

**Cambodia: 2001 Article IV Consultation and Fourth Review Under the Poverty Reduction Growth Facility—Staff Report; Public Information Notice and News Brief 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 2001 Article IV consultation and Fourth Review Under the Poverty Reduction Growth Facility with Cambodia, the following documents have been released and are included in this package:

- the staff report for the 2001 Article IV consultation and fourth review under the poverty reduction growth facility, prepared by a staff team of the IMF, following discussions that ended on **November 20, 2001**, 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 January 24, 2002.** The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- a Public Information Notice (PIN) and a News Brief summarizing the **views of the Executive Board as expressed during its February 6, 2002 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 separately released.

Statistical Appendix; Letter of Intent, Memorandum of Economic and Financial Policies, Technical Memorandum of Understanding; Poverty Reduction Strategy Papers; Joint Staff Assessment

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

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CAMBODIA

**Staff Report for the 2001 Article IV Consultation and  
Fourth Review Under the Poverty Reduction and Growth Facility**

Prepared by the Asia and Pacific Department and  
Policy Development and Review Department

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

Approved by Wanda Tseng and Mark Allen

January 24, 2002

- A staff team visited Phnom Penh during November 5–20, 2001 to conduct discussions for the 2001 Article IV consultation and the fourth review under the PRGF arrangement, including understandings on a program for 2002.
- The staff team consisted of Mr. Rumbaugh (Head), Messrs. Doi, Marciniak, Lopez-Mejia, and Ishi (all APD), and Mr. Adachi (PDR). The mission was assisted by Mr. Mario de Zamaroczy (outgoing resident representative) and Mr. Hagemann (incoming resident representative) and overlapped with World Bank missions on capacity building, civil service reform, and SAC implementation. Messrs. May and Bhatta (OED) also attended some of the policy meetings.
- The mission met with Prime Minister Hun Sen, Senior Minister of Economy and Finance Keat Chhon, Senior Minister of the Council of Ministers Sok An, Governor Chea Chanto of the National Bank of Cambodia, Minister of Commerce Cham Prasidh, and other senior officials.
- A three-year PRGF arrangement for SDR 58.5 million (67 percent of quota) was approved by the Executive Board on October 22, 1999 and the third review under the arrangement was concluded on July 19, 2001. The 2000 Article IV consultation was concluded on September 15, 2000.
- The government has agreed to the publication of all Board documents since September 2000, and has also agreed to the publication of this Staff Report, the associated MEFP, PRSP preparation status report, and Joint Staff Assessment.
- This report was prepared by a staff team under the direction of Mr. Rumbaugh.

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## Executive Summary

**The PRGF-supported program approved in October 1999 aims at sustaining economic growth, reducing poverty, and accelerating economic reconstruction.** Many reforms have hurt entrenched interests and continuing the momentum will be a challenge, especially as Cambodia is heading into an election period with the first-ever commune elections scheduled for February 2002 and national elections scheduled for 2003.

**In the first two years of the program significant progress has been made.** Economic growth has been restored, inflation kept at low levels, government revenue improved, expenditure re-oriented to the social sectors, and the international reserve position strengthened. Progress has also been achieved across a broad range of structural reforms despite delays in some areas. All quantitative and structural performance criteria under the program have been observed.

**Owing to the deterioration in the external outlook since the last review, estimated growth for 2001 has been revised downward to 5¼ percent (from 6 percent) and to 4½ percent in 2002.** This revision reflects weaker prospects for garment exports and tourism receipts. However, with lower oil prices, somewhat higher external support, and a slower programmed buildup in international reserves, the external financing situation for 2002 is expected to be manageable.

**Substantial further actions are needed to place Cambodia firmly on the path of sustainable development and poverty reduction.** The macroeconomic program for 2002 focuses on the continued strengthening of the fiscal position. Government revenue is targeted to increase further relative to GDP with the adoption of new measures. The expenditure program provides for further increases in social sector spending, the implementation of military demobilization and civil service reform, and costs associated with local elections.

**Priority structural policies for the third year of the PRGF arrangement focus on** improving tax and customs administration, enhancing expenditure management, and continuing the bank restructuring program—including reform of the publicly owned Foreign Trade Bank. The World Bank is taking the lead on the restructuring of forestry concessions, military demobilization, civil service reform, and the implementation of the governance action plan, and close collaboration in these areas will continue.

**Preparation of the full PRSP needs to be accelerated.** Following completion of the Socio-Economic Development Plan for 2001–05, and to ensure better coordination and participation, institutional oversight of the process needs to be strengthened to produce an adequate PRSP, now planned for October 2002.

## I. INTRODUCTION

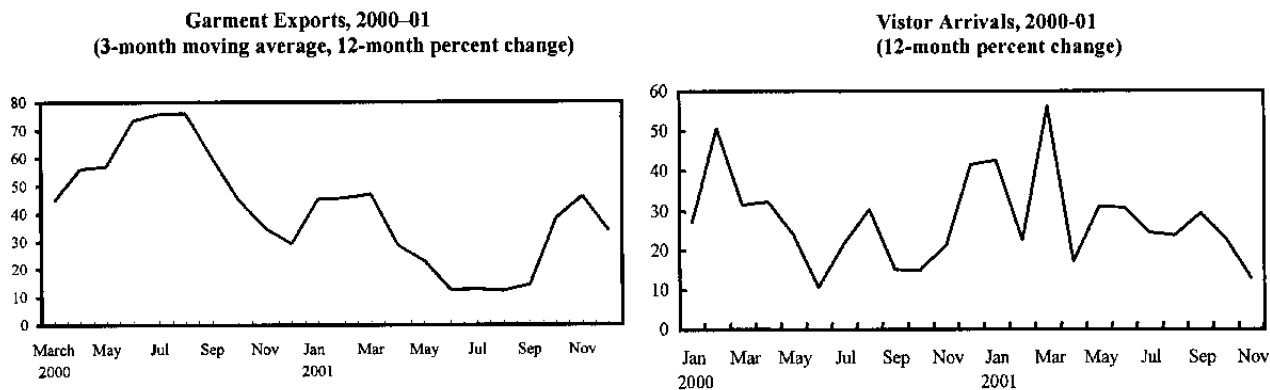
1. **The political environment stabilized in late 1998 and the government launched a reform program in 1999.** The program is being supported by the PRGF arrangement, approved in October 1999, and by a World Bank SAC program, approved in February 2000. Assistance is also being provided by the AsDB and other multilateral and bilateral donors. The government remains committed to the program at the highest level, but capacity and political constraints have led to some delays and could continue to affect program implementation in the future. The success of the program will depend on the sustained implementation of reforms, including in the run up to local elections in early 2002 and national elections in 2003.
2. **Performance during the first two years of the PRGF-supported program has been positive.** GDP growth has been sustained and inflation kept very low. Government revenue performance has improved, the share of expenditure on defense and security has declined, and spending for the priority social sectors has increased. The improved fiscal position has allowed for an expansion of private credit, the exchange rate has been stable, and international reserves have increased steadily (Table 1 and Charts 1–2).
3. **Significant structural reforms are underway.** A comprehensive bank restructuring program is nearing completion, illegal logging activity has been reduced and forestry concessions suspended, the execution of public expenditure has improved somewhat through the introduction of Priority Action Programs for health and education, and tax administration is being strengthened. Key legislation has been approved by the parliament and a comprehensive governance action plan (GAP) was approved by the government and disseminated to stakeholders.
4. **Despite this progress, the economy is still vulnerable.** This reflects the huge task that confronted the authorities at the outset of the program to rebuild a country shattered by three decades of civil strife in the context of a fragile governance environment and severe capacity constraints. Accordingly, the program will continue to require close monitoring and extensive technical assistance.
5. **In concluding the 2000 Article IV consultation,** Executive Directors commended the authorities for their economic performance and emphasized that achieving sustained growth and poverty reduction would require continued strong efforts on a wide front. In concluding the third review under the PRGF arrangement, Directors welcomed progress made in bank reform, computerization of the civil service payroll, and the establishment of a comprehensive governance action plan. They called, however, for sustained reform efforts, especially with respect to revenue mobilization, expenditure management, civil service reform, military demobilization, and bank restructuring. Directors expressed concern with slow progress in resolving outstanding bilateral debt rescheduling agreements, and indicated that completion of further reviews under the PRGF arrangement will depend on continued progress in this area.

6. **In the attached letter to the Managing Director, the authorities request completion of the fourth PRGF review.** In the accompanying Memorandum of Economic and Financial Policies, the authorities report on progress made under the PRGF-supported program, and set out their policies for 2002 and the associated performance criteria and structural conditionality.

## II. RECENT DEVELOPMENTS AND PERFORMANCE UNDER THE 2001 PROGRAM

7. **Macroeconomic performance and policy implementation in 2001 have been broadly consistent with the program.** Objectives for 2001 have been largely achieved despite some slowing in the growth of garment exports and tourist receipts. Economic growth is estimated at 5¼ percent, slightly below the program target of 6 percent, while inflation has remained well below 5 percent. The exchange rate has been stable and international reserves have increased, reaching \$548 million (3 months of imports) at end-December. Quantitative performance criteria for September 2001 and the structural performance criteria for end-October 2001 were observed, but there were delays in meeting a few structural benchmarks (Tables 2 and 3). Preliminary data indicate that the end-December 2001 quantitative benchmarks are likely to have been observed.

8. **Economic activity in 2001 has remained relatively strong despite a slowing global economy.** A modest recovery in agricultural production is expected, and both garment exports and tourist arrivals increased by more than 20 percent in the first nine months compared to the same period in 2000. The deterioration in the global economy since September was expected to adversely affect these key sectors. However, the growth of garment exports has been largely maintained through end-November as an expected negative impact on garment export volumes has been mitigated by a diversion of orders from other



countries with a perceived higher security risk. Despite this, some slowing in the growth of garments is projected in the near term as prices for new orders are believed to have declined by 10–15 percent. There is also evidence that the tourism industry is being adversely affected. While continued arrivals from Asian countries have helped to offset a sharp decline from the United States and Western Europe, the growth of total arrivals has started to decline. Moreover, the higher end of the market and overall tourist receipts also seem to have been adversely affected. Based on these trends, and assuming a global rebound in mid-2002,

the staff projects that economic growth in 2002 could be reduced to 4½ percent. Inflation is projected to remain well below 5 percent.

9. **The implementation of the 2001 budget has been consistent with financing targets under the program.** Tax revenue from domestic sources has been in line with projections, and the measures agreed during the third PRGF review have been implemented. However, customs revenue in the second half of the year fell short of projections, reflecting lower import volumes and slow progress in improving customs administration. As a result, overall revenue in the first 10 months of the year was slightly below indicative program targets.<sup>1</sup> Overall expenditure was also held below indicative targets, and budget financing has been well within program limits. For the year as a whole, the current surplus is projected at 1½ percent of GDP and the overall deficit at 5¼ percent of GDP, in line with program objectives (Table 4). Some progress has been made in raising spending for health and education through the use of Priority Action Programs (PAPs) which expedites the allocation of funds from the central level to line ministries, even though procedures among line ministries at provincial levels have continued to impede more rapid disbursements.

10. **Monetary and external developments have also been in line with the program.** Broad money growth for 2001 is estimated at 22 percent, while the avoidance of bank financing of the budget has provided room for a further increase in private credit (Tables 5–6). The external current account deficit (excluding grants) is estimated to have been 9 percent of GDP, slightly better than the program target, reflecting strong export performance (Table 7). Gross international reserves have reached the equivalent of three months of imports, and the exchange rate has been broadly stable against the U.S. dollar and in real effective terms (Chart 3).

11. **Progress has been made in the implementation of structural reforms.** The liquidation of nonviable banks and the monitoring of banks under Memoranda of Understanding (MOUs) have proceeded as envisaged. A large taxpayers unit (LTU) was established and a work plan for implementing improvements in tax administration was adopted. Following the recent approval of a World Bank project in support of military demobilization, the discharge of 15,000 soldiers (11½ percent of the military) began in mid-October and was completed in December. The National Assembly has approved a new Land Law and is considering a new Forest Law. The computerization of the civil service payroll was also completed in all provinces, leading to the elimination of 9,000 ghost workers (6 percent of the civil service workforce).

12. **However, reforms in forestry policy fell short of program objectives.** While significant steps have been taken since the onset of the program, restructured concession agreements were not completed on schedule (structural benchmark for end-September 2001).

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<sup>1</sup> Taking into account a downward revision in the nominal GDP forecast, the program target for total government revenue of 12.2 percent of GDP in 2001 is expected to have been achieved.



Forestry concessionaires submitted information on their operations to the government by end-September, but these plans were not viewed as credible and did not provide a basis for continued logging operations. The authorities have taken specific actions to redress this situation in the context of the 2002 program.

### III. REPORT ON THE DISCUSSIONS AND THE PROGRAM FOR 2002

#### A. Medium-Term Macroeconomic Framework and Objectives for 2002

13. **The medium-term objectives of the macroeconomic framework presented in the I-PRSP remain appropriate.** The authorities' program aims to maintain economic growth with low inflation and focuses on human resource development and building basic economic institutions. Increasing fiscal revenue and a continued redirection of expenditure to priority social objectives in an environment of improved governance are critical elements of the strategy. In the policy discussions, the authorities hoped for a quick rebound in growth, but recognized the external uncertainties, and agreed that economic growth in the range of 4½–5 percent and continued low inflation would be realistic targets for 2002. The authorities and staff agreed that medium-term prospects remain positive: growth could resume at an annual rate of 6–7 percent, inflation should stay in the low single digits, the external current account deficit would be contained to a level consistent with concessional financing and FDI flows, and international reserve coverage would increase to about 3½ months of import coverage (Table 8). The projected increase in output growth is based on rising levels of savings and investment, development of the agricultural sector, and continued growth in industrial production, tourism-related services, and construction.

14. **The government's program for 2002 is centered on continued prudent macroeconomic policies and structural reforms in key areas.** The current budget surplus will be maintained at 1½ percent of GDP, while the overall fiscal deficit (excluding grants) will be kept under 6 percent of GDP and fully financed by external concessional resources. The emphasis will continue to be on improving revenue mobilization and redirecting expenditure away from defense and security toward priority social sectors. The monetary program will provide room for a further increase in private credit, and although the external current account deficit is projected to widen slightly to 10 percent of GDP, gross international reserves are expected to be maintained at about 3 months of imports.

#### *Fiscal Policy for 2002*

15. **The 2002 budget has been formulated to be consistent with the medium-term fiscal objectives.** Revenue is budgeted to increase to 13½ percent of GDP from 12½ percent of GDP estimated for 2001, with current expenditure to rise correspondingly to 11½ percent of GDP. The main features of the revenue and expenditure program are described in Box 1. As in previous years, the budget will be implemented cautiously and locally financed development spending will be adjusted, if necessary, to keep expenditure in line with available financing, while protecting priority social spending.

16. **Achieving improved revenue performance in 2002 is crucial for meeting expenditure needs.** Tax policy and administrative measures implemented in 2001 should help set the stage for improved revenue performance in 2002. Nevertheless, effective administration is still constrained by limited capacity in revenue agencies. The mission emphasized the importance of improving revenue administration and further broadening the tax base, as there still remained both the scope and the need for increasing revenue over the medium term without relying on further increases in tax rates. The authorities reaffirmed their commitment to achieving agreed revenue targets under the program and emphasized their intention to do so by broadening the tax base. While they will intensify efforts to improve tax administration, it would take time to substantially boost revenue. In the meantime, several specific tax increases will be implemented to help meet revenue targets (see Box 1 and MEFP, Annex II).

17. **The enforcement capabilities of the Customs and Excise Department (CED) need to be considerably strengthened.** The authorities indicated their intention to take further action to reduce smuggling, but expressed caution over the difficulties in establishing the necessary institutional coordination. To strengthen this effort, an inter-agency task force has been established, enforcement activity will be extended to key border provinces, the monitoring of duty-free imports will be improved, and a more comprehensive anti-smuggling strategy will be developed (MEFP, paragraph 8). To complement the limited capabilities of the CED, improvements are needed in the pre-shipment inspection service (PSI) for imports which, thus far, has not met expectations. To achieve this, more effective use of the reconciliation and dispute settlement process established with the PSI provider in 2001 will be required.

18. **Further improvements in spending for the social sectors, and funding for priority government reforms, are provided for in the 2002 budget.** Reductions in defense and security spending, together with improved revenue collection, should allow for a significant increase in spending for health, education, agriculture, and rural development. Despite this substantial improvement, spending for health and education is still lagging behind the average for other PRGF countries (text table) and further increases will be needed over the medium term. The wage bill is budgeted to be about 4 percent of GDP, including reserve funds provided to finance salary increases to be implemented as part of the civil service reform program. The budget also includes other reserve and contingency funds to cover potential costs associated with the implementation of the military demobilization program, payments for international obligations (including debt service), and costs associated with holding the first commune elections.

19. **The program for 2002 also includes measures to improve expenditure management.** Strict financial control by the Ministry of Economy and Finance (MEF) has been exercised over the last several years, and has been critical to the maintenance of macroeconomic stability. However, cumbersome budgetary procedures, deficiencies in overall cash management, and institutional rivalries have adversely affected the implementation of the budget, resulting in large allocations at the end of the year to meet agreed spending targets. The staff team emphasized the need to streamline procedures and take steps to consolidate government accounts and improve overall cash management to

ensure a more even expenditure pattern during the course of the year (Box 2 and MEFP, Annex III). The authorities agreed with this objective, but also emphasized the need to maintain overall financial control while implementing expenditure reforms.

### Recurrent Spending on Health and Education

	1998	1999	2000	2001 Est.	2002 Budget
(In percent of GDP)					
Cambodia					
Health	0.4	0.6	0.9	1.1	1.2
Education	1.0	1.3	1.4	1.8	2.1
Low income countries 1/					
Health	1.4	1.7	1.8	...	...
Education	3.3	3.6	4.0	...	...
(In percent of current expenditure)					
Cambodia					
Health	4.7	6.7	8.3	10.3	10.6
Education	10.8	13.4	13.6	17.0	17.7
Low income countries 1/					
Health	6.6	7.4	5.4	...	...
Education	17.3	17.8	17.4	...	...

1/ Fund staff estimates based on a sample of 27 PRGF and PRGF-eligible countries. Data for 2000 refers to budget estimates and includes only 21 PRGF and PRGF-eligible countries.

### *Monetary Policy and Bank Restructuring*

20. **The monetary program for 2002 is consistent with the growth and inflation objectives.** The authorities agreed that, with the use of traditional monetary instruments constrained by the highly dollarized environment, fiscal discipline was the key to maintaining monetary stability. Accordingly, net domestic assets of the banking system are programmed to increase by 3 percent of broad money, with net foreign assets accounting for most of the 19 percent programmed increase in broad money. The continued avoidance of bank financing of the budget will allow room for an expansion of private credit by 13 percent.

21. **The Bank restructuring agenda for 2002 is directed at completing the relicensing of privately owned commercial banks.** The staff team commended the authorities for consistently subjecting all banks to relicensing, and resisting political pressure for special treatment on several occasions. Twelve banks that failed to meet the requirements of the Financial Institutions Law were closed, while 13 other banks are operating under conditional licenses granted as part of their Memoranda of Understanding (MOU), to allow time for remedial actions to be taken to meet licensing requirements (see Annex I). For the banks subject to MOUs, about 10 have met the requirements, while 2–3 others are expected to be voluntarily liquidated. At the end of the program, the number of banks will have been reduced from more than 30 to about 15 banks in full regulatory compliance with the law.

22. **Reform of the state-owned Foreign Trade Bank, in preparation for eventual privatization, is to be accelerated.** The first unqualified external audit of the bank is expected to be completed by end-May 2002, after fully provisioning for any remaining balance sheet discrepancies. The Ministry of Economy and Finance will issue bonds by end-March 2002 to replace the central bank as the major shareholder, and external management assistance began in January 2002 to assist with the implementation of a reorganization plan. Public announcement of the intention to privatize the bank is expected by end-November 2002.

23. **The authorities agreed that, with the bank relicensing program nearly complete, there was an urgent need for further improving bank supervision.** A detailed plan for improving overall supervision is being implemented with support from the Fund and the AsDB's financial sector program loan. The central bank has prepared a new chart of accounts for the banking system consistent with international standards, and is actively discussing the new accounts with the recently established Bankers' Association. Final agreement on uniform standards should be reached in time for implementation to begin in July 2002. After a transition period, all banks would be using the new chart of accounts from the beginning of 2003. Additional work is also being undertaken to develop the payments system. Based on technical assistance provided by the Fund, a Payments Transactions Law, a Law on Bills of Exchange and Promissory Notes, and a Law on Checks and Collection and Payment of Checks are expected to be finalized and submitted to the Council of Ministers by end-May 2002.

#### *External Sector Policies and Capacity to Repay the Fund*

24. **The present flexible exchange rate policy will be continued.** The authorities reaffirmed their commitment to keep the margin between the official exchange rate and the market rate at less than 1 percent, and to move gradually to eliminate the margin entirely in the future. As Cambodia maintains no restrictions on current international transactions and does not engage in any discriminatory currency arrangements or multiple currency practices, the authorities have formally accepted the obligations of Article VIII, Sections 2, 3, and 4, with effect from January 1, 2002.

25. **The deterioration in the external outlook is expected to have an adverse impact on the balance of payments in 2002.** To the extent that garment export quotas to the United States have been binding for some categories, a 15 percent increase in quotas announced for 2002 would provide scope for these exports to continue to increase.<sup>2</sup> However, nonquota exports are expected to slow considerably because of both volume and price effects. Tourism could also suffer, but to an uncertain extent given developments so far. Slower growth in garment exports and tourism receipts will be partly offset by slower import growth, mainly reflecting lower oil prices and lower imports for export industries. As a result, the current account deficit is projected to increase only marginally to 10 percent of GDP in 2002 (from

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<sup>2</sup> About 50 percent of garment exports are subject to quota restrictions.

9 percent in 2001) before declining over the medium term. Cambodia will continue to be dependent on external financial support for the foreseeable future. Official transfers in 2002 are expected to be about \$280 million, with Japan the most significant donor, while concessional lending from the World Bank, the AsDB, and other donors is expected to be about \$131 million.<sup>3</sup>

26. **Discussions on completing rescheduling agreements with the Russian Federation and the United States have been ongoing.** The authorities have indicated their commitment to reach agreement with these creditors during 2002 (MEFP, paragraph 17). In the recent tour d'horizon at the Paris Club, creditors expressed their willingness to give financing assurances on a concessional basis (Naples terms) to cover the financing gap of the 2002 program.<sup>4</sup> Under alternative debt rescheduling scenarios, debt indicators for Cambodia are broadly consistent with standard sustainability criteria. However, owing to Cambodia's limited capacity for revenue collection, the fiscal burden of debt service would be substantial, even for a rescheduling on Naples terms. Government debt service payments would increase considerably, to 14 percent of government revenue in 2003. This underscores the importance the authorities attach to reaching agreement on a concessional rescheduling in line with Cambodia's fiscal constraints to avoid compromising poverty reduction objectives.

27. **The medium-term external position would be sustainable, provided that prudent external debt management is maintained, including successful conclusion of external debt discussions and new concessional financing in line with Cambodia's repayment capacity.** The current account deficit (excluding official transfers) is expected to decline gradually to about 8 percent of GDP by 2006, assuming a global recovery from the second half of 2002, continued export growth, rising tourism, and a resumption of forestry exports based on sustainable practice. Including official transfers, the deficit would decline from about 2 percent of GDP in 2002 to about 1¼ percent by 2006. The main risks to external sustainability would be slower export growth due to a prolonged global slowdown or reduced access to export markets, and reduced inflows of donor support or foreign direct investment arising from delays in the implementation of the reform agenda.

28. **Based on this scenario, Cambodia should be able to continue servicing its obligations to the Fund.** A good recent record of meeting scheduled payments has been maintained, and the targeted build up of international reserves provides sufficient room for future payments (Tables 8–9). If debts are rescheduled on concessional terms, debt service payments are projected to remain at 3–4 percent of gross exports during 2003–06. However, adjusting for the very high import content of the garment and tourism industries, the

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<sup>3</sup> Despite the deterioration in the global economic outlook since September 2001, Cambodia is not seeking an augmentation in Fund access, as its balance of payments and financing position remain manageable.

<sup>4</sup> Details of rescheduling scenarios and the current debt situation are described in Annex II.

debt-service payments would increase to the equivalent of 9 percent of net goods and services receipts in 2003.

29. **Further progress has been made with respect to Cambodia's accession to the WTO.** The Integrated Framework exercise (Box 3) has boosted preparatory work and mobilized domestic support for implementing the measures necessary for joining the WTO. The government is committed to move as quickly as possible with the process, and has indicated a preference to accede by end-2002. While agreement on tariff bindings and establishing WTO consistent valuation procedures should be feasible, meeting requirements for various aspects of legislative reform may require a longer timeframe. A second round of discussions of the government's replies to questions raised by other members is expected to take place in Geneva in early 2002. Tariff reforms implemented in 2001 lowered the number of tariff bands to four, reduced the maximum tariff rate to 35 percent, and the unweighted average tariff rate from 17 percent to 16 percent.<sup>5</sup> In the discussions, the government emphasized their intention to make further reductions in tariff rates, including reductions in the maximum rate, with the details to be determined during the discussions with WTO partners.

#### **B. Other Structural Reforms**

30. **In addition to the key structural reforms discussed above, other reforms for 2002 with a bearing on macroeconomic performance and growth** include forestry policy, the military demobilization program, civil service reform, implementation of the governance action plan, and completing revisions to the Law on Investment.

31. **Further steps are needed to put in place a forestry concession system consistent with sustainable resource management.** While reforms over the last two years have shifted the basic direction of policy, decisive actions are now needed to complete the restructuring of concession agreements. The Prime Minister has emphasized his commitment to the successful completion of the process, and in view of the delays already experienced, the government has announced a suspension of all logging activity with effect from January 1, 2002. Logging activity can be resumed only after sustainable management plans and environmental impact assessments are approved by the government. The creation of the Forest Crime Monitoring Unit (FCMU), with participation by an independent outside observer, was a ground-breaking development. However, the operations of the FCMU have not lived up to expectations. The staff emphasized the importance of having consistent government responses to reported cases of forest crime through a transparent case-tracking system. The government has committed to improving the operations of the FCMU by enhancing the oversight role of the Council of Ministers.

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<sup>5</sup> In the Fund's index of trade restrictiveness, Cambodia is currently rated a 6 (moderately restrictive).

32. **In addition to implementing the military demobilization program, the government has also formulated a civil service reform strategy with World Bank assistance** (Box 4). As a foundation for implementing the strategy, the computerized civil service database has now been extended to all of the provinces, and the elimination of ghost workers from the payroll will help to finance the first stage of salary adjustments to be implemented in 2002. Under the authorities' strategy for 2002–06 further reductions in the size of the civil service for non-education personnel are targeted to provide scope for significant increases in the number of teachers, with pay increases targeted to be consistent with medium-term fiscal sustainability. The authorities view Priority Mission Groups (PMGs) as a catalyst for change and a mechanism for introducing overall pay reform. Bank and Fund staffs agreed that PMGs can indeed act as catalysts for better management practices, but felt that the second objective needs to be addressed through more comprehensive pay and employment reform, including through a donor-supported retrenchment scheme.

33. **In view of pervasive governance issues, the government is taking action in a number of areas.** Many of the reforms described above are expected to contribute to improved governance. Other recent steps include providing funding for the operations of the National Audit Authority in 2002, publishing the first external audit of the central bank, and enactment of key legislation.<sup>6</sup> These reform efforts are summarized in a comprehensive Governance Action Plan (GAP) which has been approved by the government and disseminated to a broad range of stakeholders. The mission urged the government to make effective use of the GAP through regular reporting of progress against a performance matrix, especially since much remains to be done in the areas of legal and judicial reform. Such reporting will figure prominently in the consultative group meeting scheduled for mid-2002.

34. **Completing amendments to the Law on Investment (LOI) is a condition for second tranche release under the World Bank's Structural Adjustment Credit.** The debate on how best to promote investment in Cambodia has been protracted and sparked substantial controversy within the government as well as in the private sector. To better promote transparency in the context of a rules-based system, and to reduce the potential for revenue leakage, Fund and Bank staff advised that in lieu of a system of discretionary tax holidays, investment incentives should be incorporated into the Law on Taxation in the form of a uniform investment allowance and accelerated depreciation applicable to all investors. With assistance from the Foreign Investment Advisory Service (FIAS) and the World Bank, the government has recently made progress in reaching internal consensus on a reform package which should contribute to stronger ownership. These revisions incorporate several

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<sup>6</sup> This has included the Financial Institutions Law (1999), forestry concession management subdecree (2000), a Land Law (2001), and a new Forest Law (forthcoming). Specific aspects of commercial legislation are under preparation consisting of laws on intellectual property, insolvency, and secured transactions (with the later two laws being prepared with technical assistance from the Fund).

recommendations previously made by Fund staff.<sup>7</sup> However, they also include differential tax holidays by economic sector that could complicate tax administration, and also go beyond the maximum 3-year holiday advised by Fund staff. The government maintains that these minimum provisions are needed to encourage investment in the uncertain global environment, and also reflect overall private sector concern that investment provisions in the Law on Taxation may not be consistently applied. Since many of the earlier concerns are being addressed, the Bank staff indicated that the government is expected to meet SAC conditionality by submitting an amended LOI to the National Assembly by end-March 2002.

### C. PRSP and Social Impact of Reforms

35. **The full PRSP is now expected to be completed by October 2002.** Following the completion of an I-PRSP in late 2000, a national workshop was held on the PRSP process in April 2001. At that time, the government decided to focus on the completion of the second five-year Socio-Economic Development Plan (SEDP II) covering 2001–05, as the foundation for the full PRSP. The sectoral strategies developed in the SEDP II, and the consultation and participatory process carried out in preparing the document, provide a good basis for completing the full PRSP in 2002. The government has submitted a PRSP preparation status report that outlines the next steps to be taken. However, major issues remain to be addressed for a good quality PRSP and are highlighted in the accompanying Joint Staff Assessment. This process will pose considerable challenges to the government and expectations for the full PRSP need to be in line with the limited administrative capacity. Particularly important will be full support for the process from within the government, including through the Council for Social Development. The number of government initiatives also imply a need for a careful costing of priority reform measures in the context of a medium-term expenditure framework. In addition to priority social spending, these initiatives include costs associated with commune elections in 2002 and national elections in 2003, the increased frequency of international meetings for ASEAN and other regional groupings, and significantly higher debt service payments that will result from the envisaged completion of bilateral debt reschedulings agreements.

36. **The social impact of reforms implemented thus far under the program are generally considered to have been positive.** The thrust of the reform effort has been to develop human capacity and economic potential through significantly increased spending for the social sectors and improved economic infrastructure. While data for a full incidence analysis do not exist, new revenue measures adopted to finance this expenditure are not believed to have adversely affected the most vulnerable groups. The income tax thresholds are very high, and the VAT base excludes most small businesses and markets frequented by the poorest. The bulk of excise taxes is raised from cigarettes, beer, automobiles, and petroleum products. While petroleum prices do have an impact on the poor, lowering prices

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<sup>7</sup> These include eliminating the cumbersome matrix determining the length of the tax holiday, eliminating the reduced tax rate on profits of investment companies, eliminating the dividends tax exemption, and limiting grandfathering provisions for existing tax holidays.



would not be a well targeted way of providing assistance and would lead to substantial losses in government revenue. The closing of nonviable banks has resulted in depositors in one bank losing money, but the smallest depositors have received a full refund. Social safety nets are prominent in the design of the military demobilization program, and are also being developed in support of civil service retrenchment. With respect to forestry, it will be important for the government to enforce regulatory requirements for adequate safeguards to protect local people from the resumption of logging activity under approved plans. Finally, taking steps to reduce inefficiencies in the domestic production, processing, and transportation of rice would be important for reducing poverty in rural areas.

#### IV. PROGRAM MONITORING AND TECHNICAL ASSISTANCE

37. **The program for 2002 will be monitored through the quantitative and structural performance criteria outlined in paragraph 26 of the MEFP.** The coverage of quantitative benchmarks and performance criteria is the same as in previous reviews (Table 1 of the MEFP) and the approach to structural conditionality for the program is described in Box 5 (and Table 2 of the MEFP). The program remains vulnerable to political uncertainty, the fragile governance environment, and capacity constraints. The government's good record so far in meeting program conditionality, its clear indications of commitment to the reform program, and prior actions taken in the context of this review help to mitigate these risks.

38. **Considerable technical assistance in support of the reform effort is being provided under the Technical Cooperation Action Plan (TCAP) approved in 2001.** Under the TCAP, resident advisors are being provided in bank restructuring, tax administration, customs administration, budget and treasury management, and economic statistics (see Annex IX). The plan also coordinates technical assistance with efforts being provided by other agencies including the World Bank, the AsDB, and UNDP. The main priority is to ensure that this assistance develops lasting local capacity. This will require the government's strong support, as well as the proper institutional mechanisms to develop local capacity and effective coordination among the different donor agencies. The first annual review of experience under the TCAP program will be conducted by mid-2002.

39. **Cambodia is subject to the transitional procedures governing safeguards assessments.** A report of the external audit mechanism for the NBC was completed in July 2001 and concluded that the NBC has made considerable progress in updating its external audit mechanism in line with safeguards assessment policy requirements. The authorities have published the external audit report, as required by the safeguards policy, and although safeguard controls in place were assessed as adequate, a number of others steps will be taken to further strengthen the process (Annex III).

#### V. STATISTICAL ISSUES

40. **The government has taken initial steps to improve economic statistics, and the reporting of basic data is adequate for the purpose of monitoring the program.** Publication of government finance data in Cambodia's IFS page was recently initiated, and a full GFS submission is expected by mid-2002, while progress in improving balance of

payments compilation is also being made. Serious deficiencies remain, as noted in Annex VIII, but there is a good prospect for further improvements in the future. The government has now agreed to use the Fund's GDDS as a framework to guide statistical development, and a resident statistics advisor is in place to assist in this effort.

## VI. STAFF APPRAISAL

41. **Cambodia has achieved positive results during the first two years of the PRGF-supported program.** Macroeconomic stability and growth momentum have been maintained, despite extensive flooding in late 2000 and the deterioration in the global economy in 2001. Progress has also been made in key areas of structural reform. The bank restructuring program is proceeding, improvements in tax administration and expenditure management are underway, and after some initial delays, the discharge of soldiers under the first phase of the military demobilization program has been completed.
42. **The reform momentum will need to be continued and strengthened in key areas to sustain high growth rates and reduce poverty.** The forthcoming election period with the first commune elections to be held in February 2002 and national elections in 2003 will pose challenges to the consistent implementation of reforms. Despite important progress already made, the reform agenda remains daunting and Cambodia remains vulnerable to risks that could jeopardize the progress that has been made. In particular, strong efforts are required for fostering ongoing reforms in key areas, including tax administration and expenditure management, winding up the bank restructuring process, preparing the Foreign Trade Bank for privatization, completing the restructuring of forestry concessions, and implementing military demobilization and civil service reform. Moreover, effective actions to improve governance will continue to be important for the success of the program.
43. **The PRSP preparation status report submitted by the authorities highlights the areas that need support to develop an effective national poverty reduction strategy.** The Joint Staff Assessment emphasizes the importance of broadening the participatory process and strengthening institutional support for the preparation of the PRSP by the target date of October 2002. Fully costing priority reforms and developing a medium-term expenditure framework are crucial, particularly in view of the many expenditure needs and the impact of prospective debt rescheduling agreements.
44. **Improvements in fiscal policy continue to be a key objective of the PRGF-supported program.** The staff commends the authorities for their commitment to overall fiscal control and the avoidance of domestic financing of the budget. Significant progress has also been made in improving revenue mobilization and directing expenditure to priority social sectors and away from defense. However, there is a need to mobilize additional revenue to finance expenditure needs over the medium term, and to improve overall budget and expenditure management. The authorities have committed to the implementation of far-reaching reforms in these areas, and working closely with technical assistance provided by the Fund will be essential for success.

45. **Implementation of agreed revenue measures in 2002 will be crucial for meeting fiscal objectives.** The staff welcomes the formation of the large taxpayers unit and urges the authorities to continue to make much needed improvements in tax administration, including the collection of outstanding tax arrears. Moreover, any significant improvement in revenue performance will require fundamental improvements in customs administration. The staff welcomes recent efforts to strengthen the anti-smuggling task force and urges the government to improve customs enforcement. It will also be important to increase the effectiveness of preshipment inspection for imports. The staff urges the authorities to complete revisions to the investment regime, in consultation with the Bank and the Fund, to streamline the use of tax incentives and avoid features that would overstretch an already weak tax administration capacity. Increasing the share of garment quotas subject to auction would also increase transparency and contribute to improved revenue performance.
46. **Completing the restructuring of forestry concessions will be crucial for ensuring that government revenue from forestry is based on sustainable resource management.** Specific actions will be needed in the period ahead to finalize decisions on the termination of nonviable concessions, and more effective monitoring of forest crimes through stronger management and use of a case-tracking system will be required.
47. **Improvement in cash management and overall budget execution is needed to enhance public service delivery and to make the budget a more effective instrument of economic policy.** The staff welcomes progress in increasing allocations for priority social sectors, and encourages the authorities to make effective use of technical assistance, to improve financial control in line ministries. Improvements in cash management and public accounting will be necessary in the period ahead to make the budget a more reliable instrument of economic management. Improving budget management will be particularly important before proceeding with fiscal decentralization in the future.
48. **Improving the environment for private investment and greater diversification of production and exports will be crucial for enhancing growth prospects.** While maintaining overall macroeconomic stability will be essential, addressing the significant constraints to efficient trade facilitation will also be needed, and will require improvements in customs administration, better public service delivery and reduced use of unofficial fees and charges, and improvements in basic economic infrastructure. Further improvements in overall governance will also continue to be needed, especially with respect to developing the legal framework and establishing consistency in the application of the law.
49. **The staff welcomes progress under the military demobilization program and preparation for administrative reform.** Completing the discharge of 30,000 soldiers by end-2002 under the World Bank project will help free funds for other budget priorities in the future. At the same time, moving forward with administrative reform in 2002 will be important for improving the efficiency of public service delivery and overall governance. The completion of the automated payroll system in all provinces has provided a good foundation for the implementation of the program. For sustainability, it will be crucial to implement wage increases consistent with fiscal constraints, and to introduce priority mission groups in a transparent way and in close consultation with the World Bank and other donors.

The staff encourages the government to make further reductions in non-education personnel, once a suitable safety net has been developed, to allow for further increases in wages.

50. **Bank restructuring should be completed in the period ahead, while work to reform the Foreign Trade Bank needs to be accelerated.** The staff welcomes the consistent application of policy in the liquidation of nonviable banks and urges that actions against banks that have not met requirements under their Memoranda of Understanding be taken in a timely fashion. The staff also urges the authorities to accelerate action to reform the Foreign Trade Bank and prepare the bank for eventual privatization. Efforts to modernize the payments system will be important to support financial development over the medium term.

51. **The external position is expected to be manageable provided that reform efforts are sustained.** The staff supports the maintenance of the flexible exchange rate policy while moving toward exchange market unification, and welcomes the authorities' recent acceptance of the obligations of Article VIII, Sections 2, 3, and 4. However, external viability will require the sustained implementation of policies and continued donor support and debt relief. In this regard, the staff urges the authorities to follow through on their commitments to pursue a dialogue with the United States and the Russian Federation toward resolving outstanding bilateral rescheduling agreements during 2002. Trade reform will also continue to be important for meeting medium-term growth objectives, and the staff advocates that further specific steps be taken to implement tariff reductions in the period ahead.

52. **The staff welcomes the authorities' decision to participate in the GDDS system as a framework to guide statistical development.** While the quality and timeliness of statistics are adequate for surveillance purposes, further improvement is needed. Progress in this area, as well as other aspects of the program, will require that the authorities make effective use of substantial technical assistance being provided, and to take necessary steps to ensure that this assistance builds local capacity.

53. **Cambodia has made progress during the second year of its program and the staff recommends that the Executive Board complete the fourth review under the PRGF.** The policies for 2002 set out in the Memorandum of Economic and Financial Policies are designed to make further progress in implementing reforms, and provide a solid basis for the continuation of Fund support. Risks to program implementation stemming from weak capacity and political uncertainties during the forthcoming election period will persist. Accordingly, close program monitoring and continued technical assistance will be required.

54. It is proposed that the next Article IV consultation with Cambodia take place on the standard 12-month cycle.

## Box 1. Cambodia: Fiscal Program for 2002

### Overall Budget Framework

The 2002 budget targets a further improvement in revenue to 13½ percent of GDP from 12½ percent in 2001. This is programmed to finance an increase in current expenditure to 11½ percent of GDP (from 10½ percent of GDP in 2001), mainly reflecting expenditure needs for civil service reform, demobilization, and other obligations (including elections) totaling 0.9 percent of GDP and budgeted as reserve funds. The current surplus is budgeted at 1.4 percent of GDP, total capital expenditures projected to rise slightly, and the overall deficit is projected to be 5.9 percent of GDP, roughly the same as in 2001. The deficit will be fully financed by foreign financing, and no bank or domestic financing is envisaged.

### Revenue Target

Improvements in tax administration during the last two years are expected to contribute to better revenue performance in 2002. At the same time, other measures are expected to have negative revenue effects. These include repeal of the minimum profits tax, and reduced timber royalty revenue (due to suspension of logging activities). To boost revenue, the authorities will undertake several measures, calculated to yield additional revenue totaling about 0.8 percent of GDP:

- Increasing the excise rate on beer from 10 percent to 20 percent;
- Increasing excise tax rates on gasoline and diesel by 2 cents per liter for gasoline and 4 cents per liter for diesel (equivalent to a tax rate of about 10 and 20 percent, respectively);
- Increasing the share of garment quotas to be auctioned from 10 percent to at least 20 percent; and
- Introducing increased royalty fees for casinos and reviewing revenue sharing contract with the Angkor monument complex management company, and for telecommunication services.

With respect to tax administration, under the Technical Cooperation Action Plan (TCAP), tax and customs advisors have been in place in both the Tax Department and Customs and Excise Department (CED), and reform objectives and implementation plans have been established. Given that the overall administration capacity is limited, the initial reform program aims at improving tax collections from large taxpayers and minimizing tax leakage. To this end, the Tax Department and CED will focus on strengthening the recently established large taxpayers unit, and the anti-smuggling task force (for example, by establishing formal cooperation arrangements among the CED, the Armed Forces, and the Police).

### Expenditure Priorities

- **Allocating more funds to the priority social sectors.** Expenditure for the key social ministries (education, health, agriculture, and rural development) is budgeted at 3.7 percent of GDP, up from 3.2 percent of GDP budgeted in 2001.
- **Implementing the full military demobilization program.** Reflecting the discharge of 15,000 soldiers by end-2001 (11½ percent of the military) and rigorous wage bill control, defense and security spending is expected to decline to 2.8 percent of GDP in 2002 from 3.2 percent of GDP in 2001. However, military demobilization will involve an additional 15,000 soldiers being discharged by end-2002 with the government's share of the departure package amounting to about 0.1 percent of GDP.
- **Launching civil service reform and associated increases in wages.** The net cost of selective wage increases in the first year of the program is estimated at 0.2 percent of GDP, with the total wage bill (including defense) to be held below 4.0 percent of GDP.
- **Providing contingency funds to cover new priorities.** The first commune elections in Cambodia are scheduled for February 2002, and the total cost is estimated at CR 27 billion (0.2 percent of GDP), of which CR 10 billion would be financed by the government and the rest by donors. Additional contingency funds are also budgeted, including for the expected resolution of outstanding external debt issues (0.2 percent of GDP). The annual carrying cost of a recapitalization bond for the FTB is expected to be marginal (0.3 percent of current expenditure).

## Box 2. Cambodia: Public Expenditure Management Reform

The current public expenditure management system has maintained effective control over aggregate spending, but the system is not transparent and is suffering from a lack of clear procedures and accountability. The main problems are extremely slow budget execution due to complicated pre-auditing control of spending (leading to an end-year rush of spending approval), and chronic cash shortages despite adequate government deposits. Specific examples of the problems include the following:

- The budget approved by the National Assembly does not specify details of spending items, and spending agencies need to seek approval from the Ministry of Economy and Finance for each spending request. This approval process is complicated and time consuming.
- After a spending request is approved, the spending agency struggles to get actual cash disbursements from the National Treasury (NT), which is constantly facing a cash shortage; with frequent delays in cash disbursements, agencies have little incentive to transfer collected revenue to the national budget promptly.
- Finally, there is a legacy of ineffective coordination between the MEF and the NT. Currently, the MEF holds dollar budget accounts, and the NT riel accounts. As a result, the cash management system is fragmented and the NT suffers from a cash shortage.

As part of Fund assistance under the TCAP, a comprehensive technical assistance mission on public expenditure management visited Cambodia in April 2001, and budget and treasury advisors are now in place. The authorities are currently formulating a comprehensive reform strategy for public expenditure management that will aim at establishing a rules-based, transparent, and accountable system focusing on:

- *Expenditure control:* Establish a uniform budget execution mechanism based on delegated financial control in all ministries, and develop internal audit functions and capabilities in spending agencies.
- *Cash management:* Establish and enforce a rules-based system for the collection of all revenues; strengthen cash management and ensure transparency of the cash allocation plan.
- *Treasury reform:* Harmonize government accounts in the NBC in one operational structure of accounts; redefine the institutional role and relationship of the NT with other departments in the MEF and the NBC; and gradually improve the financial information base of the NT.
- *Accounting and financial reporting:* Review standardized accounting procedures and methodology for the public sector and establish a comprehensive fiscal reporting system.

### Box 3. Cambodia: Integrated Framework for Trade and Development

#### Background

The integrated framework (IF) is the outcome of a commitment made by six multilateral agencies (IMF, ITC, UNCTAD, UNDP, World Bank, and WTO) in 1997 to coordinate their assistance in promoting the integration of least developed countries into the global economy. In April 2001, Cambodia was designated as one of three pilot countries along with Madagascar and Mauritania. In August, a team comprising officials from the World Bank, IMF and WTO visited Phnom Penh and worked with Ministry of Commerce officials to prepare a diagnostic study covering a macroeconomic assessment, trade policy, trade facilitation, poverty impacts, and technical assistance needs. The recent WTO Ministerial Declaration in Doha encouraged the extension of the IF to all LDCs following the review and appraisal of Cambodia's successful implementation of the pilot scheme.

A two-day national workshop was held in Phnom Penh in November 2001 to discuss the draft diagnostic report with broad participation from various stakeholders, including bilateral donors and NGOs. Trade policy and trade facilitation have been designated by the government as one of the pillars for its national poverty reduction strategy, and elements of the diagnostic study are expected to be reflected in the PRSP.

#### Preliminary Conclusions

- The system of requiring exporters who are entitled to import duty exemptions to complete a master list of planned imports is unwieldy and involves high bureaucratic costs. Moreover, while it is important to enable exporters to access inputs at world prices on competitiveness grounds, foregone tax revenues from these exemptions are substantial.
- For some goods (e.g., petroleum and cigarettes), the MEF sets predetermined, minimum or fixed dutiable values for calculating duties. While the purpose of setting prices in this way is to fight under-valuation, it gives rise to uncertainty in the tariff structure, as it creates hidden specific duties or concessions that are not explicitly included in the tariff schedule. It is also inconsistent with WTO rules. A differential tax treatment between imports and domestically produced goods (e.g., motorcycles) also violates WTO rules.
- Substantial transaction costs hinder trade facilitation, which is further complicated by such factors as porous borders with three neighbors, high port costs, a complicated tariff structure, limited resources, low civil service salaries, and unclear lines of responsibility between the Customs and Excise Department and other agencies. These circumstances result in various unofficial fees and charges that are levied on goods as they move through the country and across the borders.

Sectoral case studies—rice, agro-processing, handicrafts, fisheries, garments, tourism and labor services—provide practical grounding for ideas and actions. These include:

- There are many specialty crops (spices, herbs, and so on) well suited to Cambodia, which offer the potential for high returns. It is essential to improve physical and social infrastructure and trading conditions to support the development of these products, as agriculture is evolving to go beyond food security.
- Despite the remarkable growth over the past five years, the long-run competitiveness of the garment industry warrants careful assessment, as quota restrictions are scheduled to be phased out by 2005 and the number of competitors with most-favored-nation access is increasing. Existing institutional arrangements (e.g., relatively high minimum wages, unofficial taxes) as well as regulatory compliance costs need to be addressed for sustainable growth.
- Limited transportation inhibits cross regional tourism and discourages investment. A severe shortage of institutional capacity and social capital, together with the low level of locally produced food to support the tourism industry, constrains development and prevents the transfer of economic benefits to a broader constituency of beneficiaries.

## Box 4. Cambodia: Civil Service Reform Strategy (2002–06)

### Main Objectives and Targets

*Key Civil Service Issues:* Governance and service delivery by Cambodia's civil service are severely hampered by: (i) low remuneration compared with other sectors (e.g., \$24 average monthly wage compared with \$45 minimum wage in the garment sector); (ii) acute shortage of qualified civil servants; (iii) widespread absenteeism and staff exodus to nongovernment activities; and (iv) lack of adequate human resource management. Cambodia's civil service is not large compared to the country's population and labor force, but the government is highly constrained in increasing salaries by low revenue.

*Main Features of Civil Service Reform (CSR):* The government's strategy for 2002–06, prepared with assistance from the World Bank, aims at improving public service delivery and governance without compromising medium-term fiscal sustainability. The key features of the CSR strategy are:

- *New job classification system*, based on four basic categories (A, B, C, and D) depending on education levels;
- *New compensation system designed* to raise pay incentives, with a base wage compression ratio of 4.5 and five categories of allowances. The average monthly compensation level is targeted to nearly double within five years, and to be aligned with the minimum wage in the private sector. The remuneration gap between education and non-education sectors would also be closed by 2006.
- *Salary supplements* would be granted to selected groups of staff comprising senior managers under a "AA" staff category and skilled staff involved in priority tasks under a "Priority Mission Group (PMG)" program (see below). The AA category would include 500 high level managers receiving a monthly salary supplement of \$200 (equivalent to 2 percent of the projected civilian wage bill).
- *Civil service employment* would remain broadly stable at around 163,000 civil servants in 2002–06. However, staffing in the education sector would increase by 16.2 percent, offsetting a 17.6 percent decline in other sectors. A departure scheme would be required in support of the downsizing of some 15,000 employees (9 percent of the civil service workforce).
- *The civil service wage bill* would be kept below 2.5 percent of GDP, or 19 percent of current budget expenditure during 2002–06.

### Priority Mission Groups (PMGs)

PMGs have a dual objective: (i) triggering fundamental changes in staff performance; and (ii) raising wage incentives. The government considers that PMGs are crucial for ensuring a successful CSR. PMGs are expected to strengthen the quality of service delivery, highlight staff inefficiencies in preparation for future downsizing, and eliminate remuneration distortions stemming from about \$6–10 million in salary supplements provided by donors. PMGs are expected to be capped at 1,000 staff in 2002 and to increase by 500 in subsequent years to reach a maximum of 2,500 by 2005. PMG's monthly salary supplements would range from \$50–\$150, depending on grades and would account for about 3 percent of the projected civil service wage bill in 2006. PMGs would be primarily financed from the budget, but donor participation would also be sought.

### Bank and Fund Staff Assessment

While recognizing that PMGs could provide useful incentives to enhance civil service performance in key areas, Bank and Fund staff consider that PMGs may not provide an adequate framework for a broad pay reform in the civil service, largely because of their limited scope (less than 2 percent of civil service staffing in 2006). The vertical decompression under the current scenario is not sufficient to retain and motivate senior level officials, and the establishment of competitive salaries across the whole civil service is crucial for ensuring the sustainability of the CSR. To that end, a more comprehensive program balancing remuneration improvements for all levels and employment restructuring would be needed. Bank staff will continue to be closely involved with the implementation of the CSR, which would be supported by a potential Poverty Reduction Support Credit (PRSC).



## **Box 5. Cambodia: Structural Conditionality for 2002**

### **Coverage of Conditionality for 2002**

Consistent with the guidelines for streamlining conditionality, the structural conditions for 2002 are set out in Table 2 attached to the MEF. <sup>1</sup> These conditions are focused on completing the bank restructuring program, reform of the Foreign Trade Bank, addressing slippages in forestry policy, developing the payments system, improving tax and customs administration, trade reform, and strengthening public sector accounting and expenditure management. All of these areas are judged critical for maintaining macroeconomic stability or enhancing growth prospects.

### **Status of Structural Conditionality from Earlier Programs**

Since the start of the PRGF program in October 1999 all structural performance criteria have been observed, but there have been delays in the implementation of some structural benchmarks. Some of these delays were relatively minor reflecting time needed to design reforms in the context of a very heavy agenda. Some other measures subject to benchmarks, however, experienced considerable delays during 2000-01, in particular, implementation of the full military demobilization program, formulating an acceptable strategy for civil service reform, and completing revisions to the Law on Investment (LOI).

The demobilization program is now moving forward with the support of the World Bank. Civil service reform will begin in 2002, and the process of revising the LOI is being addressed in the context of the World Bank SAC and is nearly complete. In sum, all of the structural reforms envisioned at the beginning of the program have been completed or are in process. The structural performance criterion for end-October was observed and the status of other structural conditions for the fourth review is reported in Table 3. The implementation of a revised chart of accounts for commercial banks has been delayed by the need for further consultations with the banking industry to establish uniformity. A timetable for implementation has been worked out in close consultation with MAE technical assistance. Taking action against forestry concessions that have not submitted adequate management plans was also delayed but is being addressed through a suspension of logging activity imposed with effect from January 1, 2002.

### **Structural Areas Covered by the World Bank**

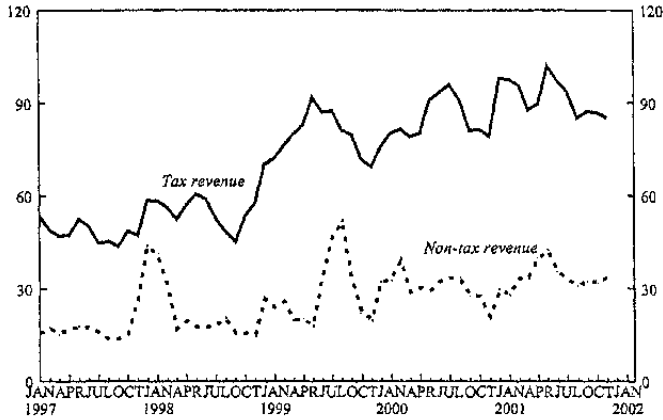
The current SAC program, approved in February 2000, aims at improving natural resource and public sector management, as well as enhancing governance and fighting corruption, and includes conditionality related to the pilot military demobilization program, public expenditure management, forestry policy, and revisions to the Law on Investment. Implementation of the full military demobilization program is being covered by a demobilization and reintegration project approved by the World Bank's Board in August 2001; forestry policy is supported by a Learning and Innovation Loan (LIL) approved in June 2000; and civil service reform and the implementation of the Governance Action Plan is being addressed through the preparation of an Economic and Public Sector Capacity Building project, a potential Poverty Reduction Support Credit, and an associated Policy and Human Resource Development grant. The World Bank also has a Legal and Judicial Reform Project and a Land Management Project. Land reform, a critical component of the poverty reduction strategy, and aspects of natural resource management (excluding forestry) are also major areas of structural reform that are being addressed by the Asian Development Bank and other donors.

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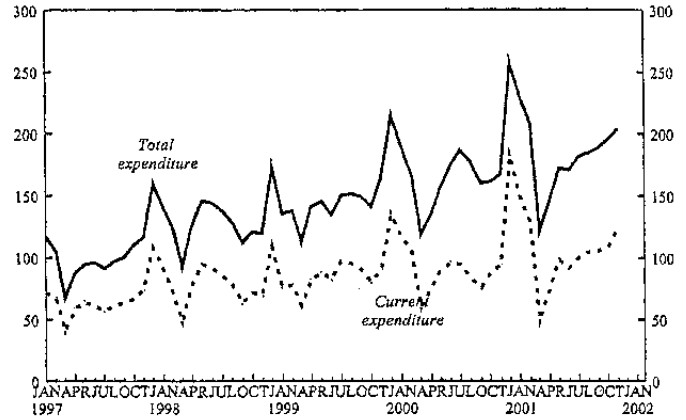
<sup>1</sup> Structural conditionality for the 2001 program is described in the Staff Report for the third review (EBS/01/109, 07/03/01, Box 5).

Chart 1. Cambodia: Selected Economic Indicators, 1997-2001

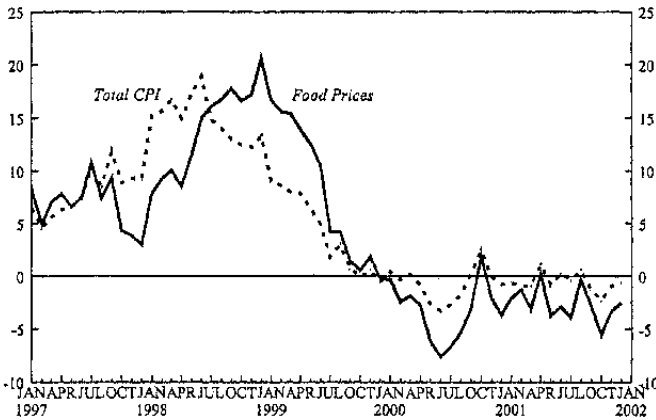
General Government Revenue  
(3-month moving average, in billions of riel)



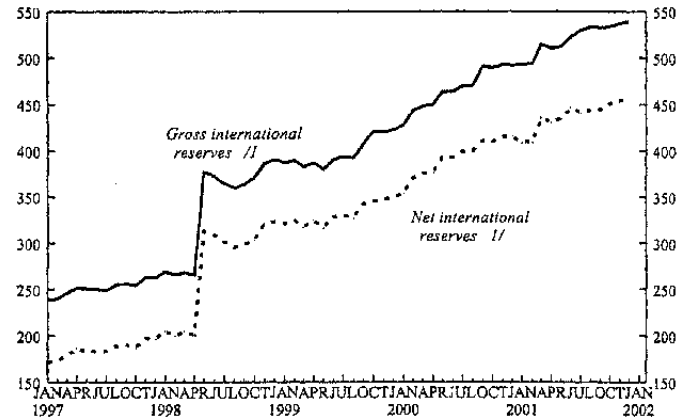
General Government Expenditure  
(3-month moving average, in billions of riel)



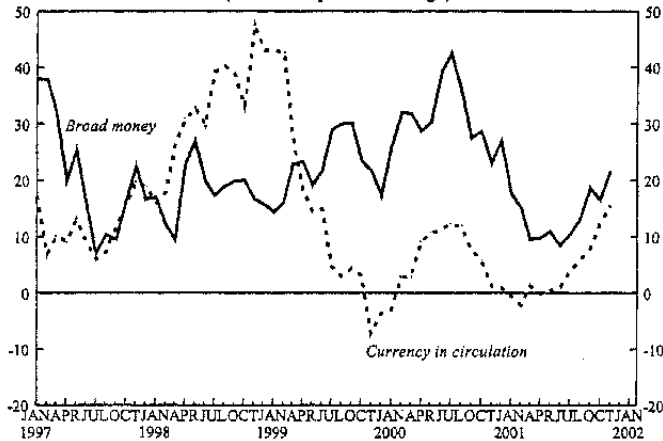
Consumer Price Index  
(12-month percent change)



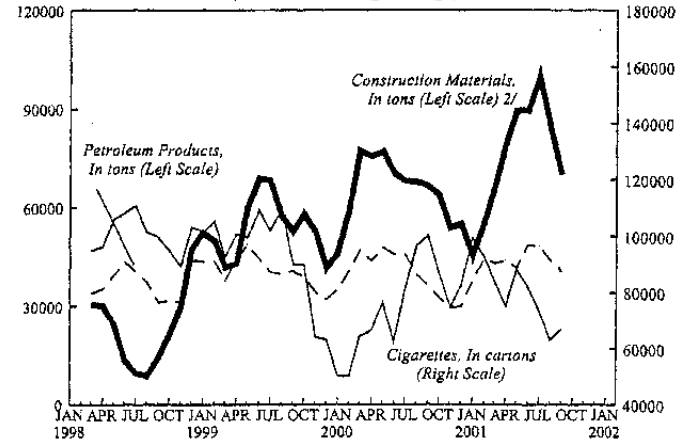
International Reserves  
(In millions of U.S. dollars)



Monetary Indicators  
(12-month percent change)



Import Volumes of Key Commodities  
(3-month moving average)

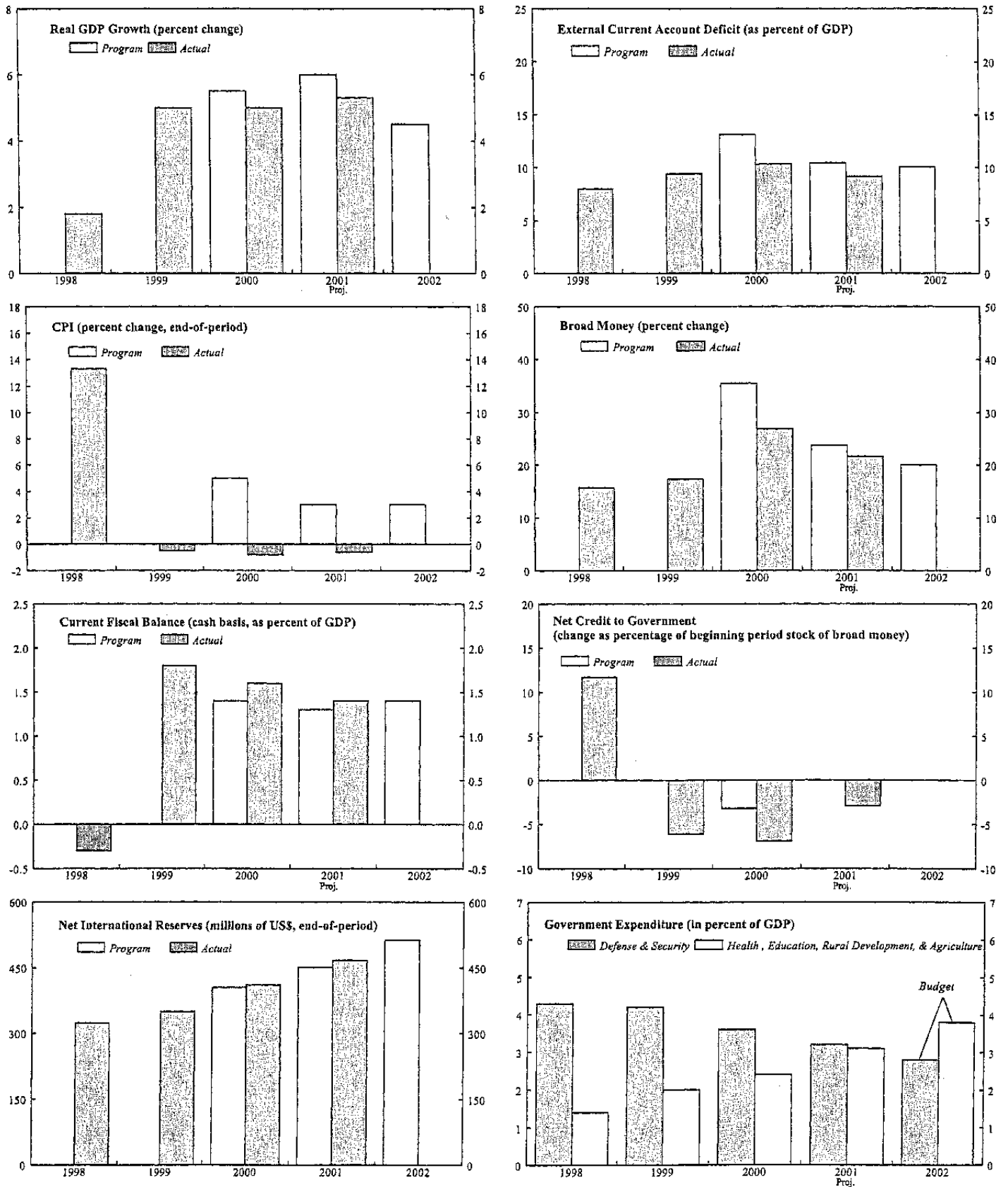


Source: Data provided by the Cambodian authorities.

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

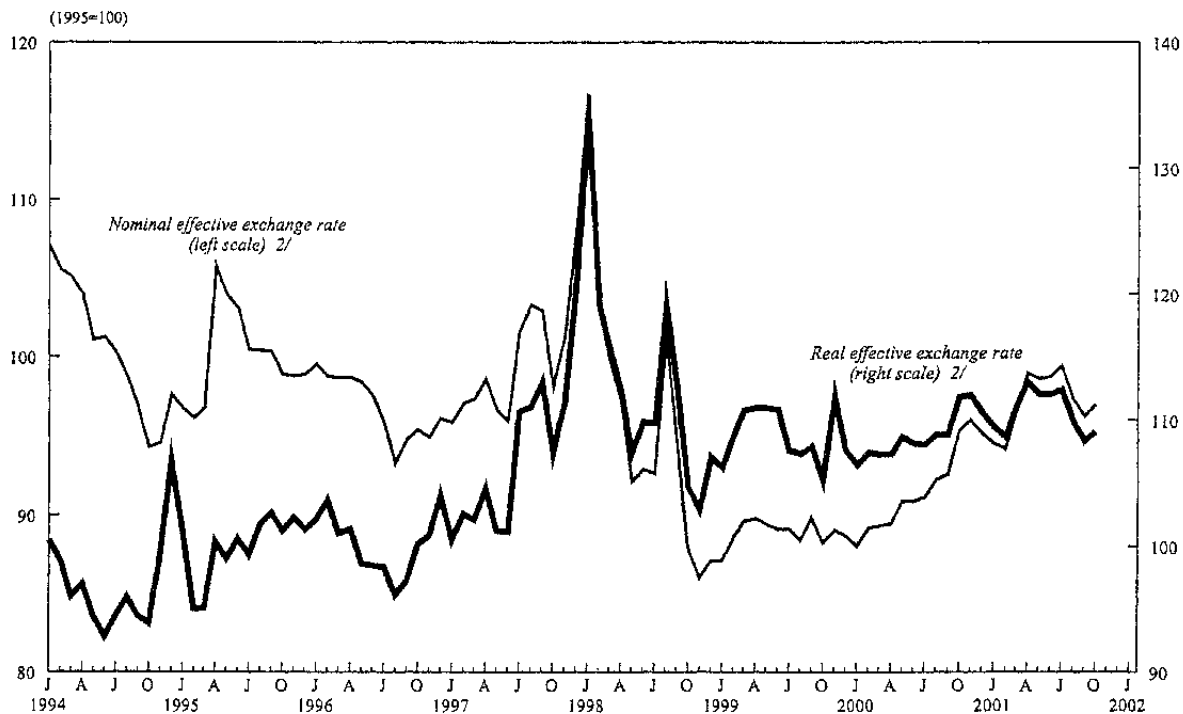
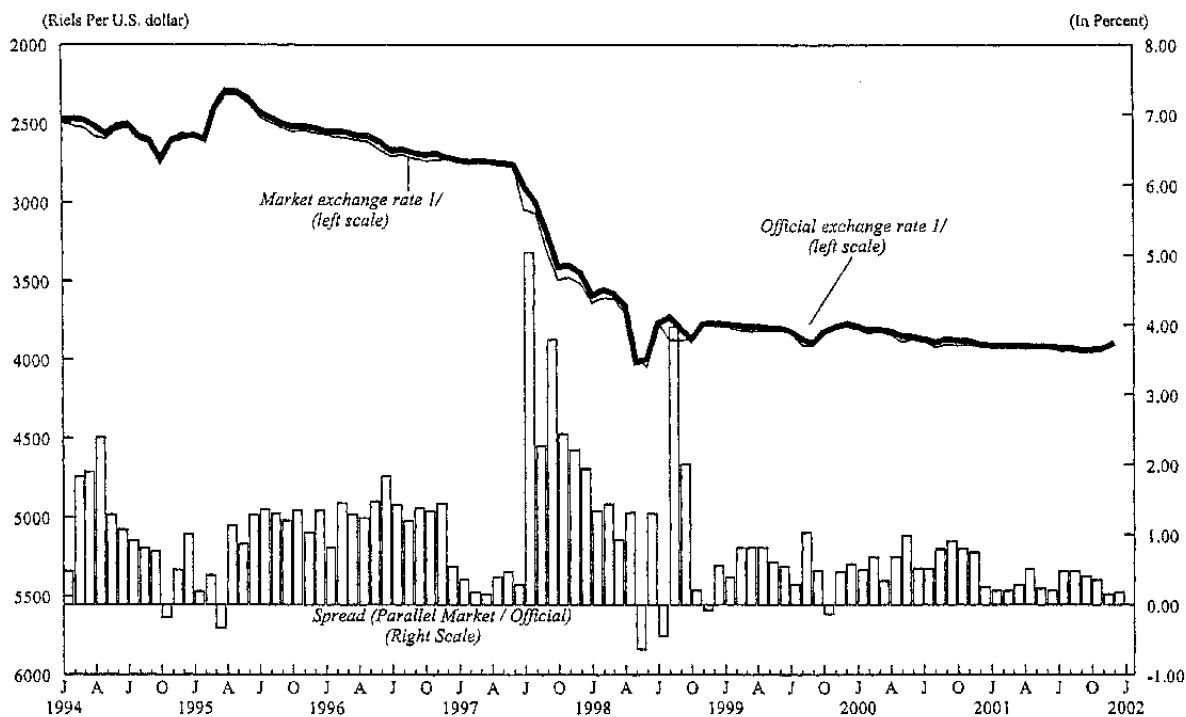
2/ Includes imports of steel, cement, and construction equipment.

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



Source: Data provided by the Cambodian authorities, and Fund staff estimates.

Chart 3. Cambodia: Exchange Rate Developments, 1994-2001



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

1/ Riels per U.S. dollar, end-period buying rate.

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

Table 1. Cambodia: Selected Economic Indicators, 1998–2002

Nominal GDP (2000): \$3,094 million  
 Population (2000): \$13 million  
 GDP per capita (2000): \$239  
 Fund Quota: SDR87.5 million

	1998	1999	2000	2001		2002
				Prog.	Proj.	
(Percent change; unless otherwise indicated)						
<b>Real economy</b>						
Real GDP	1.5	6.9	5.4	6.0	5.3	4.5
GDP deflator	13.6	3.3	-2.9	5.0	3.0	3.0
Consumer prices (end of period)	13.3	-0.5	-0.8	3.0	-0.6	3.0
(annual average)	14.8	4.0	-0.8	4.0	-0.6	1.4
<b>Money and credit</b>						
Broad money (including foreign currency deposits)	15.7	17.3	26.9	23.7	21.6	19.4
Of which: riels in circulation	43.0	-3.8	1.0	8.2	9.6	7.7
Net credit to the government 1/	11.7	-6.1	-6.9	0.0	-2.9	0.0
Velocity of money 2/	9.5	8.6	6.7	6.7	6.4	5.7
(In percent of GDP)						
<b>Government budget</b>						
Revenue (incl. capital revenue)	8.9	11.5	12.1	12.2	12.4	13.2
Of which: tax revenue	6.4	8.3	8.8	8.7	8.9	9.3
nontax revenue	2.2	3.1	3.0	3.4	3.4	3.6
Expenditure 3/	14.9	15.9	17.8	18.4	18.2	19.1
Current expenditure 3/	8.9	9.6	10.3	10.8	11.0	11.6
Capital expenditure	6.0	6.3	7.5	7.5	7.2	7.5
Current budget balance	-0.3	1.8	1.6	1.3	1.4	1.4
Overall budget balance	-6.0	-4.4	-5.7	-6.1	-5.8	-5.9
Overall budget balance (incl. grants)	-2.7	-1.4	-1.7	-2.7	-2.4	-2.9
Foreign financing	4.8	4.4	5.9	6.1	5.8	5.9
Domestic financing	1.1	-0.4	-0.2	0.0	0.0	0.0
Outstanding operations 4/	0.1	0.3	-0.1	0.0	0.0	0.0
<b>Domestic investment</b>	12.0	17.0	14.1	16.5	14.5	15.0
<b>National saving</b>	10.9	15.2	12.8	14.1	13.9	13.0
(In millions of U.S. dollars; unless otherwise indicated)						
<b>Balance of payments</b>						
Exports 5/	604	709	1,103	1,196	1,322	1,402
Imports 5/	-831	-968	-1,438	-1,524	-1,621	-1,718
Current account (excl. official transfers)	-224	-276	-316	-357	-301	-358
(In percent of GDP)	-8.0	-9.0	-10.2	-10.4	-9.1	-10.0
Current account (incl. official transfers)	-30	-55	-42	-83	-21	-72
(In percent of GDP)	-1.1	-1.8	-1.4	-2.4	-0.6	-2.0
Capital account	-66	-31	-5	85	48	78
Overall balance	-96	-86	-47	2	27	5
Gross official reserves	390	422	485	531	548	604
(In months of imports of goods and services)	3.5	3.3	2.8	2.8	2.9	2.9
(In percent of broad money)	119.9	110.5	103.6	103.8	104.4	96.3
Net official reserves	323	349	411	451	467	512
External debt	2,044	2,200	2,195	1,236	2,185	1,551
(In percent of GDP)	72.6	72.0	71.0	35.9	66.3	43.5
Debt service	124	125	129	52	54	34
(In percent of domestic exports of goods and services)	20.9	13.6	9.1	4.2	3.3	1.9
<b>Memorandum items:</b>						
Nominal GDP (in billions of riels)	10,543	11,646	11,923	13,606	12,932	13,919
(in millions of U.S. dollars)	2,816	3,054	3,094	3,440	3,296	3,569
Exchange rate (riels per dollar, end of period)	3,780	3,775	3,910	4,000	3,900	3,900

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

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

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

3/ Includes cash adjustments.

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

5/ Excludes re-exports.

Table 2. Cambodia: Quantitative Performance Criteria and Benchmarks, June–December 2001

	2000		2001					
	Stock at End -Dec. Actual	Actual	End-June		End-Sept. 1/		Actual	End-Dec. Rev. Prog.
			Rev. Prog.	Adj. Prog.	Rev. Prog.	Adj. Prog.		
			Actual	Actual	Actual	Actual		
			(Cumulative change from beginning of year)					
Net domestic assets of the central bank (in billions of riels) 2/3/	-941	-71	-68	-124	-44	-19	-156	-57
Net credit to the government from the banking system (in billions of riels) 3/	3	-42	-39	-85	-7	18	-76	0
Net domestic financing of the budget (in billions of riels) 3/	...	-66	-63	-125	-18	7	-93	0
Contracting or guaranteeing of external debt by the public sector 4/								
Up to one-year maturity 5/	...	--	--	--	--	--	--	--
1-5 year's maturity	...	--	--	--	--	--	--	--
Medium-and long-term nonconcessional debt 6/	...	--	--	--	--	--	--	--
External payments arrears 7/	...	--	--	--	--	--	--	--
Net official international reserves (in millions of U.S. dollars) 8/	411	20	20	34	27	22	38	40
			(Cumulative flows from beginning of year)					
<i>Memorandum items:</i>								
Foreign currency nonproject budget/BOP support (in millions of U.S. dollars)	...	0	...	0	10	...	5	20
Total nonproject budget support (in billions of riels)	...	45	...	42	87	...	62	144
			(Stock at end of period)					
Net domestic assets of the central bank (in billions of riels) 2/	-941	-1,012	-1,010	-1,065	-985	-961	-1,097	-998
Net credit to the government from the banking system (in billions of riels)	3	-39	-36	-82	-4	21	-73	3
Net official international reserves (in millions of US dollars)	411	431	431	445	438	432	449	451
Exchange rate (riels per U.S. dollar; end of period)	3,910	3,950	...	3,920	3,975	...	3,945	4,000

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

1/ Performance criteria.

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

3/ For purposes of verifying compliance with the program, the program ceiling for net domestic assets of the central bank, net credit to the government from the banking system, and net domestic financing of the budget were adjusted upward by CR2.5 billion in June 2001, and CR24.7 billion in September 2001 due to shortfalls in external nonproject budget support.

4/ Maturity based on original contract.

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

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

7/ Continuous performance criterion.

8/ For purposes of verifying compliance with the program, the floor on net official international reserves was adjusted downward by \$5.4 million in September 2001.

Table 3. Cambodia: Structural Benchmarks and Performance Criteria for the Fourth Review

Policy	Timing	Status
1. Establish Large Taxpayers Unit, with the possibility of direct payment by check or transfer into National Treasury accounts at the NBC for the largest taxpayers. <b>[Structural performance criterion].</b>	End–October 2001	Completed.
2. Prepare a new chart of accounts for fully licensed banks based on international standards.	End–January 2002	A new chart of accounts was prepared in September 2001. Consultations are underway with the newly formed Bankers' Association to agree on uniform standards and dates for full implementation.
3. Complete quarterly reports on the implementation of the banks' MOUs indicating actions to be taken against non-complying banks, with a view to consolidating further the banking system.	End–August 2001 and end–October 2001	Completed.
4. Cancel licenses of forestry concessions that have not submitted restructured concession agreements.	End–September 2001	Plans submitted by concessions were not sufficient to form a basis for sustainable operations. All logging operations have been suspended as of January 1, 2002 until sustainable management plans are approved.
5. Complete civil service census, and fingerprinting and registration of civil servants, in all provinces.	End–July 2001	Completed in September.
6. Submit the 2002 budget to the National Assembly according to the agreed framework, and with new tax measures (from the options recommended by FAD) and legal authorization for the issuance of FTB recapitalization bonds.	End–November 2001	Completed. The 2002 budget was submitted to the National Assembly in early December.

Table 4. Cambodia: General Government Operations, 2000-02

	2000		2001		2002		2000	2001			2002	
	Budget	Prog.	Proj.	Budget	Prog.	Budget		Prog.	Proj.	Budget	Prog.	
	(In billion of riels)						(In percent of GDP)					
<b>Total revenue</b>	1,442	1,683	1,660	1,600	1,860	1,834	12.1	12.1	12.2	12.4	13.4	13.2
<i>Of which</i> : central government	1,408	1,651	1,628	1,559	1,816	1,790	11.8	11.9	12.0	12.1	13.0	12.9
Tax revenue	1,055	1,213	1,190	1,147	1,285	1,279	8.8	8.7	8.7	8.9	9.2	9.2
Direct taxes	136	131	140	141	138	127	1.1	0.9	1.0	1.1	1.0	0.9
<i>Of which</i> : Profit taxes	101	108	113	101	108	96	0.8	0.8	0.8	0.8	0.8	0.7
<i>Of which</i> : Minimum tax refunds (-)	...	...	...	...	...	-36	...	...	...	...	...	-0.3
Indirect taxes	500	677	628	598	681	686	4.2	4.9	4.6	4.6	4.9	4.9
<i>Of which</i> : Excise taxes	113	248	179	165	165	220	0.9	1.8	1.3	1.3	1.2	1.6
Domestic	19	23	23	22	35	35	0.2	0.2	0.2	0.2	0.3	0.3
Import	94	225	156	143	130	185	0.8	1.6	1.1	1.1	0.9	1.3
VAT (net VAT refunds)	371	417	438	419	502	452	3.1	3.0	3.2	3.2	3.6	3.2
Domestic	73	86	89	88	112	112	0.6	0.6	0.7	0.7	0.8	0.8
Import	313	331	349	336	390	370	2.6	2.4	2.6	2.6	2.8	2.7
Refund (-)	-14	...	...	-5	...	-30	-0.1	...	...	0.0	...	-0.2
Trade taxes	390	379	396	373	430	430	3.3	2.7	2.9	2.9	3.1	3.1
Tax revenue from provinces	29	26	26	35	36	36	0.2	0.2	0.2	0.3	0.3	0.3
Nontax revenue	356	445	445	444	550	530	3.0	3.2	3.3	3.4	4.0	3.8
<i>Of which</i> : Timber Royalties	41	55	50	32	46	20	0.3	0.4	0.4	0.2	0.3	0.1
PTT	92	144	120	120	133	130	0.8	1.0	0.9	0.9	1.0	0.9
Quota Auction	22	10	21	27	35	75	0.2	0.1	0.2	0.2	0.3	0.5
Garment licenses	43	50	40	45	45	45	0.4	0.4	0.3	0.3	0.3	0.3
Capital revenue	31	25	25	9	25	25	0.3	0.2	0.2	0.1	0.2	0.2
<b>Total expenditure</b>	2,119	2,483	2,442	2,300	2,655	2,662	17.8	17.9	18.0	17.8	19.1	19.1
Current expenditure	1,223	1,458	1,427	1,368	1,620	1,620	10.3	10.5	10.5	10.6	11.6	11.6
Wages	512	542	557	557	524	524	4.3	3.9	4.1	4.3	3.8	3.8
Civil administration	211	235	240	240	259	259	1.8	1.7	1.8	1.9	1.9	1.9
Defense and security	301	307	317	317	265	265	2.5	2.2	2.3	2.5	1.9	1.9
Nonwage	677	884	838	770	1,052	1,052	5.7	6.4	6.2	6.0	7.6	7.6
<i>Of which</i> : Operating expenditures	497	576	566	510	676	676	4.2	4.1	4.2	3.9	4.9	4.9
Interest	21	25	25	25	25	25	0.2	0.2	0.2	0.2	0.2	0.2
Unexpected Expenses (Chapter 41)	0	15	0	0	15	15	0.0	0.1	0.0	0.0	0.1	0.1
Reserve funds (Chapter 40)	13	64	47	35	111	110	0.1	0.5	0.3	0.3	0.8	0.8
<i>Of which</i> : Election	...	10	10	...	...	10	...	0.1	0.1	...	...	0.1
Civil service reform	...	...	...	...	...	30	...	...	...	...	...	0.2
Demobilization	...	...	...	...	...	14	...	...	...	...	...	0.1
Financial obligation	...	...	...	...	...	25	...	...	...	...	...	0.2
Provincial expenditure (net subsidy)	33	32	32	41	44	44	0.3	0.2	0.2	0.3	0.3	0.3
Capital expenditure	896	1,025	1,015	932	1,035	1,042	7.5	7.4	7.5	7.2	7.4	7.5
Locally financed	303	325	315	232	335	342	2.5	2.3	2.3	1.8	2.4	2.5
Local cost	190	200	171	171	215	202	1.6	1.4	1.3	1.3	1.5	1.5
Budget support	113	125	144	61	120	140	0.9	0.9	1.1	0.5	0.9	1.0
Externally financed	592	700	700	700	700	700	5.0	5.0	5.1	5.4	5.0	5.0
Cash adjustments 1/	...	...	-50	-50	0	0	...	...	-0.4	-0.4	...	...
<b>Current balance</b>	188	200	171	185	215	189	1.6	1.4	1.3	1.4	1.5	1.4
<b>Overall balance</b>	-677	-800	-832	-751	-795	-828	-5.7	-5.8	-6.1	-5.8	-5.7	-5.9
<b>Overall balance (including grants)</b>	-293	-400	-363	-308	-395	-404	-2.5	-2.9	-2.7	-2.4	-2.8	-2.9
<b>Financing</b>	677	800	832	751	795	828	5.7	5.8	6.1	5.8	5.7	5.9
Foreign financing (net)	708	813	832	751	808	828	5.9	5.9	6.1	5.8	5.8	5.9
<i>Of which</i> : Budget support (grant)	24	0	69	43	0	24	0.2	0.0	0.5	0.3	0.0	0.2
Budget support (loans)	89	125	75	18	120	116	0.7	0.9	0.6	0.1	0.9	0.8
Project grants	360	400	400	400	400	400	3.0	2.9	2.9	3.1	2.9	2.9
Project loans	234	300	300	300	300	300	2.0	2.2	2.2	2.3	2.2	2.2
Domestic financing	-11	-14	0	0	-13	0	-0.1	-0.1	0.0	0.0	-0.1	0.0
<i>Of which</i> : Central bank financing	-113	-14	0	-53	-5	0	-0.9	-0.1	0.0	-0.4	0.0	0.0
Exchange rate adjustments	-7	0	0	0	0	0	-0.1	0.0	0.0	0.0	0.0	0.0
Outstanding operations	-12	0	0	0	0	0	-0.1	0.0	0.0	0.0	0.0	0.0
<b>Memorandum items:</b>												
Defense and security outlays	446	421	431	419	390	390	3.7	3.0	3.2	3.2	2.8	2.8
Health, education, rural development, agriculture	299	415	415	415	518	518	2.5	3.0	3.1	3.2	3.7	3.7
Tax department revenue	229	252	264	260	299	258	1.9	1.8	1.9	2.0	2.1	1.9
Customs department revenue	797	935	900	852	950	985	6.7	6.7	6.6	6.6	6.8	7.1
Total demobilization cost 2/	9	58	58	88	88	88	0.1	0.4	0.4	0.7	0.6	0.6
<i>Of which</i> : government's expense 3/	1	9	9	14	14	14	0.0	0.1	0.1	0.1	0.1	0.1
GDP	11,922	13,900	13,606	12,932	13,919	13,919	...	...	...	...	...	...

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

1/ CR-50 billion of cash disbursement projected for 2001 reflects the cash impact of expenditure committed at end-2000.

2/ 1,500 soldiers were discharged in 2000, 15,000 in 2001, and an additional 15,000 are expected in 2002. Cost per soldier is US\$1,500.

3/ The government's financial contribution to the demobilization program is US\$240 per soldier.



Table 5. Cambodia: Monetary Survey, 1999-2002

	1999	2000	2001					2002				
	Dec.	Dec.	Mar.	June	Sept.	Nov.	Dec.		Mar.	June	Sept.	Dec.
							Prog.	Proj.	Program			
(In billions of riels; end of period)												
Net foreign assets	2,019	2,588	2,733	2,807	2,951	3,051	2,995	3,047	3,106	3,240	3,318	3,400
National Bank	1,649	2,102	2,198	2,257	2,313	2,363	2,450	2,416	2,452	2,562	2,616	2,675
Deposit money banks (DMBs)	370	486	535	550	634	688	545	631	654	678	702	725
Net domestic assets	-576	-758	-834	-821	-827	-857	-732	-821	-780	-800	-779	-743
Domestic credit	876	904	837	866	927	918	1,041	954	1,007	999	1,032	1,084
Government (net)	103	3	-69	-82	-43	-69	3	-49	-29	-69	-69	-49
Public enterprises	10	3	1	1	4	7	4	4	4	4	4	4
Private sector	763	898	905	947	963	981	1,033	1,000	1,032	1,065	1,097	1,130
Other items (net)	-1,453	-1,662	-1,672	-1,687	-1,754	-1,775	-1,772	-1,775	-1,787	-1,799	-1,811	-1,827
Of which: capital	-1,638	-1,791	-1,780	-1,851	...	-1,979	...	...	...	...	...	...
National Bank	-870	-1,000	-988	-1,022	...	-1,042	...	...	...	...	...	...
DMBs	-767	-791	-792	-828	...	-937	...	...	...	...	...	...
Broad money	1,443	1,831	1,899	1,985	2,129	2,194	2,263	2,227	2,326	2,440	2,539	2,658
Narrow money	532	540	548	544	569	589	581	581	593	606	618	631
Currency in circulation	490	495	511	510	537	559	535	542	552	563	573	584
Demand deposits	42	45	37	35	35	31	46	39	41	43	45	47
Quasi-money	911	1,291	1,351	1,441	1,555	1,604	1,682	1,646	1,733	1,834	1,920	2,027
Time deposits	32	46	48	52	58	54	54	60	65	69	74	78
Foreign currency deposits	879	1,245	1,303	1,390	1,496	1,551	1,629	1,586	1,668	1,765	1,847	1,949
(12 - month percent change)												
Net foreign assets	16.8	28.2	15.2	11.8	20.4	20.9	15.7	17.7	13.6	15.4	12.4	11.6
Net domestic assets (- increase)	15.7	31.5	30.4	21.1	25.6	19.1	-3.5	8.3	-6.5	-2.6	-5.8	-9.5
Private sector	16.6	17.7	16.1	10.2	6.5	1.8	15.0	11.3	14.1	12.4	10.6	13.0
Broad money	17.3	26.9	9.6	8.4	18.5	21.6	23.7	21.6	22.5	22.9	19.5	19.4
Of which: currency in circulation	-3.8	1.0	1.3	0.9	7.8	15.3	8.2	9.6	8.1	10.4	7.1	7.7
(Contribution to annual growth of broad money; in percent)												
Net foreign assets	23.6	39.5	20.8	16.2	27.9	29.2	22.2	25.1	19.6	21.8	17.3	15.9
Net domestic assets	-6.3	-12.6	-11.2	-7.8	-9.4	-7.6	1.4	-3.4	2.9	1.1	2.3	3.5
Domestic credit	3.0	2.0	-2.6	-2.3	-0.9	-3.1	7.4	2.7	8.9	6.7	5.0	5.8
Government (net)	-6.1	-6.9	-9.4	-6.7	-4.4	-4.3	0.0	-2.9	2.1	0.6	0.2	0.0
Private sector	8.8	9.4	7.2	4.8	3.4	1.0	7.4	5.5	6.7	5.9	5.0	5.8
Other items (net)	-9.4	-14.5	-8.6	-5.5	-8.5	-4.5	-6.0	-6.2	-6.1	-5.6	-2.7	-2.3
<i>Memorandum items:</i>												
Foreign currency deposits (in millions of U.S. dollars)	233	318	333	354	379	395	407	407	428	453	473	500
Foreign currency deposits (in percent of broad money)	61	68	69	70	70	71	72	71	72	72	73	73
Credit to the private sector (in millions of U.S. dollars)	202	230	231	242	251	250	258	256	265	273	281	290
Velocity 1/	8.6	6.7	6.6	6.6	6.5	6.4	6.7	6.4	6.3	6.1	5.7	5.7

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

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

Table 6. Cambodia: Summary Accounts of the National Bank of Cambodia, 1999-2002

	1999	2000	2001						2002			
	Dec.	Dec.	Mar.	June	Sept.	Nov.	Dec.		Mar.	June	Sept.	Dec.
							Prog.	Proj.	Program			
(In billions of riel; end of period)												
Net foreign assets	1,649	2,102	2,198	2,257	2,313	2,363	2,450	2,416	2,452	2,562	2,616	2,675
Foreign assets	1,924	2,389	2,503	2,549	2,645	2,679	2,768	2,730	2,795	2,895	2,977	3,027
Foreign liabilities	-275	-286	-305	-292	-332	-316	-318	-314	-343	-334	-361	-352
Net domestic assets	-719	-941	-1,022	-1,053	-1,085	-1,064	-998	-1,099	-1,081	-1,125	-1,127	-1,109
Claims on central government (net)	107	4	-69	-82	-73	-69	3	-49	-29	-69	-69	-49
Claims	283	272	272	272	272	272	...	...	...	...	...	...
Deposits	176	268	341	354	345	341	...	...	...	...	...	...
Claims on deposit money banks (net)	-77	-69	-81	-69	-76	-79	-106	-79	-81	-83	-85	-87
Claims on deposit money banks	5	16	16	56	53	53	6	53	13	13	13	13
Credit from deposit money banks	-6	0	0	0	0	0	-6	0	0	0	0	0
Restricted deposits	-76	-84	-97	-85	-89	-93	-106	-92	-94	-96	-98	-100
Due to the FTB	0	0	0	-40	-40	-40	0	-40	0	0	0	0
Claims on public enterprises (net)	0	0	0	0	0	0	0	0	0	0	0	0
Claims on private sector (net)	0	0	0	0	0	0	0	0	0	0	0	0
Other items (net)	-749	-877	-873	-902	-935	-916	-895	-970	-971	-972	-973	-973
Assets	121	124	116	120	127	126	...	...	...	...	...	...
Liabilities	870	1,000	988	1,022	1,062	1,042	...	...	...	...	...	...
Of which: capital	-870	-1,000	-988	-1,022	-1,062	-1,042	...	...	...	...	...	...
Reserve money	930	1,161	1,176	1,204	1,229	1,299	1,452	1,318	1,370	1,437	1,489	1,566
Currency outside banks	490	495	511	510	535	559	535	542	552	563	573	584
Currency in banks	20	34	30	42	38	37	42	43	45	48	50	52
Reserve deposits	420	633	635	653	656	703	875	733	773	826	866	930
Required	83	109	119	117	123	128	...	...	...	...	...	...
Other	337	524	516	536	533	575	...	...	...	...	...	...
Other deposits	0	0	0	0	0	0	0	0	0	0	0	0
(12 - month percent change)												
Net foreign assets	15.7	27.5	9.6	6.7	10.3	10.6	16.5	14.9	11.5	13.5	13.1	10.7
Net domestic assets (- increase)	15.6	31.0	28.8	17.1	15.9	12.9	6.0	16.7	5.8	6.8	3.9	1.0
Reserve money	15.9	24.9	-3.0	-0.9	5.8	8.8	25.0	13.5	16.5	19.3	21.2	18.8
Of which: currency outside banks	-3.8	1.0	1.3	0.9	7.8	15.3	8.2	9.6	8.1	10.4	7.1	7.7
(Contribution to annual reserve money growth; in percent)												
Net foreign assets	27.9	48.8	15.9	11.7	18.6	19.0	29.9	27.0	21.6	25.3	24.7	19.6
Net domestic assets	-12.1	-23.9	-18.8	-12.7	-12.8	-10.2	-4.9	-13.6	-5.0	-6.0	-3.5	-0.8
Net credit to government	-9.4	-11.1	-13.5	-10.2	-6.9	-6.5	-0.1	-4.6	3.3	1.0	0.3	0.0
Net claims on banks	-1.2	0.9	-0.2	0.9	0.4	0.3	-3.3	-0.9	0.0	-1.2	-0.7	-0.6
Other items (net)	-1.4	-13.7	-5.2	-3.4	-6.3	-4.0	-1.5	-8.1	-8.3	-5.8	-3.1	-0.2
<i>Memorandum items:</i>												
Money multiplier (Broad Money/Reserve Money)	1.6	1.6	1.6	1.6	1.7	1.7	1.6	1.7	1.7	1.7	1.7	1.7

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

Table 7. Cambodia: Balance of Payments, 1997-2002  
( In millions of U.S. dollars)

	1997	1998	1999	2000	2001		2002
					Prog.	Est.	Prog.
<b>Current account (excluding official transfers)</b>	<b>-246</b>	<b>-224</b>	<b>-276</b>	<b>-316</b>	<b>-357</b>	<b>-301</b>	<b>-358</b>
<b>Current account (including official transfers)</b>	<b>-37</b>	<b>-30</b>	<b>-55</b>	<b>-42</b>	<b>-83</b>	<b>-21</b>	<b>-72</b>
Trade balance 1/	-263	-227	-259	-336	-328	-299	-316
Exports	786	867	971	1,399	1,498	1,577	1,663
Domestic exports	534	604	709	1,103	1,196	1,322	1,402
Of which: GSP (incl. Garments)	279	392	564	1,012	1,113	1,252	1,353
Forestry	224	178	111	49	43	35	12
Re-exports	252	263	261	296	302	255	261
Imports, f.o.b.	-1,050	-1,094	-1,230	-1,734	-1,826	-1,876	-1,979
Retained imports, f.o.b.	-798	-831	-968	-1,438	-1,524	-1,621	-1,718
Garments sector	-195	-275	-363	-658	-724	-814	-879
Petroleum	-91	-111	-121	-299	-292	-291	-281
Other retained imports	-511	-445	-484	-481	-508	-516	-558
Imports for re-export, f.o.b.	-252	-263	-261	-296	-302	-255	-261
Services and Income (net)	-43	-57	-87	-50	-100	-77	-118
Services (net)	4	-9	-10	32	39	40	40
Of which: Tourism (credit)	68	66	119	178	202	206	218
Income (net)	-47	-48	-76	-82	-139	-118	-158
Of which: Interest (debit)	17	18	11	11	43	11	32
Private transfers (net)	60	60	70	70	70	76	77
Official transfers (net)	210	194	220	274	274	280	285
<b>Capital and financial account</b>	<b>-44</b>	<b>-66</b>	<b>-31</b>	<b>-5</b>	<b>85</b>	<b>48</b>	<b>78</b>
Medium- and long-term loans	-77	-69	-57	-23	101	63	96
Disbursements	38	46	57	91	137	97	131
Amortization	-115	-115	-114	-114	-36	-35	-35
Foreign direct investment	168	121	146	110	110	95	75
Short-term flows and errors and omissions	-135	-117	-119	-92	-126	-110	-94
<b>Overall balance</b>	<b>-81</b>	<b>-96</b>	<b>-86</b>	<b>-47</b>	<b>2</b>	<b>27</b>	<b>5</b>
<b>Financing</b>	<b>81</b>	<b>96</b>	<b>86</b>	<b>47</b>	<b>-1,358</b>	<b>-43</b>	<b>-1,440</b>
Change in gross official reserves	-28	-11	-32	-63	-47	-63	-55
Use of Fund credit	0	-1	8	4	9	9	9
Change in arrears (- = reduction)	109	108	110	105	-1,320	11	-1,395
<b>Initial Financing gap</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>-1,356</b>	<b>-16</b>	<b>-1,435</b>
Debt restructuring 2/	0	0	0	0	1,356	16	1,435
Debt forgiveness	0	0	0	0	788	15	800
Debt rescheduling	0	0	0	0	568	1	636
<b>Financing gap after debt restructuring</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>
<b>Memorandum items:</b>							
Trade balance (in percent of GDP)	-8.5	-8.1	-8.5	-10.8	-9.5	-9.1	-8.9
Current account balance							
Excluding official transfers (in percent of GDP)	-7.9	-8.0	-9.0	-10.2	-10.4	-9.1	-10.0
Including official transfers (in percent of GDP)	-1.2	-1.1	-1.8	-1.4	-2.4	-0.6	-2.0
Gross official reserves 3/	262	390	422	485	531	548	604
In months of imports of goods, services & income	2.4	3.5	3.3	2.8	2.8	2.9	2.9
In months of core imports of goods, services & income 4/	3.7	3.9	5.8	5.3	5.7	5.8	5.8
Net international reserves	197	323	349	411	451	468	513
Nominal GDP (in millions of U.S. dollars)	3,105	2,813	3,054	3,094	3,440	3,296	3,569

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

1/ Includes estimates for unrecorded forestry exports and unrecorded petroleum imports.

2/ Assumes a Paris Club rescheduling under Naples terms (67 percent NPV reduction) in 2002. Bilateral rescheduling agreements were reached with the Czech and Slovak Republics in 2001.

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

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

Table 8. Cambodia: Medium-Term Macroeconomic Framework, 1999–2006  
(In percent of GDP, unless otherwise indicated)

	1999	2000	2001	2002	2003	2004	2005	2006
	Projections							
<b>Real sector</b>								
Real GDP (percent change)	6.9	5.4	5.3	4.5	6.0	6.0	6.5	6.5
CPI Inflation (end-period; percent change)	-0.5	-0.8	-0.6	3.0	3.0	3.0	3.0	3.0
CPI Inflation (average; percent change)	4.0	-0.8	-0.6	1.4	3.0	3.0	3.0	3.0
GDP deflator (percent change)	3.3	-2.9	3.0	3.0	3.1	3.1	3.0	3.0
Per capita GDP (in U.S. dollars)	241	239	249	265	280	296	315	336
<b>National saving</b>								
National saving	15.2	12.8	13.9	13.0	13.9	14.9	15.5	16.0
Government saving	1.8	1.6	1.4	1.4	1.4	1.4	1.4	1.4
Private saving	13.4	11.2	12.5	11.6	12.5	13.5	14.1	14.6
<b>Domestic investment</b>								
Domestic investment	17.0	14.1	14.5	15.0	15.5	16.3	16.8	17.3
Government investment	6.1	7.3	7.2	7.3	6.8	6.6	6.3	6.2
Private investment	10.9	6.9	7.3	7.7	8.7	9.7	10.5	11.1
<b>Fiscal sector</b>								
Revenue	11.5	12.1	12.4	13.2	13.3	13.6	13.8	13.9
<i>Of which</i> : Tax revenue	8.3	8.8	8.9	9.2	9.4	9.8	10.2	10.5
Nontax revenue	3.1	3.0	3.4	3.8	3.7	3.6	3.4	3.3
Expenditure (cash basis)	15.9	17.8	18.2	19.1	18.7	18.7	18.7	18.8
Current	9.6	10.3	11.0	11.6	11.7	12.0	12.3	12.4
Capital	6.3	7.5	7.3	7.5	7.0	6.7	6.5	6.4
Current balance	1.8	1.6	1.4	1.4	1.4	1.4	1.4	1.4
Overall balance	-4.4	-5.7	-5.8	-5.9	-5.4	-5.2	-4.9	-4.8
Domestic financing	-0.3	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
<b>Monetary sector</b>								
Broad money (percent change)	17.3	26.9	21.6	19.4	18.0	17.0	16.5	16.0
Velocity (GDP/M2)	8.6	6.7	6.4	5.7	5.3	4.9	4.6	4.3
Private sector credit (percent change)	16.6	17.7	11.3	13.1	7.8	14.8	14.8	14.8
<b>External sector</b>								
Domestic exports (percent change)	17.5	55.5	19.8	6.1	7.5	6.3	9.7	7.7
Retained imports (percent change)	16.5	48.6	12.7	6.0	6.7	5.6	6.8	7.4
Current account balance (excluding transfers)	-9.0	-10.2	-9.1	-10.0	-9.3	-8.8	-8.3	-8.0
Current account balance (including transfers)	-1.8	-1.4	-0.6	-2.0	-1.6	-1.4	-1.3	-1.3
Overall balance	-2.8	-1.5	0.8	0.1	0.8	1.2	1.0	1.2
Financing gap (in millions of US\$)	0	0	0	0	33	38	40	30
Gross official reserves (in millions of US\$)	422	485	548	604	666	745	824	909
(in months of imports)	3.3	2.8	2.9	2.9	3.0	3.2	3.4	3.5
External debt 1/	72	71	66	43	43	42	41	39
External debt (NPV) 1/	58	58	55	23	22	22	21	20
Debt-service ratio 2/	13.6	9.1	3.3	1.9	3.8	3.5	3.3	3.1

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

1/ Figures include bilateral debt with the Russian federation and the United States and reflects the impact of completing rescheduling agreements on Naples terms with these creditors in 2002.

2/ As percent of domestic exports of goods and services. The declines in 2000 and 2001 reflect the end of the large part of the scheduled payments to the Russian Federation.

Table 9. Cambodia: Indicators of Fund Credit, 1998–2010

	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
	Projections												
	(In millions of SDRs)												
Outstanding Fund Credit	47.2	53.1	56.2	63.6	70.8	69.7	62.7	56.8	52.6	45.1	34.3	22.6	12.5
GRA	5.2	4.2	3.1	2.1	1.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
SAF/PRGF	42.0	49.0	53.1	61.4	69.7	69.7	62.7	56.8	52.6	45.1	34.3	22.6	12.5
PRGF loan disbursements	0.0	8.4	8.4	16.7	16.7	8.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total debt service to the Fund	1.5	2.9	5.7	9.6	10.1	10.0	7.6	6.4	4.7	8.0	11.2	12.1	10.5
Repurchases of GRA	1.0	1.0	1.0	1.0	1.0	1.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Repayments of SAF/PRGF	0.0	1.4	4.2	8.4	8.4	8.4	7.0	5.9	4.2	7.5	10.8	11.7	10.1
Charges	0.5	0.4	0.4	0.2	0.7	0.6	0.6	0.5	0.5	0.5	0.4	0.4	0.4
	(In percent)												
Fund credit outstanding													
In percent of total public external debt	3.1	3.3	3.4	3.7	5.8	5.3	4.5	3.9	3.4	2.9	2.1	1.3	0.7
In percent of quota	72.6	60.7	64.3	72.6	80.9	79.7	71.7	65.0	60.2	51.6	39.2	25.9	14.3
Debt service to the Fund													
In percent of total public external debt service	1.7	3.1	5.8	22.5	37.5	17.6	13.6	11.3	8.3	11.5	13.6	14.6	12.7
In percent of exports of goods and services	0.3	0.4	0.5	0.7	0.7	0.7	0.5	0.4	0.3	0.4	0.5	0.5	0.4
	(In millions of SDRs, unless otherwise indicated)												
Memorandum items:													
Cambodia's quota in the Fund	65.0	87.5	87.5	87.5	87.5	87.5	87.5	87.5	87.5	87.5	87.5	87.5	87.5
Total public external debt	1,507	1,609	1,665	1,716	1,229	1,308	1,380	1,452	1,526	1,578	1,633	1,714	1,846
Total public external debt service	91	92	98	43	27	57	56	57	56	70	82	83	82
Total exports of goods and services	438	674	1,075	1,310	1,399	1,512	1,596	1,712	1,842	1,981	2,129	2,288	2,458
Total debt-service ratio													
(in percent of exports of goods and services)	20.9	13.6	9.1	3.3	1.9	3.8	3.5	3.3	3.1	3.5	3.9	3.6	3.4

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

Table 10. Cambodia: Proposed Schedule of Remaining Disbursements  
Under the PRGF Arrangement, 2001-02

Amount	Available Date	Conditions for Disbursement
SDR 8,357,000 (9.6 percent of quota)	December 15, 2001	Observance of the end-September 2001 quantitative performance criteria, relevant structural performance criteria, and completion of the fourth review.
SDR 8,357,000 (9.6 percent of quota)	June 15, 2002	Observance of the end-March 2002 quantitative performance criteria, relevant structural performance criteria, and completion of the fifth review.
SDR 8,358,000 1/ (9.6 percent of quota)	December 15, 2002	Observance of the end-September 2002 quantitative performance criteria, relevant structural performance criteria, and completion of the sixth review.

1/ An extension of the PRGF arrangement, which will expire on October 21, 2002, will be required.

## **Cambodia—Banking Sector Reform and Next Steps<sup>1</sup>**

1. **The Cambodian banking system has played only a limited role in economic development.** The total size of the banking system (excluding the central bank) represents only 20 percent of GDP, and the system does not function effectively as a financial intermediary. Although the authorities have intensified efforts to restructure the banking sector over the last few years, the system is far from meeting development needs.

### **A. Background and Development of the Banking System**

2. **Cambodia began to depart from a market-oriented banking system in the 1960s, and this process continued over three decades.** In the early 1960's, there was a growing tendency of nationalism in Cambodia, and all banks were nationalized in 1963.<sup>2</sup> Following the emergence of the Khmer Rouge regime (1975–1979), the banking system and all aspects of private ownership were abolished. In 1980, the government created the National Bank of Cambodia (NBC) and established a socialist style monobank system with the NBC engaged in both central and commercial banking activities.

3. **In the early 1990s, major reforms were initiated to modernize the banking sector.** Some initial progress was made: the entry of foreign banks was allowed; a new central bank law provided for the independence of the National Bank of Cambodia (NBC); and the NBC was divested of its interest in all commercial banks except the Foreign Trade Bank (FTB). However, not much progress was made in developing bank supervision or in regulating banking activity. The number of banks increased rapidly to 24 at the end of 1994, but due to a lack of a clear entry policy, most of these banks were later found to be inefficient, and concerns about the quality of their assets soon emerged. Due to weaknesses in management, the banking system was poised to cause problems in the future by misallocating funds or taking excessive risks. Accordingly, public confidence in the banking system (as well as mutual confidence among banks) remained very low.

4. **In the last two years, the authorities have taken additional actions to restructure the banking system.** A new Financial Institutions Law providing a clear mandate, responsibility, and power of the NBC to execute a supervisory function, was promulgated in 1999. Under the new law, the NBC reassessed the viability of all banks, and in 2000–01 closed 12 banks that were insolvent or not complying with the law. As of end-

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<sup>1</sup> This annex was prepared by Kotaro Ishi (APD).

<sup>2</sup> As that time, nine private commercial banks were operating in Cambodia; four Cambodian local banks, and five foreign banks. These foreign banks included Credit Agricole Indosuez and Standard Chartered Bank, currently two of the largest banks in Cambodia.

December 2001, 18 private banks remained, of which 5 banks were fully relicensed and 13 banks were subject to corrective action.

5. **Some progress has been made in financial development, but the overall impact is still rather limited.** Cambodia's efforts in modernizing the banking system started from a very low level with the total asset size of all commercial banks at less than 10 percent of GDP, and both broad money and private sector credit at only 3–5 percent of GDP in the early 1990s. After some initial success, a deteriorating economic and political environment during 1997–98 slowed the process. More importantly, this slow progress could also be accounted for by a lack of sound banks. Various indicators (Table 1) show that the level of financial development in Cambodia ranks below comparable countries, suggesting that there is a lot of room for further progress.

Table 1. Selected Indicators of Financial Developments  
(In percent of GDP; unless otherwise indicated; 1998–2000 average)

	Broad money	Credit to the private sector	Currency/Broad money (percent)	Interest rate spreads 4/ (percent)	Per capita GDP (1999, in U.S. dollar)
PRGF Asian countries 1/	28.5	17.9	20.2	9.2	398
PRGF Sub-Saharan African countries	22.5	12.0	33.9	14.7	335
<i>Of which: post conflict countries 2/</i>	19.8	9.7	32.6	12.5	243
<b>Cambodia</b>	<b>13.2</b>	<b>6.8</b>	<b>33.2</b>	<b>15.4</b>	<b>241</b>
ASEAN 3/ 4/	82.0	68.0	8.4	2.7	2,242

Source: IMF International Finance Statistics, World Bank, World Development Indicators.

1/ Bangladesh, Lao P.D.R., Mongolia, Nepal, Sri Lanka, and Vietnam.

2/ Cameroon, Dem. Rep. of the Congo, Ethiopia, Mozambique, Rwanda, Sierra Leone, Uganda

3/ Indonesia, Malaysia, Philippines, and Thailand.

4/ For Cambodia, foreign currency—foreign currency saving rate (both short term). For other countries, lending rate—deposit rate (both short or medium term).

## B. Structure and Performance of Cambodia's Banks

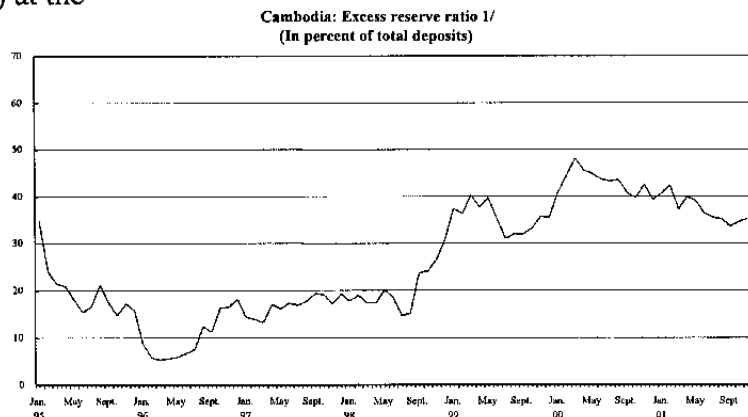
6. **The banking sector is highly concentrated.** Of the 18 relicensed banks, the top five banks represent about  $\frac{3}{4}$  of total deposits and  $\frac{2}{3}$  of total credit. In the deposit markets, the top 3 banks are locally owned banks (including the FTB), which take an active role in collecting public deposits. On the contrary, in lending markets, foreign bank branches are better represented among the top 5 banks as they support business activities of their home country customers in Cambodia and do not play as active a role in deposit taking.

7. **There are various factors hindering development of the banking sector.** These include: (i) high information cost, (ii) the lack of legal infrastructure to support the enforceability of financial contracts, and (iii) a weak bank supervisory and regulatory framework. All these factors together lead to a high risk and high cost structure for the



banking system, resulting in credit rationing and inefficient financial intermediation. Banks are very cautious to provide loans because of a lack of enforceable collateral and limited investment projects, and often prefer placing funds at the NBC. As a result, the loan to deposit ratio is low (68 percent).<sup>3</sup> While this cautious portfolio management helps to secure a stable source of income, expected returns remain low, and banks have little incentive to mobilize savings. Furthermore, the public itself still does not fully trust the banking system, and people often prefer holding gold or cash to opening deposit accounts at banks.

8. **The banking system is highly dollarized and very liquid.** Ninety-five percent of bank assets and liabilities are denominated in foreign currencies (mainly in U.S. dollars). The FTB holds a larger share of local currency denominated lending and deposits, but still about ¾ of total assets and liabilities are denominated in foreign currencies. At the end of 2000, banks held more than 90 percent of total deposits in foreign exchange accounts abroad or as reserves (both required and excess) at the NBC.<sup>4</sup> In addition, banks hold a large amount of vault cash to prepare for unexpected requests for deposit withdrawals, reflecting the lack of a central bank liquidity facility or an interbank market. Furthermore, the excess reserve ratio (excess reserves divided by total deposits) significantly increased in the second half of 1998, reaching about 40–50 percent of total deposits, reflecting a new prudential regulation implemented in October 1998 preventing the transfer of domestically collected funds abroad.



Source: Data provided by the Cambodian authorities.  
 1/ Excess reserves divided by total deposits. Excess reserves are defined by commercial banks' deposit at the NBC excluding reserve requirement and capital guarantee deposit.

9. **The profitability of the whole banking system has improved after the closing of a number of nonviable banks.** Most remaining banks are profitable, except those that require corrective actions and are likely to be closed at the final stage of bank restructuring. The banking system is well capitalized with a capital asset ratio of about 30 percent, but this simply reflects the small asset size due to the limited loan portfolio. However, the system is

<sup>3</sup> For example, as economic and political confidence returned in 1999–2000, foreign currency deposits increased sharply. However, an increase in deposits was not accompanied by an increase in loans, and the loans to deposits ratio declined during this period.

<sup>4</sup> Excess reserves are defined by commercial banks' deposit at the NBC minus required reserves and the capital guarantee deposit.

suffering from a high ratio of nonperforming loans to total loans (about 20 percent at end-December 2000) even with a rather generous definition of nonperforming loans.<sup>5</sup> Although these loans are almost fully provisioned for and do not bring immediate concerns about banking system instability, the high nonperforming loan ratio squeezes the profitability of Cambodian banks. As a result, interest rate spreads are persistently high. Although the spreads have been shrinking since late 1998, they remain at about 15 percentage points. High interest rate spreads reflect various factors including inefficiency of the banks, high risk premiums (e.g., due to high default risks), and high intermediation costs (e.g., due to non transparency of the market, high information costs, and an inefficient payments system).

Table 2. Cambodia: Banks Loan Classification 1/

(In millions of U.S. dollars)

Total loans	182.3
Standard	143.7
Substandard	6.8
Doubtful (I)	6.5
Lost (II)	25.4
Lost provisions (III)	26.5
Total nonperforming loans (I+II)	31.9
(In percent of total loans)	17.5

1/ Based on Auditor's 2000 audit report for 18 remaining banks.

### C. Promoting Financial Development in Cambodia

10. **A significant improvement in transparency is critically important to reduce information costs.** The NBC should adopt a uniform chart of accounts for banks—currently under discussion—and establish a disclosure rule. The government also needs to establish a basic accounting and audit system. Furthermore, to further reduce information costs, development of the financial information system (including establishing a credit bureau) could be developed.

11. **Ongoing government wide efforts to improve the legal framework need to be strengthened.** Key commercial laws, such as a companies law, commercial contracts law, commercial arbitration law, secured transactions law, bankruptcy law, and payments laws are currently being drafted or close to being submitted to the National Assembly and should be adopted as a priority. The government also needs to move forward with judiciary reform as an integral part of the Governance Action Plan.

12. **Further upgrading of NBC's capacity and overall bank supervision framework is urgently needed.** There are important supervision issues that arise from the dollarized nature of the system, and from the key role played by foreign bank branches. Since Cambodia's banking system, as well as large economic transactions, are virtually fully

<sup>5</sup> For example, the definition of loan classification regarding the period of past due is as follows: "standard," past due less than 3 months; "substandard," over 3 months and less than 6 months; "doubtful," over 6 months and less than 12 months; and "lost," over 12 months.

dollarized, the risk of currency mismatches arising from fluctuations of exchange rates is not a major concern. However, if Cambodia faces a large capital outflow, there is a systemic risk since the authorities have only limited ability to provide dollar liquidity to the banking system. This is not an immediate concern since the banking system currently holds large liquidity, but as the system develops this could become an important consideration.

13. **The significant presence of foreign banks is another reason to strengthen banking supervision.** While foreign bank branches are, in general, expected to bring advanced technology, sophisticated operations, and more transparency (i.e., better accounting practices), most of the foreign owned banks have only limited lending to domestic enterprises. In addition, these banks hold large foreign assets, and there is reason to have some concern about the quality of these assets, as some of these banks have significant nonperforming loans in their home country.

14. **Training for banking supervision staff should be strengthened so that the staff clearly understands the objectives of bank supervision, the details of prudential regulation, and banking risks.** This will allow NBC staff to participate more actively in onsite inspections which are currently carried out by external audit firms on behalf of the NBC. To strengthen and complement the NBC's capacity, regional cooperation in the area of bank supervision (especially with Thailand, Malaysia, and Singapore) should be encouraged.

15. **To complement its weakness in bank supervision, the NBC has implemented tougher prudential regulations than international standards.** For example, since the onset of the Asian crisis, the NBC prohibits banks to transfer domestically collected funds abroad. Given the persistent fragility of the banking system, tougher prudential regulations could be justified. However, too strict prudential regulation may prevent the efficient allocation of funds and discourage banking sector development.

16. **Finally, the introduction of a deposit insurance system could be considered in the medium term, but only after the current round of bank restructuring is fully completed.** A well designed deposit insurance system will only produce better outcomes after improving bank supervision capacity, strengthening banking sector soundness, and establishing the rule of law.

## **Cambodia—Outstanding External Debt and Rescheduling Scenarios<sup>1</sup>**

1. **This note updates the analysis conducted in October 1999 (EBS/99/188) and focuses on the implications of the envisaged debt restructuring with the United States and the Russian Federation on Cambodia's debt-servicing capacity.** With a current net present value of debt-to-GDP of 55 percent, the projections show that after full use of traditional debt relief this ratio would decline to 22 percent at end-2002, while the debt-service ratio would be about 3–4 percent over the medium term. However, the fiscal burden of servicing this debt will be heavy at over 10 percent of government revenue during 2003–06, and would have a substantial impact on the composition of government expenditure.

### **The Current Situation**

2. **Cambodia had one rescheduling operation with the Paris Club in 1995.** The terms of reference were signed in January 1995 and provided for a restructuring of maturities falling due during January 1995–June 1997 on Naples terms (67 percent NPV reduction). All bilateral agreements with participating creditors were signed except with the United States. Cambodia also has outstanding ruble-denominated debt to the Russian Federation.

3. **Cambodia has accumulated technical arrears to the United States because of delays in the conclusion of the bilateral agreement under the 1995 Paris Club, and has also accumulated payment arrears to the Russian Federation.** The total amount of debt to these creditors is estimated at about \$1.6 billion (\$1.3 billion to the Russian Federation)<sup>2</sup> as of end-2001, of which some \$1.3 billion is believed to be in arrears (\$1.1 billion to the Russian Federation).

4. **The substantial arrears accumulated with the United States since the end of the consolidation period could be treated in the context of a new Paris Club agreement.** The issue was raised by the U.S. authorities in the July *tour d'horizon*, where Paris Club creditors, including Russia, decided in principle to consider the possibility of a rescheduling on Naples terms of arrears to the U.S. and Russia in the context of a program for 2002. In the October *tour d'horizon*, the Chairman agreed with a preference of the U.S. for a new Paris Club rescheduling over purely bilateral discussions but made it conditional on their making progress in the reconciliation with the Cambodian authorities.<sup>3</sup>

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<sup>1</sup> This annex was prepared by Mr. Adachi (PDR).

<sup>2</sup> Russian claims are evaluated at the official Gosbank exchange rate of SUR0.6 per US\$1.

<sup>3</sup> Cambodia contracted five loans to the United States during 1972–74. All documentation on the Cambodian side was destroyed after the Khmer Rouge came to power in April 1975. In December 2001, the United States provided official copies of the loan documents, and these are being reviewed by the Cambodian government.

5. **Bilateral discussions with the creditors have been continued and intensified recently.** A Russian delegation visited Phnom Penh in April 2001 to conduct technical discussions with the Cambodian authorities, followed by the Cambodian Foreign Minister's visit to Moscow in May. The Cambodian Minister of Finance visited Paris on September 24 to discuss a possible Paris Club rescheduling. He then flew to Moscow to continue discussions with the Russian authorities prior to a scheduled visit by the Prime Minister in late September/early October. High profile meetings with U.S. officials were also planned in conjunction with the Annual Meetings, but these meetings, as well as the Prime Minister's visit to Moscow were cancelled due to increased security concerns after September 11. Nevertheless, further discussions with these creditors are envisaged in the period immediately ahead. A letter has been sent to the U.S. authorities inviting a delegation to come to Phnom Penh. A letter has also been sent to the Russian authorities indicating the government's willingness to discuss the issue and proposing that a delegation visit Moscow.

### **Debt-Restructuring Scenarios**

#### *Common Assumptions*

6. **The scenarios are based on an assumed Paris Club rescheduling in the first half of 2002,** the signing of bilateral agreements with the U.S. and Russian authorities toward the middle of the same year, and payments of interest beginning in the second half of 2002. The scenarios could also represent the completion of bilateral deals on similar terms.

7. The debts to which this rescheduling will apply are the following:

- a) U.S. debt consisting of five loans extended during 1972-74 ("PL-480" Credits). The U.S. debt is all pre-cut-off date ODA.
- b) Pre-cut-off date Russian debt consisting of eight credits extended between 1980-83.
- c) Post-cut-off date Russian debt consisting of five credits extended between 1986-90.

8. **Russian claims (both pre-cut-off date and post-cut-off date debt) are evaluated in accordance with the terms of the memorandum of understanding between the Russian Federation and the Paris Club in September 1997.** The official Gosbank exchange rate of SUR 0.6 per US\$1 and a 70 percent upfront discount is applied to arrears and *all* future maturities. After the upfront discount on the stock of debt, the remaining amounts (denominated in the U.S. dollars) are transformed into commercial debt with the U.S. dollar CIRR rate for DSA as a relevant market interest rate.

#### **Scenarios**

9. Four scenarios, which are based on different assumptions on the consolidation period and/or treatment of the pre- and post-cut-off date Russian debt, are presented below. Treatment of the U.S. debt differs only in terms of the consolidation period assumed in the different scenarios.

### ***Scenario A***

10. This scenario serves as a benchmark scenario in the attached tables.
- *Terms of Consolidation:* Arrears (including in principal and interest) as of end-2001 and maturities in principal and interest falling due from January to October 2002.
  - *U.S. debt:* The consolidated amount is subject to a concessional rescheduling under Naples terms with a 40-year maturity including a 16-year grace period and the original interest rate of 3 percent.
  - *Pre-cut-off date Russian debt:* A debt-service reduction (DSR) option with a flow operation under Naples terms is applied. This option entails a 33-year maturity with no grace period and a reduced interest rate to achieve a 67 percent net present value reduction.
  - *Post-cut-off date Russian debt:* The consolidated amount is subject to a nonconcessional deferral with a 15-year maturity including a 5-year grace period and the U.S. dollar CIRR rate for DSA as a commercial interest rate.<sup>4</sup>

### ***Scenario B***

11. This scenario differs from Scenario A only in that it assumes a debt-reduction (DR) option instead of a DSR option for the pre-cut-off date Russian debt. Specifically, 67 percent of the consolidated amount is cancelled and the remaining amount is rescheduled according to the DR option under Naples terms (i.e., a 23-year maturity with a 6-year grace period and the U.S. dollar CIRR rate for DSA as the appropriate market rate). Terms of consolidation and the treatment of the post-cut-off date Russian debt and the pre-cut-off date U.S. debt are identical to Scenario A.

### ***Scenario C***

12. This scenario is identical to the hypothetical rescheduling operation assumed in EBS/01/2 (Second PRGF Review document) and EBS/01/109 (Third PRGF Review document), which was first presented in EBS/99/188 with the original ESAF (PRGF) request. This scenario assumes a stock-of debt operation under a DSR option and implicitly assumes

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<sup>4</sup> The 1997 memorandum stipulates “Russia agreed to provide special treatment, following consultation with other Paris Club creditors and the IMF, for countries for which post-cutoff date arrears are large relative to their capacity of payments.”

that Cambodia agrees with the Fund on a successor arrangement.<sup>5</sup> It differs from Scenario A in terms of the consolidation period.

**Scenario D**

13. This scenario extends a Naples flow rescheduling to the post-cut-off date Russian claims. All other aspects are identical to Scenario A.

Table 1. Summary of Rescheduling Scenarios

	Scenario A	Scenario B	Scenario C	Scenario D
Consolidation Period	Arrears as of end-2001 and maturities Jan.–Oct. 2002.	Same as Scenario A.	Arrears as of end-2001 and maturities Jan.2001 onward.	Same as Scenario A.
Pre-cod Russian	Flow DSR option: 33 (0)	Flow DR option: 23 (6)	Stock DSR option: 33 (0)	Flow DSR option: 33 (0)
Post-cod Russian	Nonconcessional deferral: 15 (5)	Nonconcessional deferral: 15 (5)	Nonconcessional deferral: 15 (5)	Flow DSR option: 33 (0)
U.S.	Concessional deferral: 40 (16)	Concessional deferral: 40 (16)	Concessional deferral: 40 (16)	Concessional deferral: 40 (16)

**Results**

14. **Debt service to the United States and the Russian Federation under alternative scenarios are summarized in Figure 1 and Table A1.** With the exception of scenario D, total debt-service payments would range between \$38 million (Scenario C) and \$50 million (Scenario B) in 2003 and go up to \$60 million and \$68 million, respectively,<sup>6</sup> toward 2008. Scenario D allows for more smooth debt-service payments with increasing debt service toward the end of the rescheduling period. To put the rescheduling implications in the perspective of debt sustainability, Table A1 also reports debt services to other creditors, namely multilateral institutions and bilateral creditors which have already gone through the 1995 Paris Club rescheduling. Table A2 shows profiles of debt stock (in net present value terms) under alternative rescheduling scenarios.

15. **Under all scenarios, Cambodia’s external debt burden is consistent with standard sustainability indicators.** The ratio of debt service to exports of goods and services would peak in 2003 at 3.3 percent in the harshest scenario (Scenario B) and then decline over time albeit with some fluctuations. The ratio of debt stock, in present value terms, to exports of goods and services would peak in 2002 at 39.2 percent (Scenario B) and

<sup>5</sup> The consolidation period does not normally extend beyond the termination of a Fund arrangement.

<sup>6</sup> A rather sharp reduction in these payments in 2018 is a result of the assumption on the post-cut-off date Russian claims (i.e., nonconcessional deferral of 15 years).

then decline steadily over time. These indicators in Scenario A also depict a similar picture. The ratio of debt stock to GDP would stay below 22.1 percent throughout the period in Scenarios A and B.

16. **However, the ratio of debt service to government revenue indicates more clearly a substantial fiscal burden.** The fiscal constraint will be particularly burdensome given the government's objective to increase social sector spending in line with other low-income countries. In 2003, when the strain of debt service looks most acute, this ratio would be 13.8 percent under Scenario B and 10.7 percent even under Scenario D. While it would decline over time in all scenarios, it would hover around 10 percent until 2008 under Scenarios A and B and would be significantly above 10 percent during the critical reform years of 2003–05. On this basis there would be a case for seeking nonstandard debt relief under either Scenario C or D within the Naples framework.

17. **All of the rescheduling scenarios imply that a fundamental adjustment in expenditure priorities would be required to meet prospective debt-service obligations especially during 2003–05.** However, all of the increased revenue effort (under Scenario A) would have to be directed toward debt-service payments. The medium-term fiscal framework (below) is predicated on further improvements in revenue relative to GDP to finance increased current expenditure for the social sectors and infrastructure maintenance.

Table 2. Medium-Term Fiscal Framework, 2001–06  
(In percent of GDP)

	2001	2002	2003	2004	2005	2006
Revenue	12.4	13.2	13.3	13.6	13.8	13.9
<i>Of which:</i> tax revenue	8.9	9.2	9.4	9.8	10.2	10.5
nontax revenue	3.4	3.8	3.7	3.6	3.4	3.3
Expenditure (cash basis)	18.2	19.1	18.7	18.7	18.7	18.8
Current	11.0	11.6	11.7	12.0	12.3	12.4
Capital	7.3	7.5	7.0	6.7	6.5	6.4
Current balance	1.4	1.4	1.4	1.4	1.4	1.4
Overall balance	-5.8	-5.9	-5.4	-5.2	-4.9	-4.8
Domestic financing	0.0	0.0	0.0	0.0	0.0	0.0
<b>Memorandum item:</b>						
External debt service (US\$) (Scenario A)	18.4	33.3	69.6	67.1	66.1	63.8
(in percent of GDP)	0.6	1.0	1.8	1.6	1.4	1.3

Source: Data provided by the Cambodian authorities, and Fund staff estimates.



Figure 1. Cambodia: Debt Service to the United States and the Russian Federation  
(In millions of U.S. dollars)

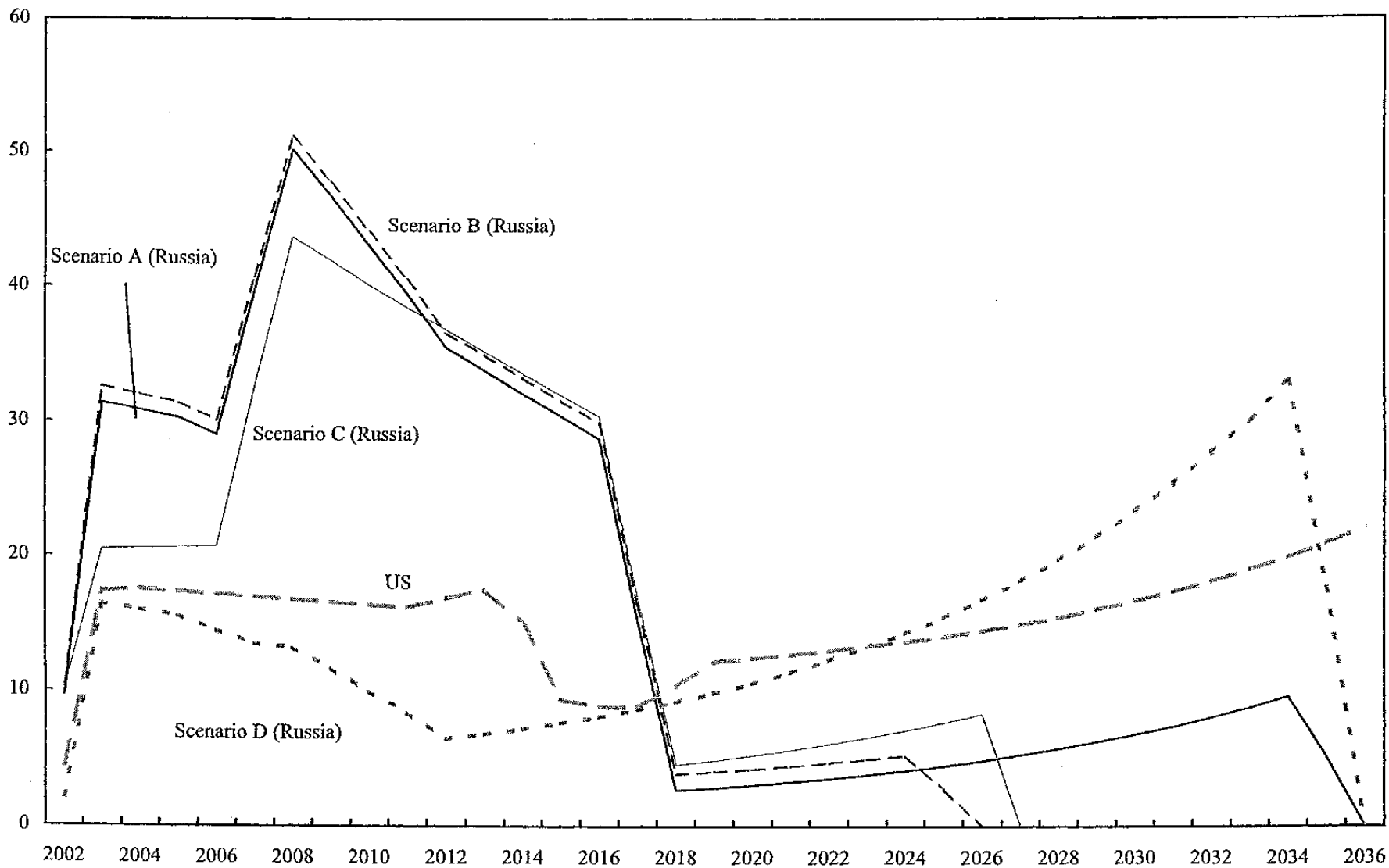


Table A1. Debt Service After Debt Relief, 2001–18 1/  
(In millions of U.S. dollars, unless otherwise indicated)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
<b>Total debt service 2/</b>																			
Scenario A	12.2	18.4	33.3	69.6	67.1	66.1	63.8	78.0	90.7	87.5	82.1	74.8	68.0	66.4	63.3	57.5	57.4	45.1	34.3
Of which: Russia and the United States	0.0	0.0	14.0	48.7	48.3	47.6	46.1	56.6	66.9	63.2	59.3	55.6	52.2	51.2	47.0	39.7	37.5	24.1	13.0
Scenario B			33.9	70.8	68.2	67.2	64.9	79.0	91.6	88.5	83.2	75.8	69.1	67.5	64.4	58.7	58.6	46.3	35.5
Of which: Russia and the United States			14.7	49.9	49.5	48.7	47.2	57.6	67.9	64.2	60.4	56.6	53.3	52.3	48.2	40.9	38.7	25.2	14.2
Scenario C			33.7	58.7	56.8	56.5	55.5	70.9	84.1	82.7	79.2	73.7	69.3	67.8	64.7	59.1	59.0	46.9	36.2
Of which: Russia and the United States			14.5	37.8	38.0	37.9	37.8	49.5	60.3	58.4	56.4	54.5	53.5	52.6	48.5	41.3	39.2	25.8	14.9
Scenario D			25.8	54.6	52.2	51.4	49.2	51.7	53.6	52.4	49.0	43.7	39.0	39.4	38.4	34.7	36.8	38.5	40.8
Of which: Russia and the United States			6.5	33.7	33.5	32.8	31.5	30.3	29.8	28.1	26.2	24.5	23.2	24.3	22.1	17.0	16.9	17.4	19.5
<b>Principal</b>																			
Multilateral	6.9	12.1	12.2	13.4	11.4	11.3	10.5	14.2	16.7	17.3	15.9	13.4	10.9	10.3	11.4	13.0	15.1	16.4	16.6
Official bilateral																			
Paris Club (excluding Russia and the United States)	0.0	0.0	0.0	0.4	0.9	0.9	1.0	1.0	1.1	1.2	1.3	1.3	0.6	0.8	0.9	1.0	1.2	1.3	1.5
Russia																			
Scenario A	0.0	0.0	0.2	8.5	8.6	8.6	8.0	19.6	32.0	30.7	29.2	27.7	25.6	25.7	25.8	26.0	26.1	14.0	1.9
Scenario B			0.0	8.2	8.2	8.2	7.4	19.1	31.4	30.2	28.7	27.2	25.1	25.3	25.5	25.7	26.0	14.0	2.0
Scenario C			0.3	0.8	0.9	1.0	1.1	13.5	25.9	26.0	26.0	26.1	26.3	26.5	26.7	26.9	27.2	15.2	3.2
Scenario D			0.6	9.4	9.6	9.8	9.2	8.8	9.0	8.0	6.6	5.3	3.5	3.9	4.3	4.8	5.3	5.9	6.5
United States	0.0	0.0	0.0	6.3	6.5	6.5	6.5	6.5	6.5	6.5	6.5	6.5	7.4	8.2	6.0	0.5	0.0	0.0	1.6
Non-Paris Club	0.0	1.3	1.6	1.7	1.2	1.2	1.2	1.2	1.3	1.3	1.3	0.3	0.2	0.2	0.2	0.2	0.2	0.2	0.2
<b>Interest</b>																			
Multilateral	3.7	3.7	4.0	4.1	4.0	4.0	3.9	3.8	3.7	3.6	3.5	3.4	3.3	3.2	3.1	3.0	2.9	2.7	2.6
Official bilateral																			
Paris Club (excluding Russia and the United States)	1.1	1.1	1.1	1.1	1.1	1.0	1.0	1.0	0.9	0.9	0.8	0.8	0.7	0.7	0.6	0.6	0.5	0.4	0.4
Russia																			
Scenario A	0.0	0.0	9.5	22.8	22.2	21.6	21.0	20.1	18.2	16.0	13.8	11.8	9.9	8.1	6.2	4.4	2.6	1.2	0.8
Scenario B			10.3	24.4	23.8	23.2	22.6	21.6	19.8	17.5	15.4	13.3	11.4	9.5	7.7	5.8	3.9	2.4	1.8
Scenario C			9.8	19.7	19.7	19.6	19.6	19.1	17.8	15.9	14.1	12.3	10.5	8.6	6.8	5.0	3.2	1.8	1.3
Scenario D			1.5	7.0	6.4	5.7	5.2	4.6	4.1	3.6	3.3	3.0	2.9	2.9	2.8	2.8	2.7	2.7	2.6
United States	0.0	0.0	4.4	11.0	11.0	10.8	10.6	10.4	10.2	10.0	9.8	9.6	9.4	9.3	9.0	8.8	8.8	8.8	8.8
Non-Paris Club	0.4	0.3	0.3	0.2	0.2	0.2	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
<b>Memorandum items:</b>																			
Debt-service ratio																			
Scenario A																			
(In percent of total exports) 2/ 3/	0.7	1.0	1.7	3.2	2.9	2.7	2.4	2.8	3.0	2.7	2.4	2.1	1.8	1.6	1.4	1.2	1.1	0.8	0.6
(In percent of government revenue) 2/	3.2	4.5	7.2	13.6	11.9	10.4	9.2	10.1	10.7	9.4	8.0	6.2	5.1	4.6	4.0	3.3	3.0	2.2	1.5
Scenario B																			
(In percent of total exports) 3/			1.7	3.3	3.0	2.8	2.5	2.8	3.1	2.8	2.4	2.1	1.8	1.6	1.5	1.2	1.2	0.9	0.6
(In percent of government revenue)			7.3	13.8	12.1	10.6	9.3	10.2	10.8	9.5	8.1	6.3	5.2	4.7	4.1	3.4	3.1	2.2	1.5
Scenario C																			
(In percent of total exports) 3/			1.7	2.7	2.5	2.3	2.1	2.5	2.8	2.6	2.3	2.0	1.8	1.6	1.5	1.3	1.2	0.9	0.6
(In percent of government revenue)			7.3	11.5	10.1	8.9	8.0	9.2	9.9	8.9	7.7	6.1	5.2	4.7	4.1	3.4	3.1	2.2	1.6
Scenario D																			
(In percent of total exports) 3/			1.3	2.5	2.3	2.1	1.9	1.8	1.8	1.6	1.4	1.2	1.0	1.0	0.9	0.7	0.7	0.7	0.7
(In percent of government revenue)			5.6	10.7	9.2	8.1	7.1	6.7	6.3	5.6	4.8	3.6	3.0	2.7	2.4	2.0	1.9	1.8	1.8

1/ Figures do not include prospective new borrowings.

2/ Figures in 2000 and 2001 show actual debt-service payments.

3/ In percent of current-year exports of goods and services.

4/ Based on Scenario A.

Table A2. Debt Stock (NPV) After Debt Relief, 2001–18 1/  
(In millions of U.S. dollars, unless otherwise indicated)

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
<b>Debt Stock (in NPV terms) 2/</b>																		
Scenario A	1,805.4	784.5	770.9	758.9	747.1	736.8	711.7	672.1	632.8	596.0	564.0	536.5	508.5	481.6	458.5	433.8	419.6	415.2
Scenario B	1,805.4	787.2	772.6	759.6	746.7	735.4	709.1	668.4	627.8	589.6	556.1	526.8	497.1	468.2	442.9	415.9	399.2	392.1
Scenario C	1,805.4	738.2	732.1	727.6	723.1	719.4	700.1	666.2	631.3	597.3	566.4	537.8	508.5	480.1	455.4	428.8	412.4	405.6
Scenario D	1,805.4	617.7	606.9	597.7	588.8	581.5	571.3	558.4	545.8	535.8	530.4	529.4	527.9	527.4	530.4	531.6	531.2	528.5
Multilateral	226.6	225.8	223.6	223.4	223.4	224.3	221.5	216.2	210.1	205.1	202.3	201.9	202.2	201.5	199.3	194.9	189.1	182.8
Official bilateral																		
Paris Club																		
(excluding Russia and the United States)	20.0	20.2	19.9	19.2	18.4	17.6	16.8	16.0	15.1	14.0	13.0	12.6	12.1	11.4	10.7	9.8	8.8	7.6
Russia																		
Scenario A	1,268.6	326.8	319.4	312.1	304.8	298.2	280.4	250.8	222.6	195.9	170.9	148.0	125.2	102.3	79.5	56.6	45.6	46.2
Scenario B	1,268.6	329.5	321.2	312.8	304.4	296.7	277.8	247.1	217.6	189.5	163.0	138.4	113.7	88.9	63.9	38.7	25.1	23.1
Scenario C	1,268.6	280.5	280.7	280.8	280.8	280.8	268.8	245.0	221.1	197.2	173.3	149.3	125.2	100.9	76.3	51.6	38.4	36.7
Scenario D	1,268.6	160.0	155.4	150.9	146.5	142.9	140.0	137.1	135.6	135.7	137.3	141.0	144.6	148.1	151.4	154.4	157.2	159.5
United States	277.6	202.0	199.5	196.6	193.8	190.9	188.1	185.2	182.3	179.3	176.4	172.6	167.8	165.2	168.0	171.5	175.3	177.8
Non-Paris Club	12.6	9.8	8.5	7.6	6.8	5.8	4.9	3.8	2.8	1.6	1.4	1.3	1.3	1.2	1.1	1.0	0.9	0.7
<b>Memorandum items:</b>																		
Debt-stock ratio																		
Scenario A																		
(In percent of total exports) 3/	94.7	39.0	35.9	33.3	30.7	28.2	25.4	22.5	19.9	17.5	15.6	13.9	12.3	10.9	9.7	8.6	7.8	7.2
(In percent of GDP)	54.8	22.0	20.0	18.3	16.4	14.7	12.9	11.1	9.5	8.1	7.0	6.1	5.3	4.5	3.9	3.4	3.0	2.7
(In percent of government revenue)	438.3	169.1	150.5	134.3	117.9	106.0	92.2	79.0	67.8	58.2	46.9	40.6	35.1	30.3	26.3	22.7	20.0	18.0
Scenario B																		
(In percent of total exports) 3/	94.7	39.2	35.9	33.4	30.7	28.1	25.4	22.4	19.7	17.3	15.3	13.6	12.0	10.6	9.4	8.3	7.4	6.8
(In percent of GDP)	54.8	22.1	20.1	18.3	16.4	14.7	12.9	11.0	9.4	8.1	6.9	6.0	5.1	4.4	3.8	3.3	2.9	2.6
(In percent of government revenue)	438.3	169.7	150.8	134.4	117.8	105.8	91.9	78.6	67.3	57.6	46.2	39.9	34.3	29.5	25.4	21.7	19.0	17.0
Scenario C																		
(In percent of total exports) 3/	94.7	36.7	34.1	32.0	29.7	27.5	25.0	22.3	19.8	17.6	15.6	13.9	12.3	10.9	9.7	8.5	7.7	7.1
(In percent of GDP)	54.8	20.7	19.0	17.5	15.9	14.4	12.7	11.0	9.5	8.2	7.1	6.1	5.3	4.5	3.9	3.4	2.9	2.6
(In percent of government revenue)	438.3	159.1	142.9	128.7	114.1	103.5	90.7	78.3	67.6	58.3	47.1	40.7	35.1	30.2	26.1	22.4	19.7	17.6
Scenario D																		
(In percent of total exports) 3/	94.7	30.7	28.2	26.3	24.2	22.3	20.4	18.7	17.1	15.8	14.6	13.7	12.8	12.0	11.3	10.6	9.9	9.2
(In percent of GDP)	54.8	17.3	15.8	14.4	12.9	11.6	10.4	9.2	8.2	7.3	6.6	6.0	5.5	5.0	4.6	4.2	3.8	3.4
(In percent of government revenue)	438.3	133.1	118.5	105.7	92.9	83.7	74.0	65.6	58.5	52.3	44.1	40.1	36.4	33.2	30.4	27.8	25.3	23.0

1/ Figures do not include prospective new borrowings.

2/ The NPV of "debt stock" is computed from projected yearly debt service payments including interest payments.

3/ In percent of current-year exports of goods and services.

Table A3. Cambodia: Balance of Payments, 1999–2006  
(In millions of U.S. dollars)

	1999	2000	2001	2002	2003	2004	2005	2006
			Est.			Proj.		
<b>Current account (excluding official transfers)</b>	<b>-276</b>	<b>-316</b>	<b>-301</b>	<b>-358</b>	<b>-360</b>	<b>-368</b>	<b>-380</b>	<b>-398</b>
<b>Current account (including official transfers)</b>	<b>-55</b>	<b>-42</b>	<b>-21</b>	<b>-72</b>	<b>-63</b>	<b>-59</b>	<b>-59</b>	<b>-64</b>
Trade balance 1/	-259	-336	-299	-316	-326	-332	-309	-327
Exports	971	1,399	1,577	1,663	1,779	1,885	2,057	2,212
Domestic exports	709	1,103	1,322	1,402	1,507	1,602	1,757	1,892
<i>Of which:</i> GSP (including garments)	564	1,012	1,252	1,353	1,423	1,485	1,585	1,708
Forestry	111	49	35	12	41	72	124	134
Re-exports	261	296	255	261	273	283	300	320
Imports, f.o.b.	-1,230	-1,734	-1,876	-1,979	-2,105	-2,217	-2,367	-2,539
Retained imports, f.o.b.	-968	-1,438	-1,621	-1,718	-1,832	-1,934	-2,067	-2,219
Garments sector	-363	-658	-814	-879	-925	-965	-1,030	-1,110
Petroleum	-121	-299	-291	-281	-284	-286	-304	-324
Other retained imports	-484	-481	-516	-558	-623	-683	-732	-785
Imports for re-export, f.o.b.	-261	-296	-255	-261	-273	-283	-300	-320
Services and Income (net)	-87	-50	-77	-118	-115	-120	-160	-164
Services (net)	-10	32	40	40	50	50	12	10
<i>Of which:</i> Tourism (credit)	119	178	206	218	233	245	260	275
Income (net)	-76	-82	-118	-158	-165	-169	-172	-175
<i>Of which:</i> Interest (debit)	11	11	11	32	46	47	48	49
Private transfers (net)	70	70	76	77	80	84	89	93
Official transfers (net)	220	274	280	285	297	309	321	334
<b>Capital and financial account</b>	<b>-31</b>	<b>-5</b>	<b>48</b>	<b>78</b>	<b>93</b>	<b>109</b>	<b>107</b>	<b>124</b>
Medium- and long-term loans	-57	-23	63	96	114	118	105	102
Disbursements	57	91	97	131	132	138	126	125
Amortization	-114	-114	-35	-35	-18	-20	-21	-23
Foreign direct investment	146	110	95	75	83	91	100	110
Short-term flows and errors and omissions	-119	-92	-110	-94	-103	-100	-98	-88
<b>Overall balance</b>	<b>-86</b>	<b>-47</b>	<b>27</b>	<b>5</b>	<b>30</b>	<b>50</b>	<b>48</b>	<b>60</b>
<b>Financing</b>	<b>86</b>	<b>47</b>	<b>-27</b>	<b>-5</b>	<b>-30</b>	<b>-50</b>	<b>-48</b>	<b>-60</b>
Change in gross official reserves	-32	-63	-63	-55	-62	-79	-80	-85
Use of Fund credit	8	4	9	9	-1	-9	-8	-5
Debt rescheduling 2/	0	0	16	1,435	0	0	0	0
Change in arrears (- = reduction)	110	105	11	-1,395	0	0	0	0
Financing Gap	0	0	0	0	33	38	40	30
<b>Memorandum items:</b>								
Trade balance (in percent of GDP)	-8.5	-10.8	-9.1	-8.9	-8.5	-8.0	-6.8	-6.5
Current account balance								
Excluding official transfers (in percent of GDP)	<b>-9.0</b>	<b>-10.2</b>	<b>-9.1</b>	<b>-10.0</b>	<b>-9.3</b>	<b>-8.8</b>	<b>-8.3</b>	<b>-8.0</b>
Including official transfers (in percent of GDP)	-1.8	-1.4	-0.6	-2.0	-1.6	-1.4	-1.3	-1.3
Gross official reserves 3/	422	485	548	604	666	745	824	909
In months of imports of goods, services and income	3.3	2.8	2.9	2.9	3.0	3.2	3.4	3.5
In months of core imports of goods, services and income 4/	5.8	5.3	5.8	5.8	5.9	6.2	6.5	6.7
Net international reserves	349	411	468	513	573	661	748	838
Nominal GDP (in millions of U.S. dollars)	3,054	3,094	3,296	3,569	3,851	4,156	4,559	5,001

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

1/ Includes estimates for unrecorded forestry exports and unrecorded petroleum imports.

2/ Assumes a Paris Club rescheduling under Naples terms (67 percent NPV reduction) in 2002. Bilateral rescheduling agreements were reached with the Czech and Slovak Republics in 2001.

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

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

**Cambodia: Fund Relations**  
As of December 31, 2001

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

II. <b>General Resources Account:</b>	<b>SDR Million</b>	<b>Percent Quota</b>
Quota	87.50	100.0
Fund Holdings of Currency	89.58	102.4
III. <b>SDR Department:</b>	<b>SDR Million</b>	<b>Percent Allocation</b>
Net cumulative allocation	15.42	100.0
Holdings	0.41	2.6
IV. <b>Outstanding Purchases and Loans:</b>	<b>SDR Million</b>	<b>Percent Quota</b>
Systemic Transformation	2.08	2.4
PRGF arrangements	61.43	70.2

V. **Financial Arrangements:**

<u>Type</u>	<u>Approval Date</u>	<u>Expiration Date</u>	<u>Amount Approved (SDR Million)</u>	<u>Amount Drawn (SDR Million)</u>
ESAF/PRGF	10/22/1999	10/21/2002	58.50	33.43
ESAF	05/06/1994	08/31/1997	84.00	42.00

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

	Overdue	Forthcoming				
	<u>12/31/2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>
Principal	--	9.4	9.4	7.0	5.9	4.2
Charges/Interest	--	<u>0.7</u>	<u>0.6</u>	<u>0.6</u>	<u>0.5</u>	<u>0.5</u>
Total	--	10.1	10.0	7.6	6.4	4.7

VII. **Safeguards Assessment:**

Under its current arrangement with the Fund, Cambodia is subject to the transitional procedures governing safeguards assessments, which require a review of the external audit mechanism of the National Bank of Cambodia (NBC). Staff reviewed the documentation provided by the central bank and concluded that NBC has made considerable progress in updating its external audit mechanism and financial reporting framework in the past year. In particular, the NBC appointed a high quality international accounting firm to audit its financial statements in accordance with International Standards on Auditing and adopted International Accounting Standards. The NBC has recently published its audited financial statements and related audit opinion in accordance with safeguards policy.

In addition, staff identified certain weaknesses in other areas of the safeguards framework, notably in NBC's financial reporting framework. Following staff advice, the NBC has agreed to the following measures: (i) the contract of the external auditor has been extended for another five years; (ii) the monitoring of the external audit mechanism (by the Fund) will be adhered to for the duration of the Fund arrangement; and (iii) NBC staff will provide periodic updates to the Fund on the status of the other recommendations made by the auditor.

**VIII. Exchange Rate Arrangement:**

Since November 8, 1992, the exchange rate of the riel has consisted of the following two rates. First, the official exchange rate, which is expressed in riels per U.S. dollar, applies to all official external transactions conducted by the government and state enterprises. Second, the market rate, which is determined through interactions of foreign exchange traders in the private sector, applies to all other transactions. The official exchange rate is adjusted so as to limit the spread between the official rate and the riel-U.S. dollar rate prevailing in the market. The spread between the official and market exchange rates is limited to no more than 1 percent on a daily basis. On December 31, 2001, the official exchange rate was CR 3,900 per U.S. dollar and the private market rate CR 3,905 per U.S. dollar.

**IX. Article IV Consultation:**

Cambodia is on a 12-month consultation cycle. The Executive Board concluded the last Article IV consultation on September 15, 2000 (EBS/00/186, 8/31/00).

**X. Technical Assistance:**

Following discussions between the Government, the IMF, UNDP, and other interested multilateral and bilateral donors, a comprehensive Technical Cooperation Action Plan (TCAP) was adopted in May 2001. An update of recent technical assistance missions is contained in Annex IX.

**XI. Resident Representative:**

The resident representative office was closed in October 1997, but it was re-opened at end-October 1999. Mr. Hagemann replaced Mr. de Zamaróczy as Resident Representative in November 2001.

### **Cambodia: Relations with the World Bank Group<sup>1</sup>**

Cambodia became a member of the World Bank on July 22, 1970 but did not borrow from the Bank until 1993. In February 2000, the World Bank approved a Country Assistance Strategy for fiscal years 2000–03, focusing on alleviation of poverty, enhancing governance, and advocating stronger partnership with other donors and nongovernmental organizations in the delivery of projects, policy advice and services. At the same time, the Bank Board also approved a Structural Adjustment Credit for \$30 million, which focuses on fiscal, and governance issues. In January 1997, an office was opened in Phnom Penh that has recently been upgraded to a Resident Office, to assist in the implementation of the Bank's assistance program and facilitate communication with the Government and other donors.

To date, 18 projects have been approved for Cambodia (\$448.5 million). Recent projects have focused in the following areas:

- In 1997, an Agricultural Productivity Improvement Project was approved, focusing on institutional development at the Ministry of Agriculture, including rehabilitation of training facilities, retraining of staff, and sponsoring pilot field activities.
- In 1998, an Urban Water Supply Project was approved to improve water facilities in both Phnom Penh and Sihanoukville.
- In 1999, four IDA projects were approved: a Social Fund II Project to finance small scale social-infrastructure projects at the local level, a Road Rehabilitation Project to improve access to rural areas, a North East Rural Development Project, and an Education Quality Improvement Project.
- In 2000, a Biodiversity and Protected Areas Project, Structural Adjustment Credit, and a Forest Concession Management and Control Pilot Project were approved.
- In March 2001, a Flood Emergency Rehabilitation Project (\$35 million) was approved.
- In June 2001, an Emergency Supplementary Credit for Social Fund II (\$10 million) was approved.
- In August 2001, a Military Demolization and Reintegration Project (\$18 million) was approved.

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<sup>1</sup> Prepared by the Fund staff based on information provided by the World Bank, as of December 10, 2001.

Cambodia became a member of the IFC in March 1997. The IFC is expected to provide entrepreneur training and business services for small and medium enterprises under the Mekong Project Development Facility. In addition, the IFC has approved an investment in a Cambodian power project. The IFC is also providing technical assistance to transform a Cambodian microfinance NGO into a commercial bank.

With regard to recent analytical work, the Bank prepared a Forest Policy Assessment report in June 1996 jointly with the UNDP and the FAO, a Public Expenditure Review in February 1999, and more recently a poverty assessment and strategy report, and a power sector strategy. A diagnostic study on governance and corruption was also prepared.

IDA: Commitments and Disbursements to Cambodia, 1993–2001  
(In millions of U.S. dollars, as of December 10, 2001)

Project	Date of Approval	Committed	Disbursed
Emergency Rehabilitation [Closed]	Oct.26, 1993	62.70	64.86
Technical Assistance	Dec.6, 1994	17.00	16.90
Social Fund [Closed]	Jun.8, 1995	20.00	18.42
Economic Rehabilitation Credit [Closed]	Sep.28, 1995	40.00	36.91
Phnom Penh Power Rehabilitation [Closed]	Sep.28, 1995	40.00	32.02
Disease Control and Health	Dec.24, 1996	30.40	24.10
Agricultural Productivity Improvement	Feb.28, 1997	27.00	10.20
Urban Water Supply	Feb. 17, 1998	30.96	17.80
Social Fund II	Mar.23, 1999	25.00	24.10
Emergency Supplementary Credit	Jun 19, 2001	10.00	0.00
Road Rehabilitation	Mar.23, 1999	45.31	6.60
North East Village	May 18, 1999	5.00	1.80
Education Quality Improvement	Aug. 31, 1999	5.00	2.40
Biodiversity and Protected Areas LIL	Feb. 8, 2000	1.90	0.4
Structural Adjustment Credit	Feb. 29, 2000	30.00	16.00
Forest Concession Management and Control LIL	Jun. 5, 2000	4.80	0.50
Flood Emergency Rehabilitation	Mar 13, 2001	35.00	2.10
Military Demobilization and Integration	Aug. 23.2001	18.40	0.00
Total		448.47	275.11



### Cambodia: Relations with the Asian Development Bank

From 1992 through October 31, 2001, the AsDB approved \$483.6 million in low-interest loans to Cambodia to finance 16 projects and one structural reform program. To date 3 projects (totaling \$122.9 million) have been completed: the Special Rehabilitation Assistance Project (approved in 1992), Power Rehabilitation Project (approved in 1994), and an Agriculture Sector Program (approved in 1996). Of the remaining loan projects, \$175.5 million were for economic infrastructure, \$107.1 million for social infrastructure, and \$78.1 million for agriculture and natural resources.

The AsDB designed and administered 83 technical assistance projects during this period. These were financed through \$60.9 million in grants from the AsDB (\$20.9 million), the Japanese Special Fund (\$29.0 million), and other sources (\$11.0 million).

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

In October 2000, the AsDB conducted an assessment of the flood damage to prepare a proposal for loan assistance to meet Cambodia's rehabilitation requirements. In December 2000 an Emergency Flood Rehabilitation Project in the amount of \$55 million was approved. The Financial Sector Development Program has been approved by the Board and the initial tranche conditions have been met.

AsDB: Loan Commitments and Disbursements to Cambodia  
(In millions of U.S. dollars)  
(as of October 31, 2001)

	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 (through Oct 2001)	-	26.8	39.6
Total	483.6	312.3	242.2

### **Cambodia—Poverty Profile<sup>1</sup>**

Despite recent efforts aimed at promoting sustained economic growth and alleviating poverty, Cambodia remains one of the poorest countries in the world. With 1999 GDP per capita estimated at \$241, Cambodia was ranked 186 among world economies, as indicated in the *2000/2001 World Development Report*. In addition, Cambodia's key social indicators lag behind other low-income countries, as evidenced by the UNDP's *Human Development Index (HDI)*<sup>2</sup> and the attached table.

**Poverty is pervasive, especially in rural areas.** About 36 percent of Cambodia's population is living below the poverty line<sup>3</sup> and 18 percent below the food-poverty line. The key features of poverty in Cambodia are:

- Poverty rates are highest in rural areas (40 percent of the poor) and highest for households whose head is engaged in agriculture. About 90 percent of Cambodia's poor live in rural areas and 71 percent are employed in agriculture;
- Poverty is lowest in Phnom Penh (11 percent);
- Poorer households are larger, younger, have more children, and are more likely to be headed by a male;
- Poor generally live in households whose head is illiterate or has only few years of schooling; and poverty is lowest for households whose head has a secondary or advanced education.

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<sup>1</sup> As derived from the *Second Five Year Socioeconomic Development Plan (SEDPII; 2001-2005)* prepared by the Ministry of Planning.

<sup>2</sup> The *Human Development Index (HDI)* is based on the following indicators: (i) life expectancy at birth; (ii) educational attainment, as measured by the weighted average of adult literacy and school enrolment ratios; and (iii) real GDP per capita in U.S. dollars. Cambodia's HDI ranks 136 among 174 countries. Among 12 Asian countries covered by the HDI exercise, only the Lao P.D.R. and Bangladesh rank lower.

<sup>3</sup> The poverty line is defined by daily food consumption equivalent to 2,100 calories per person, plus a small allowance for non-food consumption (e.g., clothing and shelter). Estimates are based on the 1997 socioeconomic survey.

**Poverty alleviation efforts are constrained by population dynamics:**

- *High population growth rate* (2.5 percent annually) compared to other developing countries in the region. Among ASEAN countries, only the Lao P.D.R has a comparable rate.
- *High fertility and mortality rates.* The fertility rate of 5.3 live births per woman is significantly higher than any other ASEAN country, except the Lao P.D.R.
- *High internal and external migration* rates entailing loss of human capital and social disruptions in rural areas.
- *Severe imbalances in age and sex structure.* Children aged 0-14 account for about 43 percent of the population. The overall ratio of 93 males per 100 females reflects high mortality and out-migration during the Khmer rouge period.
- *Gender inequalities* are widespread. Women suffer from a lack of adequate reproductive health services and access to education, paid employment, and land.
- *The workforce* is faced with unemployment and underemployment, high average hours worked and low incomes for the employed population.

**The key dimensions of poverty in Cambodia are related to:**

- *Food security.* Despite an overall rice surplus, the main staple is not accessible to a wide segment of the population lacking purchasing power or living in provinces experiencing food deficit (nearly half of the provinces);
- *Land access.* There is growing population pressure on available land, which has resulted in a reduction in farm size, increased migration to urban areas, and a landless population. Much usable land still remains contaminated by mines.
- *Physical infrastructure* is inadequately developed and maintained, hampering access to markets, as well as to education and health services;

**The government aims at eradicating poverty by 2015**, through sustained growth, comprehensive institutional reform, infrastructure building and rehabilitation, and broadened participation of civil society and the most vulnerable groups in decision-making. In response to the poverty challenge, the Cambodian government has formulated a comprehensive strategy spelled out in the *Interim Poverty Reduction Strategy Paper (I-PRSP; October 2000)* and further elaborated in the recently-released *Second Five Year Socioeconomic Development Plan, (SEDPII; 2001-2005)*). Further work is underway under the full PRSP to fully cost poverty reduction actions and establish a permanent monitoring framework needed to assess progress.

## Cambodia: Socio-demographic Indicators, 1990-99

	1990	1995	1999	Same Region/Income Group	
	(or latest year available)			East Asia and Pacific	Low-Income
<b>Population</b>					
Total population, mid-year (millions)	9.1	10.7	12.7	1,837	2,417
Growth rate (percent annual average)	3.2	3.1	2.2	1.1	1.9
Population density (people per sq. km)	54	61	67	115	73
Urban population (percent of population)	13	14	16	34	31
Total fertility rate (births per woman)	4.9	4.7	4.4	2.1	3.7
<b>Life expectancy at birth (years)</b>					
Total	50	53	54	69	59
Male	49	52	52	67	58
Female	52	54	55	71	60
<b>Mortality</b>					
Infant (per thousand live births)	122	108	100	35	77
Under 5 (per thousand live births)	..	147	143	44	116
<b>Adult (15-59)</b>					
Male (per 1,000 population)	392	349	364	184	288
Female (per 1,000 population)	319	303	315	141	258
<b>Poverty (percent of population)</b>					
National headcount index	..	36.1	..	..	..
Urban headcount index	..	21.1	..	..	..
Rural headcount index	..	40.1	..	..	..
<b>Income</b>					
GDP per capita (US\$, at current prices)	173	294	241	1,032	427
Consumer price inflation (annual change; in percent)	..	1.1	-0.8	4.0	4.1
<b>Social Indicators</b>					
<b>Public expenditure</b>					
Health (percent of GDP/GNI)	..	0.4	0.9	1.7	1.2
Education (percent of GDP/GNI)	..	1.0	1.4	2.9	3.2
<b>Gross primary school enrollment rate (in percent of school-age population)</b>					
Total	121	126	113	119	96
Male	..	138	123	121	102
Female	..	114	104	121	86
<b>Adult illiteracy rate (in percent of population above 15)</b>					
Total	69	66	61	15	39
Male	49	46	41	8	29
Female	85	83	79	22	48
Population per physician (number of people)	15,629	9,575	6,666	909	..
<b>Immunization rate (percent of children under 12 months)</b>					
Measles	38	79	64	83	64
DPT	34	75	63	82	70
Child malnutrition (percent of children under 5 years)	..	..	47	13	..
<b>Access to safe water (percent of population)</b>					
Total	..	..	30	75	76
Urban	..	..	53	..	..
Rural	..	..	25	..	..

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

## **Cambodia—Statistical Issues**

At the start of Cambodia's reform program in 1993, the statistical base was largely nonexistent. Substantial improvements have been made since then, and an *IFS* page for Cambodia was published in April 1996. Nevertheless, significant problems remain, even though the Fund, the UNDP, the AsDB, and the World Bank have provided considerable technical assistance. In October 2001, a long-term STA advisor was placed in the National Institute of Statistics (NIS) of the Ministry of Planning to provide advice and practical assistance to the authorities in all areas of economic and financial statistics covered by the Fund. Cambodia has recently agreed to participate in the Fund's General Data Dissemination System (GDDS). Core data are generally provided on a timely basis (Attachment I).

### **National accounts**

The NIS provides official estimates of GDP and its components. The available data base for the compilation of the national accounts is extremely weak and fragmentary, and information for most sectors is not collected on a systematic basis. GDP deflators are estimated mainly from CPI data, as most other price data are not available. For several years, the AsDB has been providing peripatetic technical assistance and financial support to improve the quality of the national accounts. Surveys in the main economic sectors need to be strengthened, and a significant improvement of the national accounts database will be a lengthy process. The latest publication of the national accounts includes revised estimates for 1993–2000.

### **Prices**

The NIS provides official estimates of the CPI on a monthly basis with a lag of five weeks. The 1995 STA mission assessed the estimates and made recommendations for further improvements. Significant improvements have been made since then. However, problems relating to price collection and processing procedures remain, and the coverage of the index is limited to Phnom Penh. The NIS plans to revise the weights of the CPI basket in the near future to reflect upgraded patterns of household consumption, and to broaden the regional coverage. In the interim, NIS is compiling a separate CPI for 2001 covering five major provincial cities. No producer or wholesale price indices are available yet.

### **Government finance statistics**

The MEF provides monthly fiscal data on a timely basis with a four-week lag. The quality of fiscal data, compiled on the basis of GFS methodology, has improved during the last three years, owing to substantial technical assistance mostly financed by the World Bank and by the Fund. The authorities have started providing monthly fiscal data for publication in *IFS* in July 2001 and are committed to provide data for the *GFS Yearbook* in 2002. There are still weaknesses regarding the coverage and the economic classification of expenditure. Information on external financing of the budget has improved significantly, but detailed donor-specific data on investments financed by project aid are available only with considerable lags.

### **Monetary statistics**

The NBC provides data on the monetary authorities and deposit money banks on a monthly basis with a lag of four weeks. Substantial improvements have been made in the past few years, particularly with the adoption of the new plan of accounts by the NBC in January 1996, and the introduction of an *IFS* page for Cambodia in April 1996. Monetary statistics in Cambodia cover riels in circulation and domestic bank deposits in riel and foreign currencies. However, data on the large amount of foreign currency in circulation in Cambodia are not available. As a result, the effective money stock in Cambodia is underestimated by the amount of foreign currency in circulation, which leads to overestimates of the income velocity of money.

Mr. Khay Phousnith, Director of the Economic Research Department of the NBC, is currently on secondment to STA as a Special Appointee.

### **External sector statistics**

The NBC is responsible for compilation of the balance of payments statistics. While significant improvement has been made in compiling the statistics, aided in large part by a previous long-term advisor, weaknesses remain in several areas. Customs data have substantial coverage and valuation problems arising from the nonrecording of nondutiable imports and the weakness of customs controls. In addition, the bulk of reexports to neighboring countries is included under customs' import data but may be under-reported in total exports. Estimates made to improve the coverage of customs data are subject to considerable uncertainty. The largest estimates for undercoverage of imports by direct investment enterprises are not supported by documentation and explanation of methods applied; moreover, they do not correspond to foreign direct investment flows. While efforts have been made to improve the quality of foreign direct investment data, private capital flows are likely to be large and not fully captured by official data. A range of international transactions by enterprises, such as payments for imported services, income payments, and portfolio investment abroad are not included in the data. Data on external debt are provided by the Ministry of Economy and Finance. While the data are mostly accurate, more frequent and timely updating is desirable.

An STA mission which visited Phnom Penh in January 2001 made recommendations (i) to improve the coverage of external trade statistics, including the use of partner country data for deriving the estimates; (ii) to undertake substantial revisions to travel and other business service components; and (iii) to implement a new survey form for collecting foreign direct investment data. As a result of national and international efforts to facilitate cooperation between balance of payments compiling agencies, an inter-ministerial subcommittee was set up under the auspices of the Ministry of Planning to produce more reliable estimates of Cambodia's external trade.

Cambodia: Core Statistical Indicators as of January 3, 2002

	Exchange Rates	International Reserves	Central Bank Balance Sheet	Reserve/ Base Money	Broad Money	Interest Rates	Consumer Price Index	Exports/ Imports	Current Account Balance	Overall Government Balance	GDP/GNP	External Public Debt/Debt Service
Date of Latest Observation	January 3, 2002	December 31, 2001	November 2001	November 2001	November 2001	November 2001	November 2001	September 2001	September 2001	November 2001	2000	2000
Date Received	January 3, 2002	January 3, 2002	December 2001	December 2001	December 2001	December 2001	December 2001	December 2001	November 2001	December 2001	May 2001	March 2001
Frequency of Data	Daily	Daily	Monthly	Weekly	Monthly	Monthly	Monthly	Quarterly	Quarterly	Monthly	Annual	Annually
Frequency of Reporting	Daily	Weekly with one week lag	Monthly with five weeks lag	Weekly with one week lag	Monthly with five weeks lag	Monthly with five weeks lag	Monthly with five weeks lag	During missions	During missions	Monthly with one month lag	Annual	Annually
Source of Data	NBC	NBC	NBC	NBC	NBC	NBC	NIS	NBC and MEF	NBC	MEF	NIS	NBC
Mode of Reporting	Fax or Email	Fax or Email	Fax or Email	Fax or Email	Fax or Email	Fax or Email	Fax or Email	During missions	During missions	Fax	During missions	During missions
Confidentiality	No	Yes	No	No	No	No	No	No	No	No	No	Yes
Frequency of Publication	Daily	N/A	Monthly	Monthly	Monthly	Monthly	Monthly	Annually	Annually	Annually	Annually	N/A

**Cambodia—Summary of Technical Assistance Provided by the Fund, 1999–2001<sup>1</sup>**

Purpose	Assistance and Timing (person-months)
<b>Tax Policy and Tax Administration</b>	
• Tax policy and customs administration	2, September 1999
• Technical Cooperation Action Plan (TCAP) mission	3¼, March-April 2000
• Customs administration (advisor)	5, February 2000
• Tax administration and policy	1, March 2001
• Public expenditure management	1, April 2001
• Long-term customs advisor	12, April 2001
• Long-term budget advisor	12, August 2001
• Long-term tax advisor	12, October 2001
<b>Monetary Policy and Central Bank Operations</b>	
• Long-term advisor	36, from January 1998
• Banking system reform	4, March and June 2000
• Banking system restructuring and central bank development	2, October 2000
• Banking system restructuring	1, April 2001
• Banking system restructuring and payments system development	1, August 2001
• Payments system development	1, November 2001
<b>Statistics</b>	
• Balance of payments compilation	1/2, December 1998
• Balance of payments compilation	1/2, February 2000
• Balance of payments compilation	1, January 2001
• Government Finance Statistics	1, April 2001
• Long-term mutlisector statistics advisor	12, November 2001
• General Data Dissemination System	1, November-December, 2001
• Legal Framework Review of technical assistance needs	1/2, April 2000
• Bankruptcy Law	1/2, November 2000
• Bankruptcy Law	1/2, July 2001
• Bankruptcy Law (forthcoming)	1/2, February 2002
<sup>1</sup> A detailed description of the Technical Cooperation Action Plan (TCAP) is contained in EBS/01/02 (01/04/01).	



December 26, 2001

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

Dear Mr. Köhler:

1. The attached memorandum summarizes key developments during the second year of the PRGF-supported program and sets forth the economic, financial, and poverty alleviation policies that the Royal Government of Cambodia intends to implement in 2002. It also updates the medium-term macroeconomic framework, in light of the recent global downturn. During the first two years of the program macroeconomic stabilization has been strengthened and significant progress has been achieved in key structural reforms, especially banking sector rehabilitation, forestry reform, fiscal restructuring, and preparation of a Governance Action Plan. Growth and inflation performance as well as the fiscal outcome in 2001 have been in line with program targets. All quantitative performance criteria for end-September 2001 were observed as well as the structural performance criteria for the Fourth Review under the PRGF.
2. Despite the anticipated slowdown resulting from the recent deterioration of the international economic environment, growth and inflation prospects in 2002 remain broadly favorable. The 2002 budget framework is consistent with the medium-term fiscal objectives under the PRGF-supported program. The Government has recently launched the first phase of the full military demobilization program. The resulting reduction in defense and security outlays will thus pave the way for further spending toward priority social sectors. Comprehensive reforms in the areas of tax and customs administration and expenditure management will be implemented in 2002. A broad-based reform strategy for the civil service will be initiated in 2002, and financial sector reform will be broadened to include payments system reform and improvements in bank supervision.
3. The Government has recently adopted the Second Socio-Economic Development Plan (SEDP II, 2001–05) that will serve as the foundation for the full PRSP under the leadership of the Council for Social Development (CSD). Taking into account the need to prepare a high quality document through broad consultation between government ministries, and a wide spectrum of development partners, the Government intends to finalize the full PRSP by October 2002.

4. The Government believes that the policies and measures described in the attached memorandum are adequate to achieve the objectives of the program for 2002, and stands ready to take additional measures that may become necessary for this purpose. The Government will consult with the Managing Director, at the initiative of either party, and will provide the IMF with such information as it requests on the progress made in policy implementation and the achievement of program objectives. In any event, Cambodia will conduct with the IMF the next review of the arrangement no later than end-July 2002.

5. In continuing with our policy of transparency, we consent to the publication, including on the IMF's website, of the attached Memorandum of Economic and Financial Policies and the accompanying Executive Board documents prepared by the IMF staff. In addition, we have published the audited accounts of the National Bank of Cambodia for 2000, in compliance with the requirements under the IMF's Safeguard Assessment.

Sincerely yours,

/s/

Keat Chhon  
Senior Minister  
Ministry of Economy and Finance

/s/

Chea Chanto  
Governor  
National Bank of Cambodia

Attachment

## CAMBODIA

### Memorandum of Economic and Financial Policies for 2002

December 26, 2001

#### I. INTRODUCTION AND RECENT DEVELOPMENTS

1. **The Government's PRGF-supported program aims at sustaining economic growth, reducing poverty, and accelerating economic reconstruction.** This memorandum reviews the implementation of the second year-program and sets out policies for the third year. Major strides have been achieved in the first two years of the program and economic performance has met program expectations. Stabilization efforts have been successful, with annual GDP growth averaging 5–6 percent and inflation having remained subdued. At the same time, key structural reforms have been initiated, paving the way for sustained growth over the medium term.

2. **Economic developments during the first three quarters of 2001 have generally been favorable, but growth is expected to decline in the fourth quarter, owing to the deterioration in the world economic environment.** Garment exports and tourist arrivals increased strongly through September. As a result, real GDP growth for 2001 is projected at 5¼ percent compared to 6 percent previously projected, and inflation is anticipated to remain well below 5 percent. All quantitative performance criteria for end-September 2001 were met, and the structural performance criterion on establishing the large taxpayers unit (LTU) has also been observed. Other key structural measures aimed at fiscal reform, banking restructuring, and sound governance have also been implemented.

3. **The implementation of the 2001 budget has been consistent with financing targets under the program.** The overall fiscal deficit (excluding grants) will be contained below 5 percent of GDP, while the current surplus will be maintained at 1½ percent of GDP. Government revenue has continued to improve and is budgeted to reach 12 percent of GDP. This largely reflects a boost in domestic tax revenue from additional measures introduced in the second half of the year. The overall revenue performance, however, has been adversely affected by shortfalls in customs revenue compared to budget targets. Overall expenditure has been contained below targets, thus contributing to the avoidance of domestic budget financing. Although progress has been achieved in reorienting government spending away from defense and security, social sector spending has remained short of expectations, reflecting primarily inefficient cash management procedures among line ministries at the national and provincial levels.

4. **Monetary developments in 2001 have reflected the improved fiscal position.** Broad money is projected to grow by 22 percent in 2001, largely owing to increased foreign currency deposits, while continued fiscal restraint has provided room for private credit to increase by 10 percent. Gross international reserves are expected to reach the equivalent of about 3 months of import coverage at end-2001, as programmed. The market exchange rate

has been broadly stable against the U.S. dollar and in real effective terms. Despite the recent deterioration in the outlook for garment exports and tourism receipts, the current account deficit in 2001 (excluding official transfers) is expected to be smaller than previously projected (10 percent of GDP) reflecting the strong performance in the first nine months.

5. **Progress has been made in implementing most structural reforms in 2001.** Bank restructuring has proceeded as envisaged, with the liquidation of nonviable banks progressing and improved performance of banks operating under Memoranda of Understanding (MOUs). Preparations for payments system reform and a new chart of accounts for banks have also been initiated. A large taxpayer unit (LTU) aimed at strengthening revenue collection was established in October 2001. Actions aimed at strengthening governance are mostly reflected by the adoption of the Governance Action Plan (GAP) and the establishment of the National Audit Authority (NAA) in July 2001. The full military demobilization program was launched in mid-October, financed by domestic resources, the World Bank, and other donors. The automated payroll for the civil service has been completed and a reform strategy is being finalized. A comprehensive Forestry Law was approved by the Council of Ministers and submitted to the National Assembly in August 2001, and a new Land Law was adopted by the National Assembly in October 2001. However, there has been considerable delay in completing the restructuring of forestry concessions, as most concessions have submitted pro forma management plans which do not provide a basis for sustainable operations. There have also been delays in establishing effective operations of the Forestry Crime Monitoring Unit (FCMU), reflecting donor funding problems in the initial stages, and a lack of internal coordination.

## II. MACROECONOMIC AND STRUCTURAL POLICIES FOR 2002

6. **The macroeconomic outlook for 2002 is expected to be affected by the recent deterioration in the world economic environment.** Under the revised macroeconomic framework for 2002, GDP growth is projected to slow down to 4½–5 percent, compared to 6 percent previously envisaged. The anticipated lower economic growth is expected to result from a sharp reduction in the growth of garment exports and tourism earnings. Inflation, however, is expected to remain below 5 percent. The current budget surplus will be maintained at about 1½ percent of GDP, while the overall fiscal deficit (excluding grants) will be contained at less than 6 percent of GDP and financed by external concessional resources. The external current account deficit is projected to widen to 11 percent, as against 9¾ percent programmed before the external shock. Also taking into account the deterioration in the international environment, the increase in gross international reserves in 2002 is targeted at \$55 million, which would maintain gross reserves at about 3 months of imports.

7. **Achieving the revenue target of 13 percent of GDP in 2002 is crucial for meeting expenditure needs.** This target is expected to be met through a combination of new revenue measures, and the full-year impact of measures introduced in the second half of 2001. The main new revenue measures in the 2002 budget are described in Annex II. The newly created LTU in conjunction with upgraded auditing will be instrumental in enhancing tax revenue collection in the period ahead. As a first step to strengthen collection enforcement, the LTU

will identify the 50 accounts with the largest arrears, investigate relevant information concerning each of these arrears, take corrective actions to begin to collect these arrears by end-May 2002, and prepare a first quarterly report on performance in collecting arrears by end-July 2002. The Tax Department will also review tax legislation to ensure that enabling authority exists to take appropriate collection action. Regarding nontax revenue, an inventory of state assets involving all ministries will be completed by June 2002, and assets will be confiscated from companies with arrears to the government. The government will increase revenue from the tourist sector by modifying the contract for ticket sales at the Angkor monument complex when visitors exceed 200,000, increase the monthly casino royalty and review other aspects of the taxation of casinos, and collect VAT from airport departure fees and other services. The telecommunications contract for the second international gateway will be reviewed by end-December 2001 to ensure appropriate transfer of revenue to the budget, and will be subject to an independent audit in 2002.

**8. Strengthening the enforcement capabilities of the Customs and Excise Department (CED) is urgently needed for improving revenue collection.** As a first priority, the Government will intensify anti-smuggling efforts by: (i) allocating more resources for the anti-smuggling program; (ii) issuing by end-December 2001 a government decision (through a Prime Ministerial Order) specifying the means for strengthening inter-agency cooperation, and detailing assistance requirements and practical arrangements among the Customs Department, Armed Forces, and Police; (iii) establishing anti-smuggling task forces in several key provinces by end-April 2002; (iv) developing an anti-smuggling strategy targeting key revenue sources, high-risk items, and prime locations by end-April 2002; and (v) expanding the inspection of selected garment factories to assess compliance with exemptions granted under the Law on Investment and prepare a preliminary report of findings by end-April 2002. To complement the limited capabilities of the CED, the government will continue to use the preshipment inspection system (PSI), and the PSI Steering Committee will address disputes between the government and the service provider to strengthen contract performance. Customs Department organization, human resources, and the information technology framework will be modernized in line with the work plan designed under the Technical Cooperation Action Plan (TCAP). In this context, the upgrading of revenue analysis and data processing capabilities will be given a high priority. A new Customs Code, complying with WTO requirements, will be submitted to the Council of Ministers by end-March 2002.

**9. Amendments to the Law on Investment (LOI) are near finalization.** The amended LOI is aimed at establishing a transparent and sound system of incentives for both domestic and foreign investment. The adoption of the amended LOI is critical for allowing the second tranche release of \$15 million under the World Bank's Structural Adjustment Credit (SAC). The Government intends to submit the amended LOI to the National Assembly by end-March 2002. Under the LOI amendments, which resulted from broad discussions with the private sector, all qualifying projects will be approved automatically by the Council for the Development of Cambodia (CDC) and incentives for each activity will be specified in the law. Notwithstanding a five-year grandfathering period for investors already in the country, the profit tax rate for investment companies will be unified at the standard rate. The tax

exemption on re-invested profits and on repatriation of earnings will be abolished. Investment companies will be allowed to select either the announced tax holiday system or the incentives derived from standard investment allowances and accelerated depreciation that will be reflected in the Law on Taxation.

10. **Expenditure restructuring will also remain a key objective under the 2002 budget.** Defense spending will be reduced further to allow for increased priority social outlays. Fundamental reforms of expenditure and liquidity management are also included in the program for 2002. Key priorities in the expenditure program include: (i) increasing funding to key social ministries (i.e., education, health, agriculture, and rural development); (ii) completing the discharge of soldiers under the full demobilization program; (iii) launching civil service reform; (iv) providing contingency funds to cover new priorities (commune elections, international obligations, higher debt service); and (v) increasing domestically financed capital expenditure. As a result, spending in the priority sectors is budgeted to increase to 3½ percent of GDP in 2002, compared to 3 percent in 2001. The Government will also step up efforts to improve the expenditure process, strengthen procurement practices, and upgrade cash management. In addition, the Government will prepare in 2002 the legal framework required for implementing administrative and financial decentralization in the future.

11. **Comprehensive reform of budget and cash management will be implemented in 2002 (see Annex III).** High priority will be assigned to: (i) reducing the number of government accounts by integrating more accounts with the National Treasury single account; (ii) strengthening the budgetary accounting framework and improving regulations and reporting procedures; (iii) improving the operations of the cash management unit; (iv) improving inter-agency cooperation, especially between the National Treasury, the Customs and Excise Department, the Tax Department, the Budget and Financial Affairs Department, and the NBC; (v) reporting by the NBC to the National Treasury of transactions in government budget accounts on a daily basis and full account balances and bank statements for all government accounts on a monthly basis; (vi) allowing for direct payment of taxes to the National Treasury account at the NBC by transfer or check, especially for the largest taxpayers; and (vii) establishing the new financial framework for communes with the national and provincial treasuries.

12. **The initial stage of the full military demobilization program is proceeding as planned under a \$42 million World Bank and donor-supported program.** The discharge of 15,000 soldiers (11½ percent of the military) is expected to be completed by end-2001. An additional 15,000 soldiers will be discharged by end-2002. As a result, defense and security spending is expected to decline to 2¾ percent of GDP in 2002, compared to 3 percent in 2001. The departure package will be jointly financed by the Government, the World Bank, and other donors. The Government is committed to contribute to the departure package as part of a CR 40 billion contingency fund included in the budget.

13. **A comprehensive civil service reform, aiming at providing adequate incentives and improving service delivery, will be launched in 2002.** The Government's strategy (2002–06) provides for new job classification and compensation system, a major restructuring of the civil service workforce, and is consistent with medium-term fiscal sustainability. The overall wage bill will be contained below 4 percent of GDP, reflecting savings from military demobilization and the removal of about 9,000 irregular cases identified by the computerized payroll. Government employment policy under civil service reform reflects staffing needs in priority sectors, especially education. Accordingly, a net increase of 3,000 civil servants is expected for education in 2002, while staffing in the non-education sector will be reduced by 300, mainly through natural attrition. Further staff reductions through contracting out and privatization will be carried out in 2003, contingent on establishing a donor supported social safety net.

14. **The monetary program for 2002 will be consistent with growth and inflation objectives.** With improved confidence in the banking system, broad money is expected to rise by 19 percent, reflecting a continuing trend decline in velocity. It is expected that foreign currency deposits will remain the main engine behind broad money growth, while continued fiscal discipline will allow for private sector credit growth of about 13 percent.

15. **The flexible exchange rate arrangement will be maintained, with the spread between the official exchange and market rates limited to 1 percent.** However, in view of the uncertain economic environment in the period ahead, the Government will proceed gradually toward achieving full unification of the exchange rate. The NBC will adhere to the established intervention policy of using any increased demand for the riel to bolster international reserves and not resisting downward pressure on the exchange rate, except in the event of temporary disorderly market conditions.

16. **The Government is committed to pursue further trade liberalization.** Trade reform will be implemented in the context of Cambodia's membership in the ASEAN free-trade area (AFTA) and the ongoing accession process to the World Trade Organization (WTO). This effort will entail further rationalization of the tariff structure, and reduction of the maximum and average tariff rates. As part of the Government's poverty reduction strategy, a comprehensive trade strategy is in the process of being formulated with multilateral support under the Integrated Framework (IF) for trade. The strategy, which has been widely discussed during a workshop held in Phnom Penh in November 2001, will be fully reflected in the government's forthcoming Poverty Reduction Strategy Paper (PRSP). With Cambodia's trade and exchange arrangement being free of restrictions on current account transactions, the Government intends to accept the obligations of Article VIII of the IMF's Articles of Agreement by end-2001.

17. **The Government has taken steps to advance discussions with the Russian Federation and the United States to resolve outstanding debt issues.** In September, an official delegation held discussions with the Russian authorities in Moscow, and also with the Paris Club Secretariat. Scheduled high-level discussions with US officials in Washington in late September, as well as a visit of the Prime Minister to Moscow in early October, were

canceled owing to security concerns after September 11. The Government remains fully committed to continue its efforts to resolve outstanding debt issues with the Russian Federation and the United States in good faith, with a view to reaching agreement in 2002. If there is not significant progress in resolving the issue bilaterally, the Government is ready to proceed within the Paris Club framework. Further discussions with these creditors is envisaged in the period immediately ahead. A letter has been sent to the US authorities inviting a delegation to come to Phnom Penh. A letter has also been sent to the Russian authorities indicating the government's willingness to discuss the issue and proposing that a delegation visit Moscow. The Government will continue maintaining a prudent debt management policy, and in this regard, will refrain from contracting or guaranteeing any nonconcessional debt, as defined in the technical memorandum of understanding.

18. **The first phase of bank restructuring is proceeding as planned and will be largely completed by end-2001.** Since late 1999, five banks have fully met the requirements under the Financial Institutions Law and have been awarded a full banking license. Twelve banks that were insolvent or failed to meet the requirements under the law were closed, and the liquidation (including voluntary liquidation) of 8 of them was completed. For the remaining four banks, judicial liquidation by order of the court has been initiated. Thirteen banks have been given a conditional license to operate under Memoranda of Understanding (MOUs) which include commitments regarding recapitalization and other corrective actions. Most of these banks are expected to fulfill requirements under their MOUs by end-2001, while 3 banks have not made satisfactory progress and are likely to be closed with liquidation procedures initiated in early 2002.

19. **The bank supervision department of the NBC will be further strengthened in 2002.** The NBC will establish a framework for improved bank supervision, including finalizing a new uniform chart of accounts for the banking system consistent with IAS, and taking into account IMF technical assistance recommendations, by end-July 2002. The adequacy and effectiveness of the existing prudential regulations will also be reviewed and new regulations adopted, if necessary. The role and definition of specialized banks will be clarified and associated regulations reviewed by end-June 2002, taking into consideration the government's medium-term financial sector development strategy. Until then, the NBC will not issue any new licenses for specialized banks.

20. **Restructuring of the Foreign Trade Bank (FTB) will proceed to prepare for future privatization.** The Ministry of Economy and Finance (MEF) will issue recapitalization bonds by March 2002 to replace bridge financing provided by NBC. In consultation with the external auditor, the FTB will resolve discrepancies in its accounts by end-2001 (if necessary by provisioning against unresolved discrepancies) to allow for the completion of an unqualified audit of the 2001 accounts by end-May 2002. Further to the recent appointment of an outside director to the Executive Board, outside management assistance is expected to be in place by February 2002 to help restructure the bank and initiate privatization through public notification by end-November 2002.



**21. Preparations are also underway to further develop the payments system in 2002.**

To reduce the risks involved in payment and cash settlement, the legal foundation for the payments system needs to be strengthened. As a first step towards establishing a sound market-based system, a Payments Transactions Law, a Law on Bills of Exchange and Promissory Notes, and a Law on Checks and Collection and Payment of Checks will be finalized, taking into account technical assistance from the IMF, and will be submitted to the Council of Ministers by end-May 2002.

**22. The Government is taking action to strengthen the implementation of effective forestry reforms.**

Government efforts continue to be directed at establishing sustainable management practices, improving the monitoring of forestry crimes, and ensuring the full and timely transfer of forestry revenue to the budget. The Forestry Law, which establishes the legal conditions for sound forest resource management has been submitted to the National Assembly and is expected to be adopted in the near future. The issuing of logging permits in 2001 had been restricted with no new logging permits having been granted since mid-August 2001, and no new permits will be granted during the remainder of 2001. To support the need to complete the restructuring of concession agreements in line with sustainable practice, all logging activity will be suspended with effect from January 1, 2002 until concessionaires have submitted management plans and inventory assessments that are fully in line with sustainable practice, as defined in the subdecree on forest concession management. Restructured concession agreements—including adjustments to the royalty system—are expected to be in place by end-September 2002. Efforts are also underway, in consultation with the World Bank and other donors, to address the recent difficulties experienced by the Forest Crime Monitoring Unit (FCMU), including the possibility of strengthening monitoring and reporting responsibilities at the Council of Ministers. To improve the monitoring of logs and help ensure the appropriate transfer of revenue to the budget, a new system of log tracking using electronic monitoring through bar code devices will be developed for implementation by the next logging season (September 2002).

**23. The Government is firmly committed to press ahead with the governance and anti-corruption agenda.**

Broad dissemination of the Governance Action Plan (GAP) among government partners and stakeholders will be launched by end-2001 through a series of workshops, both at the national and local levels. As part of the GAP, and consistent with the administrative reform framework, preparations are underway (with AsDB support) to deconcentrate and devolve decision-making and financial management to provincial and communal authorities. To reflect recent progress in GAP implementation in several areas, and the Government's emphasis on combating corruption and promoting social and economic development, an updated GAP will be prepared ahead of the next Consultative Group Meeting tentatively scheduled for mid-2002. To ensure full operations of the National Audit Authority (NAA), adequate provisions have been contained in the 2002 budget. The NBC will comply with the required actions under the IMF's safeguard assessment, including the publication of the full financial statements and audit report for 2000 in a forthcoming NBC bulletin.

24. **Efforts to upgrade social and economic statistics will be intensified in 2002.** The Government has obtained support from the IMF to develop a comprehensive statistical framework and broaden data dissemination. A permanent multisector statistics advisor has been assigned in November 2001 to the Ministry of Planning to assist the ministry in the coordination of statistical compilation among government agencies. To provide a consistent framework, and help coordinate donor support, further statistical development is expected to take place in the framework of the IMF's General Data Dissemination System (GDDS). Monthly fiscal data have been recently published in *International Finance Statistics (IFS)* and annual data will be submitted for publication in the *Government Finance Statistics Yearbook* in 2002. The NBC will also publish in the near future economic and financial data, as well as banking regulations and studies, in a new monthly bulletin. In compliance with PRSP requirements, significant progress has been made in developing a comprehensive framework for social data.

25. **Preparation of the full PRSP has been delayed, but is now being accelerated following the completion of the Socio-Economic Development Plan for 2001–05 (SEDP II).** In the meantime, as required under PRSP guidelines, a PRSP preparation status report will be prepared by end-December 2001. The newly created Council for Social Development (CSD), chaired by the Minister of Planning and comprising representatives of eleven ministries and government agencies, will coordinate the preparation of the PRSP through a broad participatory process involving development partners, NGOs, and civil society. The full PRSP is expected to be completed by October 2002.

26. **Actions to be taken prior to the IMF Executive Board consideration of the fourth review and performance criteria and benchmarks are shown in Annex I and Tables 1–2.** Quantitative performance criteria for 2002 include: (i) a ceiling on net domestic assets of the NBC; (ii) a ceiling on net bank credit to the government; (iii) a ceiling on net domestic financing of the budget; (iv) a zero ceiling on publicly contracted or guaranteed nonconcessional foreign currency loans; and (v) a floor on net official international reserves of the NBC. Structural performance criteria for 2002 will include: (i) completing the first unqualified audit of the Foreign Trade Bank by end-May 2002; (ii) reducing the number of government accounts by integrating revenue accounts held by line ministries into the National Treasury single account by end-March 2002; and (iii) issuing the final report of the working group on standardized accounting procedures and methodology for the public sector by end-October 2002. The fifth review under the program is expected to be completed by end-July 2002 and will focus primarily on improved revenue mobilization, budget implementation, including military demobilization and civil service reform, forestry and bank reforms, and progress in resolving outstanding external debt issues. The Government requests two disbursements in the third year of the arrangement for the equivalent of SDR 8.357 million and SDR 8.358 million. An extension of the arrangement through February 28, 2003 is also requested in order for the final disbursement to be made.

Actions to be Implemented Prior to Board Presentation of the Fourth PRGF Review

Action	Status
1. Implement remaining tax measures agreed in 2001, including application of tax stamps for cigarettes at the factory level and use of visa stickers	The application of cigarette stamps began on Dec. 15, 2001, and the application of visa stickers began on Dec. 26, 2001.
2. Publish the 2000 external audit report of the NBC	The report was published in the NBC monthly bulletin for December 2001.
3. Issue Prakas suspending all logging activity by concessionaires with effect from Jan. 1, 2002 until sustainable management plans have been approved.	The Prakas was issued on Dec. 13, 2001.
4. Issue government decision (by Prime Ministerial Order) specifying the means for strengthening inter-agency cooperation to reduce smuggling, and detailing assistance requirements and practical arrangements among the Customs Department, Ministry of Interior, and Ministry of Defense.	The Prime Ministerial Order was issued on Dec. 19, 2001.
5. Review telecommunications contract for the second international gateway and prepare assessment report to ensure appropriate transfer of revenue to the budget.	The assessment report was completed and signed on Dec. 20, 2001.
6. Submit a PRSP preparation status report to the Bank and the Fund by Dec. 28, 2001.	The status report was approved by the Prime Minister on Dec. 24, 2001, and transmitted to the World Bank and IMF on Dec. 26, 2001.

## **Cambodia: Main Revenue Measures Affecting the 2002 Budget**

### **I. Revenue Measures Introduced in the Second Half of 2001**

- Increases in selected excise rates in the context of tariff restructuring.
- Introduction of a tax stamp system for cigarettes.
- Introduction of stickers for increasing revenue collection from visas.
- Expansion of VAT coverage to include 150 additional firms.
- Treating all diesel sales as final sales for VAT purposes.
- Establishing a Large Taxpayers Unit (LTU).

### **II. New Revenue Measures Under the 2002 Budget**

#### **A. New Tax Measures**

- Expand the coverage of the real regime to five additional provinces.
- Increase excise tax on beer from 10 percent to 20 percent.
- Collect VAT on airport departure fees.
- Implement 2 cents per liter excise tax on gasoline and 4 cents per liter on diesel as specified in the Financial Law.
- Conduct a joint review by the Tax Department and the Customs and Excise Department of all aspects of taxation of motorcycles and motorcycle parts with a view toward subjecting domestically assembled motorcycles to VAT and other taxes specified in the Law on Taxation. A full assessment report will be prepared by end-March 2002.

#### **B. Nontax Measures**

- Intensify efforts to collect arrears on telecommunication services and leases of state assets. Contracts involving state revenue for telecommunications will be reviewed to ensure that appropriate funds are being transferred to the budget.
- Introduce increased royalty fees for casinos based on estimated turnover.
- Increase the share of garment quotas to be auctioned from 10 percent to at least 20 percent.
- Renegotiate contract with Sokha Hotel, the managing company for the Angkor monument complex, after the threshold of 200,000 tourists is reached.

C. Tax and Customs Administration Improvements

- Strengthen tax auditing strategy and capabilities.
- Improve coordination between the Customs (CED) and Tax Departments, especially regarding exchanges of information pertaining to large taxpayers. A Prakas will be issued to clarify reporting relationships between CED and other MEF departments.
- Strengthen inter-agency cooperation between the Customs Department, Tax Department, and CDC in monitoring duty exemptions for investment companies and apply penalties for undocumented use of duty exemptions.
- Intensify monitoring, enforcement, and collection of tax arrears for the largest taxpayers.
- Strengthen the anti-smuggling unit within CED and establish formal assistance arrangements with the Armed Forces and the Police to enforce customs regulations, especially on sensitive products and in problem areas.
- Identify the 50 largest accounts in the large taxpayers unit (LTU) that are in arrears, complete an analysis of the arrears, and establish an action plan with collection targets and reports on performance.

**Cambodia: Main Government Expenditure and Budget Management Measures in 2002**

- Issue Prakas detailing a specific format for cash management procedures as a basis for improving the operations of the Cash Management Unit and establishing better coordination between the National Treasury and the Foreign Currency Unit by end-January 2002.
- Reduce the number of government deposit accounts by integrating revenue accounts held by line ministries into the Treasury single account by end-March 2002.
- Provide daily information on transactions in government accounts, and monthly account balances, to the Treasury for all government accounts at the NBC and FTB.
- Allow tax payments by transfer or check to the Treasury single account with NBC, especially for the large taxpayers.
- Develop internal auditing capabilities within key spending ministries (i.e., Ministry of Economy and Finance, Education, Health, Agriculture and Rural Development).
- Strengthen budgetary procedures for the ministries under the Priority Action Program (PAP) to meet the social expenditure targets set forth under the poverty alleviation strategy.
- Establish a working group in the National Treasury, with assistance from the IMF's resident advisor, to prepare standardized accounting procedures and methodology for the public sector in line with international standards. The final report of the working group would be submitted by end-October 2002.
- Finalize a revised chart of government accounts meeting international standards, for implementation from January 1, 2003.
- Enhance budget preparation by improving macroeconomic and budget revenue and expenditure analysis and projections and develop budget programming in a three-year rolling budgetary framework.

Table 1. Cambodia: Quantitative Performance Criteria and Benchmarks, December 2001–02

	2001	2002			
	End-Dec. Est.	End-Mar. 1/ Program	End-June Program	End-Sept. 1/ Program	End-Dec.
		(Cumulative change from beginning of year)			
Net domestic assets of the central bank (in billions of riels) 2/3/	-157	18	-26	-28	-10
Net credit to the government from the banking system (in billions of riels) 3/4/	-53	20	-20	-20	0
Net domestic financing of the budget (in billions of riels) 3/	0	20	-20	-20	0
Contracting or guaranteeing of external debt by the public sector <sup>4</sup>					
Up to one-year maturity 5/	---	---	---	---	---
1-5 year's maturity	---	---	---	---	---
Medium-and long-term nonconcessional debt 6/	---	---	---	---	---
External payments arrears 7/	---	---	---	---	---
		(Cumulative change from beginning of year)			
Net official international reserves (in millions of U.S. dollars) 8/	56	4	27	36	46
<i>Memorandum items:</i>		(Cumulative flows from beginning of year)			
Foreign currency budget / BOP support (in millions of U.S. dollars)	20	0	19	24	29
Total nonproject budget support (in billions of riels)	142	0	74	94	137
		(Stock at end of period)			
Net domestic assets of the central bank (in billions of riels)	-1,099	-1,081	-1,125	-1,127	-1,109
Net credit to the government from the banking system (in billions of riels)	-49	-29	-69	-69	-49
Net official international reserves (in millions of U.S. dollars)	467	471	494	503	512
		(At end of period)			
Exchange rate (riels per U.S. dollar, end of period)	3,900	3,900	3,900	3,900	3,900

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

1/ Performance criteria.

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

3/ For purposes of verifying compliance with the program, the ceiling for net domestic assets, net credit to the government from the banking system, and net domestic financing of the budget will be adjusted upward (downward) by any shortfall (excess) in external nonproject budget support from the program estimates. The adjustments for shortfalls in nonproject budget support will not exceed \$10 million.

4/ Maturity based on original contract.

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

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

7/ Continuous performance criterion.

8/ For purposes of verifying compliance with the program, the floor on net official international reserves will be adjusted downward (upward) by any shortfalls (excess) in external nonproject budget support from the program estimates. The adjustments for shortfalls in budget support will not exceed \$10 million. Valuation effects on the stock of gold holdings are excluded, and gold holdings in 2001 and 2002 are evaluated at the end-December 2000 and end-2001 gold price, respectively.

Table 2. Cambodia: Structural Policy Actions for 2002

Policy Action	Program Monitoring
<p><b>1. Structural Benchmarks and Performance Criteria to be Assessed During the Fifth Review</b></p> <p>a. Suspend all logging activity by concessionaires with effect from January 1, 2002 until sustainable management plans have been approved.</p> <p>b. Issue Prakas detailing a specific format for cash management procedures as a basis for improving the operations of the Cash Management Unit and establishing better coordination between the National Treasury and the Foreign Currency Unit by end-January 2001.</p> <p>c. Revoke banking licenses for banks that have not met the requirements under their MOU, including additional closures if necessary, by end-February 2002.</p> <p>d. Submit the Payments Transactions Law, the Law on Bills of Exchange, and the Law on Checks and the Collection and Payment of Checks to the Council of Ministers by end-May 2002.</p> <p>e. Reduce the number of government accounts by integrating revenue accounts held by line ministries (as specified in the Technical Memorandum of Understanding) with the National Treasury single account by end-March 2002.</p> <p>f. Submit a new Customs Code (in line with WTO requirements) to the Council of Ministers by end-March 2002.</p> <p>g. Complete an unqualified audit of the 2001 accounts of the Foreign Trade Bank by end-May 2002.</p> <p>h. Establish anti-smuggling unit in key border provinces with clear definition of roles and responsibilities by end-April 2002.</p>	<p>Structural benchmark (continuous)</p> <p>Structural benchmark</p> <p>Structural benchmark</p> <p>Structural benchmark</p> <p>Structural performance criterion</p> <p>Structural benchmark</p> <p>Structural performance criterion</p> <p>Structural benchmark</p>
<p><b>2. Structural Benchmarks and Performance Criteria to be Assessed During the Sixth Review</b></p> <p>a. Identify the 50 largest accounts in the LTU that are in arrears, complete an analysis of the arrears, and establish an action plan with collection targets and reports on performance. The first performance report to be completed by end-July 2002.</p> <p>b. Finalize a new chart of accounts for fully licensed commercial banks based on international standards and begin implementation by end-July 2002.</p> <p>c. Issue final report of the working group in the National Treasury on standardized accounting procedures and methodology for the public sector in line with international standards by end-October 2002.</p> <p>d. Implement the next stage of tariff restructuring to reduce the unweighted average rate to below 15 percent by end-September 2002.</p> <p>e. Initiate privatization of the Foreign Trade Bank by issuing a public notice by end-November 2002.</p>	<p>Structural benchmark</p> <p>Structural benchmark</p> <p>Structural performance criterion</p> <p>Structural benchmark</p> <p>Structural benchmark</p>



### **Cambodia—Technical Memorandum of Understanding**

This memorandum sets out the understandings between the Cambodian authorities and the IMF staff regarding the definitions of the quantitative performance criteria and benchmarks for the program supported by the Poverty Reduction and Growth Facility (PRGF), and the related reporting system of monetary and financial data.

1. **Net official international reserves of the National Bank of Cambodia (NIR\*)** is defined as the unencumbered (i.e., readily available) gross official reserves of the National Bank of Cambodia (NBC) less foreign liabilities of the NBC. Under the program, the floor for NIR\* will be: (i) decreased (increased) by the amount of a shortfall (excess) in external nonproject support from program estimates—any downward adjustment would not exceed \$10 million; and (ii) decreased by any foreign-currency costs associated with bank restructuring. For purposes of monitoring performance against the program target for NIR, valuation effects on the stock of gold holdings will be excluded, and gold holdings will be evaluated at the gold price in effect on December 31<sup>st</sup> of the previous year<sup>1</sup>. Similarly, the level of foreign assets and liabilities will be evaluated at the U.S. dollar/SDR exchange rate in effect on December 31<sup>st</sup> of the previous year. NIR\* data will be transmitted to the IMF weekly with a lag of no more than one week.
2. **Net Domestic Assets of the National Bank of Cambodia (NDA\*)** are defined as reserve money minus net foreign assets of the NBC, adjusted for valuation changes arising from the difference between the program and the actual exchange rates. Reserve money is defined as the sum of notes and coins issued by the NBC, excluding NBC holdings of currency, and deposits of commercial banks and domestic nongovernmental sectors at the NBC. Reserve money excludes all NBC securities. The program ceilings for NDA\* will be adjusted upward (downward) for any shortfall (excess) in nonproject external budgetary support from program estimates—any upward adjustment will not exceed \$10 million. The ceilings will also be adjusted upward for costs associated with bank restructuring. NDA\* data will be transmitted monthly within four weeks.
3. **Net credit to the government from the banking system (NCG)** is defined as claims on the general government by the banking system less deposits of the general government with the banking system. General government is defined to include central government, provinces, and communes. The program ceilings for NCG will be adjusted upward (downward) for any shortfall (excess) in nonproject external budgetary support from program estimates—any upward adjustment would not exceed \$10 million. NCG data (as reflected in the monetary survey) will be transmitted monthly within four weeks.
4. **Net domestic financing of the budget (NDF)** is defined as the sum of NCG and any nonbank financing of the general government. The program ceilings for NDF will be

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<sup>1</sup> For example, gold holdings in 2002 will be evaluated at the end-December 2001 gold price.

adjusted upward (downward) for any shortfall (excess) in nonproject external budgetary support from program assumptions—any upward adjustment would not exceed \$10 million. For purposes of program monitoring, actual levels of NDF will not include any flows associated with “outstanding operations” (committed spending that has not yet been executed) or any “exchange rate adjustment” (valuation effects on government deposits from exchange rate fluctuations). Details on all transactions associated with outstanding operations and exchange rate adjustment will be reported at all test dates. For purposes of program monitoring, any accumulation of domestic payments arrears will be included as part of NDF. NDF data (as reflected in the consolidated report on government operations (TOFE) table) will be transmitted monthly within four weeks.

5. **The contracting or guaranteeing of external debt by the public sector** is defined as foreign currency borrowing contracted or guaranteed by the public sector in Cambodia. Public sector is defined to include the Royal Government of Cambodia, the NBC, publicly-owned enterprises, or any other agency acting on behalf of the government. The program has ceilings for all debt below five years maturity and all nonconcessional debt for maturities beyond five years (both ceilings are set at zero). The coverage of debt includes financial leases and other instruments giving rise to external liabilities on nonconcessional terms.<sup>2</sup> Details on any such borrowing should be reported within three weeks. Nonconcessional debt is defined as a debt with a grant element (NPV discount relative to face value) of less than 35 percent, based on the currency- and maturity-specific discount rates reported by the OECD (commercial interest reference rates).

6. **External payments arrears** are defined as the stock of external arrears on debt contracted or guaranteed by the public sector (as defined above), excluding debts subject to rescheduling or debt forgiveness.

7. **Completing an unqualified audit of the 2001 accounts of the Foreign Trade Bank (FTB)** (by end-May 2002) will involve resolving discrepancies in FTB’s accounts in close consultation with the external auditor and provisioning against unresolved discrepancies.

8. **Reducing the number of government accounts by integrating revenue accounts held by line ministries with the National Treasury single account** will involve the transfer of funds and closing of the following government accounts: #35.1211-T051 (Civil Aviation); #35.1211-T052 (Ministry of Industry); #35.1211-T053 (Ministry of Posts and

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<sup>2</sup> This performance criterion applies not only to debt as defined in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt (August 24, 2000) but also to commitments contracted or guaranteed for which value has not been received. Excluded from this performance criterion are amounts contracted under the government loan agreement with China, dated July 26, 2000, for a maximum loan amount equivalent to \$12 million. For purposes of program monitoring, the ceilings on external debt also exclude normal short-term trade-related credits and any borrowing associated with debt rescheduling.

Telecommunications); #35.1211-T054 (Department of Forestry and Fisheries); #39.1212-A006 (Ministry of Public Works and Transport); #35.1212-A006 (Ministry of Public Works and Transport); #35.1212-A007 (Ministry of Culture and Fine Arts); #35.1212-A008 (Ministry of Foreign Affairs and International Cooperation).

### **Summary of data reporting requirements**

- (i) Data on daily average selling and buying exchange rates (official and market rates) to be transmitted daily.
- (ii) NIR\* to be transmitted weekly with a lag of one week.
- (iii) Monetary survey and consolidated balance sheets of the NBC and commercial banks to be transmitted monthly within four weeks.
- (iv) Consolidated report of government operations (TOFE) to be transmitted monthly within four weeks.
- (v) CPI data to be transmitted monthly within five weeks.
- (vi) Flash report of NBC accounts to be transmitted weekly within one week.
- (vii) Quarterly monitoring reports on banks' under Memoranda of Understanding (MOUs) to be transmitted within one month.
- (viii) Trade data to be transmitted monthly within ten weeks.
- (ix) Any publicly contracted or guaranteed nonconcessional borrowing to be transmitted within three weeks.
- (x) Any external payments arrears to be transmitted monthly within three weeks.
- (xi) The outstanding stock of tax and nontax arrears, and any expenditure arrears, to be transmitted quarterly within four weeks.



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FOR IMMEDIATE RELEASE  
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International Monetary Fund  
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Washington, D. C. 20431 USA

## **IMF Concludes 2001 Article IV Consultation with Cambodia**

On February 6, 2002, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Cambodia.<sup>1</sup>

### **Background**

Cambodia has made significant strides in the first two years of the government's reform program supported by a three-year arrangement under the Poverty Reduction and Growth Facility (PRGF) for SDR 58.5 million (about US\$72.5 million; 67 percent of quota) approved by the Executive Board of the IMF on October 22, 1999. The PRGF-supported program aims at fostering economic growth, accelerating economic and institutional reconstruction, and reducing poverty. These objectives are to be achieved through a strengthening of fiscal revenue in tandem with a restructuring of expenditure away from defense, improved governance, and key reforms in banking and payments systems, forestry management, the trade regime, and private sector development.

Economic stabilization under the first two years of the government's program has generally been in line with expectations. Economic growth in 2000-01 has averaged 5 percent annually, despite severe flooding in 2000 and the slowing in the global economy in 2001. Economic recovery has been led by buoyant garment exports and tourist arrivals. Inflation in 2000-01 has

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<sup>1</sup> Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. This PIN summarizes the views of the Executive Board as expressed during the February 6, 2002 Executive Board discussion based on the staff report.

been well below 5 percent, reflecting continued fiscal restraint and prudent monetary management.

Fiscal reform has been the cornerstone of the government's program. The budgetary outcome during 2000-01 has been consistent with the need to increase revenue, restructure expenditure away from defense and toward education, health and rural development. As a result, in both years the overall fiscal deficit (excluding grants) has been contained below 5 percent of GDP, while the current surplus has been maintained at 1½ percent of GDP. However, difficulties in fully meeting targets for social sector spending have primarily stemmed from inadequate government cash management procedures at the national and provincial levels. The avoidance of domestic financing of the budget since 1999 has allowed for a sustained expansion in private credit.

The monetary program has been consistent with low inflation and a stable exchange rate. The increase in broad money has been largely accounted for by an increase in net foreign assets, while net domestic assets of the banking system have declined, owing to the improved fiscal position. Within the context of a flexible exchange rate policy, the riel has been relatively stable in 2000-01, both vis-à-vis the U.S. dollar and in real effective terms. The external current account deficit improved in 2001 reflecting strong export performance and is expected to reach 9 percent of GDP (excluding official transfers). At the same time, official international reserves have increased steadily. Discussions are underway with the United States and the Russian Federation to resolve outstanding debt issues.

Steady implementation of the structural reform agenda has also taken place during the first two years of the program, despite delays in several important areas. Bank restructuring has been successfully implemented since late 1999, and a major overhaul of fiscal management has been initiated. Strengthening governance and combating corruption have received high priority on the government's reform agenda, with the implementation of the donor-endorsed Governance Action Plan (GAP) and the establishment of the National Audit Authority (NAA) in mid-2001. The full military demobilization program was successfully launched in late 2001 and reforms in forestry management have contributed to a significant dampening of illegal logging. Liberalization of the trade regime has been initiated in the context of meeting requirements for membership in the World Trade Organization (WTO). Cambodia has complied with the requirements under the IMF's Safeguards Assessment and has recently accepted the obligations of Article VIII. Efforts to upgrade the country's statistical framework are also underway.

### **Executive Board Assessment**

Executive Directors agreed with the thrust of the staff appraisal. They commended the authorities for the maintenance of macroeconomic stability and growth momentum in the face of unexpected external shocks, and the progress made in key areas of structural reform. Directors stressed, however, that to sustain high economic growth and reduce poverty, reform efforts will need to be maintained in the areas of bank restructuring, tax administration and expenditure

management, and the civil service. The restructuring of forestry concessions and completion of military demobilization will also be important.

Directors broadly agreed that, in the period immediately ahead, the growth prospects are likely to weaken owing to a decline in garment exports and tourism receipts, as a result of the global slowdown. The authorities should therefore pursue, with renewed energy, their efforts to implement the reform program. Because of the high degree of dollarization of the economy, which reduces the efficacy of traditional monetary instruments, fiscal policy must be the focus for maintaining macroeconomic stability, and further improvements in expenditure management and tax administration are required.

Directors noted the progress made in enhancing revenue collection in 2001, and urged the authorities to further improve revenue performance in 2002 and over the medium term. While welcoming the formation of the large taxpayers unit, they emphasized the importance of strengthening tax administration and the collection of outstanding tax arrears, and in particular, of improving customs administration.

Directors commended the authorities for the progress made in 2001 in directing expenditure to priority social sectors and away from defense. They noted that completing the demobilization program by end-2002 will free resources for other budget priorities. Regarding administrative reform, Directors welcomed the completion of the automated payroll system in all provinces. They stressed that public sector wage increases should be consistent with fiscal constraints. Civil service reform should be pursued in coordination with the World Bank and other donors. Directors agreed that technical assistance will continue to be needed to overcome Cambodia's capacity constraints. They encouraged the authorities to make effective use of such technical assistance, especially with respect to public accounting, cash management, and budget execution.

Directors welcomed the orderly liquidation of nonviable banks and underscored the importance of taking timely actions against banks not meeting the requirements under Memoranda of Understanding. They also urged the authorities to reform the Foreign Trade Bank to prepare it for privatization, and to move forward with plans to develop the payments system.

To strengthen growth prospects, Directors recommended that the environment for private sector investment be improved, especially through enhanced governance, a strong effort to fight corruption, and legal and judicial reform. Some Directors, calling attention to the falloff in foreign direct investment in Cambodia between 1999 and 2001, recommended that the authorities take a critical look at the Law on Investment with a view to improving the investment climate. Comprehensive reform of the civil service would also help to eliminate petty corruption in the public sector.

Directors noted the recent assistance of multilateral institutions to facilitate trade sector reform and Cambodia's plan to accede to the WTO, and underscored the role of trade reform and trade facilitation in supporting the medium-term growth objectives. They were encouraged that Cambodia is a pilot country under the Integrated Framework for Trade and Development.

Directors also noted that Cambodia's exports, including garment exports, would be helped by improved market access.

Directors welcomed the maintenance of a flexible exchange rate policy and the authorities' recent acceptance of the obligations of Article VIII, sections 2, 3, and 4 of the Articles of Agreement. However, they also noted the need to take steps to eliminate the margin between the official and market rate in the future. Directors encouraged the authorities and Cambodia's key bilateral creditors to intensify their collaboration on efforts to resolve outstanding issues in their debt rescheduling negotiations, and urged the authorities to pursue a prudent external debt management policy. In that connection, several Directors drew attention to the desirability, for Cambodia's medium-term sustainability and poverty reduction efforts, of securing highly concessional debt rescheduling agreements in line with Cambodia's limited fiscal capacity. More generally, Directors underlined Cambodia's need for substantial donor support on highly concessional terms.

Directors observed that the quality and timeliness of statistics are adequate for surveillance purposes, but emphasized the need for further improvement. In this respect, Directors welcomed the authorities' decision to participate in the Fund's General Data Dissemination Standard (GDDS) and stressed the need to use effectively the technical assistance being provided while building local capacity.

The Joint Staff Assessment of the authorities' PRSP preparation status report highlights the areas that need support to develop an effective national poverty reduction strategy. In this regard, Directors emphasized, in particular, the importance of broadening the participatory process and fully costing priority reforms in the context of a medium-term expenditure framework as critical inputs for completing the full PRSP by October 2002.

It is expected that the next Article IV consultation with Cambodia will be held on the standard 12-month cycle.

**Public Information Notices (PINs)** are issued, (i) at the request of a member country, following the conclusion of the Article IV consultation for countries seeking to make known the views of the IMF to the public. This action is intended to strengthen IMF surveillance over the economic policies of member countries by increasing the transparency of the IMF's assessment of these policies; and (ii) following policy discussions in the Executive Board at the decision of the Board. The Staff Report for the 2001 Article Consultation with Cambodia is also available. The Staff Report for the 2001 Article IV Consultation with Cambodia is also available.

**Cambodia: Selected Economic Indicators, 1997–2001**

	1997	1998	1999	2000 Est.	2001 Proj.
	(Annual percent change)				
<b>Output and prices</b>					
Real GDP	3.7	1.5	6.9	5.4	5.3
GDP deflator	6.0	13.6	3.3	-2.9	3.0
Consumer prices					
(End-period)	9.2	13.3	-0.5	-0.8	-0.6
(Annual average)	8.0	14.8	4.0	-0.8	-0.6
	(In percent of GDP)				
<b>General government</b>					
Total revenue	9.6	8.9	11.5	12.1	12.4
Total expenditure	13.8	14.9	15.9	17.8	18.2
Of which: current expenditure	8.8	8.9	9.6	10.3	11.0
Current fiscal balance	0.7	-0.3	1.8	1.6	1.4
Overall fiscal balance (excluding grants)	-4.1	-6.0	-4.4	-5.7	-5.8
	(Annual percent change)				
<b>Money and credit</b> (end of period)					
Broad money	16.6	15.7	17.3	26.9	21.6
Private sector credit	46.4	2.8	16.6	17.7	11.3
	(In millions of U.S. dollars; unless otherwise indicated)				
<b>External sector</b>					
Current account balance (excluding official transfers)	-246	-224	-276	-316	-301
(In percent of GDP)	-7.9	-8.0	-9.0	-10.2	-9.1
Domestic exports	534	604	709	1,103	1,322
Retained imports	-798	-831	-968	-1,438	-1,621
Gross official reserves	262	390	422	485	548
(In months of imports of goods and services)	2.4	3.5	3.3	2.8	2.9
External debt stock (in percent of GDP) 1/	66.0	72.6	72.0	71.0	66.3
Exchange rate (end of period)					
Riels per U.S. dollar	9,100	3,780	3,775	3,910	3,900

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

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





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News Brief No. 02/09  
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## **IMF Completes Fourth Review of Cambodia's PRGF Program and Approves US\$10.4 Million Credit**

The Executive Board of the International Monetary Fund (IMF) yesterday completed the fourth review of Cambodia's performance under a three-year Poverty Reduction and Growth Facility (PRGF)<sup>1</sup> (see [Press Release No. 99/51](#)). This enables the immediate release of a further SDR 8.357 million (about US\$10.4 million) from the arrangement, which would bring total disbursements under the IMF-supported program to SDR 41.79 million (about US\$52.0 million). The Board also approved Cambodia's request for extension of the period of the current arrangement by about four months to February 28, 2003.

After the IMF Executive Board's discussion on Cambodia, Eduardo Aninat, Deputy Managing Director and Acting Chairman, made the following statement:

"The Cambodian authorities have continued to make good progress in implementing their economic reform program. Inflation has remained low and economic growth has been sustained despite a weakening in the external environment. Progress has also been made in key areas of structural reform, including bank restructuring, customs and tax administration, expenditure management, and military demobilization. However, to sustain high economic growth and reduce poverty, reform efforts need to be strengthened. To minimize the risks to program implementation stemming from weak capacity, close monitoring will be required as well as continued technical assistance to improve local capacity in bank supervision, tax and customs administration, and budget execution.

"Fiscal policy will continue to be the focus of the PRGF-supported program. Improvements in revenue mobilization will require continued progress in tax and customs administration and implementation of agreed tax measures. Improvement in cash management and overall budget execution will also be required, and by continuing to avoid domestic financing of the budget, private sector credit can be increased while maintaining overall financial stability.

"Sustaining the positive record of economic performance will require further progress in several areas of structural reform. Bank restructuring should be completed and work to reform the Foreign Trade Bank needs to be accelerated. The military demobilization program should also be completed by end-2002. Moreover, moving ahead with administrative reform is critical to improving the

efficiency of public service delivery. Trade reform and improving trade facilitation will enhance growth prospects, and these reforms need to be integrated with the national poverty reduction strategy. Efforts need to be accelerated to complete the authorities' full PRSP, and fully costing priority reforms will be an important input to that effort. Continued progress in overall governance will also be needed to improve the environment for private sector investment, including improvements in the legal framework and consistent application of the law.

"The program's success will continue to depend on donor support and debt relief. In this regard, it is important for the authorities to avoid non-concessional borrowing, and for the authorities and Cambodia's key bilateral creditors to intensify their collaboration on efforts to resolve outstanding debt issues, with a view to reaching agreement in 2002. It will also be important that Cambodia receive bilateral support on highly concessional terms so as to enable sustainable poverty reduction efforts," Mr. Aninat said.

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<sup>1</sup> On November 22, 1999, the IMF's concessional facility for low-income countries, the Enhanced Structural Adjustment Facility, was renamed the Poverty Reduction and Growth Facility, and its purposes were redefined. It is intended that PRGF-supported programs will in time be based on country-owned poverty reduction strategies adopted in a participatory process involving civil society and development partners, and articulated in a Poverty Reduction Strategy Paper (PRSP). This is intended to ensure that each PRGF-supported program is consistent with a comprehensive framework for macroeconomic, structural, and social policies to foster growth and reduce poverty. PRGF loans carry an annual interest rate of 0.5 percent, and are repayable over 10 years with a 5 ½-year grace period on principal payments.

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**Statement by Dono Iskandar Djojosebroto, Executive Director and Tola May,  
Assistant to the Executive Director for Cambodia  
February 6, 2002**

***Key points:***

- *The first two years of the PRGF program were completed successfully; all quantitative and structural performance criteria under the program have been met.*
- *The macroeconomic environment has stabilized; strong growth was achieved in 2000-2001, supported mainly by expansion in garment exports and tourism. Output in 2001 was, however, slightly below projections owing to the global economic downturn and the growth projections for 2002 has been lowered accordingly.*
- *Substantial progress in structural reforms have been achieved on many fronts despite the significant capacity constraints amidst a stable but fragile political situation. Such achievements reflect the strong commitment of the government and effective contributions by multilateral and bilateral donors.*
- *The outlook for 2002 and the third-year under the PRGF program is favorable. Preparation of the full PRSP is expected to be completed by October 2002. Given the capacity constraints, more technical assistance is needed for the preparation of the PRSP. Frequent reviews and adjustments may be needed to ensure smooth implementation.*
- *Debt resolution is in progress. Highly concessional terms for debt resolution would be needed given Cambodia's weak financial capacity for debt servicing. Otherwise, the ongoing efforts in poverty reduction could be compromised.*

***Introduction***

Cambodia has completed the first two years of the PRGF program successfully. Macroeconomic stability has been maintained and significant advancements in structural reforms have been accomplished. Noticeable progress has been achieved in sustaining economic growth, reducing poverty, and accelerating economic reconstruction. All quantitative and structural performance criteria for the fourth review were observed with good progress in banking sector rehabilitation, forestry policy reforms, fiscal restructuring, and promotion of good governance.

***Macroeconomic Developments***

Despite the negative impact of drought followed by floods (affecting more than two million people) on domestic production, coupled with the impact of the global economic downturn in the fourth quarter of 2001, preliminary estimates are that annual output grew by 5.3 percent, slightly below the program target. Recent developments, however, indicate that garment exports and tourist arrivals continued to grow in the last quarter of 2001, providing some upside potential that growth could be somewhat better

than the existing forecast. Given the global economic slowdown, the projected rate of growth in 2002 has been revised downwards to 4.5 – 5.0 percent.

Continued tight monetary policy pursued by the Cambodian authorities has helped to curb inflation, which remained slightly negative over the past three years. At the same time, the exchange rate continued to be generally stable. Gross official reserves increased gradually, reaching US\$548 million at end-December 2001, equivalent to three months of imports. Reflecting strong export performance, the current account deficit (excluding grants) is estimated to have declined to 9.0 percent of GDP in 2001 from 10.0 percent the previous year, or about a percentage point below the program target.

Consistent with the authorities' commitment to the international financial community and to facilitate international payments, Cambodia has accepted Article VIII, Sections 2, 3, and 4 of the Fund's Articles of Agreement, with effect from January 1, 2002.

### *Fiscal Policy*

The Cambodian authorities have continued to rigorously implement economic and fiscal reforms so as to consolidate macroeconomic stability. Budget management has been improved during 2000-2001 and fiscal performance has been in line with the program targets. In 2001, **government revenue** rose to about 12.5 percent of GDP, and is expected to increase further to 13.5 percent of GDP in 2002. The rise in revenue in 2001 was attributable to improved collection of tax and non-tax revenues. However, there was some slippage in collection of customs revenue in the second-half of 2001 owing to the decline in import volumes and administrative constraints. Both the Tax as well as the Customs and Excise Departments have initiated their reform action plans to further strengthen their administrative and operational capacity with technical assistance from the Technical Cooperation Action Plan (TCAP) program. The government will focus on (i) enhancing the Large Taxpayer Unit (LTU), (ii) broadening the tax base, (iii) improving the collection of non-tax revenue (from telecommunications and leases of public property), (iv) enhancing the pre-shipment inspection (PSI) system, and (v) curbing smuggling, in order to achieve the 2002 revenue target.

As for **expenditures**, the formulation of a comprehensive reform strategy for public expenditure management is in progress. The reform strategy covers (i) expenditure control, (ii) cash management, (iii) treasury reforms, and (iv) adopting standardized accounting and fiscal reporting systems with TCAP technical assistance. The government is committed to a pro-poor fiscal policy and will divert more resources from defense and security to the social sector. As an outcome of the on-going military demobilization exercise, defense and security spending is expected to decline to 2.8 percent of GDP in 2002 from 3.2 percent in 2001. On the other hand, social sector spending is budgeted to increase to 3.7 percent of GDP in 2002 from 3.2 percent in 2001.

### *Financial Sector Reforms*

In 2001, the National Bank of Cambodia (NBC) continued to implement its banking sector restructuring plan. Accordingly, 12 banks were closed, of which 8 were

liquidated smoothly, while judicial liquidation in accordance with the court ruling has been initiated for the remaining 4 banks. Another 13 banks were given conditional licenses to operate under Memoranda of Understanding (MOUs), and the NBC monitors them closely and assesses their performance in accordance with a preset timetable. Most of these banks have fulfilled the requirements of their MOUs, and a final decision on the liquidation of those banks that failed to meet the requirements is expected to be made by end-February 2002. Various measures have been adopted to upgrade the supervisory capacity of the NBC. These include the plan to implement a standardized accounting system for the banking sector in consultation with the Bankers' Association in order to improve the reporting system. In the meantime, a strategy for the development and supervision of micro-finance business is being formulated to boost activities in support of the poverty reduction strategy. A blueprint for financial sector development has also been completed with the assistance of the Asian Development Bank to strengthen overall financial sector development.

With regard to the restructuring of the Foreign Trade Bank (FTB), an outside director has been appointed to the Board of Directors and a foreign expert has been engaged to help upgrade the bank's management and prepare it for eventual privatization by end-2002. At end-March 2002, the Ministry of Economy and Finance (MEF) will issue government bonds to replace the bridge financing provided by NBC in FTB's capital base.

With the successful implementation of the US dollar clearing system alongside the local currency clearing system, the NBC has made significant progress towards establishing a modern payment system in Cambodia. In this regard, preparation of the draft bills on negotiable instruments and payment transactions is progressing earnestly and the final draft will be submitted to the Council of Ministers in May 2002. An international audit firm has completed its audit of the accounts of the NBC and the report has been published in compliance with the policy on safeguards in the use of Fund resources.

### ***Governance Action Plan***

The Cambodian authorities consider that good governance is a prerequisite for sustainable socio-economic development and social justice in Cambodia. Accordingly, the Governance Action Plan (GAP) has identified two categories of governance reform that will be critical to the country's development over the near and medium-term. The first involves four overlapping areas, namely legal and judicial; public finance; civil service and administration; and anti-corruption. The second includes two specific policy areas—natural resource management and demobilization of the armed forces. The authorities have disseminated the GAP in December 2001 to the public as a milestone for its implementation. Within the GAP framework, the National Audit Authority will commence operations in 2002 and undertake audits of public revenues and expenditures in order to improve transparency and accountability.

### ***Forestry Policy***

The Cambodian authorities also consider that the sustainable management of its natural resources and the protection of the environment are among the main elements of its strategy for combating poverty in Cambodia. In the forestry sector, the government issued a decree requiring the concession companies to submit their forestry management plans by end-September 2001 as a condition for extending their logging licenses. Unfortunately, the plans that were submitted did not provide an adequate basis for sustainable forestry management. Consequently, the government took decisive action, effective from January 2002, to suspend the operations of 17 logging concessionaires throughout the country in order to preserve the forestry resources. The ban will only be lifted and the logging licenses extended when adequate forestry management plans are submitted and approved by the government.

### ***Administrative reform, Civil Service Reform and Military Demobilization***

On administrative reforms, the government has shifted from a centralized to a decentralized management system by introducing technical devolution of power from the central to the local levels. This will strengthen public services and increase public participation in the government's decision-making process. The starting point for this process was the communal elections that were held on February 3, 2002.

The implementation of the nationwide computerized payroll system for the civil service has been successfully completed, resulting in annual savings of up to US\$ 2.2 million from the elimination of about 9,000 irregular (ghost) workers from the payroll. A strategy for further civil service reform in 2002-2006 has been developed in order to improve administrative efficiency in the delivery of public services. The strategy provides the foundation for (i) reviewing job classifications, (ii) providing incentives to core groups (AA and Priority Management Group) while at the same time, successively raising salaries in line with improved public revenues, and (iii) rationalizing the size of the civil service with special focus on the increasing needs of the education sector. Given the current budget constraint, financial assistance from donors would help expedite implementation of such a program.

Military demobilization has been undertaken with the objective of transferring all demobilized soldiers into productive economic sectors. At the same time, savings from the reduced military expenditure will be allocated to the development of public infrastructure, and the social and economic sectors. The government has completed the first phase of the demobilization program by discharging 15,000 soldiers in December 2001. In the second phase, another 15,000 soldiers will be discharged by end-2002.

### ***Poverty Reduction Strategy Papers***

The establishment of the Council of Social Development (CSD) and its General Secretariat (GSCSD) would advance the preparation of the full PRSP, expected to be completed by October 2002. Although much needs to be done to improve coordination and cooperation amongst all stakeholders as well as overcome the human resource constraints, the institutional arrangements and work plan that have been put in place will

allow the preparations to progress forward. Using the second Socio-Economic Development Plan 2001-2005 (SEDP II) as the foundation for the poverty reduction strategy, the CSD will now focus on poverty diagnosis and monitoring, identifying priority public actions, and stimulating the participatory process. Despite the above arrangements, the CSD will encounter tremendous challenges to resist compromising on the priority actions because of pressures from the urgent needs throughout the country and the serious capacity constraints in human, institutional and financial resources. External support would be urgently needed and close monitoring and frequent adjustments may be necessary as the strategy is implemented.

### ***World Trade Organization—Trade for Poverty Reduction***

The Cambodian authorities are committed to better integrate their economy into the regional and international community. In recent years, Cambodia has been actively fulfilling its obligations towards possible accession to the WTO. The law on trademarks has been adopted and other key legislations such as the bankruptcy law and secured transactions law are forthcoming. Tariff rates and the number of tariff bands have been reduced. A national workshop was held in November 2001 to foster a comprehensive integrated framework for Cambodia's trade strategy to serve as one of the pillars for its poverty reduction strategy.

### ***Debt Resolution***

As the staff report clearly indicates, the Cambodian authorities have taken a number of steps since the last Board meeting to advance discussions toward resolving outstanding debt obligations. A meeting between a Cambodian delegation and their Russian counterparts in Moscow in September 2001 marked further progress in the resolution of Cambodia's debt to the Russian Federation. The Prime Minister of Cambodia was initially scheduled to visit Moscow in October to further the debt rescheduling discussions, but this was cancelled following the events of September 11. The next round of discussions is now scheduled for this month in Moscow. The Cambodian authorities have confirmed in written communication to the Russian authorities their readiness to be flexible regarding all aspects of a potential rescheduling agreement.

Similar efforts have been made vis-à-vis Cambodia's debt arrears to the United States. The plan to discuss the debt issues with the United States during the occasion of the IMF-World Bank Annual Meetings in September 2001 did not materialize due to the cancellation of the Annual Meetings. The Cambodian delegation is now scheduled to visit Washington DC this month for meetings with their US counterparts. Progress has also been made in finalizing agreements with other creditors.

As noted in staff's analysis, Cambodia's financial capacity remains very weak. It would therefore be important for the Cambodian authorities to be able to reschedule their outstanding debts on very concessional terms. Otherwise, there could be major implications on Cambodia's ability to make progress in its poverty reduction efforts.

***Conclusion***

In conclusion, Cambodia has made impressive progress under the PRGF program despite its significant capacity constraints and its still fragile political situation. These successes would not have been possible without the strong commitment of the authorities and the continuous support of the international community. However, the authorities recognize that there is still a long journey ahead to reduce and eradicate poverty. Much more assistance will be needed in the years ahead to support the authorities' ongoing efforts. In this regard, my Cambodian authorities are grateful for the assistance and support received from the international community and various bilateral donors. The Cambodian authorities would like to thank the Executive Board, Management and staff, for their continuous support.