluding wages) will be increased to 1½ percent of GDP and more resources allocated to rural development.[6] Room will also be made for a gradual increase in civil service pay and a decompression of the wage structure in the context of a broader civil service reform program. The authorities intend to use savings arising from the MDRI to implement new rural irrigation projects—such spending is projected to be about $6 million in 2006. Infrastructure development, including in the power sector, remains a priority and the authorities are investigating various financing sources, including public-private partnerships and borrowing from China and the Asian Development Bank (AsDB). Staff urged that every effort should be made to secure concessional financing for these projects.

23. **The public financial management (PFM) reform program is key to improving expenditure performance.** Staff supported the wide-ranging agenda of this program (see Chapter IV of the Selected Issue Paper) and urged the authorities to accelerate its implementation. The authorities agreed that particular attention needed to be paid to actions to improve the 2007 Budget, most importantly adopting the new Chart of Accounts. Staff emphasized the importance of using this to identify clearly and track poverty-reducing spending and to regularize the exceptional spending procedures such as the Priority Action Programs. The authorities agreed in principle but noted that these exceptional procedures were created to ensure that shortcomings in budget execution did not prevent key expenditure

---

[6] Work is underway to establish a clear definition of poverty-reducing spending linked to NSDP priorities. In the meantime, spending by key social sector ministries is used as a proxy.

priorities from being financed. They preferred to address these shortcomings, including rationalizing government bank accounts and constructing a database of payment arrears, before abandoning these procedures.

C. Monetary, Exchange Rate and Financial Sector Policies

24. **The monetary program is predicated on an inflation target of around 5 percent at end-2006**. Broad money is projected to grow by around 20 percent in 2006, as money demand continues its upward trend. Reserve money growth would be driven largely by net international reserve accumulation. Net domestic credit from the banking system to the government is projected to remain unchanged, thereby allowing for year-on-year growth in credit to the private sector of around 40 percent in 2006.[7]

25. **The NBC will adhere to its established intervention policy of stabilizing excessive fluctuations in the dollar exchange rate**. Some officials were concerned about the effect a sharp depreciation in the dollar may have on economic performance but the staff argued that the overall impact could be favorable (see Box 4). Staff and the authorities agreed that exchange rate adjustments reflecting shifts in underlying market fundamentals should not be resisted. The NBC is considering possible strategies for de-dollarization and will develop a framework paper that would set the scene for developing more effective monetary and exchange policy instruments in the medium term. They remain, however, concerned that these initiatives could stretch their limited internal capacity and requested technical assistance. The staff supported the NBC's approach of encouraging increased use of the riel while avoiding imposing restrictions on the use of foreign currencies."

26. **The NBC aims to enforce prudential norms more strictly to ensure rapid private sector credit growth does not have an adverse impact on banks' balance sheets**. Given its still low overall level in relation to GDP, rapid growth in private sector credit is to be expected. NBC has recently begun to compile financial soundness indicators; they show that compliance with key prudential regulations is not the norm. Staff also expressed concern about the potential risks of connected lending and overdependence on real estate collateral in making loan decisions, particularly in an environment where contract enforcement is weak and banks' classification of non-performing loans is acknowledged to be deficient. The NBC currently allows a large number of exemptions, especially on large exposure limits (albeit in most cases with a guarantee from the local bank's foreign parent).

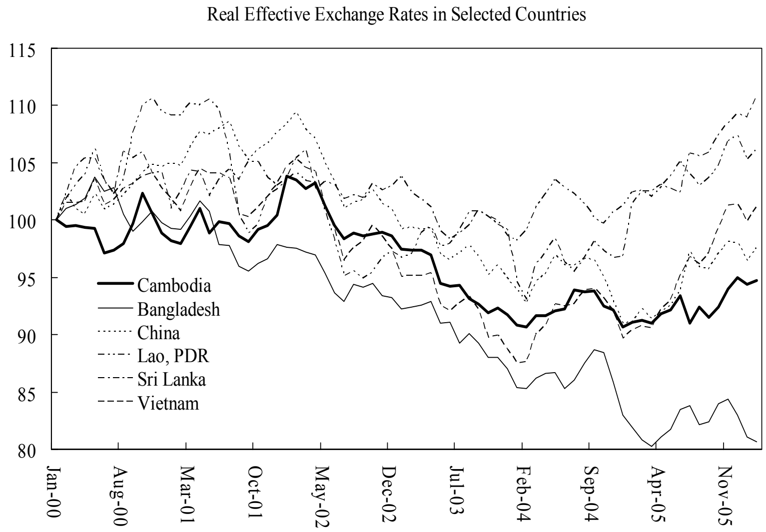
Average Prudential Ratios for Cambodia's 18 Commercial Banks

Indicator	Prudential Benchmark	2005 Dec.	Number of banks in breach
Liquidity	>50%	118%	0
Net worth to risk-weighted assets	>15%	32%	1
Loan to Deposit	<100%	61%	8
Large exposure loans to net worth	< 20%	50%	7
Non-performing loans	...	7.5%	...

[7] Excluding the impact of MDRI debt relief on government deposits.

Box 4: Exchange Rates and Competitiveness

Managed floating exchange rate policy has been broadly appropriate for Cambodia. The policy to allow the exchange rate to be market-determined—as evidenced by the low and stable premium of the parallel rate over the official rate—while limiting fluctuations in the bilateral exchange rate against the U.S. dollar has provided a stable base for the development of tourism and garment sectors. Reflecting the general movement of the U.S. dollar against the currencies of trading partners, and a recent record of mild inflation, Cambodia's CPI-based real effective exchange rate (REER) has experienced a substantial depreciation over 2002-04, only partly unwound in 2005. Hence, by this measure, Cambodia has maintained its competitiveness relative to other countries in the region.



By other indicators, there has been little progress in improving competitiveness in recent years. Poor infrastructure, and corruption and red tape, remain major issues of concern, with mixed evidence of progress. According to the World Bank's "Cost of Doing Business" surveys, there was a decrease in the administrative costs of starting a business (normalized by per capita income) between the 2004 and 2006 surveys. However, there were increases in the length of procedures to enforce contracts, and no clear gains in a range of other measures of red tape, such as the length of customs procedures, labor regulation, or creditor rights. On the labor front, wages do not appear to have risen in recent years at a pace that poses a threat to external competitiveness, and there even are indications of a small dip in garment sector wages as export prices declined early in 2005.

Of interest, in a country where most transactions are conducted or priced in U.S. dollars, is the effect of a possible depreciation of the dollar against other currencies. As almost half of Cambodia's exports is garments to the United States—and most inputs, including labor, are priced in dollars—a depreciation of the dollar would have limited effect on export demand. If anything competitiveness may improve as appreciation of competing countries' currencies makes their products more expensive in dollar terms. Depreciation against the Euro could additionally help Cambodian garment exports to Europe, and also make Cambodia a cheaper tourist destination than neighboring countries with appreciating currencies. However, imports, especially from neighboring countries, would likely become more expensive—particularly if exporters do not engage in pricing-to-market behavior—contributing to higher inflation. This would hurt the poor, and partially mute the competitive gains for Cambodian exports.

The NBC Governor agreed to introduce more extensive supervision based on the newly-completed accounting standards and to enforce prudential regulations more strictly and concurred with staff that systemically-important banks should be closely supervised. He emphasized that retaining strong, foreign-owned banks was vital for reinforcing still-fragile confidence in the banking system and that NBC was anxious not to take measures that could jeopardize regional banks from continuing to invest in Cambodia. Nevertheless, he committed to conduct a thorough review of current practices, while refraining from granting new approvals for large exposure loans unless detailed due diligence had been undertaken by NBC on the guarantee provided.

27. **The authorities are pursuing a number of initiatives to reduce impediments to financial intermediation.** The absence of reliable borrower information and the lack of enforceability of financial contracts have hampered financial sector development, particularly for small- and medium-size enterprises. The financial sector blueprint, currently being updated with the assistance of AsDB, contains a broad range of initiatives to deepen intermediation. Staff supported NBC's action to address this, including implementing a program of legislative and administrative reforms to establish a secure and reliable payments system and the establishment of a credit information system.[8] In addition, a draft Insolvency Law, developed in collaboration with the Ministry of Commerce, is close to finalization.

28. **NBC officials reiterated their commitment to implement safeguards recommendations and proceed with anti-money laundering (AML) efforts**. The safeguards assessment completed in March 2004 noted weaknesses in financial reporting, internal audit and internal control systems. The NBC has started to implement an action plan to address these weaknesses, in particular the creation, at end-November 2005, of a new internal audit department and Board-level audit committee. Officials agreed that more rapid action would be required. This will be reviewed in the context of an update of the safeguards assessment in the second half of 2006. Draft AML legislation and regulations aimed at meeting international standards are under consideration. The NBC has issued a decree on bank guidelines for identifying money laundering and introducing provisions to combat the financing of terrorism. The draft legislation will need to be passed into law and implementation commenced by the first quarter of 2007 to enable it to be taken into account when Cambodia is assessed for its compliance with the international standards in 2007.

D. External Sector Issues

29. **The authorities are undertaking trade facilitation reforms to improve competitiveness and support export diversification**. Reforms that focus on reducing administrative costs and consolidating the trade inspection process are being implemented under the World Bank supported Trade Facilitation and Competitiveness Project. Staff urged the authorities to make a swift decision on the implementation arrangements for the single window system for processing trade documents. In addition to their importance to trade facilitation, staff underscored that these arrangements would enable customs modernization to move ahead.

30. **Commitments under WTO accession and the ASEAN Free Trade Area (AFTA) are expected to facilitate international trade.** While commendable progress has been made

---

[8] A Negotiable Instruments and Payment Transactions Law was passed and a Secured Transactions Law submitted to the National Assembly in 2005.

in making wide-ranging changes to legislation required under the WTO accession agreement, much remains to be done. For AFTA, tariff rates under the Common Effective Preferential Tariff Scheme will be reduced to a maximum of 5 percent by 2010, and all items in the temporary exclusion list will be transferred to the inclusion list by 2007. The mission urged the authorities to reduce tariffs further on a nonpreferential basis to avoid trade diversion.

31. **The authorities stressed their commitment to finalizing agreement on debt restructuring with the United States and Russian Federation**. The United States and Cambodian authorities have now agreed on the total amount of debt principal and rescheduling of outstanding obligations is planned in the context of a new Paris Club agreement. Recent negotiations with the Russian Federation made progress but did not yet yield agreement over the nature of one claim and the repayment terms for post cut-off debt.

E. Other Structural Reforms

32. **Creating an environment conducive to private-sector investment is essential to broaden the base for economic growth**. A further draft of legislation on anti-corruption (a core theme of the NSDP) is close to being completed. Substantial technical assistance has been provided to ensure the legislation is consistent with international standards. Staff emphasized the importance of safeguarding the financial and operational autonomy of the anti-corruption secretariat in the draft submitted to the National Assembly**.** They also supported the authorities' reforms focusing on streamlining administrative procedures for registering a company, and strengthening commercial arbitration processes with support from the World Bank. The authorities are also taking a number of measures to establish a credible and transparent legal and judicial system that will inspire confidence in the rule of law in Cambodia, including a Law on the Status of Judges and Prosecutors, which is critical to the independence of the courts, and revisions to the draft penal code.

33. **Clear and transparent land policies are essential to curtail land grabbing by the powerful and to unlock agricultural growth potential**. Staff noted that land concessions have been granted by discretion; only about 7 percent of the area granted as concessions for agricultural purposes has been cultivated, resulting in significant loss of productive potential, particularly for the poor. The authorities' approach to improve the efficient allocation of land for agriculture includes a program of land titling, which is proceeding at a steady rate for undisputed land, and ensuring that land concessions are granted on a fair and transparent basis. Staff urged the authorities to ensure that the implementation of the land concession sub-decree is fully consistent with the provisions of the 2001 Land Law, and contains strong provisions for dealing with unsolicited bids to minimize scope for discretion and corruption.

IV. Staff Appraisal

34. **The Cambodian authorities are to be commended for implementing sound macroeconomic policies in recent years,** even while the domestic political environment has been at times unsettled. Despite the surge in world oil prices, inflation stayed low, and debt declined in terms of GDP.

35. **Growth has been very robust, but widespread rural poverty highlights the continued challenges**. The narrow growth base has resulted in uneven progress in reducing poverty—particularly in rural areas—and in growing income disparities. This situation is neither sustainable, nor desirable over the long term. The staff supports the approach of the authorities' NSDP to channel more resources to increasing agricultural productivity through rural irrigation, improved land allocation, and rural credit.

36. **Overall medium-term prospects are favorable. Growth is expected to remain robust—and could well exceed the projected rate—and inflation moderate.** There are risks but these are balanced by upside possibilities. Further escalation of oil prices would impose a major cost, while the phasing out of garment safeguards restrictions on China could adversely affect prospects for the medium term. However, oil exploitation will likely significantly boost the economy, mainly in the longer run and provided the opportunities are well managed. The path of external debt is sustainable, although there are risks of distress because of the low revenue base. Thus, a prudent borrowing policy—limiting foreign finance wherever possible to concessional resources—is appropriate. Staff supports the authorities' efforts to resolve outstanding arrears with official creditors.

37. **The government needs to finance more of Cambodia's development, reducing its dependence on aid**. Almost one-third of public expenditure is financed by aid. Despite progress in increasing tax revenue over the last two years, Cambodia's revenue-to-GDP ratio continues to be among the lowest in the world, handicapped by a narrow tax base and difficulties in ensuring revenue collected is received. Current tax regulations should be strictly enforced, and all revenue collected transferred to the National Treasury. Effort should focus on strengthening capacity in the tax and customs department, updating the anti-smuggling plan, and clarifying petroleum-sector tax provisions, but tax policy measures may also be needed in the 2007 budget. Expanding the scope of tax exemptions would undermine the revenue effort and have only marginal effectiveness in attracting foreign investment.

38. **The authorities' plan to reorient expenditure is welcome.** Social spending in support of the MDGs and infrastructure spending to upgrade the country's physical capital stock will support achieving the NSDP's objectives. The funds freed up by the MDRI will also provide some additional resources for poverty-reducing spending priorities. New expenditure arrears and recourse to domestic financing should be avoided to maintain fiscal integrity and support the low inflation objective.

39. **Strong ownership and implementation of the PFM reform program combined with civil service reform would provide for a more credible and effective budget.** The staff fully supports the budget and treasury reforms envisaged under the government's program. More rapid implementation of key measures, in particular the introduction of the new Chart of Accounts and rationalizing government bank accounts is important. Such measures would strengthen the government's control over fiscal policy and provide better monitoring of poverty-reducing spending, as envisaged by the MDRI relief. In the medium term, moving to a smaller, better-qualified and better-paid civil service is essential to complement the revenue and financial management efforts and to combat corruption.

40. **The monetary objectives and exchange rate and trade policies are appropriate**. Monetary aggregates will be expected to continue to reflect the increase in financial intermediation. De-dollarization should remain a long-term objective, but coercive measures could jeopardize public confidence. Staff supports the NBC's approach to stabilize excessive fluctuations in the exchange rate, while allowing the rate to adjust to any shifts in underlying market fundamentals. The authorities are encouraged to strengthen competitiveness, including through improved trade facilitation through prompt introduction of ASYCUDA and the single window, while integrating further within the region.

41. **Strengthening the financial framework through enhanced supervision enforcement and adoption of remaining legislation is key to promoting sound financial intermediation.** The impact of rapid private sector credit growth on banks' balance sheets needs to be closely monitored and the NBC should pay particular attention to the performance of the two large banks that are now jointly owned. The NBC needs to limit exemptions on prudential requirements, especially on capital requirements and large exposure limits. Staff looks forward to the implementation of the laws on negotiable instruments and secure transactions as a means to create a better functioning payments system. The submission of the draft anti-money-laundering law to the National Assembly is welcome as are continued measures to address weaknesses in the control, accounting, reporting, and auditing procedures of the NBC, as indicated by the safeguard assessment.

42. **Addressing widespread corruption will enhance the business environment as well as strengthen revenue collection**. The proposed anti-corruption law needs to provide an important pillar upon which future anti-corruption efforts will be based, combined with the enforcement of existing laws. Staff encourages the authorities to ensure that weaknesses in the current draft are addressed and the anti-corruption secretariat can be established promptly. More immediately, the authorities are urged to use the current laws and procedures to guard against misuse of funds and to investigate irregularities as they come to light.

43. **A sound and transparent framework for managing state land is important for good governance**. Staff welcomes the commitment to cease state asset transactions that are inconsistent with the Land Law, and to subject all government concession contracts to open and transparent competitive bidding, which will help strengthen non-tax revenue.

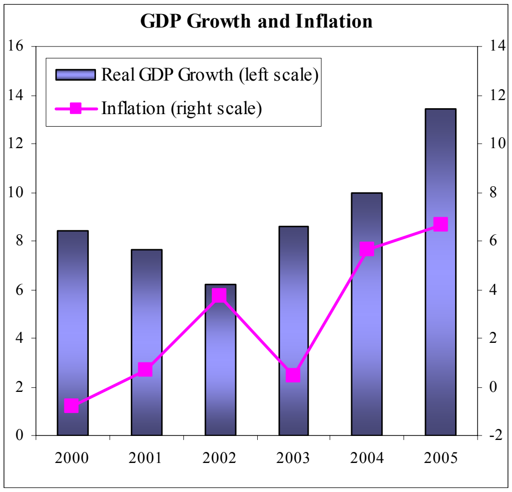
44. **The staff welcomes efforts to improve statistics.** While there has been considerable improvement in recent years in this area, continued efforts are warranted for monitoring both economic and poverty developments. Government agencies should continue to collaborate in the sharing of data, and statistical operations and agencies receive adequate budget resources.

45. **The authorities have demonstrated ownership of a credible program of structural reform aimed at tackling the impediments to broad-based growth and poverty reduction.** Their commitment has been demonstrated over the past year by sound macroeconomic policies and the implementation of measures for which understandings were reached with the staff in earlier program discussions. The recently completed NSDP provides a good road map for tackling poverty, although some critical elements of the sectoral strategy still need to be finalized and costing improved. Moreover, achieving the objectives of the NSDP will require sustained attention to the broad-ranging structural reform agenda. Once the outstanding debt arrears issues are resolved staff would support a request for a new PRGF arrangement that could support the program and help close the gap in financing the medium-term balance of payments.

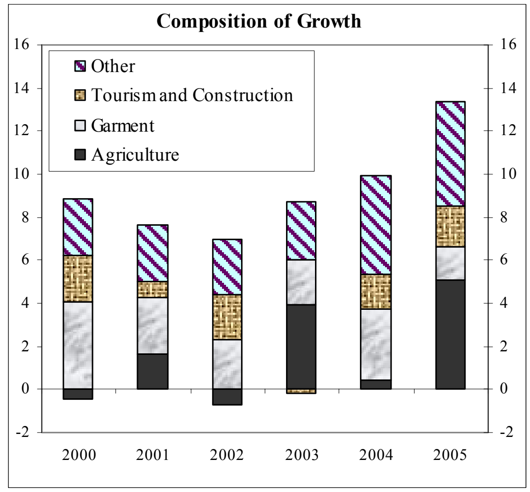
46. It is recommended that the next Article IV consultation take place within the standard 12-month cycle.

Figure 1: Cambodia: Selected Economic Indicators 2000-06

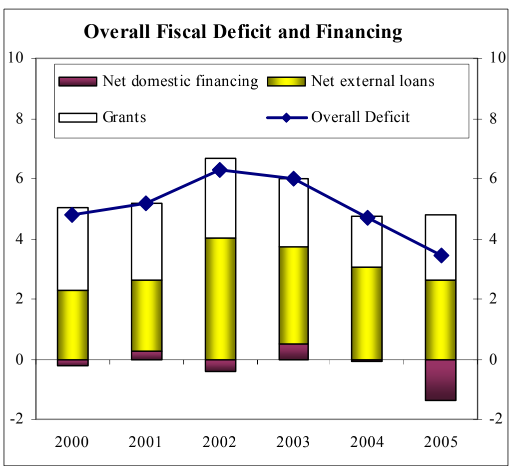
Growth has been robust and inflation under control…



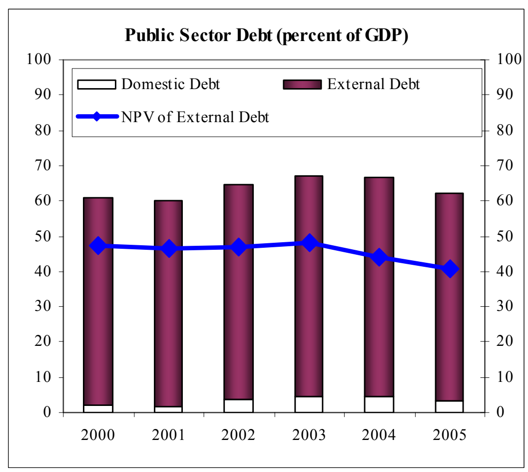
...based on sustained non-agricultural growth.



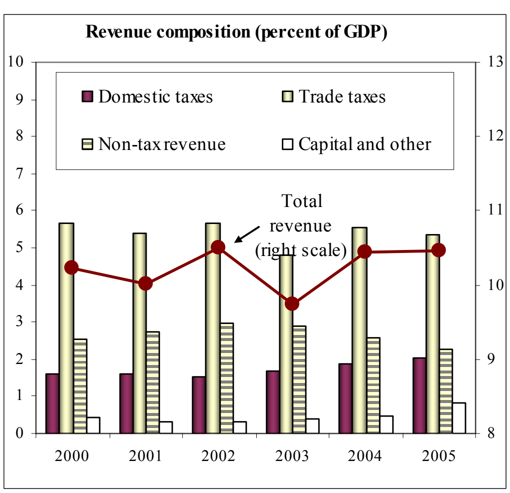
The fiscal deficit has been more-than financed externally...



...and public debt is sustainable.



However, revenue is low and dominated by trade taxes...



...while capital expenditure is being restrained.

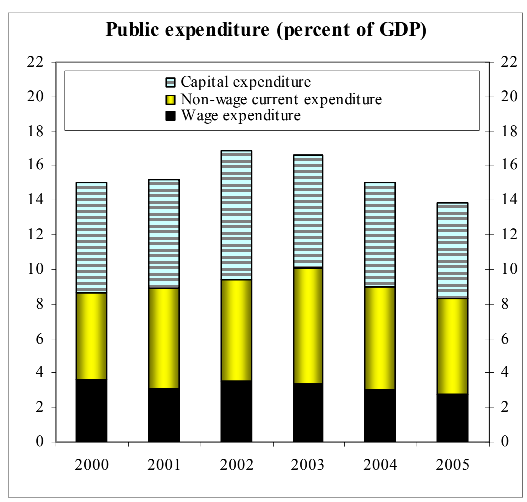
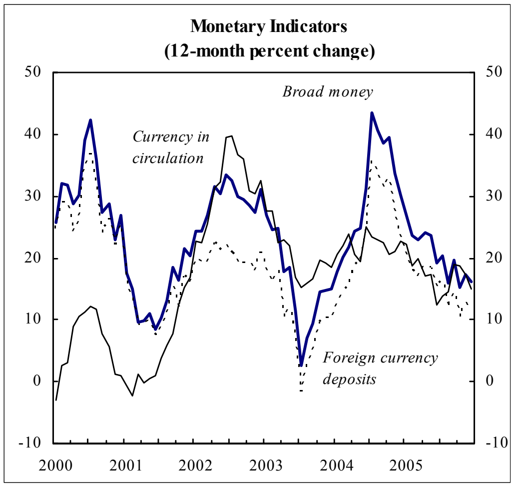
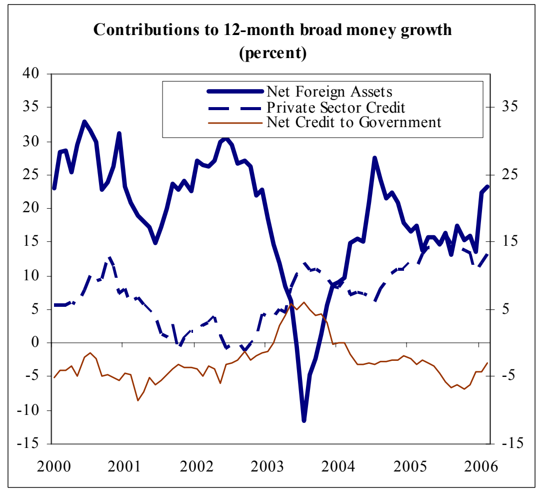


Figure 1: Cambodia: Selected Economic Indicators 2000-2006 (cont)

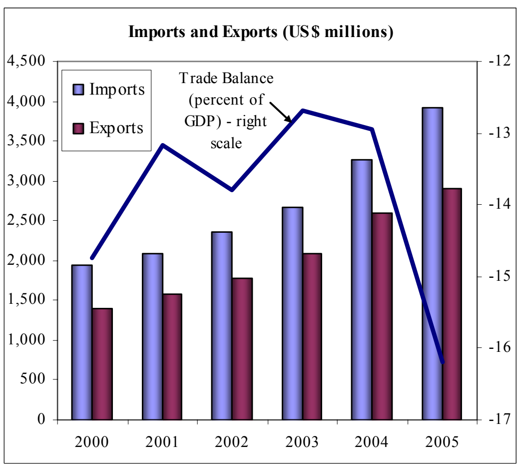
Monetary aggregates are increasing ...



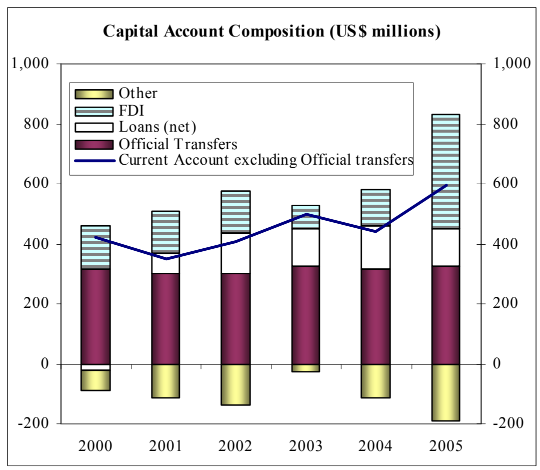
...driven by increases in foreign assets and private credit.



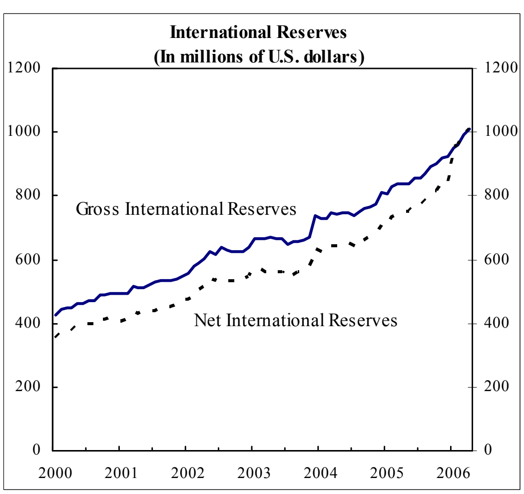
The trade balance deteriorated markedly in 2005...



...with financing from aid and increased FDI.



International reserves have steadily accumulated...



...while the exchange rate has remained broadly stable.

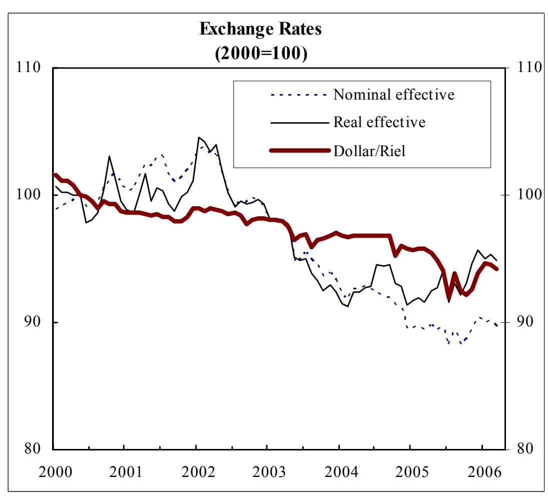


Table 1. Cambodia: Selected Economic Indicators, 2002–07

Nominal GDP (2005): $6287 million
Population (2005): 13.9 million
GDP per capita (2005): $454
Fund Quota: SDR87.5 million

	2002	2003	2004	2005 Est.	2006 Proj.	2007 Proj.
Real economy						
Real GDP	6.2	8.6	10.0	13.4	5.0	6.5
Real GDP excluding agriculture	10.7	6.9	14.3	12.0	8.8	7.3
Real agricultural output	-2.2	12.1	1.2	16.6	-3.4	4.3
GDP deflator	1.4	0.2	5.3	5.7	5.2	4.0
CPI Inflation (end of period)	3.7	0.5	5.6	6.7	5.0	4.0
Domestic investment	19.7	21.5	17.5	19.7	20.3	20.7
Government investment	7.5	6.6	6.1	5.6	5.7	6.2
Non-budgetary grant-financed investment	4.6	4.9	4.3	3.0	3.4	3.3
Nongovernment investment	7.6	10.1	7.1	11.1	11.2	11.2
National saving	17.3	17.8	15.2	15.4	14.7	14.3
Government saving	1.1	0.4	1.3	1.6	1.2	1.8
Nongovernment saving	16.2	17.4	13.9	13.8	13.5	12.5
Money and credit						
Broad money	33.0	15.0	30.4	16.1	20.0	19.0
Net credit to the government 1/	-2.0	-0.3	-2.4	-4.9	0.0	0.0
Private sector credit	13.1	26.2	35.9	29.4	39.5	19.9
Velocity of money 2/	6.4	6.1	5.4	5.4	4.9	4.3
Government operations						
Revenue 3/	10.5	9.7	10.4	10.5	12.0	11.3
Of which : Tax revenue	7.4	6.7	7.8	7.7	8.3	8.6
Expenditure	16.7	15.7	15.2	13.9	15.0	15.5
Current expenditure	9.4	10.1	9.0	8.2	9.3	9.4
Capital expenditure 4/	7.5	6.6	6.1	5.6	5.7	6.2
Overall budget balance	-6.3	-6.0	-4.7	-3.4	-3.0	-4.2
Overall budget balance (incl. grants)	-3.6	-3.7	-3.0	-1.3	-1.3	-2.7
Foreign financing, net	6.7	5.5	4.8	4.8	4.4	4.4
Domestic financing 5/	-0.4	0.5	-0.1	-1.4	-1.4	-0.2
Balance of payments						
Exports 6/	1,659	1,970	2,454	2,773	3,081	3,296
Imports 6/	-2,275	-2,579	-3,166	-3,822	-4,441	-4,894
Current account (excl. official transfers)	-406	-497	-440	-594	-719	-824
(in percent of GDP)	-9.5	-10.8	-8.4	-9.5	-10.7	-11.3
Current account (incl. official transfers)	-104	-170	-122	-268	-377	-469
(in percent of GDP)	-2.4	-3.7	-2.3	-4.3	-5.6	-6.4
Overall balance	33	6	31	47	108	56
Financing gap	...	...	...	...	50	40
Gross official reserves	663	737	806	915	1,050	1,161
(in months of imports of goods and non-factor services)	2.9	2.8	2.6	2.4	2.4	2.4
Public external debt 7/ 8/	2,492	2,740	2,976	3,180	2,277	2,513
(in percent of GDP)	58.2	59.8	56.6	50.6	33.9	34.3
Public debt service (cash basis)	0	73	69	109	135	111
(in percent of exports of goods and services)	0.0	2.8	2.0	2.7	2.9	2.2
Memorandum items:						
Nominal GDP (in billions of riels)	16,768	18,250	21,141	25,350	27,991	30,991
(in millions of U.S. dollars)	4,280	4,585	5,260	6,287	...	...
Exchange rate (riels per dollar; end of period)	3,935	3,980	4,031	4,116	...	...

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

1/ Contribution to broad money growth.
2/ Ratio of nominal GDP to average stock of broad money.
3/ In 2006, includes transfer of MDRI proceeds as capital revenue transfer (1.2 percent of GDP).
4/ Includes net lending, and compensation payments to Thailand in 2003. Includes repayment of arrears in 2004 and 2005.
5/ Includes funds in transit and payment orders in excess of cash released.
6/ Excludes re-exports.
7/ Includes IMF debt forgiveness under the MDRI in January 2006.
8/ Debt rescheduling with the United States and Russia is assumed to take place in 2006.

Table 2. Cambodia: General Government Operations, 2003-07

	2003	2004	2005	2006			2007
				March	Budget	Proj.	Proj.
				(In billion of riels)			
Total revenue	1,776	2,209	2,653	959	2,873	3,366	3,501
Of which: Central government	1,725	2,116	2,559	918	2,781	3,258	3,386
Tax revenue	1,219	1,645	1,948	501	2,176	2,319	2,664
Direct taxes	150	158	222	61	205	251	305
Indirect taxes	635	895	1,075	279	1,206	1,275	1,463
Trade taxes	395	513	573	135	692	702	799
Nontax revenue	525	544	578	122	625	623	742
Capital revenue 1/	31	19	127	335	72	424	33
From MDRI capital transfer	...	...	...	332	0	333	0
Unidentified revenue measures	...	...	...	...	...	...	62
Total expenditure	2,868	3,205	3,521	823	3,778	4,203	4,817
Current expenditure (Central gov.)	1,758	1,791	1,943	355	2,382	2,450	2,730
Wages	615	640	711	140	863	863	941
Nonwage	1,143	1,152	1,232	214	1,519	1,587	1,789
Of which: interest	34	49	55	10	50	118	146
Current expenditure (Provinces; net subsidy)	85	110	130	11	93	150	172
Capital expenditure	1,196	1,282	1,412	271	1,304	1,603	1,915
Locally financed	333	296	315	74	446	511	622
From MDRI capital transfer	...	...	...	0	0	27	85
Externally financed	863	986	1,097	197	858	1,066	1,208
Cash adjustments 2/	172	-22	-36	-187	0	0	0
Current balance	73	266	417	72	327	342	566
Overall balance	-1,092	-997	-869	135	-905	-837	-1,316
Financing	1092	997	869	-135	905	837	1,315
Foreign financing (net)	1,002	1,008	1,217	197	905	1,229	1,372
Grants	412	361	551	105	524	487	486
Loans	649	694	703	100	477	823	966
Amortization	-59	-25	-38	-8	-96	-81	-80
Domestic fin. (net; incl. outst. oper.)	90	-12	-348	-333	0	-392	-57
Bank financing (net)	-9	-81	-212	-331	0	-306	85
Other 3/	99	69	-136	-2	0	-85	-142
				(In percent of GDP)			
Total revenue	9.7	10.4	10.5	3.4	11.9	12.0	11.3
Of which: Central government	9.5	10.0	10.1	3.3	11.5	11.6	10.9
Tax revenue	6.7	7.8	7.7	1.8	9.0	8.3	8.6
Nontax revenue	2.9	2.6	2.3	0.4	2.6	2.2	2.4
Capital revenue	0.2	0.1	0.5	1.2	0.3	1.5	0.1
Unidentified revenue measures	...	...	...	...	...	...	0.2
Total expenditure	15.7	15.2	13.9	2.9	15.6	15.0	15.5
Current expenditure (General gov.)	10.1	9.0	8.2	1.3	10.2	9.3	9.4
Capital expenditure	6.6	6.1	5.6	1.0	5.4	5.7	6.2
Cash adjustments 2/	0.9	-0.1	-0.1	-0.7	0.0	0.0	0.0
Current balance	0.4	1.3	1.6	0.3	1.3	1.2	1.8
Overall balance	-6.0	-4.7	-3.4	0.5	-3.7	-3.0	-4.2
Financing	6.0	4.7	3.4	-0.5	3.7	3.0	4.2
Foreign financing (net)	5.5	4.8	4.8	0.7	3.7	4.4	4.4
Domestic fin. (net; incl. outst. oper.)	0.5	-0.1	-1.4	-1.2	0.0	-1.4	-0.2
Memorandum items:							
Defense and security outlays	2.3	2.0	1.8	0.3	2.1	1.8	1.8
Social spending 4/	3.1	2.9	2.9	0.4	3.7	3.2	3.5
Effective tariff rate 5/	13.3	13.7	14.2	...	15.2	14.4	14.6
Primary deficit excl. MDRI transactions, incl. grants	-3.5	-2.8	-1.0	-0.3	-1.4	-1.9	-1.9
Overall deficit excl. MDRI transactions	-6.0	-4.7	-3.4	-0.7	-3.7	-4.1	-4.0
GDP	18,250	21,141	25,350	27,991	24,211	27,991	30,991

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

1/ For 2005, includes MEF's share from the privatization of FTB equal to CR 65 billion (0.3 percent of GDP). For 2006, includes capital transfer from NBC from the privatization of FTB equal to CR 18.7 bln. In the official accounts, all FTB privatization receipts--CR 89.6 billion--is treated as capital revenue and the transfer to NBC for its share in FTB (20 percent) as well as MEF's share in the new bank (10 percent) are classified as other current expenditure.

2/ Cash payments on expenditure committed in the previous year (-); or expenditure committed but for which cash has not yet been disbursed (+).

3/ Includes funds in transit and payment orders in excess of cash released. From 2006 onwards also includes repayment of expenditure arrears equal to CR 107 bln. Before 2006 any repayments are classified under other current expenditure.

4/ Current spending by the ministries of Health, Educ., Rural Dev., Agriculture, and spending on Social Aff., Labor, and Voc. Training.

5/ Excluding garment and adjusted for oil price changes (as Cambodia uses administered prices).

Table 3. Cambodia: Monetary Survey, 2003-07

	2003	2004	2005				2006		2007
	Dec.	Dec.	Mar.	Jun.	Sep.	Dec.	Mar	Dec. Proj.	Dec. Proj.
	(In billions of riels; end of period)								
Net foreign assets 1/	4,027	4,797	4,883	5,084	5,391	5,475	6,410	6,714	7,398
National Bank	3,494	4,114	4,192	4,237	4,356	4,434	5,092	5,546	6,179
Deposit money banks	533	682	691	846	1,035	1,041	1,319	1,169	1,219
Net domestic assets 1/	-706	-467	-382	-455	-397	-450	-699	-684	-223
National Bank	-1,344	-1,450	-1,477	-1,656	-1,765	-1,797	-2,200	-2,408	-2,458
Deposit money banks	637	983	1,095	1,201	1,368	1,346	1,501	1,724	2,235
Domestic credit	1,209	1,608	1,730	1,823	1,983	1,929	2,022	2,231	2,970
Government (net)	-128	-209	-252	-343	-404	-421	-756	-1,048	-963
Private sector	1,337	1,817	1,983	2,166	2,386	2,350	2,778	3,279	3,933
Other items (net)	-1,915	-2,075	-2,112	-2,278	-2,380	-2,379	-2,721	-2,916	-3,297
Broad money	3,321	4,329	4,501	4,629	4,994	5,025	5,711	6,030	7,176
Narrow money	938	1,153	1,201	1,215	1,279	1,323	1,449	1,571	1,870
Currency in circulation	908	1,115	1,167	1,167	1,235	1,282	1,403	1,523	1,812
Demand deposits	29	38	34	48	44	41	45	49	58
Quasi-money	2,383	3,176	3,300	3,414	3,715	3,702	4,262	4,458	5,306
Time deposits	82	97	109	119	118	113	116	151	180
Foreign currency deposits	2,301	3,079	3,191	3,295	3,596	3,589	4,146	4,307	5,126
	(12 - month percent change)								
Net foreign assets	7.7	19.1	14.5	15.3	19.2	14.1	31.3	22.6	10.2
Private sector credit	26.2	35.9	42.7	44.3	42.6	29.4	40.1	39.5	19.9
Broad money	15.0	30.4	23.0	19.1	19.8	16.1	26.9	20.0	19.0
Of which : currency in circulation	18.6	22.7	20.0	12.4	18.9	15.0	20.3	18.8	19.0
	(Contribution to annual growth of broad money; in percent)								
Net foreign assets	10.0	23.2	16.9	17.4	20.8	15.7	33.9	24.7	11.3
Net domestic assets	4.9	7.2	6.1	1.7	-1.1	0.4	-7.1	-4.7	7.7
Domestic credit	9.2	12.0	13.0	11.7	9.7	7.4	6.5	6.0	12.2
Government (net)	-0.3	-2.4	-3.2	-5.4	-7.4	-4.9	-11.2	-12.5	1.4
Private sector	9.6	14.5	16.2	17.1	17.1	12.3	17.7	18.5	10.8
Other items (net)	-4.3	-4.8	-6.9	-10.0	-10.8	-7.0	-13.5	-10.7	-6.3
Memorandum items:									
Foreign currency deposits (in millions of dollars)	578	774	792	802	861	872	1,012	1,021	1,209
Foreign currency deposits (in percent of broad money)	69	71	71	71	72	71	73	71	71
Riel component of broad money	1,020	1,250	1,311	1,334	1,398	1,435	1,565	1,723	2,050
(in percent of broad money)	31	29	29	29	28	29	27	29	29
Credit to the private sector (in millions of dollars)	336	456	492	527	572	571	678	777	927
Velocity 2/	6.1	5.4	...	...	...	5.4	...	4.9	4.5
Money multiplier (Broad Money / Reserve Money)	1.54	1.62	1.66	1.79	1.93	1.91	1.97	1.92	1.93
Reserve Money (12 month percent change)	8.5	23.9	12.2	2.8	5.5	-1.0	6.5	19.0	18.6

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

1/ Changes in 2006 reflect in part the receipt of MDRI debt relief.

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

Table 4. Cambodia: Balance of Payments, 2003-09
(In millions of U.S. dollars)

	2003	2004	2005	2006	2007	2008	2009
			Est.	Projection			
Current account (excluding official transfers)	-497	-440	-594	-719	-824	-790	-806
Current account (including official transfers)	-170	-122	-268	-377	-469	-424	-434
Trade balance	-581	-681	-1,018	-1,329	-1,567	-1,688	-1,841
Exports, f.o.b.	2,087	2,589	2,910	3,214	3,428	3,640	3,868
Domestic exports	1,970	2,454	2,773	3,081	3,296	3,510	3,739
Of which garment	1,601	1,986	2,206	2,440	2,680	2,890	3,120
Re-exports	117	134	137	132	131	130	129
Imports, f.o.b.	-2,668	-3,269	-3,928	-4,542	-4,995	-5,328	-5,709
Retained imports, f.o.b.	-2,579	-3,166	-3,822	-4,441	-4,894	-5,228	-5,610
Of which garments sector	-812	-1,010	-1,061	-1,198	-1,316	-1,419	-1,532
Of which petroleum	-451	-649	-842	-1,145	-1,251	-1,293	-1,337
Imports for re-export, f.o.b	-90	-103	-105	-102	-101	-100	-99
Services and Income (net)	-69	65	214	386	499	632	756
Services (net)	115	290	471	691	846	1,017	1,174
Of which: Tourism (credit)	389	603	840	1,045	1,237	1,440	1,633
Income (net)	-184	-225	-257	-305	-347	-385	-418
Private transfers (net)	153	176	209	224	244	265	279
Official transfers (net)	326	318	326	342	356	367	372
Capital and financial account	176	153	315	485	525	550	571
Medium- and long-term loans	127	144	125	175	199	190	179
Disbursements	162	182	165	188	218	216	212
Amortization	-36	-38	-40	-13	-19	-26	-33
Capital transfers 1/	0	0	0	76	0	0	0
Foreign direct investment	74	121	381	394	426	460	492
Short-term flows and errors and omissions	-25	-112	-191	-160	-100	-100	-100
Overall balance	6	31	47	108	56	126	136
Financing	-6	-31	-47	-108	-56	-126	-136
Change in gross official reserves 2/	-45	-61	-79	-82	-97	-157	-157
Use of Fund credit	-2	-10	-9	-82	0	0	0
Purchases/disbursements	12	0	0	0	0	0	0
Repurchases/repayments 3/	13	10	9	82	0	0	0
Debt restructuring 4/	0	0	0	1,533	0	0	0
Debt forgiveness 5/	0	0	0	998	0	0	0
Debt rescheduling	0	0	0	536	0	0	0
Change in arrears (- = reduction)	40	41	41	-1,527	0	0	0
Financing Gap 6/	-	-	-	50	40	30	20
Memorandum items:							
Trade balance (in percent of GDP)	-12.7	-12.9	-16.2	-19.8	-21.4	-21.2	-21.3
Current account balance							
Excluding official transfers (in percent of GDP)	-10.8	-8.4	-9.5	-10.7	-11.3	-9.9	-9.3
Including official transfers (in percent of GDP)	-3.7	-2.3	-4.3	-5.6	-6.4	-5.3	-5.0
Gross official reserves	737	806	915	1,050	1,161	1,331	1,502
In months of imports of goods & services	2.8	2.6	2.4	2.4	2.4	2.6	2.7
Net international reserves	634	710	834	1,030	1,120	1,270	1,430
Public debt service, including IMF (cash basis)	26.1	27.7	28.6	44.7	54.4	63.3	73.2
Public external debt	2,740	2,976	3,180	2,277	2,513	2,730	2,929
Public external debt (in percent of GDP)	59.8	56.6	50.6	33.9	34.3	34.2	33.8
Public external debt (NPV in percent of GDP)	48.2	44.1	40.5	22.5	23.4	23.7	23.3

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

1/ Debt forgiveness of debt due after 2006, under MDRI.
2/ Excludes unrestricted foreign currency deposits at NBC and valuation changes.
3/ Includes the impact of MDRI.
4/ Assumes debt rescheduling with the Russian Federation and the United States in 2006.
5/ Includes debt forgiveness by the Russian Federation and the United States, as well as forgiveness of debt due in 2006 under the MDRI (US$6 milli
6/ The financing gap is expected to be closed by PRGF, World Bank's PRSO, ADB's FSPL and possible Paris Club rescheduling of payments falling

Table 5. Cambodia: Medium-Term Macroeconomic Framework, 2003–11
(In percent of GDP, unless otherwise indicated)

	2003	2004	2005	2006	2007	2008	2009	2010	2011
			Est.	Projections					
Real sector									
Real GDP (percent change)	8.6	10.0	13.4	5.0	6.5	6.1	5.8	5.8	5.8
GDP deflator (percent change)	0.2	5.3	5.7	5.2	4.0	3.0	3.0	3.0	3.0
Domestic savings (excl. transfers)	7.3	5.8	6.9	6.3	6.1	7.7	8.6	10.6	11.7
National saving	17.8	15.2	15.4	14.7	14.3	15.6	16.1	17.7	18.3
Government saving	0.4	1.3	1.6	1.2	1.8	2.1	2.4	2.7	2.7
Private saving	17.4	13.9	13.8	13.5	12.5	13.4	13.6	15.0	15.6
Domestic investment	21.5	17.5	19.7	20.3	20.7	20.9	21.1	21.3	21.8
Government investment	6.6	6.1	5.6	5.7	6.2	6.0	5.7	5.3	5.0
Non-budgetary grant-financed investment	4.9	4.3	3.0	3.4	3.3	3.2	3.0	2.9	2.7
Private investment	10.1	7.1	11.1	11.2	11.2	11.8	12.4	13.1	14.1
Fiscal sector									
Revenue	9.7	10.4	10.5	12.0	11.3	11.8	12.3	12.7	13.1
Tax revenue	6.7	7.8	7.7	8.3	8.6	8.9	9.2	9.4	9.6
Of which: Domestic Taxes	1.7	1.9	2.0	2.2	2.3	2.6	2.8	3.0	3.2
Of which: International Taxes	4.8	5.5	5.3	5.8	6.0	6.0	6.1	6.1	6.1
Nontax revenue	2.9	2.6	2.3	2.2	2.4	2.8	3.0	3.2	3.4
Expenditure	15.7	15.2	13.9	15.0	15.5	15.5	15.4	15.2	15.3
Current	10.1	9.0	8.2	9.3	9.4	9.6	9.7	9.9	10.3
Wages	3.4	3.0	2.8	3.1	3.0	3.1	3.2	3.3	3.4
Interest payments	0.2	0.2	0.2	0.4	0.5	0.5	0.4	0.4	0.5
Social spending (excluding wages)	1.7	1.4	1.3	1.5	1.4	1.8	2.1	2.3	2.5
Other	4.9	4.4	3.9	4.3	4.4	4.2	3.9	3.8	4.0
Capital 1/	6.6	6.1	5.6	5.7	6.2	6.0	5.7	5.3	5.0
Current balance	0.4	1.3	1.6	1.2	1.8	2.1	2.4	2.7	2.7
Primary balance (including grants)	-3.5	-2.8	-1.1	-0.8	-2.2	-1.8	-1.4	-1.0	-0.7
Overall balance	-6.0	-4.7	-3.4	-3.0	-4.2	-3.7	-3.2	-2.5	-2.2
Overall balance (including grants)	-3.7	-3.0	-1.3	-1.3	-2.7	-2.3	-1.8	-1.4	-1.2
Domestic financing (incl. outstanding operations)	0.5	-0.1	-1.4	-1.4	-0.2	-0.1	-0.2	-0.3	-0.3
External financing, net	5.5	4.8	4.8	4.4	4.4	3.8	3.4	2.8	2.5
Monetary sector									
Broad money (percent change)	15.0	30.4	16.1	20.0	19.0	18.0	17.0	16.0	15.0
Velocity (GDP/M2)	6.1	5.4	5.4	4.9	4.3	4.0	3.7	3.5	3.3
Private sector credit (percent change)	26.2	35.9	29.4	39.5	19.9	15.5	16.9	11.6	15.8
External sector									
Domestic exports (percent change)	18.8	24.6	13.0	11.1	7.0	6.5	6.5	6.9	7.4
Retained imports (percent change)	13.3	22.8	20.7	16.2	10.2	6.8	7.3	5.4	7.6
Retained imports (excl. garments, percent change)	8.5	12.2	22.1	28.1	17.4	10.4	6.4	7.1	4.4
Current account balance (excluding transfers)	-10.8	-8.4	-9.5	-10.7	-11.3	-9.9	-9.3	-7.6	-7.2
Current account balance (including transfers)	-3.7	-2.3	-4.3	-5.6	-6.4	-5.3	-5.0	-3.6	-3.5
Foreign direct investment (in millions of US$)	74	121	381	394	426	460	492	526	563
Overall balance	0.1	0.6	0.7	1.6	0.8	1.6	1.6	2.6	2.6
Gross official reserves (in millions of US$)	737	806	915	1,050	1,161	1,331	1,502	1,747	2,007
(in months of imports of goods and services)	2.8	2.6	2.4	2.4	2.4	2.6	2.7	3.0	3.2
Memo item: Net capital flows 2/	9.8	8.6	7.0	30.0	8.1	7.4	6.6	5.7	5.2
External debt 3/ 4/	59.8	56.6	50.6	33.9	34.3	34.2	33.8	33.1	32.3
External public debt-service ratio, accrual basis 5/	2.6	2.1	1.8	0.8	1.1	1.2	1.3	1.3	1.4
External public debt-service ratio, cash basis 5/	1.0	0.9	0.7	1.0	1.1	1.2	1.3	1.3	1.4

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

1/ Includes net lending and compensation payments to Thailand in 2003 and 2004.
2/ Net official disbursement, exceptional financing, and official transfers.
3/ Figures include bilateral debt with the Russian Federation and the United States and reflect the impact of completing rescheduling agreements with these creditors in 2006.
4/ Includes IMF debt forgiveness under the MDRI in January 2006.
5/ As percent of domestic exports of goods and services.

Table 6. Cambodia: Millennium Development Goals

	1990	1995	2000	2002	2003	2004	2005	2015 MDG Target
Goal 1: Eradicate extreme poverty and hunger								
Percentage share of income or consumption held by poorest 20%	..	*8.5*	..	..	..	..	7	11
Population below minimum level of dietary energy consumption (%)	..	..	..	33	..	..	..	20.5
Poverty headcount, national (% of population) 1/	..	47	..	..	..	..	35	19.5
Prevalence of underweight in children (under five years of age)	..	..	45	..	..	..	..	26.2
Goal 2: Achieve universal primary education								
Net primary enrollment (% of relevant age group)	67	..	85	93	..	..	91	100
Primary completion rate, total (% of relevant age group)	..	..	53	69	81	...	..	100
Proportion of pupils starting grade 1 who reach grade 5	..	..	70	*58*	..	..	59	100
Youth literacy rate (% ages 15-24)	73	76	79	80	..	83	..	100
Goal 3: Promote gender equality and empower women								
Proportion of seats held by women in national parliament (%)	..	..	8	7	7	10	17	30
Ratio of girls to boys in primary and secondary education (%)	73	..	83	85	..	..	90	100
Ratio of young literate females to males (% ages 15-24)	81	84	89	90	..	90	90	100
Share of women employed in the nonagricultural sector (%)	41	46	52	53	..	*53*	..	
Goal 4: Reduce child mortality								
Immunization, measles (% of children ages 12-23 months)	34	62	65	52	65	*65*	..	90
Infant mortality rate (per 1,000 live births)	80	88	95	..	97	*97*	*66*	50
Under 5 mortality rate (per 1,000)	115	120	135	..	140	*140*	*82*	38.3
Goal 5: Improve maternal health								
Births attended by skilled health staff (% of total)	..	..	32	..	..	..		80
Maternal mortality ratio (modeled estimate, per 100,000 live births)	..	..	450	..	..	..		250
Goal 6: Combat HIV/AIDS, malaria, and other diseases								
Incidence of tuberculosis (per 100,000 people)	577	549	523	513	508	*508*		
Prevalence of HIV, total (% of population 15-49)	..	..	..	..	3	*3*	*2*	
Goal 7: Ensure environmental sustainability								
Access to an improved water source (% of population)	..	..	..	34	..	..		
Access to improved sanitation (% of population)	..	..	..	16	..	..		
Nationally protected areas (% of total land area)	..	..	..	..	19	*19*		
Goal 8: Develop a global partnership for development								
Aid per capita (current US$)	4	50	31	37	38	*38*		
Fixed line and mobile phone subscribers (per 1,000 people)	0	2	12	30	38	*38*		
Internet users (per 1,000 people)	..	..	0	2	2	*3*		
Personal computers (per 1,000 people)	..	0	1	2	2	*2*		
Total debt service (% of exports of goods and services)	..	1	2	1	1	..		
Goal 9: De-mining, UXO and assistance								
Annual numbers of civilian casualties recorded		*1,691*					797	0
Percentage of suspected contaminated areas cleared		10					50	100
Other								
Fertility rate, total (births per woman)	6	..	..	4	4	*4*		
GNI per capita, Atlas method (current US$) 2/	..	280	280	290	300	320		
GNI, Atlas method (current US$) (billions) 2/	..	3.1	3.5	3.8	4.1	4		
Gross capital formation (% of GDP) 2/	8	15	17	22	22	23		
Life expectancy at birth, total (years)	50	..	..	54	54	*54*		
Literacy rate, adult total (% of people ages 15 and above)	62	64	68	69	..	74		
Population, total (millions)	9.6	11.2	12.7	13.2	13.4	14		
Trade (% of GDP)	19	80	114	127	133	146		

Sources: World Development Indicators database, UN Human Development Indicators Report (2003)
Cambodia MDG 2005 Update and staff estimates.

1/ Revised 1995 baseline for poverty headcount, and latest 2005. Source: Wordl Bank Poverty Assessment, February 2006.
2/ Do not reflect recent revisions to GDP estimates.

Note: Figures in italics refer to periods other than those specified.

ANNEX I

Cambodia: Fund Relations
As of April 30, 2006

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

II. **General Resources Account**:	**SDR Million**	**Percent Quota**
Quota	87.50	100.00
Fund Holdings of Currency	87.50	100.00

III. **SDR Department**:	**SDR Million**	**Percent Allocation**
Net cumulative allocation	15.42	100.00
Holdings	0.15	0.92

IV. **Outstanding Purchases and Loans**:	**SDR Million**	**Percent Quota**
PRGF arrangements	0	0

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	58.50
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):

	Forthcoming				
	2006	2007	2008	2009	2010
Principal	0	0	0	0	0
Charges/Interest	0.40	0.54	0.54	0.54	0.54
Total	0.54	0.54	0.54	0.54	0.54

VII. **Multilateral Debt Relief Initiative**

As part of the Multilateral Debt Relief Initiative the IMF Executive Board on January 5, 2006 approved relief on 100 percent of debt incurred by Cambodia to the IMF before January 1, 2005. This resulted in all of Cambodia's outstanding debt to the IMF, a total of SDR 56.8 million (about US$82 million) being forgiven. The authorities intend to spend the resources over a number of years, initially on rural irrigation projects. The National Bank of Cambodia (NBC) transferred the full MDRI proceeds to the Ministry of Economy and Finance, effective March 2006.

VIII. **Safeguards Assessment**:

Under the Fund's safeguard assessment policy, the NBC is subject to a full safeguard assessment with respect to the successor PRGF Arrangement. The assessment was completed in March 2004 and specific measures were proposed to address weaknesses in financial reporting, internal audit and internal control systems. An update is expected to be undertaken in the second half of 2006.

IX. **Exchange Rate Arrangement**:

Cambodia follows a managed float with no pre-announced exchange rate path. 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 by the foreign exchange market, 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 April 30, 2006, the official exchange rate was CR 4,096 per U.S. dollar and the market rate CR 4,102 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 the making of payments and transfers for current international transactions.

X. **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 September 13, 2004 (Country Report No. 04/328).

XI. **Technical Assistance**:

There are currently three resident advisors in Cambodia: a Banking advisor; a Treasury advisor; and a multi-sector Statistics advisor. A detailed summary of recent technical assistance activities is attached. Annex III provides a summary of key policy and strategic issues.

XI. **Resident Representative**:

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

Cambodia—Summary of Technical Assistance Provided by the Fund
1999-February 2006

Purpose	Assistance and Timing (person-months)
Fiscal	
• Tax policy and customs administration	September 1999; (2)
• Technical Cooperation Action Plan (TCAP) mission	March-April 2000; (3¾)
• Tax administration and policy	March 2001; (1)
• Public expenditure management	April 2001; (1)
• Long-term customs advisor	April 2001; (24)
• Long-term treasury advisor	August 2001; (14)
• Long-term tax advisor	October 2001; (24)
• Income tax changes regarding new Law on Investment	April 2002; (½)
• Review of draft customs law	May 2002; (¼)
• Long-term budget advisor	August 2002; (6)
• Tariff restructuring	October 2002; (1)
• Regulations on taxation	November/December 2002; (¾)
• Customs administration	May 2003; (½)
• Budget advisor	July-August 2003; (½)
• Revenue mobilization	August/September 2003; (1)
• Tax policy and administration	August-October 2003; (2)
• Customs administration expert	October-November/Dec. 2003 (1½)
• Tax administration	November 2003; (¼)
• Budget advisor	December 2003; (7)
• Tax administration expert	February 2004; (2)
• Tax administration follow-up	February-March 2004; (½)
• Tax and Customs administration IT	February 2004-April 2005 (4 ¾)
• Customs administration	March 2004-May 2005 (4 ¾)
• Budget management	December 2003-June 2004 (6)
• Tax administration expert on audit circulars and training	July-November 2004 (4)
• Treasury advisor	June-November 2004 (6)
• Tax and Customs administration follow-up	Sept. 2004 (3/4); February 2005 (3/4)
• Treasury Advisor	January-June 2006 (18)
• Tax Policy (oil, gas)	June 2005 (1½)
• Tax administration mission	July 2005 (1½)
• Customs administration expert	October 2005, January 2006 (1½)
• Tax Computerization	October 2005 (1)
Monetary	
• General advisor	1999; (1)
• Bank supervision advisor	2000 – 2002; (1)
• Banking system restructuring	April 2001; (1)
• Banking system restructuring and payments system development	August and November 2001; (2)
• Law on negotiable instruments and payment transactions	March and May 2002; (½)
• Banking system restructuring and supervision	July and December 2002; (2)
• Foreign exchange management	September 2002; (¾)

Purpose	Assistance and Timing (person-months)
• Banking system restructuring and accounting	January 2003; (1)
• Banking, accounting and foreign exchange management	April 2003; (2)
• Banking supervision expert	November 2003; (6+12+2)
• Banking, accounting and foreign exchange management	December 2003; (1)
• AML/CFT	December 2003; (¼)
• Accounting	May 2004 (3/4)
• Mission on Central Bank internal audit	May 2004; February 2005; June 204 (3)
• AML/CFT Legislation	July 2004 (1/2)
• Prakas on AML/CFT	October 2004 (1/2)
• Banking supervision, reserve management and TA review	September 2004 (3)
• Central bank restructuring	January 2005 (1)
• Banking supervision	February 2005 (2)
• Seminar on Draft Law on Negotiable Instruments	March 2005 (1/4)
• Central bank operations and banking supervision mission	July 2005 (3)
• Banking advisor	July 2005 (12)
• Payment System Regulation	October, December 2005 (2)
• Bank Supervision	October 2005 (1)
• Central Bank Restructuring	January 2006 (1)
Statistics	
• Government finance statistics	April 2001; (1)
• Long-term multisector statistics advisor	November 2001; (24)
• General data dissemination system	November –December 2001; (1)
• Monetary statistics	March –April 2002; (1)
• Balance of payments compilation expert	April-June; Oct.-Nov. 2002; (6)
• Balance of payments compilation expert	March-May 2003; (3)
• Producer price statistics	July-August 2003; (1)
• Consumer price index	October 2003; (½)
• GFS follow-up	December 2003; (½)
• Multisector statistics advisor	January 2004; (6)
• Balance of payments statistics	March 2004 (½)
• Producer price statistics	June 2004 (½)
• Multisector statistics advisor	November 2004 (12)
• Multisector statistics advisor	November 2005 (12)
• Government finance statistics	April 2005 (½)
• Government finance statistics	February 2006 (½)
Legal	
• Insolvency Law	November 2000; (½)
• Insolvency Law	July 2001; (½)
• Insolvency Law	February and December 2002; (1)
• AML/CFT	December 2003; (¼)
• Anti-Corruption	August 2005 (½)

ANNEX II

Cambodia: Debt Sustainability Analysis[9]

External debt—of which almost 60 percent is owed to the United States and the Russian Federation—constitutes over 90 percent of Cambodia's public debt. At end-2005, Cambodia's total external public debt was about $3.2 billion (50½ percent of GDP), while domestic debt amounted to 3½ percent of GDP, denominated entirely in local currency. Considerable progress has been made in recent months in resolving the issue of outstanding debt obligations to the United States and the Russian Federation.

This joint WB/IMF debt sustainability assessment comes to the conclusion that Cambodia's debt is on a sustainable path, but the current risk of debt distress remains high. If debt rescheduling agreements are reached, the risk of debt distress will moderate, though low revenue collections and extreme external shocks will continue to pose risks to debt sustainability. The analysis is based on the assumption that real GDP growth will be sustained at 6 percent and exports will grow at around 9 percent a year, with economic activity underpinned by garment exports and tourism. Business environment reforms are expected to help improve competitiveness. Although oil production is expected during the projection period, the potential impact is not included in the baseline or alternative scenarios due to uncertainty as to its scale, timing, and fiscal return. Foreign aid is assumed to remain broadly stable in nominal U.S. dollar terms. On the fiscal front, fiscal consolidation is expected to begin with the 2006 budget, underpinned by improvements in the tax and customs administration. The primary balance will improve over the medium term with improved fiscal performance. New borrowing is projected to be highly concessional and external debt owed to United States and the Russian Federation is assumed to be restructured in 2006.

The assessment also incorporates Cambodia's receipt of debt relief from the Fund under the Multilateral Debt Relief Initiative (MDRI). As outlined in the published staff assessment (12/08/05), Cambodia satisfied the three conditions for eligibility, thus qualifying to receive immediate debt relief from the Fund of SDR57 million (US$82 million).[10] The impact of this measure on the NPV of external debt-to-GDP ratio is about 1¼ percentage points, with debt relief providing around 1¼ percent of additional revenue in 2006 that will be spent over the medium term on poverty reducing projects.

A. The Current Situation

Cambodia's two largest creditors are the Russian Federation and the United States. Since Cambodia is not servicing its debt to either creditor and is making efforts to conclude agreements with both creditors under the framework of the Paris Club, the DSA assumes a

[9] This DSA has been prepared jointly with the World Bank staff based on a new framework considered by the Boards of the Fund and the Bank in April 2005.

[10] Three criteria are: (i) good macroeconomic performance, (ii) implementation of a poverty reduction policy, and (iii) adequate public expenditure management systems.

debt restructuring agreement with the United States and Russia in 2006. As a consequence, Cambodia's net present value (NPV) of external debt-to-GDP ratio would drop from 40½ percent at end-2005 to 22½ percent in 2006.

The outstanding differences between the United States and Cambodia, until recently, have involved the total amount of principal. After clarification of outstanding legal issues, the countries have agreed on a total obligation of US$162 million. The next steps required to settle this issue include signing a bilateral agreement based on the 1995 Paris Club agreement (i.e., flow rescheduling on Naples terms assuming a 40-year maturity, 16-year grace period, and an interest rate of 3 percent), and calculating arrears up to now. It is expected that Cambodia would then request a rescheduling of those arrears through the Paris Club. While the exact terms of such rescheduling are not certain, staff assumes that the Naples terms will be applied.

Cambodia and the Russian Federation have discussed rescheduling with a stock operation. They have agreed that (i) after applying the stipulated exchange rate and the 70 percent upfront discount, the total debt would be US$457 million, and (ii) interest rate for the pre-cut-off-date debt would be about 0.8 percent, with concessional repayment schedule. However, the countries have disagreed on the classification of US$40 million as either pre-cut-off-date or post-cut-off-date debt, and the interest rate on the post-cut-off-date debt. The current Fund staff assumption for the macroeconomic framework is (i) the disputed US$40 million is classified as post-cut-off-date debt, and (ii) the interest rate for the post-cut-off-date is set according to the Russian offer at the latest bilateral meeting.

Cambodia ranks as a 'weak performer' in terms of its policies and institutions according to the latest World Bank's Country Policy and Institutional Assessment (CPIA). Indicative debt-burden thresholds for countries in this category are a NPV of external debt-to-exports of 100 percent, to GDP of 30 percent and to revenues of 200 percent, and debt service ratios to exports and to revenues of 15 and 25 percent, respectively.

B. Public Debt Sustainability

Cambodia's public debt burden indicators reflect the country's weak fiscal revenue base. The NPV of public debt-to-revenue ratio, which was 348 percent at end-2005, will remain high at around 182 percent even under the assumption that the bilateral restructuring agreements with the United States and Russia will be concluded in 2006.[11] The ratio will remain below 200 percent in the medium term, with improved revenue performance as assumed in the baseline, declining to 161 percent by 2011. However, the debt-to-revenue threshold is breached for multiple years under all the bounds tests, indicating the risk that low revenues pose to debt sustainability. Under the baseline scenario, the stock of public debt, which amounted to 54 percent of GDP at the end of 2005, is projected to decline to 36½ percent in 2006, or around 25 percent in NPV terms. Given the assumption that the

[11] Due to the MDRI relief being booked as a one-off capital revenue item in the fiscal accounts, the ratios to revenue drop in 2006 and increase in 2007.

primary deficit improves gradually in the medium term and remains at about 1 percent of GDP in the long run, the NPV of public sector debt-to-GDP ratio would drop to 8½ percent by 2026.

Cambodia's debt sustainability hinges on the improvement of weak fiscal performance. A continuation of 2005's fiscal performance would lead to a greater decline in the NPV of public debt-to-GDP ratio than under the baseline (Test A2). However, maintenance of primary deficit at the 2004 level—at 3 percent of GDP—would result in the NPV of public debt-to-GDP ratio remaining above 30 percent and the NPV of debt-to-revenue ratio remaining above 200 percent in the scenario, both above their respective indicative thresholds. A one-time exchange rate depreciation (Test B4) would raise the NPV of debt-to-GDP ratio by 9 percentage points and the NPV of debt-to-revenue ratio by 70 percentage points in 2007 relative to the baseline.[12] The difference between this stress test and the baseline is projected to decrease only slowly over time. However, the debt-service-to-revenue ratio remains relatively low in most scenarios since it is assumed that concessionality of external debt is high in the medium term.

C. External Debt Sustainability

Cambodia's external debt burden indicators are likely to remain below their indicative thresholds following conclusion of rescheduling agreements. The baseline scenario, however, shows that the NPV of debt-to-revenue ratio will remain close to the threshold in the medium term.[13] The ratio to GDP of the NPV of external debt will remain below the 30 percent indicative threshold in the medium-term, although breaching the threshold under some stress tests. The NPV of debt-to-export ratio, however, is 32½ percent in 2006, well below its indicative debt burden threshold of 100 percent. The debt service-to-exports ratio remains between 1 and 1½ percent in the long term reflecting the fact that new borrowing is assumed to be highly concessional.

The ratio to GDP of the NPV of external debt would breach its indicative threshold in the event of an export shock, indicating that Cambodia's debt sustainability remains vulnerable to exogenous shocks.[14] Lower export growth would result in a NPV of debt-to-GDP ratio of more than the indicative threshold of 30 percent in 2008 and 2009, remaining above the threshold in the medium term. The NPV of debt-to-export ratio would also substantially deteriorate by 19 percentage points (relative to the baseline scenario) to 53 percent in 2008. However, the ratio remains below its indicative debt burden threshold. Debt service ratios would remain below their indicative thresholds throughout the entire projection period even under the most extreme stress test, since the new borrowing is

---

[12] This test grossly overestimates the negative impact since Cambodia is highly dollarized and nearly all the transactions are executed in U.S. dollars.

[13] The temporary drop in the ratio in 2006 is due to the treatment of the MDRI relief as capital revenue.

[14] One standard deviation shock is very large (12 percent) since Cambodia's exports have expanded very rapidly for past several years. Cambodia has never experienced such a large negative shock since it started exporting garment products in mid-1990s.

assumed to be highly concessional. If no agreement is reached with the United States and the Russian Federation, the external debt-to-GDP ratio will remain at a high level. Consequently, in the absence of debt service to their largest creditors, Cambodia's debt service payments will remain low (Figure A-3).

D. Impact of Less-Concessional Loan

The authorities are planning to borrow on less concessional terms. The authorities are considering financing critical infrastructure investment projects through the Asian Development Bank's Ordinary Capital Resource (OCR) lending, which may have only limited concessionality.[15] Additional less concessional resources may be made available from China, which could add to the debt burden. While it is understandable that better infrastructure is needed to foster higher living standards and a favorable business environment, attention should be paid to its implication for future expenditure, given the country's low revenue base and weak institutions. Careful assessment is needed to plan for such large infrastructure investments, and transactions should be monitored closely and transparently. If these loans are made available to the private sector, with political risk guarantee being provided by the Government, the contingent liabilities implications need to be considered. The current staff simulation shows that if such less-concessional borrowing were limited to US$20 million per year, the revenue impact would be about ½ to ¾ percent in the medium-term (Figure A-3).

E. Conclusion

Staffs come to the conclusion that Cambodia's debt is sustainable, and that the current risk of debt distress is high. Once rescheduling agreements are concluded, the risk will moderate sharply thereafter if baseline assumptions—improved revenue performance and sustained growth—hold. The NPV of public sector debt-to-GDP ratio falls below the indicative threshold in the medium-term after rescheduling of United States and Russian debts, and the NPV of debt-to-revenue ratio remains near its indicative threshold of 200 percent in the medium-term under the baseline, and is highly sensitive to fluctuations in macroeconomic and fiscal parameters. While the NPV of external debt-to-GDP ratio is slightly below its indicative debt burden threshold in the medium-term, stress tests indicate that an extreme export shock could substantially increase Cambodia's probability of debt distress in the medium term. Continuation of prudent economic policies—including strengthening its revenue base, which currently stands at less than 11 percent of GDP, and thus improving its primary balance—and export diversification should ameliorate these concerns and allow debt dynamics to be sustainable. Further, the positive impact of oil production on exports and revenues in the longer term would obviously reduce the risks Cambodia faces. Close attention, however, needs to be paid to Cambodia's debt management strategy, especially regarding less concessional loans, as it may impair sustainability, especially in the presence of a low revenue base and weak institutions.

---

[15] The interest rate of OCR is in line with market rate. The lending period is from 15-20 years and the grace period is 2-7 years.

Table A1. Cambodia: Public Sector Debt Sustainability Framework, Baseline Scenario, 2003-2026
(In percent of GDP, unless otherwise indicated)

	Actual					Estimate	Projections								
	2003	2004	2005	Historical Average 5/	Standard Deviation 5/	2006	2007	2008	2009	2010	2011	2006-11 Average	2016	2026	2012-26 Average
Public sector debt 1/	64.3	61.1	54.0			36.5	36.3	35.7	34.9	33.8	32.9		26.5	13.6	
o/w foreign-currency denominated	59.8	56.6	50.6			33.9	34.3	34.2	33.8	33.1	32.3		25.9	12.9	
Change in public sector debt	2.2	-3.3	-7.1			-17.5	-0.2	-0.6	-0.8	-1.1	-0.9		-1.4	-1.7	
Identified debt-creating flows	0.2	-4.3	-7.2			-18.7	-0.7	-0.7	-1.0	-1.4	-1.5		-0.9	-0.1	
Primary deficit	3.5	2.8	1.0	2.3	1.0	0.8	2.2	1.8	1.4	1.0	0.7	1.3	1.0	1.0	1.0
Revenue and grants	12.0	12.2	12.6			13.8	12.9	13.2	13.6	13.8	14.1		13.9	13.9	
of which : grants	2.3	1.7	2.2			1.7	1.6	1.4	1.3	1.1	1.0		0.7	0.2	
Primary (noninterest) expenditure	15.5	14.9	13.7			14.6	15.1	15.1	15.0	14.7	14.9		14.9	14.9	
Automatic debt dynamics	-4.2	-7.9	-8.9			-3.5	-2.9	-2.5	-2.4	-2.3	-2.2		-1.8	-1.0	
Contribution from interest rate/growth differential	-5.7	-6.9	-8.4			-3.2	-2.5	-2.3	-2.2	-2.1	-2.0		-1.6	-0.9	
of which : contribution from average real interest rate	-0.8	-1.1	-1.2			-0.7	-0.2	-0.2	-0.2	-0.2	-0.2		-0.1	-0.1	
of which : contribution from real GDP growth	-4.9	-5.8	-7.2			-2.6	-2.2	-2.1	-2.0	-1.9	-1.9		-1.5	-0.8	
Contribution from real exchange rate depreciation	1.5	-1.0	-0.5			-0.3	-0.4	-0.2	-0.2	-0.2	-0.2		...	...	
Other identified debt-creating flows	0.9	0.8	0.6			-16.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Privatization receipts (negative)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Debt relief (HIPC and other)	0.9	0.8	0.6			-16.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Residual, including asset changes	2.0	1.1	0.2			1.2	0.5	0.1	0.1	0.3	0.6		-0.5	-1.6	
NPV of public sector debt	52.7	48.6	44.0			25.1	25.4	25.2	24.4	23.5	22.8		17.5	8.4	
o/w foreign-currency denominated	48.2	44.1	40.5			22.5	23.4	23.7	23.3	22.8	22.2		16.8	7.7	
o/w external	48.2	44.1	40.5			22.5	23.4	23.7	23.3	22.8	22.2		16.8	7.7	
NPV of contingent liabilities (not included in public sector debt)	...	...	...			...	...	...	...	...	...		...	...	
Gross financing need 2/	4.1	3.3	1.5			1.5	2.9	2.6	2.2	1.8	1.7		2.1	1.5	
NPV of public sector debt-to-revenue ratio (in percent) 3/	439.9	400.0	347.8			182.2	197.4	190.4	179.5	170.4	161.3		125.9	60.5	
o/w external	401.8	363.2	320.8			163.3	182.0	179.3	171.8	165.6	157.0		121.1	55.7	
Debt service-to-revenue ratio (in percent) 3/ 4/	4.6	4.4	3.7			4.8	5.7	5.9	6.1	6.4	6.6		7.9	4.3	
Primary deficit that stabilizes the debt-to-GDP ratio 6/	1.3	6.1	8.1			2.4	2.4	2.4	2.2	2.1	1.6		2.3	2.6	
Key macroeconomic and fiscal assumptions															
Real GDP growth (in percent)	8.6	10.0	13.4	9.5	2.6	5.0	6.5	6.1	5.8	5.8	5.8	5.8	5.8	5.8	5.8
Average nominal interest rate on forex debt (in percent)	0.4	0.4	0.4	0.3	0.1	0.9	1.6	1.5	1.5	1.4	1.5	1.4	1.5	1.2	1.4
Average real interest rate on domestic currency debt (in percent)	...	...	-5.1	...	...	-5.2	-4.4	-3.6	-3.9	-4.2	-4.7	-4.3	2.9	2.9	2.9
Real exchange rate depreciation (in percent, + indicates depreciation)	2.8	-1.8	-1.1	1.3	3.8	-0.6	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	0.2	5.3	5.7	2.0	3.0	5.2	4.0	3.0	3.0	3.0	3.0	3.5	3.0	3.0	3.0
Growth of real primary spending (deflated by GDP deflator, in percent)	1.3	5.8	3.8	10.2	7.0	12.0	9.9	6.0	5.2	4.0	6.9	7.3	5.8	5.8	5.8
Grant element of new external borrowing (in percent)	...	...	48.4			47.6	47.5	47.6	48.9	49.0	49.0	48.3	49.0	49.6	...

Sources: Country authorities; and Fund staff estimates and projections.
1/ General government gross debt is used.
2/ Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period.
3/ Revenues including grants.
4/ Debt service is defined as the sum of interest and amortization of medium and long-term debt.
5/ Historical averages and standard deviations are generally derived over the past 7 years, since the consistent balance of payments data are available only since 1998.
6/ Debt rescheduling with the Russian Federation and the United States is assumed in 2006.

Table A2. Cambodia: Sensitivity Analysis for Key Indicators of Public Debt 2006-2026

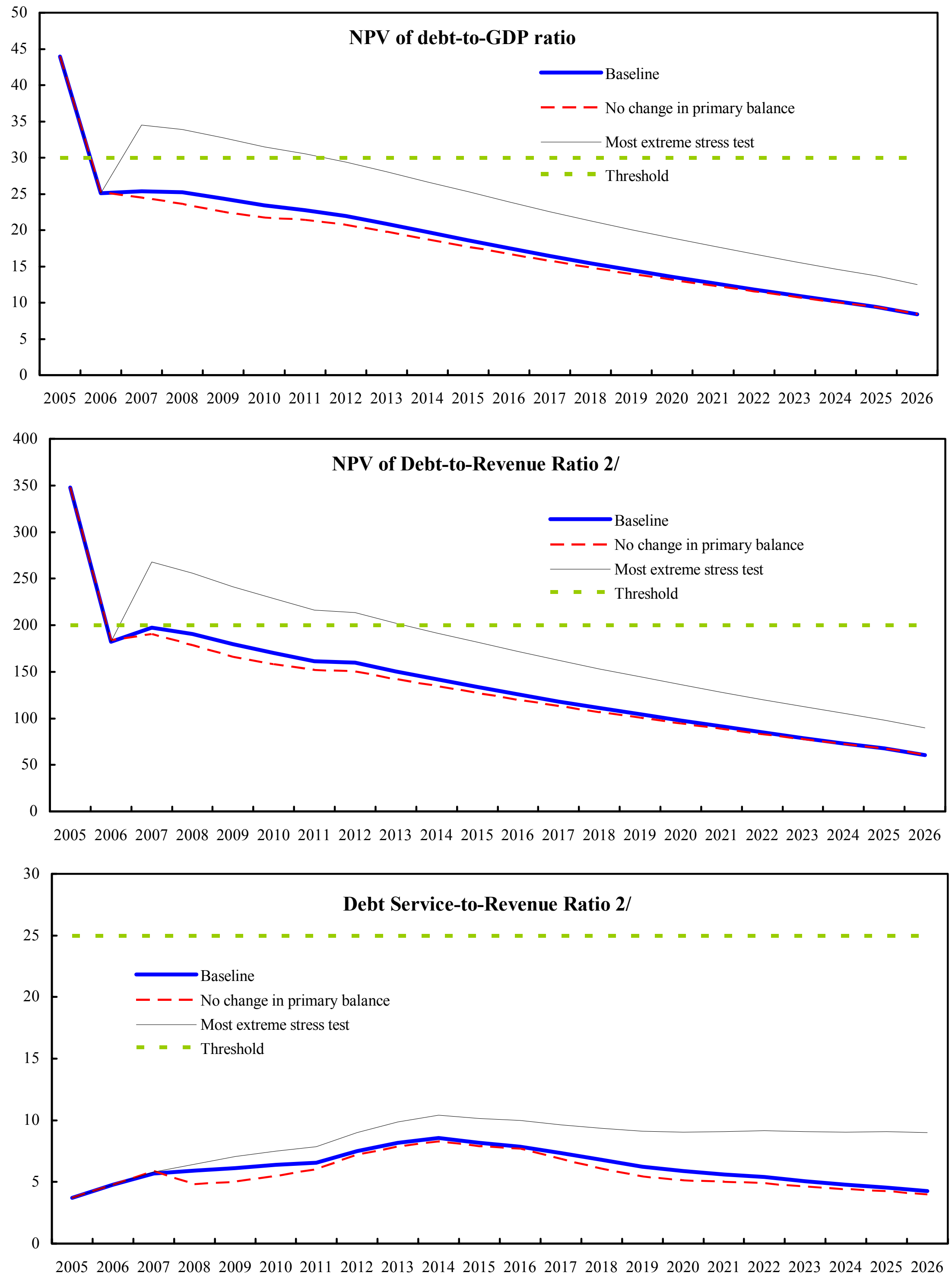
	Estimate	Projections						
	2006	2007	2008	2009	2010	2011	2016	2026
NPV of Debt-to-GDP Ratio								
Baseline	25	25	25	24	23	23	18	8
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	25	25	25	25	24	25	24	23
A2. Primary balance is unchanged from 2005	25	25	24	23	22	21	17	8
A3. Permanently lower GDP growth 1/	25	26	26	25	25	24	22	21
B. Bound tests								
B1. Real GDP growth is at baseline minus one standard deviations in 2007-2008	25	26	27	27	26	26	23	17
B2. Primary balance is at baseline minus one standard deviations in 2007-2008	25	26	27	26	25	24	19	9
B3. Combination of B1-B2 using one half standard deviation shocks	25	26	27	26	25	24	18	9
B4. One-time 30 percent real depreciation in 2007	25	34	33	32	30	29	21	11
B5. 10 percent of GDP increase in other debt-creating flows in 2007	25	34	34	33	31	31	24	12
NPV of Debt-to-Revenue Ratio 2/								
Baseline	182	197	190	179	170	161	126	60
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	182	196	190	183	180	177	172	167
A2. Primary balance is unchanged from 2005	184	190	179	166	158	152	120	61
A3. Permanently lower GDP growth 1/	182	199	193	184	178	171	155	148
B. Bound tests								
B1. Real GDP growth is at baseline minus one standard deviations in 2007-2008	182	203	204	196	191	184	164	121
B2. Primary balance is at baseline minus one standard deviations in 2007-2008	182	204	203	191	182	172	135	66
B3. Combination of B1-B2 using one half standard deviation shocks	182	203	200	188	179	169	131	61
B4. One-time 30 percent real depreciation in 2007	182	267	252	234	219	205	154	78
B5. 10 percent of GDP increase in other debt-creating flows in 2007	182	268	256	241	229	216	172	90
Debt Service-to-Revenue Ratio 2/								
Baseline	4.8	5.7	5.9	6.1	6.4	6.6	7.9	4.3
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	4.8	5.5	6.0	6.6	7.3	8.0	10.3	12.2
A2. Primary balance is unchanged from 2005	4.8	5.9	4.8	5.0	5.5	6.0	7.7	4.0
A3. Permanently lower GDP growth 1/	4.8	5.7	6.0	6.4	6.8	7.1	9.6	10.2
B. Bound tests								
B1. Real GDP growth is at baseline minus one standard deviations in 2007-2008	4.8	5.8	6.4	7.0	7.5	7.8	10.0	9.0
B2. Primary balance is at baseline minus one standard deviations in 2007-2008	4.8	5.7	6.8	7.4	7.0	7.1	8.3	5.0
B3. Combination of B1-B2 using one half standard deviation shocks	4.8	5.7	6.5	6.8	6.7	6.9	8.1	4.4
B4. One-time 30 percent real depreciation in 2007	4.8	6.5	7.6	7.9	8.1	8.3	9.5	5.9
B5. 10 percent of GDP increase in other debt-creating flows in 2007	4.8	5.7	15.9	9.7	9.2	9.1	10.0	8.0

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

1/ Assumes that real GDP growth is at baseline minus one standard deviation divided by the square root of 20 (i.e., the length of the projection period).

2/ Revenues are defined inclusive of grants.

Figure A1. Cambodia: Indicators of Public Debt Under Alternative Scenarios, 2005-2026 1/



Source: Staff projections and simulations.
1/ Most extreme stress test is test that yields highest ratio in 2016.
2/ Revenue including grants.

Table A3. Cambodia: External Debt Sustainability Framework, Baseline Scenario, 2003-2026 1/
(In percent of GDP, unless otherwise indicated)

	Actual			Historical	Standard	Estimate	Projections								
	2003	2004	2005	Average 6/	Deviation 6/	2006	2007	2008	2009	2010	2011	2005-10 Average	2016	2026	2012-26 Average
External debt (nominal) 1/	59.8	56.6	50.6			33.9	34.3	34.2	33.8	33.1	32.3		25.9	12.9	
o/w public and publicly guaranteed (PPG)	59.8	56.6	50.6			33.9	34.3	34.2	33.8	33.1	32.3		25.9	12.9	
Change in external debt	1.6	-3.2	-6.0			-16.7	0.4	-0.1	-0.4	-0.7	-0.8		-1.4	-1.7	
Identified net debt-creating flows	-1.8	-7.6	-11.0			-2.6	-1.4	-2.4	-2.5	-3.8	-3.8		-5.3	-7.6	
Non-interest current account deficit	3.3	2.0	3.9	2.7	1.3	5.2	5.9	4.8	4.6	3.2	3.0		1.3	-1.3	0.5
Deficit in balance of goods and services	10.2	7.4	8.7			9.5	9.8	8.4	7.7	5.9	5.3		1.5	-3.1	
Exports	57.5	64.5	64.1			68.6	68.8	68.8	68.6	68.3	68.1		69.1	75.5	
Imports	67.6	71.9	72.8			78.1	78.7	77.2	76.3	74.2	73.4		70.7	72.5	
Net current transfers (negative = inflow)	-10.5	-9.4	-8.5	-10.5	1.3	-8.4	-8.2	-7.9	-7.5	-7.1	-6.6		-4.4	-1.8	-3.6
Other current account flows (negative = net inflow)	3.6	3.9	3.8			4.2	4.3	4.4	4.4	4.4	4.3		4.1	3.6	
Net FDI (negative = inflow)	-1.6	-2.3	-6.1	-3.9	1.8	-5.9	-5.8	-5.8	-5.7	-5.6	-5.5		-5.5	-5.7	-5.6
Endogenous debt dynamics 2/	-3.5	-7.3	-8.9			-2.0	-1.5	-1.5	-1.4	-1.4	-1.3		-1.1	-0.6	
Contribution from nominal interest rate	0.4	0.4	0.3			0.4	0.5	0.5	0.5	0.4	0.5		0.4	0.2	
Contribution from real GDP growth	-4.7	-5.2	-6.3			-2.4	-2.0	-1.9	-1.8	-1.8	-1.8		-1.5	-0.8	
Contribution from price and exchange rate changes	0.8	-2.5	-2.9			…	…	…	…	…	…		…	…	
Residual (3-4) 3/	3.3	4.5	5.0			-14.1	1.8	2.3	2.1	3.1	3.0		3.9	5.9	
o/w exceptional financing 8/	0.9	0.8	0.6			-16.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
NPV of external debt 4/	48.2	44.1	40.5			22.5	23.4	23.7	23.3	22.8	22.2		16.8	7.7	
In percent of exports	83.8	68.4	63.3			32.7	34.0	34.5	34.0	33.4	32.5		24.4	10.2	
NPV of PPG external debt	48.2	44.1	40.5			22.5	23.4	23.7	23.3	22.8	22.2		16.8	7.7	
In percent of exports	83.8	68.4	63.3			32.7	34.0	34.5	34.0	33.4	32.5		24.4	10.2	
Debt service-to-exports ratio (in percent) 7/	0.9	1.0	0.9			0.8	1.1	1.2	1.2	1.3	1.4		1.5	0.7	
PPG debt service-to-exports ratio (in percent) 7/	0.9	1.0	0.9			0.8	1.1	1.2	1.2	1.3	1.4		1.5	0.7	
Total gross financing need (billions of U.S. dollars)	0.1	0.0	-0.1			0.0	0.1	0.0	0.0	-0.1	-0.2		-0.5	-2.3	
Non-interest current account deficit that stabilizes debt ratio	1.8	5.1	9.9			21.9	5.5	4.9	5.0	3.9	3.8		2.7	0.4	
Key macroeconomic assumptions															
Real GDP growth (in percent)	8.6	10.0	13.4	9.5	2.6	5.0	6.5	6.1	5.8	5.8	5.8	5.8	5.8	5.8	5.8
GDP deflator in US dollar terms (change in percent)	-1.3	4.3	5.4	1.0	3.2	1.8	2.5	2.5	2.6	2.6	2.7	2.4	2.7	2.7	2.7
Effective interest rate (percent) 5/	0.7	0.7	0.7	0.7	0.0	0.8	1.6	1.5	1.5	1.4	1.5	1.4	1.5	1.2	1.4
Growth of exports of G&S (US dollar terms, in percent)	11.0	28.7	18.7	22.9	12.1	14.5	9.4	8.8	8.2	8.0	8.4	9.6	9.2	9.9	9.4
Growth of imports of G&S (US dollar terms, in percent)	13.4	22.0	20.9	18.9	9.1	14.7	9.9	6.8	7.3	5.5	7.5	8.6	8.3	9.4	8.6
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	47	47	47	48	49	49	48	49	-1	46
Memorandum item:															
Nominal GDP (billions of US dollars)	4.6	5.3	6.3			6.7	7.3	8.0	8.7	9.4	10.2		15.5	35.5	

Source: Staff simulations.

1/ Includes both public and private sector external debt.
2/ Derived as [r - g - ρ(1+g)]/(1+g+ρ+gρ) times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, and ρ = growth rate of GDP deflator in U.S. dollar terms.
3/ Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes.
4/ Assumes that NPV of private sector debt is equivalent to its face value.
5/ Current-year interest payments divided by previous period debt stock.
6/ Historical averages and standard deviations are generally derived over the past 7 years, since the consistent balance of payments data are only available since 1998.
7/ Debt services are cash basis until 2005.
8/ Includes effect of MDRI debt relief. Debt rescheduling with the Russian Federation and the United States is also assumed in 2006.

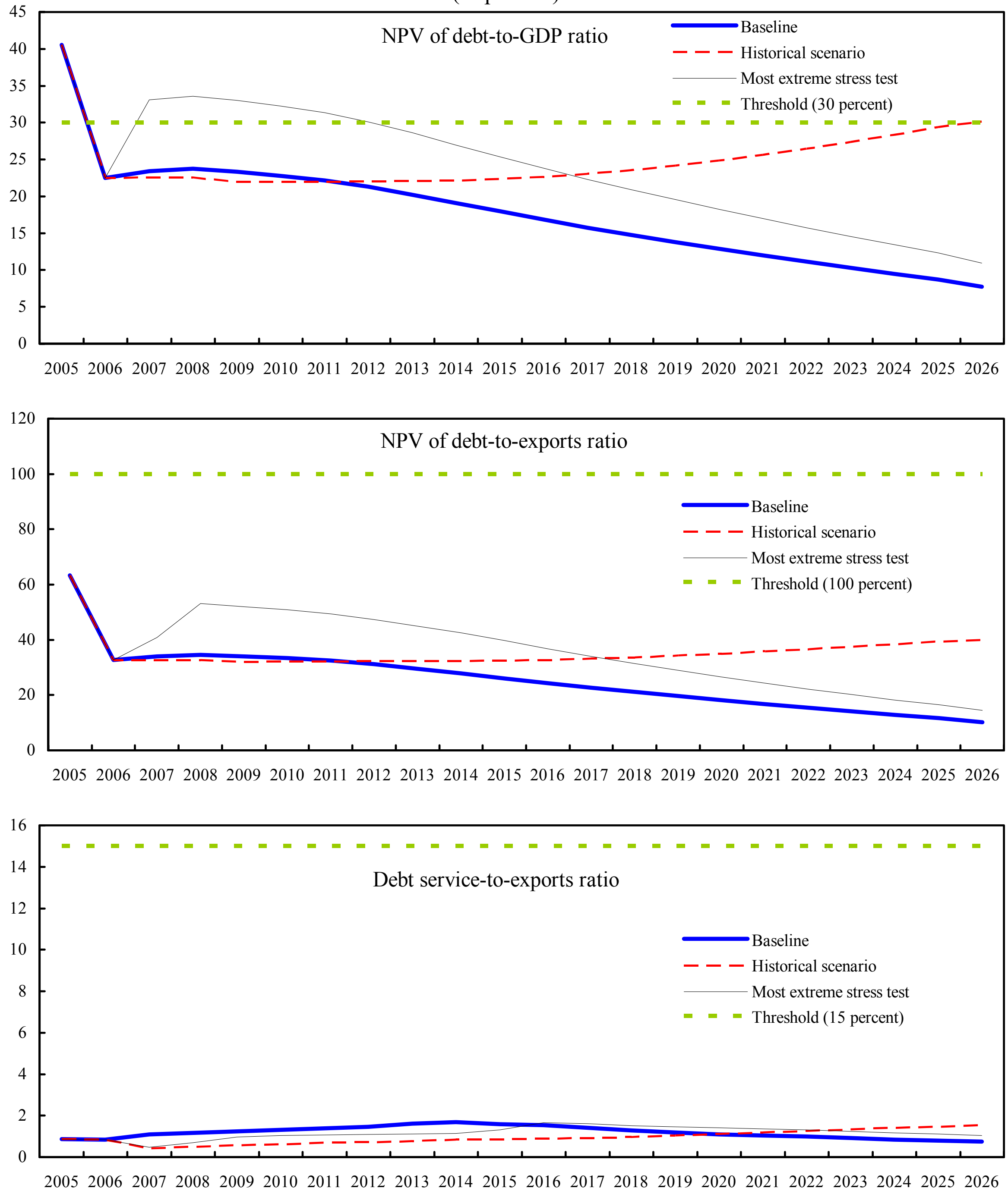
Table A4. Cambodia: Sensitivity Analyses for Key Indicators of Public and Publicly Guaranteed External Debt, 2006-26
(In percent)

	Estimate	Projections						
	2006	2007	2008	2009	2010	2011	2016	2026
NPV of debt-to-GDP ratio								
Baseline	22	23	24	23	23	22	17	8
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2007-26 1/	22	23	23	22	22	22	23	30
A2. New public sector loans on less favorable terms in 2007-26 2/	22	24	25	25	25	25	21	12
B. Bound Tests								
B1. Real GDP growth at baseline minus one standard deviation in 2007-08	22	24	25	24	24	23	18	8
B2. Export value growth at baseline minus one standard deviation in 2007-08 3/	22	26	32	31	30	29	22	9
B3. US dollar GDP deflator at baseline minus one standard deviation in 2007-08	22	24	25	25	24	24	18	8
B4. Net non-debt creating flows at baseline minus one standard deviation in 2007-08 4/	22	25	27	26	26	25	19	8
B5. Combination of B1-B4 using one-half standard deviation shocks	22	26	31	30	29	28	21	9
B6. One-time 30 percent nominal depreciation relative to the baseline in 2007 5/	22	33	34	33	32	31	24	11
NPV of debt-to-exports ratio								
Baseline	33	34	34	34	33	33	24	10
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2007-26 1/	33	33	33	32	32	32	33	40
A2. New public sector loans on less favorable terms in 2007-26 2/	33	35	37	37	37	37	30	16
B. Bound Tests								
B1. Real GDP growth at baseline minus one standard deviation in 2007-08	33	34	34	34	33	33	24	10
B2. Export value growth at baseline minus one standard deviation in 2007-08 3/	33	41	53	52	51	49	37	14
B3. US dollar GDP deflator at baseline minus one standard deviation in 2007-08	33	34	34	34	33	33	24	10
B4. Net non-debt creating flows at baseline minus one standard deviation in 2007-08 4/	33	36	39	39	38	37	27	11
B5. Combination of B1-B4 using one-half standard deviation shocks	33	38	45	44	43	42	31	13
B6. One-time 30 percent nominal depreciation relative to the baseline in 2007 5/	33	34	34	34	33	33	24	10
Debt service ratio								
Baseline	0.8	1.1	1.2	1.2	1.3	1.4	1.5	0.7
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2007-26 1/	0.8	0.4	0.5	0.6	0.6	0.7	0.9	1.5
A2. New public sector loans on less favorable terms in 2007-26 2/	0.8	0.4	0.6	0.7	0.9	0.9	1.1	1.0
B. Bound Tests								
B1. Real GDP growth at baseline minus one standard deviation in 2007-08	0.8	0.4	0.5	0.6	0.7	0.7	0.8	0.7
B2. Export value growth at baseline minus one standard deviation in 2007-08 3/	0.8	0.5	0.7	1.0	1.0	1.1	1.7	1.0
B3. US dollar GDP deflator at baseline minus one standard deviation in 2007-08	0.8	0.4	0.5	0.6	0.7	0.7	0.8	0.7
B4. Net non-debt creating flows at baseline minus one standard deviation in 2007-08 4/	0.8	0.4	0.6	0.7	0.8	0.8	1.1	0.8
B5. Combination of B1-B4 using one-half standard deviation shocks	0.8	0.4	0.6	0.8	0.9	0.9	1.3	0.9
B6. One-time 30 percent nominal depreciation relative to the baseline in 2007 5/	0.8	0.4	0.5	0.6	0.7	0.7	0.8	0.7
Memorandum item:								
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	43	43	43	43	43	43	43	43

Source: Staff projections and simulations.

1/ Variables include real GDP growth, growth of GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.
2/ Assumes that the interest rate on new borrowing is by 2 percentage points higher than in the baseline., while grace and maturity periods are the same as in the baseline.
3/ Exports values are assumed to remain permanently at the lower level, but the current account as a share of GDP is assumed to return to its baseline level after the shock (implicitly assuming an offsetting adjustment in import levels).
4/ Includes official and private transfers and FDI.
5/ Depreciation is defined as percentage decline in dollar/local currency rate, such that it never exceeds 100 percent.
6/ Applies to all stress scenarios except for A2 (less favorable financing) in which the terms on all new financing are as specified in footnote 2.

Figure A2. Cambodia: Indicators of Public and Publicly Guaranteed External Debt Under Alternative Scenarios, 2005-2026
(In percent)



Source: Staff projections and simulations.
1/ Debt rescheduling with the Russian Federation and the United States is assumed in 2006.
2/ Most extreme stress test is test that yields highest ratio in 2015.

Figure A-3 : External Debt Indicators

Figure A3-1: NPV of External Debt to GDP (in percent)

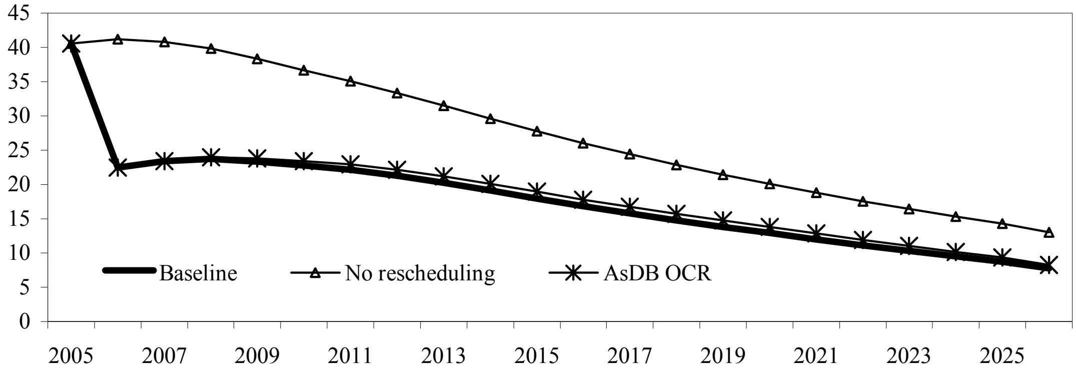


Figure A3-2: Debt Service to Exports (in percent)

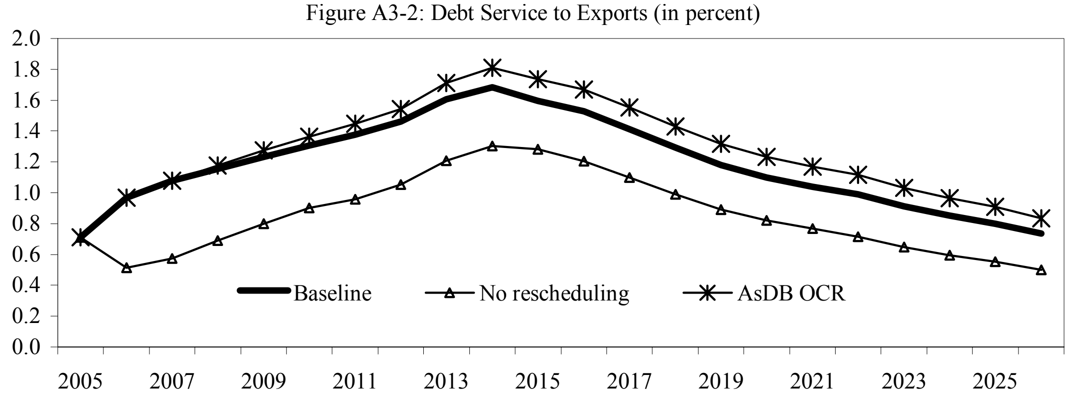
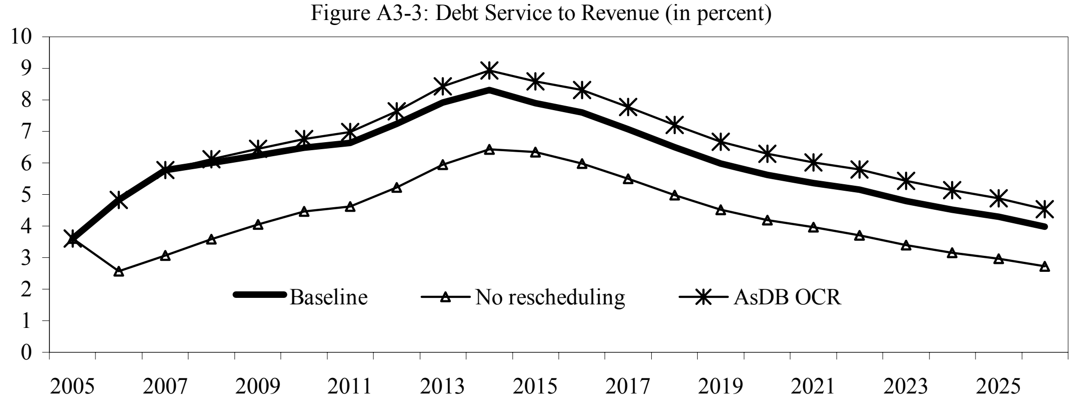


Figure A3-3: Debt Service to Revenue (in percent)



1/ Baseline scenario assumes that debt rescheduling with the U.S. and the Russian Federation will be implemented in 2006.

2/ No rescheduling scenario assumes that debt rescheduling with the U.S. and the Russian Federation will not be implemented.

3 AsDB OCR scenario assumes that the Asian Development Bank will provide non-concessional loan (Ordinary Capital Resources lending) US$20 million per year from 2008.

4/ Currently no debt service is paid to the U.S. and the Russian Federation. If the rescheduling agreement with the U.S. and the Russian Federation is not reached, Cambodia will pay less debt service under "No rescheduling" scenario comparing with baseline scenario and keep high debt outstanding level.

ANNEX III

IMF Technical Assistance and Donor Coordination

Over the previous decade, Cambodia has received considerable IMF technical assistance (TA). The most significant period was during the Technical Cooperation Assistance Program (TCAP) from 2001–03, a joint initiative of the authorities, IMF and other donors, but it has remained high.

Cambodia is one of ten countries participating in the IMF's pilot Country Technical Assistance Strategy Note exercise. The Cambodia strategy note, which was discussed with the authorities in March, envisages that Fund technical assistance to Cambodia will be gradually scaled back from the high intensity of recent years and will have narrower focus on key macroeconomic constraints. Modes of delivery would emphasize the need to build local capacity and favor subject-specific missions and visits over resident advice. The substantial capacity gaps that still exist, and the importance of cementing the gains from previous Fund investment, do mean, however, that Cambodia will continue to be a major recipient of Fund TA. There are currently three resident advisors in Cambodia: a Banking advisor; a Treasury advisor; and a multi-sector Statistics advisor.

The objective of TA in banking sector reform has been to create a robust and efficient banking system—through bank relicensing, strengthening regulations, and improving bank supervision. The impact of TA in the banking system has been mostly satisfactory as capacity of the authorities increased, banking sector soundness improved, banking supervision strengthened, and the new Chart of Accounts was developed. However, further capacity building is needed in the areas of banking supervision, internal audit and control, and to engender a payments system based less on cash.

Fiscal TA focused on strengthening revenue administration and budget management. Significant progress has been made in strengthening the tax administration as reflected in the implementation of a large taxpayer unit (LTU), improved audits and taxpayer services, computer system enhancement, identification of missing or improperly classified taxpayers, and recently the commencement of a functional restructuring. TA to the customs department has assisted with the drafting of the new customs law and implementing regulations, WTO accession, anti-smuggling operations, and IT development. Since 2001, assistance in budget preparation and execution has focused on treasury reforms, strengthening cash management, and addressing payment arrears. TA in this area yielded only limited tangible results during the TCAP period, although the diagnosis of the PEM system played an important role in the development of the Public Financial Management Reform Program (PFMRP) launched at the end of 2004. More headway has been made recently under the PFMRP, but significant challenges remain—see Chapter IV of the Selected Issues Paper.

Legal TA aimed to improve the financial sector legal framework, such as in the area of insolvency. More recently, TA was provided for the drafting of the anti-corruption law and in the area of AML/CFT, including the development of specialized institutional capacity in financial investigations and supervision. Cooperation by the authorities has been mixed.

Statistical TA has been very effective in improving national accounts, price and foreign trade data, and balance of payments, government finance, and money and banking statistics. Significant progress has been made with capacity building as reflected in the creation of a new consumer price index and improvement in the availability, quality, and compilation methodologies of data. Considerable progress has also been made in producing monthly and quarterly GFS reports.

A strong focus on donor coordination has been an important element of recent TA delivery, for instance in the government's Sector Wide Approaches (SWAps). Donor coordination was an important characteristic of the TCAP as well, but was less effective than envisaged particularly in the area of PEM reform. Unlike the TCAP, the SWAPs seek to emphasize discussions and agreements at the diagnosis and design stages. TA efforts by donors—including the IMF, World Bank, AsDB, UNDP, AusAID, and JICA—especially in the areas of public financial management and legal and judicial reform—are coordinated through various technical working groups, some of which include the participation of the private sector. Recently, donors have started to coordinate closely TA activities related to oil and gas exploration, an area not covered explicitly under the PFMRP.

ANNEX IV

Cambodia: Statistical Issues

1. Despite significant shortcomings in some areas, core economic and financial data provided to the Fund are generally adequate for surveillance. In March 2002, metadata were posted on the Dissemination Standards Bulletin Board, and Cambodia began participation in the Fund's General Data Dissemination System.

2. Extensive technical assistance from the IMF, UNDP, AsDB, and World Bank has contributed to substantial improvements in Cambodia's macroeconomic statistics. A long-term IMF advisor has worked in the National Institute of Statistics (NIS) since October 2001 (with a one-year interruption) to assist the authorities in upgrading economic and financial statistics. A new Statistics Law was passed by the National Assembly in March 2005. Technical assistance from the UNDP will facilitate the implementation of the Statistics Law provisions in relation to establishing governance, coordination, and dissemination mechanisms, as well as general statistical training.

National accounts and prices statistics

3. Official GDP estimates are produced annually with support from the AsDB's peripatetic expert and a long-term IMF advisor. Revised national accounts series for 2001–04 and preliminary estimates for 2005 have been completed and will soon be released. These estimates show an upward revision of GDP growth rates for 2001–04 due to the incorporation of the results of the 2004 household expenditures survey.[16] Good progress is also being made in preparing quarterly national accounts estimates for 2000 onwards. Nevertheless, the quality of GDP estimates remains hampered by the lack of comprehensive and reliable sectoral information.

4. The NIS provides a monthly CPI with a five-week lag; this series was recently updated with new expenditure weights and rebased to July–December, 2000 = 100. Since July 2000, the NIS has compiled a quarterly urban CPI for five major provincial cities and Phnom Penh. A quarterly producer price index was developed, with support from STA and financing from the AsDB. The experimental producer price index was released in April 2005 and manual entitled "Cambodian Prices Statistics: Concepts, Sources and Methods" was recently published. However, compilation of the PPI has been discontinued owing to resource constraints.

Government finance statistics

5. The Ministry of Economy and Finance provides monthly fiscal data (broadly based on *GFS* standards) with a four-week lag. There remain, however, certain weaknesses with regard to the reliability of source data, coverage, and the economic and functional classifications of expenditure. Data on donor-financed projects are available with a considerable lag. Some of these issues are currently being addressed; with the support of a

---

[16] GDP growth rates for 2001–04 have been revised to 7.7, 6.2, 8.6 and 10 percent, respectively.

Treasury advisor (FAD) and a Statistical Advisor (STA), the authorities are undertaking a reform of the government accounting system and budgetary nomenclature (based on the classification of the *Government Finance Statistics Manual 2001)*. In addition, several STA missions to improve GFS compilation procedures and assist with the implementation of the new methodology have taken place in recent years, the latest in February 2006..

6. In 2005, the authorities resumed providing monthly fiscal data for publication in *IFS* after an interruption of several months and for the first time reported data for publication in the *Government Finance Statistics Yearbook.*

Monetary and financial statistics

7. The National Bank of Cambodia (NBC) provides monthly data on the monetary authorities and deposit money banks with a four-week lag. In addition to the accounts of the monetary authorities and deposit money banks, the NBC also compiles the sectoral balance sheet and survey for central bank and other depository corporations in accordance with the methodology recommended in the IMF's *Monetary and Financial Statistics Manual.* Since August 2005, the NBC has reported monetary and financial statistics to STA using the Standardized Report Forms (SRFs).

External sector statistics

8. 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, underreporting of re-exports, and weaknesses in 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 in the 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.

9. Gross external debt data are provided by the Ministry of Economy and Finance, but public and publicly guaranteed debt by maturity, external debt service schedule and timely information on disbursements by bilateral donors are not available. In January 2003, the authorities implemented an International Transactions Reporting System (ITRS) to collect data on international transactions made through the banking system to improve balance of payments estimates. An STA balance of payments statistics mission in March–May 2004 reviewed source data used for compiling the balance of payments and recommended improvements; a multisector statistics advisor is currently residing in Cambodia to assist in improving external sector statistics.

Cambodia: Table of Common Indicators Required for Surveillance
(As of June, 2006)

	Date of latest Observation	Date Received	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of Publication[6]
Exchange Rates	Apr. 2006	May 2006	M	M	M
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	Mar. 2006	April 2006	D	D, two day lag	N/A
Reserve/Base Money	Feb. 2006	Apr. 2006	M	M, 5 week delay	M
Broad Money	Feb. 2006	Apr. 2006	M	M, 5 week lag	M
Central Bank Balance Sheet	Feb. 2006	Apr. 2006	M	M, 5 week lag	M
Consolidated Balance Sheet of the Banking System	Feb. 2006	Apr. 2006	M	M, 5 week lag	M
Interest Rates[2]	Dec 2005	Feb 2006	M	M, 5 week delay	M
Consumer Price Index	Feb. 2006	April 04, 2006	M	M, 5 week lag	M
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	June 2005	April 10, 2005	M	M, 6-12 week delay	M
Revenue, Expenditure, Balance and Composition of Financing[3] – Central Government	June 2005	April 10,	M	M, 6-12 week delay	M
Stocks of Central Government and Central Government-Guaranteed Debt[5]	Dec. 2004	April 10, 2005	M	M, 6-12 week delay	M
External Current Account Balance	Dec. 2004	Mar. 2005	Q	Missions, email	A
Exports and Imports of Goods and Services	Dec. 2004	Mar. 2005	Q	Missions, email	A
GDP/GNP	Dec. 2004	June 2005	A	Missions, email	A
Gross External Debt	Dec. 2004	Mar. 2005	M	M, 3 month lag	A

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[2] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[3] Foreign, domestic bank, and domestic nonbank financing.
[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[5] Including currency and maturity composition.
[6] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A), Irregular (I); and Not Available (NA).

ANNEX V

Cambodia: IMF-World Bank Relations[17]

The Royal Government of Cambodia's (RGC) *Rectangular Strategy for Growth, Employment, Equity and Efficiency in Cambodia* (2004) identifies improved governance as "the most important precondition to economic development with sustainability, equity and social justice." This analysis accords with that set out in the World Bank's Country Assistance Strategy (CAS), which stresses the need to improve governance in order to maximize the impact of development efforts. As reflected in the new CAS, discussed at the Board in May 2005, the Bank's policy dialogue in Cambodia focuses on public financial management, private sector development, natural resource management, and local governance, while also addressing the national poverty reduction strategy, legal and judicial reform, rural development, decentralization, social sector development, and infrastructure.

Bank-Fund collaboration in Cambodia takes place at two levels: (i) through the policy-based lending program; and (ii) through analytical and advisory services, including in the context of the technical working groups. The following sections describe that collaboration in the context of the Bank's policy dialogue.

National Strategic Development Plan (NSDP). An NSDP Secretariat, chaired by the Ministry of Planning (MOP) with inputs from the Supreme National Economic Council (SNEC), has managed the formulation of the RGC's next five year plan, the National Strategic Development Plan (NSDP, 2006-2010), approved by the National Assembly in May 2006. The NSDP, which constitutes the RGC's second poverty reduction strategy, will guide implementation of the vision laid out in the Government's Rectangular Strategy (RS) and help Cambodia achieve the Cambodian MDGs. The Asian Development Bank (ADB), the UN system, and Bank have cooperated over the course of 2005 to coordinate technical support to the NSDP Secretariat, with the Bank and the UN Resident Coordinator both serving as co-lead donor coordinators in the Technical Working Group on Planning and Poverty Reduction (TWG-PPR). In addition to this general support on issues of process, the Bank has provided technical inputs to the NSDP in the areas of public financial management, civil service reform, and private sector development. Recent and on-going analytical work—the national Poverty Assessment, the Rural Sector Strategy Note, the Sources of Growth study, and the transport sector strategy—have also provided additional inputs to the NDSP. The Fund has ensured that the macroeconomic framework is consistent with its projections and recommendations and engaged on key structural policy issues.

National Poverty Assessment and Related Initiatives. The Bank, in cooperation with local research partners, EIC (Economic Institute of Cambodia) and CDRI (Cambodia Development Resource Institute), has led the production of a national Poverty Assessment,

---

[17] Cleared (May 25, 2006). Questions may be referred to Mr. Taliercio (855-23-217-304 x324).

released at the CG Meeting in March 2006. This provided a much-needed update of the poverty profile (the last such poverty assessment was published over six years ago, using poverty estimates that are now over eight years old) and, for the first time in Cambodia, a robust analysis of poverty trends. The analysis is based primarily upon new household consumption data derived from the 2004 Cambodia Socio-Economic Survey (CSES), complemented by mixed methods research into local variations and household poverty dynamics (the Moving out of Poverty Study). The assessment finds that poverty has fallen by between 10 and 15 percent in the decade since the first household survey was carried out in 1993/4 as the poor that have obtained benefits from high rates of economic growth. However, the benefits of growth have been very unevenly distributed, with living standards rising far faster in urban areas and in the highest quintile. Thus, while poverty has been reduced, inequality has increased dramatically: the Gini coefficient is now 0.42, among the highest in the Asia Pacific Region.

Sources of Growth Study. The Bank has initiated an assessment of the sources of growth and employment in Cambodia. In particular, the study will: i) review the relative sectoral contributions to economic growth and employment over the last decade; ii) identify and rank the key binding constraints to sustained higher growth and employment; and iii) assess the potential growth and employment that could be feasible provided the binding constraints are eased. The Fund is engaged in this study in a peer review capacity.

Rural Sector Strategy. With 85 percent of the population living in rural areas, and 79 percent of the poor mainly depending on agriculture and natural resource for their livelihoods, economic growth and poverty reduction will to a large extent depend on reviving the rural economy. In 2003, the Bank initiated the preparation of the Rural Sector Strategy Note (RSSN), which aimed to identify critical rural development issues and options to address them. The RSSN was finalized in June 2005 and will provide a basis for further dialogue with Government and other partners on priorities for agricultural and rural development. The Bank is also preparing a Land Allocation for Social and Economic Development project.

Transportation Sector Strategy. Despite significant diagnostic work and investment in reconstruction and development of infrastructure, transport remains a constraint to overall and equitable growth. Management of the transport sector remains weak, though there has been some recent progress. In particular, the absence of a sustainable road maintenance funding mechanism is a major concern, and the Bank is continuing the policy dialogue on the issue. Despite the availability of recently completed background and analytical works by ADB and the Bank, the Government has not yet made significant progress in formulating the transport sector strategy. The technical work to develop a road law that would govern the management of the road sector is near completion.

Social Sector Policy Dialogue. In the *health* sector the key policy issues under discussion are: (i) improved effectiveness of health financing through improved sector wide planning and budgeting processes, equity funds (access to health services for the poor), and contracting with NGOs for improved service delivery and outcomes; and (ii) pay and employment reform in the Ministry of Health. The recent joint health sector performance review established maternal and child health as health priorities. In the *education* sector the

Bank has been an active contributor to the Education Strategic Plan and the Education Sector Support Program. The key policy issues the Bank is focusing on are: (i) disparities in education participation rates by different regions, income groups, and gender; (ii) inefficiency and poor quality in education service delivery at primary, secondary, and tertiary levels; (iii) weak local management capacity; (iv) lack of reliability in education finance disbursements; and (v) pay and employment reform. Both the education and health sectors are undertaking public expenditure tracking surveys.

Public Financial Management (PFM). The joint WB-ADB *Integrated Fiduciary Assessment and Public Expenditure Review*, 2003 (IFAPER) found that though Cambodia had made some progress in reforming public expenditure policy and management, it would have to make much more progress on fiscal, fiduciary, and institutional challenges in order to implement its development agenda. In comparative perspective, Cambodia's PFM system ranks below average (as compared to the low income countries assessed by a joint World Bank-IMF diagnostic tool), indicating the need for substantial upgrading.

The Government launched a potentially far-reaching Public Financial Management Reform Program (PFMRP) in December 2004. The PFMRP comprises a detailed, sequenced, and time-bound action plan, a performance management framework, and measures to address organizational reform, including staff incentives. A joint effort of ten of Cambodia's development partners committed to assist in strengthening the Government's ability to lead and implement this agenda and to provide fully coordinated support via a sector wide approach (SWAp). The Bank will support the PFMRP through the recently negotiated Public Financial Management and Accountability Project (Board presentation scheduled for June 2006) which will finance, inter alia, the computerization if the government accounting and payment system. In addition, the Bank is managing a multi-donor trust fund to support the program on behalf of several other donors. The collaborative approach is supported by the Public Expenditure and Financial Accountability (PEFA) secretariat, as envisioned in the recent Bank-Fund board paper.[18] The Fund has provided extensive TA to the RGC in tax and customs administration and selected areas in budget management and Treasury operations. The Bank and Fund have established a productive working relationship on PFM.

Civil Service Reform. The IFAPER found serious problems afflicting the civil service: low and compressed pay, low skills, and thus low capacity. Low public sector wages provide a breeding ground for corrupt practices and are a leading cause of Cambodia's relatively poor standing on public sector performance. The Bank's Country Policy and Institutional Assessment (CPIA) ranks Cambodia in the fourth lowest quintile among low income countries on issues pertaining to public sector management and institutions. Though the Government has recently made some progress, more is required.

The Bank has provided the Government with a significant amount of grant funding to carry out an agreed set of studies that would provide the analytical foundation for reform. These studies cover: (i) labor market pay comparator analysis, (ii) pay and employment fiscal

[18] "Bank/Fund Collaboration on Public Expenditure Issues," February 14, 2003.

sustainability analysis, (iii) reallocation and retrenchment analysis, (iv) development of a functional analysis methodology and its application to select ministries, and (v) preparation of an establishment register. Work on the studies commenced last year but the program is behind schedule. The Fund has supported the Bank's program in this area.

In addition, the Bank is working with the Government and other donors to pilot accelerated pay and employment reform in high priority sectors. The Merit Based Pay Initiative (MBPI), which is an official Government program, has recently been agreed and is expected to be implemented first in the Ministry of Economy and Finance. The MBPI provides for substantial increases in remuneration (with some decompression) for a small group of officials selected based on merit and regular, appropriate performance management. The promise of the MBPI is to introduce the principles and practices of meritocracy into the Cambodian civil service. The Fund has also supported this pilot initiative for the Ministry of Economy and Finance in the context of the PFM reform program.

Private Sector Development. The Government needs to place a higher priority on structural reforms to support sustainable, private-led growth. In addition to providing ongoing technical support to the Government through assistance to the Government Private Sector Forum, the Bank Group, including the IFC (Mekong Project Development Facility, the Foreign Investment Advisory Service, and the Public Private Infrastructure Advisory Facility), has provided an input to the Government's Private Sector Development Strategy through an investment climate assessment and value chain analysis. The objective of this effort has provided focus on a three-fold strategy aimed at removing impediments to productivity growth, to help diversify the economy, and to increase the role of the private sector in service delivery. The findings of the work to date have identified overlapping trade facilitation, inspection, and licensing processes of various agencies as contributing to an excessive regulatory burden and a high incidence of corruption. In light of these findings, the Bank is focusing its efforts on operationalizing the reform recommendations through the 2005 Trade Facilitation and Competitiveness Project with participation from other donors, including the European Commission, AusAID, and IMF. Its key component will streamline import and export processes, and the Bank and Fund are working together on customs automation. A sector-wide approach (SWAp) on private sector development is being reviewed in line with other donors to provide a unified input into supporting required reforms in private sector development. Initial focus areas for the SWAp are trade facilitation, small and medium enterprise (SME) development, PPI, and investment climate.

Legal and Judicial Reform, Governance, and Anti-Corruption. In its framework for improved governance, the *Rectangular Strategy* identifies "legal and judicial reform" (LJR) and "fighting corruption" as key factors for success. With support from the Bank, the Government devised a Legal and Judicial Reform (LJR) Strategy in 2002 (formally adopted in June 2003). Priority actions with regard to LJR were agreed at the consultative group (CG) meeting in December 2004. These focused on the passing of eight key laws (Criminal Code, Criminal Procedure, Civil Code, Civil Procedure, Law on Anti-Corruption, Law on the Supreme Council of the Magistracy, Law on the Organization and Functioning of the Courts, and Law on the Status of Judges and Prosecutors). Though progress was made in the legislative drafting process, none of these laws had been passed by May 2006. Donor efforts are focusing on improving the ability of the TWG to coordinate among the variety of government agencies where are active in the LJR process. Beyond the legislative agenda, the RGC has prioritized the following as core reform areas: (a) access to legal and judicial services and the collection and dissemination of relevant legal and judicial information; (b) strengthening the market economy and legal and judicial reforms in support of private sector development; and (c) the creation and support of alternative dispute resolution mechanisms. In line with this agenda, the Bank is: (a) providing support (through the Trade Facilitation and Competitiveness Project) to the Ministries of Justice and Commerce and the courts to create a national database of legal information of particular relevance for the private sector; and (b) conducting analytical work with a view to the design of an IDA grant supporting a range of access to justice initiatives involving greater citizen participation in issues of governance at the local level.

Poverty Reduction Support Operation (PRSO). The first proposed PRSO focuses on public financial management, private sector development, and land resources management (subsequent PRSOs would broaden the coverage to other priority sectors). The PRSO process is designed to strengthen the linkage between results and donor assistance. The proposed operation will help provide support to the implementation of the policy agenda laid out in the RS and the NSDP. The PRSO is linked closely to the joint monitoring indicators (JMIs) agreed at the 2004 and 2006 CG Meetings so that the reform program remains government-owned and led and supported by the entire donor community collectively. The prior actions for PRSO-1, which are a subset of the CG Meeting JMIs, will need to demonstrate the government's commitment to reform, and fiduciary safeguards will have to be adequately addressed.

The proposed PRSO-1 under discussion with the Government focuses the prior actions on land resources management, PSD, and PFM. The proposed prior actions focus on key issues in each of the three areas: in land resources management the prior actions address the issues of state land management and economic land concessions; in PSD the prior actions focus on trade facilitation and investment law; in public financial and human resource management the prior actions focus on budget process and treasury operations, procurement, and meritocratic pay and employment reform.

Staff have coordinated closely on the proposed PRGF and PRSO programs, and have agreed on streamlined conditionality arrangements. Though there is proposed conditionality in both proposed programs on land resources management, PSD, and PFM, the Bank and Fund have ensured that conditionalities are complementary and mutually reinforcing, while not overlapping on any specific areas. Comprehensive consultations are on-going, most recently taking place during the Fund mission in May 2006, but continuing at the country office level on a regular basis.

Lending Operations and Non-lending Instruments

Lending operations and non-lending instruments are described in the following tables. Disbursement levels have been above the average for the region.

IDA: Commitments and Disbursements to Cambodia
(In millions of dollars, as of January 10, 2006)

Project	Effective Date	Committed	Disbursed
Credits:			
Biodiversity and Protected Areas Management Project	May 3, 2000	1.91	1.47
Economic and Public Sector Capacity Building Project	February 10, 2003	5.50	0.98
Education Sector Support Project	September 12, 2005	8.00	0.30
Health Sector Support Project	August 14, 2003	17.20	3.97
Land Management and Administration Project	June 19, 2002	24.30	9.62
Provincial and Peri-Urban Water and Sanitation Project	November 16, 2003	16.90	2.95
Provincial and Rural Infrastructure Project	March 16, 2004	20.00	10.93
Rural Investment and Local Governance Project	September 16, 2003	22.00	11.41
Road Rehabilitation Project	June 14, 1999	45.31	43.13
Rural Electrification and Transmission Project	March 29, 2005	40.00	2.02
Agriculture Productivity Improvement Project [Closed]	June 20, 1997	21.80	20.02
Cambodia: Flood Emergency Rehabilitation Project [closed]	June 4, 2001	35.00	37.03
Forest Concession Management and Control Pilot Project [closed]	October 20, 2000	4.82	4.59
Social Fund II (BACKUP TTL=HAHN) (03) [closed]	September 27, 2001	10.00	10.61
Social Fund II (BACKUP TTL=HAHN) (02) [closed]	July 7, 1999	25.00	23.22
Social Fund Project (01) [closed]	December 21, 1995	20.00	18.42
Education Quality Improvement Project [closed]	December 20, 1999	5.00	4.87
Northeast Village Development Project [closed]	November 11, 1999	5.00	4.68
Urban Water Supply Project [closed]	June 2, 1998	30.96	30.10
Demobilization and Reintegration Project [closed]	July 1, 2002	18.40	1.20
Structural Adjustment Credit Project [closed]	March 28, 2000	30.00	31.60
Disease Control and Health Development Project [closed]	June 23, 1997	30.40	26.80
Phnom Penh Power Rehabilitation Project [closed]	December 20, 1995	40.00	35.13
Economic Rehabilitation Credit Project [close]	December 18, 1995	40.00	36.31
Technical Assistance Project [closed]	March 23, 1995	17.00	15.98
Emergency Rehabilitation Project [closed]	January 13, 1994	62.70	62.66
Total Credits		**597.20**	**450.00**
Grants:			
Provincial and Peri-Urban Water and Sanitation Project [H0340]	November 16, 2003	3.00	0.16
Health Sector Support Project [H0150]	August 14, 2003	7.80	2.95
Health Sector Support Project [H0160]	August 14, 2003	2.00	0.32
Education Sector Support Project [H1610]	September 12, 2005	20.00	0.52
Cambodia Trade Facilitation and Competitiveness	December 12, 2005	10.00	-
Biodiversity and Protected Areas Management Project (GEF TF023524)	May 3, 2000	2.75	1.99
Rural Electrification and Transmission Project (GEF TF053036)	February 6, 2001	5.82	0.31
Total Grants		**51.37**	**6.25**

World Bank's Main Non-Lending Services: Issues and Instruments

(Recently completed and ongoing, as of January 2006)

Issue	Instruments
Civil Service Reform	IFAPER (2003), grant on public sector reform (ongoing), grant on civil service reform (ongoing), and pay and employment study on the education sector (2006).
Environment	Cambodia Environment Monitor (2003), Phase II Cambodia, Lao PDR and Vietnam Poverty-Environment Nexus Study (ongoing), Environment Monitor (FY06).
Gender	Cambodia Gender Assessment (April 2004) and grant on gender (ongoing).
Governance	Annual Report to the CG Meeting (12/04), grant on public sector reform (ongoing).
Human Development	PSIA on evaluating conditional means-tested school subsidies (ongoing), "Quality Basic Education for All" study on determinants of schooling participation (ongoing), Social Protection Policy Note (2005), Safeguards Research (2006), Child Labor Study (2006).
Infrastructure	Urban Water and Sanitation Strategy (2006)
Legal and Judicial Reform	Justice for the Poor study (FY06)
Poverty Reduction and Economics	IDF grant on poverty reduction (2003), Poverty Reduction Strategy Trust Funds (ongoing), Sources of Growth (2006), Moving out of Poverty study (2006), and Annual Report to the CG Meeting (3/06): National Poverty Assessment; CG Report on Inequality (2007).
Private Sector Development and Trade	FIAS report on FDI (2001), Integration and Competitiveness Study (2002), Private Sector Development Strategy/Investment Climate Assessment (2004), Investment Climate Assessment (FY05), and PPIAF grant to develop an interim regulatory framework (ongoing).
Public Financial Management	IFAPER (2003), grant on public sector reform (ongoing), Country Procurement Assessment Report (2004), Fiduciary Review (2005), Public Expenditure Tracking Survey—Education (2005), Public Expenditure Tracking Survey – Health (2006), and grant to assist with development of private sector accounting capacity (ongoing).
Rural and Agriculture	Rice Value Chain Study (2002), PSIA on social land concessions (2004), Rural Sector Strategy Note (2005), Land Taxation & Valuation Study (2005), and Land Policy and Strategy (FY06).

ANNEX VI

Cambodia: Relations with the Asian Development Bank

From 1992 through 31 December 2005, the Asian Development Bank (AsDB) approved $973.4 million in low-interest loans (including $42 million in grants in 2005) to Cambodia to finance 28 projects and 8 structural reform programs. To date 13 loan projects, for a total of $333 million, have been completed: (i) Phnom Penh High Voltage Transmission [approved in 1970, and closed in 1993] (ii) the Special Rehabilitation Assistance Project [approved in 1992]; (iii) Power Rehabilitation Project [approved in 1994]; (iv) Agriculture Sector Program [approved in 1996]; (v) Basic Skills Project [approved in 1995]; (vi) Rural Infrastructure Improvement Project [approved in 1995]; (vii) Basic Education Text Book Project (approved in 1996); (viii) Basic Health Services Project [approved in 1996]; (ix) Phnom Penh Water Supply and Drainage Project [approved in 1996]; (x) Siem Reap Airport Project (approved in 1996); (xi) Financial Sector Program, Subprogram I [approved in 2001]; (xii) Education Sector Development Program [approved in 2001]; and (xiii) Emergency Flood Rehabilitation [approved in 2000].

The sector composition and loan amounts of the remaining portfolio is as follows: agriculture and natural resources ($58.6 million); education ($40 million); energy ($62.9 million); finance ($30 million); health, nutrition and social protection ($20 million); industry and trade ($35.6 million); law, economic management and public policy ($10 million); multi-sector ($43.2 million); transport and communication ($158 million); and water supply, sanitation and waste management ($26.3 million).

During the same period, the AsDB also designed and administered 129 technical assistance projects amounting to $82.13 million. They were financed through grants from AsDB's Technical Assistance Special Fund ($30.6 million), the Japanese Special Fund ($33.4 million), and other sources ($18.3 million). In 2005, the AsDB approved three more loans: Tonle Sap Water Supply and Sanitation; Financial Sector Program Loan I (Cluster III); and Tonle Sap Sustainable Livelihoods.

AsDB's overarching goal in Cambodia is sustainable poverty reduction. AsDB's Country Strategy and Program (CSP) will focus on: (i) broad-based economic growth through investments in physical infrastructure, development of the financial sector, sustainable development of small and medium-scale enterprises, and investments in agriculture and irrigation; (ii) inclusive social development through basic education, empowering vulnerable groups such as women and ethnic minorities, control of communicable diseases, the provision of rural water supply and sanitation facilities, and community-based sustainable management and conservation of natural resources in the Tonle Sap Basin; and (iii) good governance through improving accountability and service delivery, supporting legal, regulatory and policy reforms, strengthening institutional capacity building, and improving efficiency and effectiveness of project implementation. A focus on the Tonle Sap basin to address geographical disparities in development, and a subregional focus to benefit from the broader opportunities provided by AsDB's Greater Mekong Sub-region program are also included. Four cross-cutting themes, namely governance, private sector development, gender, and the environment are also proposed to support the poverty reduction objectives of the country strategy.

The CSP was developed based on wide ranging consultations with the Government, donors, civil society, and the private sector. In particular, AsDB, the World Bank, the United Kingdom's Department for International Development (DFID), and the UN agencies undertook a joint strategic planning process for their country strategies which resulted in shared analysis and assessments.

AsDB: Loan Commitments and Disbursements to Cambodia, 1992-2005
(In millions of U.S. dollars)
as of December 31, 2005

	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	116.5	64.4	78.9
2003	98.3	62.0	73.3
2004	65.0	65.8	76.7
2005	52.0[1]	96.9	84.5
2006 (projected)	82.8[2]	65.3	65.8
Total	**973.4**	**680.6**	**630.1**

[1] Loans amount to $10 million, and grants $42 million
[2] Loans amount to $62.9 million; and grants $19.9 million

INTERNATIONAL MONETARY FUND

Public Information Notice

EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 06/78
FOR IMMEDIATE RELEASE
July 20, 2006

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2006 Article IV Consultation with Cambodia

On July 7, 2006, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Cambodia.[1]

Background

Cambodia has enjoyed a broad degree of macroeconomic stability in recent years, underpinned by prudent fiscal and monetary policies. The economy has successfully created new jobs to absorb the rising working age population, which has been growing at 3 percent annually, faster than the population. Inflation has remained under control. The economy has withstood pressures from high world oil prices, albeit with a small deterioration in the balance of payments. The external debt burden has eased to 51 percent of GDP in 2005, from a peak of 60 percent in 2003. Nevertheless, the country remains poor and governance weaknesses limit both critical spending and the environment for broad-based development. Growth has been narrowly based on garment exports and tourism and thus while the overall poverty rate has declined—from 47 percent in 1993 to 35 percent in 2004—rural poverty remains stubbornly high, and many Millennium Development Goals appear beyond reach. Low revenue has led to development spending shortfalls while corruption has contributed to poor government operations and high costs of doing business.

Real GDP growth rose to 13½ percent in 2005 with all sectors contributing. Largely because of exceptionally favorable weather conditions, following a drought in 2004, agriculture output grew

[1] 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.

by around 17 percent. Contrary to earlier concerns of a large negative impact of the termination of MFA quotas, with the introduction of safeguard restrictions put in place by the United States and European Union, garment exports continued to expand in 2005, albeit at a slower pace. After increasing by 50 percent in 2004, tourist arrivals rose by 35 percent in 2005 to nearly 1½ million with a related increase in construction activity. Inflation remained under control—at end-April 2006, inflation had eased to below 5 percent as the effect of the 2004 drought on food prices and oil-price shock diminished.

Fiscal policy was cautious, as expenditure restraint and slower donor project execution led to a decline in the overall deficit to 3½ percent of GDP in 2005, from 4¾ percent in 2004. The deficit was again more than financed by external aid. Despite greater than budgeted tax revenues and one-off receipts from the privatization of a state bank, the revenue to GDP ratio in 2005 was only 10½ percent. Expenditure declined as a share of GDP as capital spending continued its downward trend—in line with external financing—and current spending grew only moderately.

Financial intermediation continued to expand, in the context of extremely high dollarization. Broad money and bank deposits grew by about 16 percent (year-on-year) in 2005 and have picked up pace in early 2006. The banking system, however, remains relatively undeveloped and concentrated—financial intermediation remains low—private sector credit averaged less than 10 percent of GDP in 2005, allocated mainly to the services and retail sectors.

External developments were mixed. Robust tourism earnings and tourism only partly offset higher petroleum prices and strong non-garment imports. The current account deficit (excluding transfers) widened to 9½ percent of GDP in 2005, but this was financed by an upswing in foreign direct investment, concentrated in garment, tourism, and construction sectors. The riel was fairly stable both in terms of dollars and partner country currencies.

Progress has been made on the wide-ranging structural reform agenda. The authorities are implementing their flagship public financial management (PFM) reform program, which addresses the weaknesses of Cambodia's public expenditure management system. In the area of land policy, the issuances of sub decrees on economic land concessions and on state land management were significant developments.

Executive Board Assessment

Executive Directors commended the Cambodian authorities for their sound macroeconomic policies, which have contributed to the strong growth performance of recent years. The fiscal position has improved, inflation remains under control, structural reforms have been implemented in key areas, and poverty has fallen significantly. Directors considered that, in the period ahead, the authorities should place emphasis on improving governance and the investment climate, to lay the groundwork for faster and broader-based private sector growth and to allow for reducing reliance on aid inflows over the long term.

Directors welcomed the government's commitment to reorient expenditure toward achieving the Millennium Development Goals (MDGs). They observed that greater stress is appropriately being placed under the National Strategic Development Plan (NSDP) on reducing poverty, enhancing physical infrastructure, and improving social services. Given that poverty in rural areas is still high, Directors also endorsed the NSDP's intention to channel more resources to increasing agricultural productivity. They encouraged the authorities to strengthen further the costing and prioritization of the NSDP. They commended the authorities' intention to use resources freed up by the Multilateral Debt Relief Initiative (MDRI) to further strengthen poverty reduction efforts.

At the same time, Directors expressed concern that revenue collection continues to be well below what is needed to support the government's expenditure objectives. They called for the full enforcement of current tax regulations and a reining-in of tax exemptions, and they endorsed the authorities' intention to enhance revenue administration. They suggested that additional tax policy measures be considered in the 2007 budget. Directors recommended that the authorities take early measures to ensure that future proceeds from the exploitation of recently discovered petroleum reserves, which could be substantial, are well managed. In that connection, they called on the authorities to participate soon in the Extractive Industries Transparency Initiative.

Directors endorsed the current approach to monetary policy, which is constrained by the high degree of dollarization. De-dollarization should remain a long-term objective. Directors supported the National Bank of Cambodia's (NBC) policy of stabilizing excessive fluctuations in the exchange rate, while allowing the rate to adjust to shifts in underlying market fundamentals. They encouraged the government to continue deepening Cambodia's integration into the region.

Directors called on the government to strengthen the financial infrastructure through enhanced supervision—particularly of the dominant banks—and enforcement, and through the development of a more effective payments system. They urged the NBC to limit exemptions on prudential requirements, especially on capital requirements and large exposure limits. They encouraged the NBC to continue to address weaknesses in its internal control, accounting, and auditing procedures, as identified in the safeguards assessment. Directors welcomed the submission to parliament of a draft law to combat money laundering and the financing of terrorism.

Directors encouraged the authorities to continue their prudent borrowing policy—limiting non-concessional foreign financing. They observed that although the path of external debt is sustainable, the small and narrow revenue base presents risks. Directors looked forward to an early resolution of outstanding official bilateral debt issues, which could clear the way for Fund financial support within the PRGF framework.

Directors encouraged the authorities to accelerate structural reforms to promote equitable growth, increase competitiveness, and reduce the vulnerability of the economy to risks. They welcomed the government's commitment to the comprehensive public financial management reform program, which should make spending more effective. They encouraged the authorities to hasten the program's implementation, in particular by introducing the new Chart of Accounts for the 2007 budget and by rationalizing government bank accounts.

Directors stressed the need to improve governance to enhance the business environment and strengthen revenue collection. They emphasized the importance of civil service reform to fight corruption, and urged the authorities to make full use of current regulations to guard against misuse of funds and to investigate irregularities. They called for the promulgation of an anti-corruption law of international standard, and the prompt establishment of an anti-corruption secretariat.

Directors noted the considerable improvement in statistics in recent years, and encouraged the government to ensure that adequate budget resources are allocated to this area so that the macroeconomic and social objectives of the NSDP can be properly monitored.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case. The Staff Report for the 2006 Article IV Consultation with Cambodia is also available.

Cambodia: Selected Economic Indicators, 2002–2005

	2002	2003	2004	2005 Est.
	(Annual percent change)			
Output and prices				
Real GDP	6.2	8.6	10.0	13.4
GDP deflator	1.4	0.2	5.3	5.7
CPI Inflation (end of period)	3.7	0.5	5.6	6.7
Money and credit				
Broad money	33.0	15.0	30.4	16.1
Net credit to the government	-2.0	-0.3	-2.4	-4.9
Private sector credit	13.1	26.2	35.9	29.4
	(In percent of GDP)			
Government budget				
Total Revenue	10.5	9.7	10.4	10.5
Expenditure	16.7	15.7	15.2	13.9
Of which: current expenditure	9.4	10.1	9.0	8.2
Current budget balance	1.1	0.4	1.3	1.6
Overall budget balance	-6.3	-6.0	-4.7	-3.4
Overall budget balance (incl. grants)	-3.6	-3.7	-3.0	-1.3
	(In millions of U.S. dollars; unless indicated)			
External sector				
Current account (excl. official transfers)	-406	-497	-440	-594
(in percent of GDP)	-9.5	-10.8	-8.4	-9.5
Exports	1,659	1,970	2,454	2,773
Imports	2,275	2,759	3,166	3,882
Gross official reserves	663	737	806	915
(in months of imports of goods and services)	2.9	2.8	2.6	2.4
Public external debt	2,492	2,740	2,976	3,180
(in percent of GDP)	58.2	59.8	56.6	50.6
Exchange rate (riels per dollar; end of period)	3,935	3,980	4,031	4,116

Source: Cambodian authorities.

Statement by Hooi Eng Phang, Executive Director for Cambodia and Tola May, Advisor to Executive Director
July 7, 2006

Introduction

On behalf of the Cambodian authorities, we would like to thank Executive Directors and Management as well as donor countries for their continued support for Cambodia, including the provision of debt relief under the Multilateral Debt Relief Initiative (MDRI) early this year. We would also like to express our appreciation to development partners of the Consultative Group meeting held in March 2006 in Phnom Penh for their endorsement of the Cambodian government's reform program, and reaffirmation of their continued support. The authorities are in broad agreement with the staff's assessment and policy recommendations and thank staff for the constructive policy dialogue during the recent Article IV consultation.

Leveraging on the opportunities afforded by the donor countries and development partners, the authorities have continued with efforts to advance the reform program so as to strengthen economic growth and reduce poverty along with the progress made in promoting democracy, peace and stability. With prudent macroeconomic management, the economy has achieved remarkable progress over the last 12 years with GDP growth averaging over 7.6 percent per annum, while poverty has fallen from 47 percent in 1993 to 35 percent in 2004. These achievements reflect the success of strong country ownership of national policies and effective international support, including continued cooperation with the IMF. Despite the progress that has been made, the authorities are well aware of the challenges ahead in maintaining high but sustainable rates of broad-based growth and reducing poverty and inequality, in continuing efforts to attain the Cambodian Millennium Development Goals (CMDGs).

Going forward, Cambodia will increasingly be exposed to greater international competition. As such, greater economic diversification, improvements in agricultural productivity and profitability, and stronger regional integration will be necessary for sustaining high growth and effective poverty reduction. Therefore, the authorities are committed to accelerating the reform program as envisaged under the National Strategic Development Plan (NSDP) for 2006 to 2010.

Recent Economic Developments and Prospects for 2006

In 2005, against the backdrop of continued sound macroeconomic policies, strong aid flows coupled with a favorable external environment, real GDP growth was at a record high of about 13½ percent. Growth in 2005 was broad based, largely driven by continued high export growth, healthy tourism receipts, robust construction activity, and strong agriculture production bolstered by favorable weather conditions and conducive government policies. Nonetheless, due largely to the impact of higher oil price, inflation rose to 6¾ percent but has subsequently been contained below 5 percent by the end of April 2006.

Looking ahead, economic prospects continue to be favorable in 2006 and into the medium term, underpinned by ongoing political stability, active private sector initiatives, progress in reform efforts, and continued aid flows and foreign direct investment. Nevertheless, the authorities are well aware of risks to the outlook from an avian flu pandemic, high oil prices, uncertainty in the garment export market, and the weather-dependence of the agriculture sector. Taking all this into consideration, the authorities are in broad agreement with the staff's projection for real GDP growth of 5 percent in 2006, but are of the view that there is potential upside to the forecast given the continued progress in structural reforms and prudent macroeconomic policy management.

Fiscal Policy

Fiscal policy continues to remain prudent. In 2005, as indicated by staff, expenditure was restrained and slower donor project execution led to a decline in the overall deficit to 3½ percent of GDP in 2005 from 4¾ percent in 2004. Revenue collection exceeded the annual budget projections, but remained low at 10.8 percent of GDP. However, progress has been made since early 2006 to improve revenue collection, with the authorities working concertedly towards achieving total revenue of 11.3 percent of GDP for 2006. To improve revenue collection, measures have been taken to enforce the Law on Taxation, broaden the tax base on the informal sector, and strengthen the tax audit. Other measures include reorganizing the tax department, modernizing the customs department, creating a non-tax revenue department, and upgrading the anti-smuggling plan. In addition, the authorities have made efforts to ensure that all tax revenue collected must be immediately deposited into the National Treasury, and to prohibit any tax exemptions beyond the limit allowable under the Law on Investment. The 2005 Prime Minister Order has also helped initiate a transparent bidding procedure for future government concession contracts.

On the expenditure side, greater focus will be put on supporting poverty reduction and achieving the CMDGs. Social spending is projected to be about 1½ percent of GDP in 2006 with more resources being allocated for rural development. Current expenditure is projected to increase by only about 1¼ percent in order to provide greater resources for capital spending. In line with the civil service reform program, civil service salaries are projected to increase but at a gradual pace. The authorities plan to utilize the initial $33.38 million of freed-up MDRI resources to support the irrigation project in the eastern part of the country. The authorities are aware of the need to source for concessional financing, and as such, are actively seeking alternative financing from China and the Asian Development Bank (AsDB) for infrastructure investment in sectors such as the energy sector, to support growth.

Over the medium-term, the fiscal policy objectives are to enhance revenue performance and re-orient expenditures to meet pro-poor priority spending. In order to meet these objectives, the authorities adopted the Public Financial Management Reform Program (PFM), a comprehensive multi-year reform program, in late 2004. The PFM is designed to upgrade public finance in order to provide effective support for growth and poverty reduction through the promotion of good governance. The authorities agree with staff on the need to pay close attention to measures to improve budget management in the 2007 budget, including the adoption of the new chart of account and the development of a system for tracking poverty spending.

Monetary and Exchange Rate Policy and Financial Sector Reform

With respect to monetary policy, the National Bank of Cambodia (NBC) has maintained a prudent monetary policy stance aimed at maintaining price stability. Inflation will be kept below 5 percent in the near-term and at about 3½ percent over the medium-term. During 2005, broad money and bank deposits had grown by about 16 percent (year-on-year) with an upward trend continuing into early 2006, reflecting robust economic activity and improved confidence in the banking system as a result of political stability. Credit to the private sector grew by about 30 percent but accounts for only around 10 percent of GDP. The low level of financial intermediation reflects the still inadequate legal framework. Efforts have been made to address this through the adoption of the law on the Negotiable Instruments and Payment Systems in 2005. The law provided an important legal framework for the NBC to work towards developing an effective money-market, inter-bank market and payment system with the assistance of the IMF and AsDB.

The NBC will continue with the managed float exchange rate policy and no interventions have been and will be made to target a specific level of exchange rate. Interventions are only made to limit exchange rate volatility. Despite the growth in bank deposit and lending as stated above, the share of the local currency, riel, in total bank deposits and lending was as low as 4 percent and 6 percent respectively reflecting the highly dollarized nature of the economy. While the Cambodian authorities would like to encourage greater use of the local currency, they would like to emphasize that they have no intention whatsoever to impose restrictions on the use of foreign currency. They envisage that greater use of local currency would develop as an outcome of economic development.

On the financial sector front, bank supervision efforts continue to focus on ensuring a sound banking system. With the success of the banking system restructuring in 2000–01 the banking sector has remained relatively stable. The NBC's capacity in conducting both on-site and off-site bank supervision has been enhanced. Normally, all banks are subject to at least one on-site examination every two years, but based on the assessment of the supervisor, banks can be subjected to more frequent assessments, if deemed prudent. The NBC is aware of the high concentration and market share in the banking sector of two local banks. These banks are among the banks that supervisors conduct on-site examinations at least once a year. The NBC has also met with the Board of Directors of the bank that has not complied with prudential regulations to discuss measures taken to enhance operational and credit risk management. With respect to exemptions for large exposure limits, the NBC is fully cognizant of the associated risks and will grant exemptions only in cases where due diligence reveals that the loan is fully secured and the risk is fully covered.

The NBC has also issued additional banking regulations to enhance the banking system, including measures on anti-money laundering and combating the financing of terrorism in anticipation of the approval of the AML/CFT law. The draft law, with the help of IMF technical assistance, has been discussed at the inter-ministerial level and is now awaiting approval by the National Assembly. The draft law also envisages the establishment of the Financial Intelligence Unit (FIU) at the NBC with active participation of related ministries, including the Council of Ministers, the Ministry of Justice, the Ministry of Interior and the Ministry of Economy and Finance.

Structural Reform

On the structural front, private sector development, competitiveness and trade facilitation are the main features of reforms in 2005 so as to put in place the necessary conditions to support greater trade openness following the accession to the World Trade Organization (WTO) in 2004. With support from the World Bank, the authorities have pressed forward with the trade facilitation agenda, which is aimed at reducing the cost of doing business, such as reducing the time and cost incurred for import and export clearance. A number of regulations have also been issued including the sub-decree on risk management strategy, the sub-decree on the creation of special economic zones, the Law on Concessions, and the sub-decree for the amended Law on Investment. Cognizant of the importance of nurturing a vibrant small and medium-sized enterprise (SME) sector, the government has also launched the Small and Medium Enterprise Development Framework, which is a blueprint for the development of the SME sector. Towards this end, the NBC has introduced the Credit Information System (CIS) and prepared the legal framework for leasing activity to improve SME access to financing.

Multilateral Debt Relief Initiative

The authorities have committed to utilizing the freed-up MDRI resources in a transparent, accountable and efficient manner in order to accelerate poverty reduction towards meeting the CMDGs. The proceeds from the MDRI will be focused on investment in rural areas since rural poverty remains high. The government has initiated a three-year project amounting to $33.38 million of the MDRI proceeds for investment in irrigation projects in the eastern provinces so as to improve agriculture production and reduce rural poverty in those areas.

Governance

The anti-corruption law is being revised in order to accommodate and comply with international standards. As suggested by staff, the authorities will ensure that the Anti-Corruption Secretariat has an independent status and the requisite financial resources will be earmarked in the 2007 budget.

Debt Issues

The outstanding debt issues are viewed as the main impediment to economic growth and poverty reduction. In this regard, the Royal Government of Cambodia is committed to resolving the outstanding debt issues as soon as possible in order to bring closure to debts of the Cold War era and pave the way forward for the rebuilding and continued development of Cambodia. Nevertheless, the debt issue has to be resolved within the constraints of Cambodia's financial capacity without compromising efforts in poverty reduction and achieving the CMDGs. The provision of debt relief to Cambodia under the MDRI acknowledges the limited financial capacity of the country and its level of poverty as well as the need to meet the CMDGs. In this regard, the Cambodian authorities urge the major creditors, especially the United States and the Russian Federation, to seriously consider Cambodia's request for concessional terms and to reach a consensus agreement as soon as possible to allow Cambodia to enter into a new PRGF program to accelerate poverty eradication efforts. The total debt stock with the United Sates has finally been reconciled after numerous bilateral rounds of verification and adjustments. With regard to debt owed to the Russian Federation, a few differences still remain after the last meeting in March 2006 between the two parties. In view of the urgent need for a PRGF program to support development and poverty eradication efforts, the Cambodian authorities urge the Russian authorities to consider favorably their request for concessional terms for post 1985 debt.

National Strategic Development Plan

The NSDP is a unified national poverty reduction strategy that carries forward the achievements gained from the implementation of the Government's 2004 Rectangular Strategy, the second Socio-Economic Development Plan for 2001-05 and the National Poverty Reduction Strategy for 2003-05. The NSDP has been formulated through a highly inclusive process involving wide ranging consultations with all stakeholders within and outside the government, and as such, presents a true consensus on the priority strategies to be pursued. The authorities have placed emphasis on the implementation of the focused and prioritized Public Investment Program (PIP), a three-year rolling program adopted in January 2006, as the key to success for the implementation of the NSDP. The authorities agree with the staffs' assessment as stated in the JSAN. The authorities assure the Fund of their strong ownership of the strategy. In essence, the NSDP provides an overall strategy and common framework for the government and development partners to align their resources and efforts for achieving the envisaged goals and the Cambodian authorities hope to work with their development partners to realize their development goals.

Conclusion

The Cambodian authorities give high priority and importance to a heavy reform agenda and during the recent Consultative Group meeting in Phnom Penh, the donor community had welcomed and acknowledged the satisfactory achievements to date. They have agreed to work in partnership with the authorities to help lift Cambodia out of poverty. The authorities have successfully maintained a strong and stable macroeconomic environment with a credible poverty reduction strategy and strong country ownership of policies despite the absence of an IMF program in place. Against such a backdrop, the Cambodian authorities are optimistic about a PRGF program in the near future in order to support their ongoing developmental and reform efforts. The PRGF program is important for Cambodia as it allows staff to evaluate and assess the progress of reforms, be actively involved in the formulation and implementation of sound policies, as well as to endorse Cambodia's achievements. The program will provide much value added and impetus to the Cambodian reform agenda as well as development and poverty reduction efforts to achieve the CMDGs. The authorities therefore hope that Executive Directors will support Cambodia's request for the PRGF program.