August 2007
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Cambodia: 2007 Article IV Consultation—Staff Report; Staff Supplement; and Public Information Notice on the Executive Board Discussion

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 2007 Article IV consultation with Cambodia, the following documents have been released and are included in this package:

- The staff report for the 2007 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on June 5, 2007, 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 July 2, 2007. 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 supplement on the joint IMF/World Bank debt sustainability analysis.

- A Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its July 25, 2007 discussion of the staff report that concluded the Article IV consultation.

The document listed below has been or will be separately released.

Selected Issues Paper and Statistical Appendix

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

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

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INTERNATIONAL MONETARY FUND

CAMBODIA

Staff Report for the 2007 Article IV Consultation

Prepared by the Asia and Pacific Department
(in consultation with other Departments)

Approved by Daniel Citrin and Adnan Mazarei

July 10, 2007

- The 2007 Article IV discussions took place in Phnom Penh May 22–June 5, 2007. The staff team comprised Messrs. Carter (Head) and Davies (both APD), Ntamatungiro (FAD), and Luengnaruemitchai (PDR), and was assisted by Mr. Nelmes, the resident representative. Mr. Warjiyo (Executive Director) and Mr. Eng (OED Advisor) participated in the discussions.

- Cambodia's last PRGF arrangement ended in February 2003, with access of 67 percent of quota fully drawn.

- The 2006 Article IV Consultation was completed on July 7, 2006. Executive Directors views can be viewed at: http://www.imf.org/external/np/sec/pn/2006/pn0678.htm.

- Cambodia accepted the obligations of Article VIII, Sections 2, 3, and 4 in January 2002, and has maintained an exchange system that is free of restrictions on the making of payments and transfers for current international transactions.

- Prime Minister Hun Sen's CPP party has consolidated power ahead of the 2008 elections. The CPP's main coalition partner, FUNCINPEC, split up in 2006 following constitutional changes, and its long-time leader, Prince Ranariddh, formed a competitor party. He was subsequently sentenced, in absentia, to 18 months in prison for breach of trust for his role in selling a FUNCINPEC building. The recent local elections saw a comprehensive CPP victory (60 percent of the vote) but also saw the main opposition Sam Rainsy Party, emerge as a distinct force with 25 percent of the vote.

- Despite significant shortcomings in some areas, core economic and financial data provided to the Fund are generally adequate for surveillance.

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Executive Summary

- **Strong macroeconomic policies have enabled Cambodia to achieve impressive growth and make inroads into poverty.** Supported by prudent fiscal and monetary policies that have strengthened the economy's resilience to shocks, growth has averaged over 9 percent since 2000 and was 10¾ percent in 2006. Anchored in part by extraordinarily high dollarization, inflation has remained low and confidence increased. Overall poverty has declined markedly but with a rise in inequality.
- **Growth, however, remains narrowly based and rural poverty stubbornly high.** Growth has been driven by the garment and tourism sectors, with agriculture only recently making a sustained contribution. As a consequence, poverty remains high in rural areas and progress will have to be accelerated if Cambodia is to meet its Millennium Development Goals.
- **Debt is on a sustainable path**. This reflects continued strong economic growth and the highly concessional structure of Cambodia's lending. Moderate risks do remain, particularly given the low level of government revenues and continued external arrears.

Key issues and policy discussions

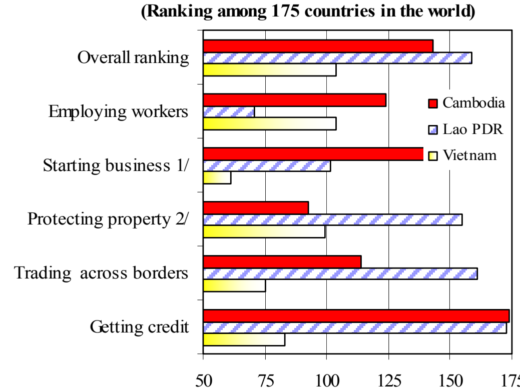
- **Appropriate policies and institutions are needed to sustain growth and poverty reduction over the medium term.** The authorities remain optimistic about medium-term prospects and are taking steps to mitigate risks that stem from the narrow growth base, the banking sector and governance concerns. Oil production, should it occur, would enhance prospects but there is still much uncertainty as to its scale and timing.
- **Fiscal policies focus on improving the level and quality of revenue and expenditure.** The authorities agree in principle with staff that further policy measures would improve the efficiency and equity of the tax system. However, for the 2008 budget they intend to rely on gains from improved administration. Expenditure policy aims to improve public services and increase investment. Staff supports these policies and emphasizes the importance of improving fiscal planning so that revenue increases are used to finance additional expenditure rather than build up domestic savings.
- **Monetary policy is accommodating rising money demand while exchange rate policy targets nominal stability—the rate is in line with fundamentals, with the underlying current account in equilibrium**. Neither the authorities nor staff believe rapid growth of monetary aggregates is currently a macroeconomic concern. It does, however, present risks to the immature financial sector which the authorities are responding to through better enforcement of prudential regulations. The main monetary policy tool is unsterilized foreign exchange intervention targeted at maintaining a stable nominal exchange rate. Staff supports this policy, which, with the current strong demand for local currency, is adding to international reserves without fueling inflation.
- **Structural reforms in the fiscal and banking sectors are progressing well.** Good progress has been made in the authorities' flagship public financial management reform program while gains have also been made in improving the financial sector's regulatory framework. However, much needs to be done to improve the capacity of public institutions, enhance governance and reduce corruption.

I. BACKGROUND

1. **Since emerging from conflict and political instability in the late 1990s, Cambodia has rapidly attained macroeconomic stability.** Supported by prudent fiscal and monetary policies that have strengthened the economy's resilience to shocks, growth has averaged over 9 percent since 2000 and has accelerated in recent years. Anchored in part by the extraordinarily high degree of dollarization, inflation has remained low and the resulting growth in confidence has encouraged re-monetization.

2. **Nevertheless, the country remains poor.** Growth has been narrowly based on garment exports and tourism and while the overall poverty rate has declined—from 47 percent in 1993 to 35 percent in 2004—there has been a rise in inequality. Encouragingly, the increase in inequality occurred primarily in the early part of the decade (1994-97) and mostly within rural areas.[1] During the second half of the period (1997-2004), the benefits of growth were shared reasonably equally between the rich and the poor but rural poverty remains high. Despite the progress reported in the recently completed Annual Update of the National Strategic Development Plan (NSDP), the authorities' PRSP, some Cambodian Millennium Development Goals appear beyond reach (Box 1 and Table 6).

World Bank Doing business indicators in 2006
(Ranking among 175 countries in the world)



1/ Average of "starting a business" and "licensing."
2/ Average of "registering property," "protecting investors," and "enforcing contract."

3. **Poor governance weakens the environment for broad-based development.** Human and institutional capacity remains very weak, constraining the ability of the public sector to contribute to poverty reduction. Cambodia ranks very poorly on indicators of economic governance, hindering gains in external competitiveness. Corruption is endemic and human rights problems continue. Land grabbing and illegal logging with damaging economic, social and environmental effects are widely reported.

4. **A proposed PRGF arrangement remains stalled as negotiations on outstanding debt obligations to the United States and Russia continue.**[2] An in-principle deal has been struck with the United States but is still to be finalized. Russian debt rescheduling negotiations continue. At the authorities' request, staff is maintaining an intensive policy

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[1] World Bank's Equity and Development Report 2007.

[2] IMF policies prevent lending in the presence of arrears to official creditors, see IMF Country Report 06/265, Chapter V for further details.

dialogue until a formal program can be presented to the Board. This dialogue includes monitoring progress against the authorities' quarterly macroeconomic targets and annual structural reform priorities.

Box 1: The National Strategic Development Program 2006 -10 (NSDP)

The NSDP focuses on broadening growth, particularly in rural areas. Staffs concluded that it provided a good road map for tackling poverty, although some critical elements of the sectoral strategies needed to be finalized and costing improved.*

The recent annual progress report (APR) is positive about achievements in the first year of implementation. Although it reports some progress in aligning objectives and financing, the linkages between NSDP priorities, the budget and the public investment program still would benefit from strengthening. The APR was discussed at the Cambodia Development Cooperation Forum (CDCF) in June 2007 where aid pledges of around US$700 million annually over 2007–09 indicate that the NSDP's investment framework would be fully financed over this period. Of note, China was included for the first time in the medium-term indicative financing framework.

The authorities stress the importance of aligning aid delivery with NSDP priorities. A recent report on aid effectiveness found that while assistance was broadly aligned with the NSDP, it is too fragmented and excessively focused on technical assistance thus reducing the resources available for much needed capital investment. The authorities and development partners agreed a new set of Joint Monitoring Indicators at the CDCF to assist in monitoring progress against NSDP objectives in a framework of mutual responsibility and accountability. Development partners, particularly the World Bank, are aligning their programs with these indicators.

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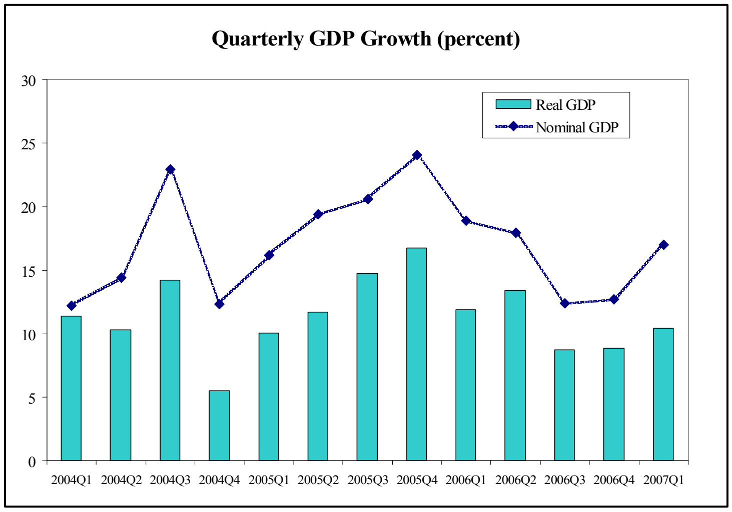
* IMF Country Reports: 06/267 (the NSDP); and 06/267 (the Joint Staff Advisory Note).

5. **Emerging creditors are playing a more prominent role.** Officials publicly contrast the ease of official financing from China and Korea with the conditionality applied by donors such as the World Bank—who, amid much publicity and dispute, suspended a number of projects in mid-2006 due to corruption. The projects have since resumed and with a recent agreement on a repayment schedule for the misprocured amounts, the first in a series of Poverty Reduction and Growth Operations (PRGOs) will be considered by the Bank's Board in mid-July. At the Cambodia Development Cooperation Forum (CDCF) in Phnom Penh in June, aid pledges were of the order of $700 million annually, notwithstanding considerable donor concerns about governance.

II. Recent Economic Developments and Near-Term Outlook

6. **Macroeconomic performance in 2006 continued to be impressive and the near-term outlook is favorable (Figure 1)**. Growth in 2006 was 10¾ percent and, with first quarter growth of 10 percent, is projected to be around 9 percent in 2007.



- **Buoyant domestic activity is set to continue**. Agricultural production has improved on 2005's record-breaking year, reflecting increases in yields and cultivated land. Construction and services, particularly the financial sector, underpin a vibrant urban economy. Inflation has recently picked up slightly, as a result of rising fish and petroleum prices, but is expected to remain around 4 percent, assuming broadly stable international oil prices for the rest of the year.

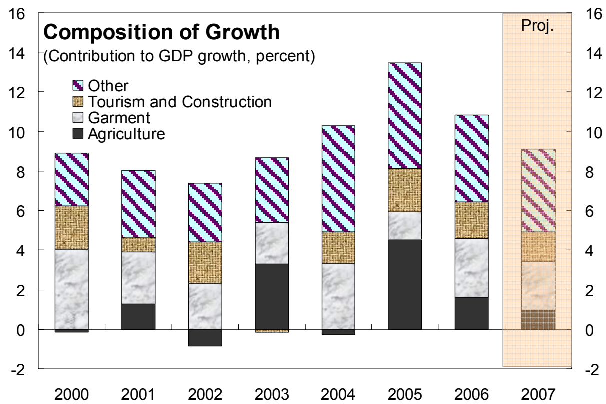
- **Exports remain buoyant**. Garments and tourism grew by around 20 percent in 2006 and continued growing rapidly in early 2007. Imports are increasing on the back of strong GDP growth and high oil prices—an external current account deficit (excluding official transfers) of around 7 percent of GDP is projected in 2007. External financing comes mainly from aid and FDI focused on garments, tourism, agriculture and construction.

- **Fiscal policy continues to be prudent**. The overall fiscal deficit in 2007 is expected to be similar to 2006, at 3¼ percent of GDP (excluding MDRI receipts). Revenue collection in 2007 is again exceeding expectations, with tax department revenues in the year to April up by around 60 percent and customs department revenues also performing strongly. Expenditure restraint in 2006 and slow spending in early 2007 has led to further increases in government bank deposits and significant reductions in domestic arrears— from CR471 billion at end-2004 to CR77 billion at end-March 2007.

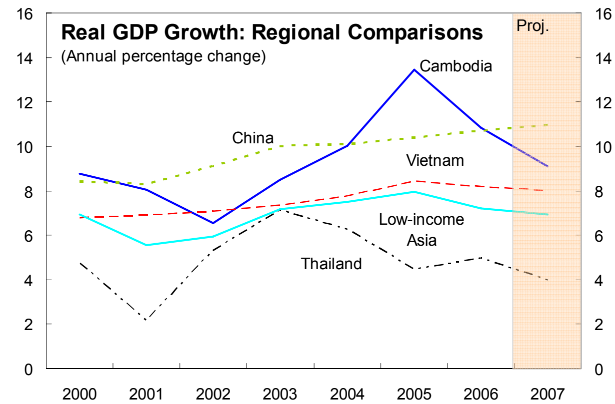
- **Money demand is rising.** Broad money grew by around 40 percent in 2006, mainly reflecting increases in bank deposits, almost entirely in dollars. Credit to the private sector, also in dollars, grew even more rapidly but the level remains very low (only 12 percent of GDP). These trends continued in early 2007.

Figure 1. Economic Developments & Outlook 2000-07 [1]

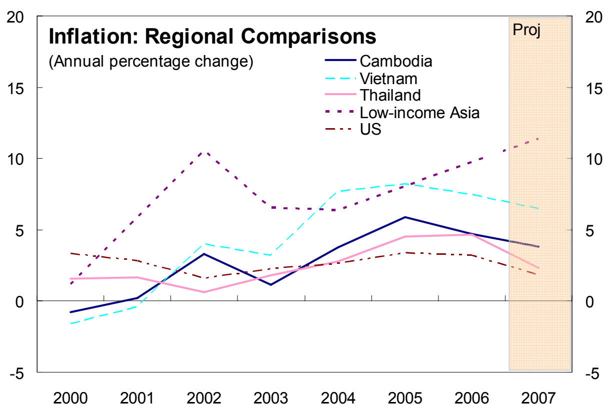
Garments, tourism and agriculture drive strong growth...



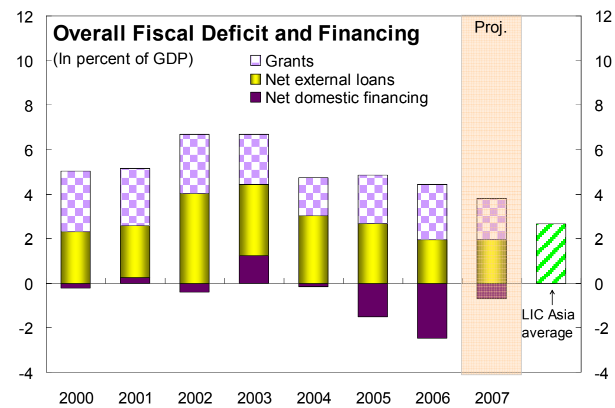
...which is above average for the region.



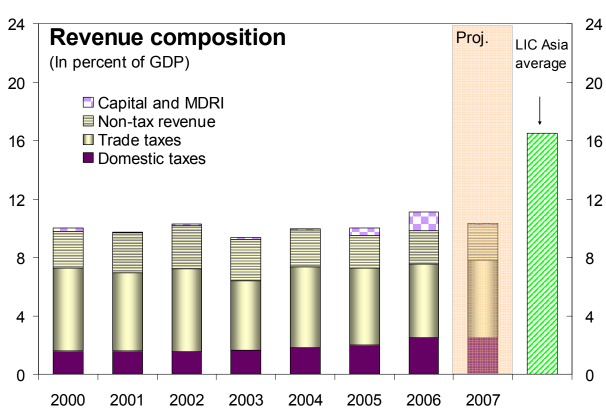
Dollarization anchors inflation below most of the region.



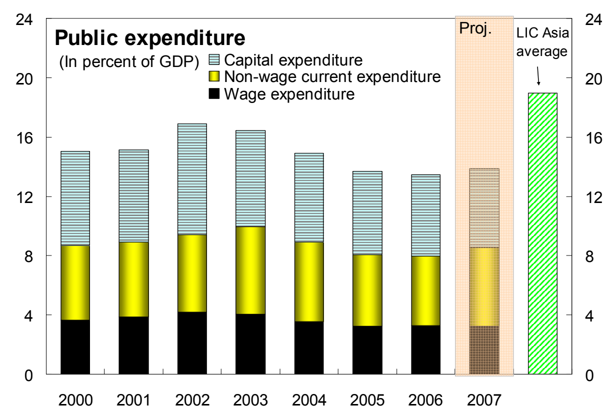
The fiscal deficit is more than financed externally...



... but revenue is low...



...constraining public expenditure.

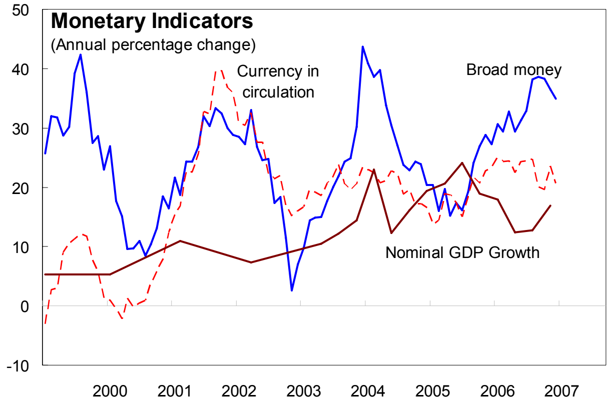


Sources: Cambodian authorities and Fund staff estimates.

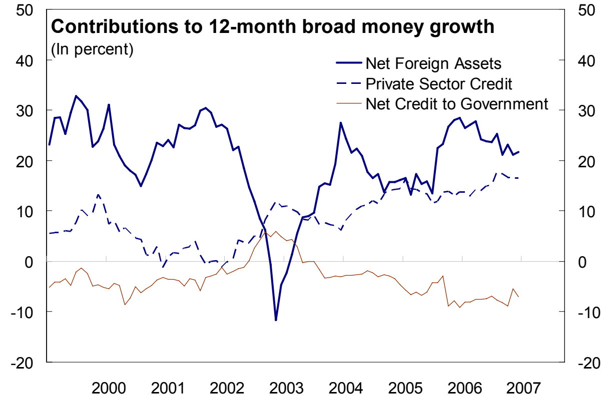
[1] LIC Asia average refers to 2006 data for the following countries: Bangladesh, Bhutan, Cambodia, Lao P.D.R, Mongolia, Myanmar, Nepal, Vietnam and Sri Lanka.

Figure 1. Economic Developments & Outlook 2000-07 (Con't)

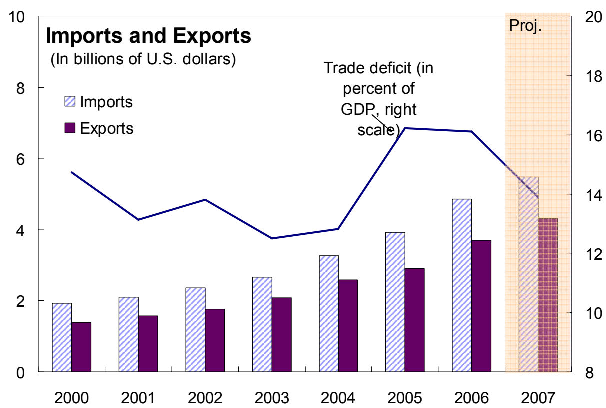
Money is growing much faster than GDP...



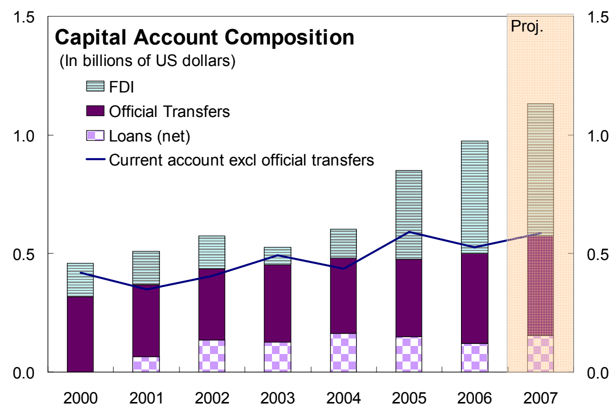
...driven by foreign assets and private sector credit.



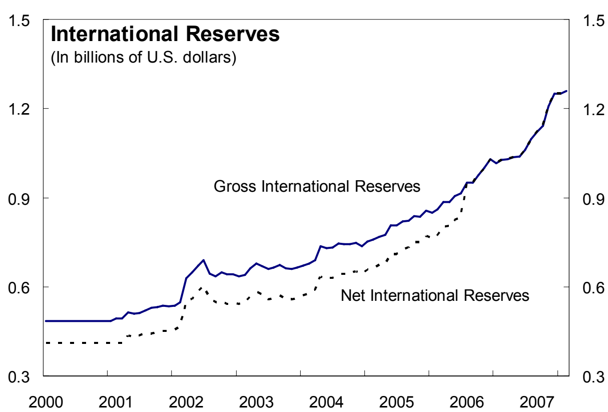
Trade flows are growing and the deficit is now narrowing...



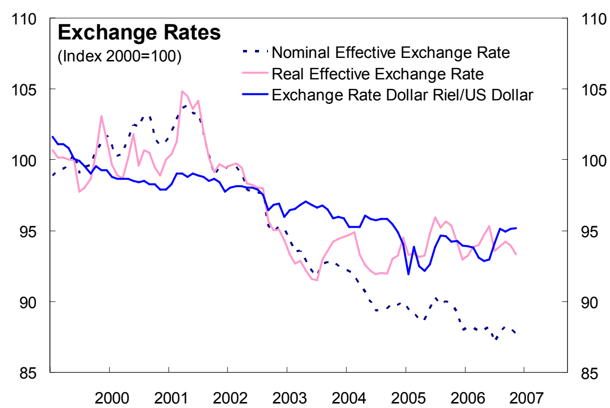
...financing comes from aid and increasing FDI.



International reserves are steadily accumulating, MDRI eliminated the small amount of liabilities...



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



Sources: Cambodian authorities and Fund staff estimates.

- **The exchange rate is stable and reserve growth is healthy**. The riel has remained broadly stable in bilateral and real effective terms with some small nominal appreciation in early-2007. Increased demand for riel, in part as a result of improved tax compliance, has allowed the National Bank of Cambodia (NBC) to make greater-than-expected dollar purchases from the market. NBC's reserves now exceed US$1.2 billion. However, they are not keeping pace with the growth in banks' foreign currency deposits and there is a continued small build up of external arrears to the United States and Russia.

7. Progress has been made on structural reforms but much remains to be done. Efforts in the fiscal and financial sectors are bearing fruit, boding well for the remaining broad agenda. However, legal and judicial reform progress has been much slower. Efforts to strengthen the draft anti-corruption law halted pending review of the penal code and an anti-corruption unit in the Council of Ministers was created in the interim. The Anti-Money Laundering and Counter Financing of Terrorism Law passed but drafts of the Insolvency Law and the Law on the Status of Judges and Prosecutors are still being debated at Ministry level.

III. Policy Discussions

8. **Discussions focused on establishing appropriate policies and institutions to sustain growth and poverty reduction over the medium term in the context of NSDP.** Weak institutions continue to limit the authorities' ability to respond to evolving economic conditions.

- **Fiscal policy is currently the authorities' main policy lever** for adjusting to economic shocks and contributing to poverty reduction.

- **Monetary and exchange rate policy aims to promote confidence in the nascent financial sector.** Deepening and strengthening the banking sector are critical for continued modernization of the economy.

- **Broad-based improvement in governance is needed to increase investor confidence and enhance public sector performance.** Establishing a comprehensive and independent legal and judicial system will take many years. Policy discussions focused on macroeconomic aspects of governance, especially public financial management, trade facilitation and financial sector supervision.

9. **Strengthening economic institutions continues to require substantial technical assistance.** The authorities broadly agreed with the Fund's strategy for future technical assistance. They noted that, resource constraints notwithstanding, in some situations resident advice would continue to be important in designing and implementing policies and monitoring progress through improved statistics.

A. Medium-Term Outlook and Risks

Outlook

10. **Staff and the authorities shared optimism for medium-term prospects for growth and poverty reduction.** Continued strong growth in garments and tourism with sustained improvements in agriculural productivity and a rapidly growing working population will be key factors in growth averaging 7½ percent in the medium term. Combined with public financial management (PFM) improvements, this should enable further inroads to be made into poverty.

Macroeconomic Framework

	2006	2007	2008	2009
	(annual percent change)			
Real GDP	10.8	9.1	7.9	7.5
Consumer Price Inflation (average)	4.7	3.8	3.8	3.5
	(in percent of GDP)			
Overall fiscal balance (excluding MDRI)	-3.1	-3.0	-3.0	-3.0
Primary fiscal balance (excluding MDRI)	-1.7	-1.1	-1.4	-1.3
External Current Account Balance (Excl. Transfers)	-7.2	-7.0	-8.5	-8.8
	(in millions of US Dollars)			
Gross International Reserves	1,097	1,400	1,600	1,800
(in months of imports)	2.0	2.3	2.4	2.4
(in percent of uncovered dollar deposits in banks)	113	90	78	70

11. **Continued prudent macroeconomic policies underlie the positive outlook.** The authorities expressed a strong commitment to maintain prudent policies in the lead up to the 2008 general elections and beyond.

- Inflation is expected to remain in the low single digits, reflecting prudent fiscal policy even as monetary policy accommodates rapidly rising money demand against the background of high dollarization.

- The external current account deficit (excluding transfers) will stabilize at around 8 percent of GDP (Table 4) as increased domestic demand increases imports and export diversification gathers momentum. The deficit is admittedly large but financing will come from FDI and, consistent with pledges made at the CDCF and past flows, annual aid of around 6 percent of GDP.

- Steady accumulation of international reserves remains an important policy objective for the authorities. Import coverage is well below the 3-month benchmark and maintaining adequate coverage of rapidly increasing dollars in the banking system is challenging. The latter is a more relevant indicator in Cambodia's highly dollarized environment where the NBC would be reliant on its international reserves to provide liquidity to the financial sector.

12. **Oil production, should it occur, could significantly increase national income, and the fiscal revenues it yields would provide vital financing for development spending as well as allowing saving for future generations**. Given the substantial uncertainty still surrounding the level of reserves and the timing of production, staff agreed with the authorities that the principal macroeconomic framework should not include any estimates of

the impact of oil production. The DSA does, however, include an alternative scenario that illustrates the significant but not overwhelming impact of a moderate oil sector—fiscal revenues from oil would peak at around 5 percent of GDP (Chapter II of the Selected Issues paper).

13. **Staff stressed the importance of a clear institutional framework for the oil sector in reducing uncertainty and facilitating early commercial production.** The authorities agreed and pointed to the comprehensive petroleum law that is currently being drafted. The authorities' main current priority is to set a taxation regime that promotes exploitation of the resources while maximizing the government's take. Although covering taxation within the petroleum law was considered, the authorities are now committed to placing taxation provisions within the existing Law on Taxation to ensure transparency and consistency, as the IMF had recommended. The authorities have publicly committed that all future oil revenues will pass through the budget and be directed towards the goals of the NSDP. They are currently considering whether to formally endorse the Extractive Industries Transparency Initiative (EITI) stressing that irrespective of formal adoption, the PFM reform program already embodies the principles of EITI.

Risks

14. **Narrowly based growth increases the economy's exposure to shocks**.

- **Agricultural growth, vital for the majority of the population, remains vulnerable to weather conditions.** The authorities are attempting to counter this through investment in rural irrigation and improvements in extension services.

- **Garments, which dominate exports, are vulnerable to domestic and external developments.** Although demand appears to be holding up well in the face of strong regional competition, the recent accession of Vietnam to the WTO and the prospect of safeguards measures on China being lifted threaten future competitiveness. The authorities are therefore seeking improved access in existing (United States) and new (Russia) markets. They have also recently passed legislation that reduces the premium paid to night shift workers. Garment producers see this as important in increasing productivity and potentially bringing upstream garment activities into Cambodia. The move has, however, been strongly opposed by the trade unions.

15. **The rapidly growing financial sector continues to be an area of vulnerability.** Bank lending would be exposed were recent land price hikes and real estate speculation to reverse, eroding the growing confidence in the banking system. The absence of any state involvement in the banking sector would limit direct the fiscal impact of banking sector weaknesses, but NBC's international reserves would be at risk.

16. **Public debt is sustainable although with moderate risk of distress.**[3] Public debt, which is almost entirely external, declined to 33 percent of GDP in 2006. The continued strong economic growth anticipated in the medium and long term places debt on a sustainable path and the highly concessional structure of Cambodia's lending dampens the risk of distress. Nevertheless, moderate risks do remain, particularly given the current low level of government revenues, the continued existence of external arrears and the potential for contingent liabilities. Only the Minister of Finance can issue loan guarantees, which are currently very small.

17. **The authorities see the recently acquired sovereign credit ratings as confirmation of their sound polices but do not intend to borrow on commercial terms from capital markets in the near future.** The DSA shows that while some borrowing on commercial terms is not necessarily inconsistent with debt sustainability it would significantly increase fiscal debt service costs. Cognizant of this, the authorities stressed that, at least for the foreseeable future, they have no intention of pursuing the offers of commercial bond financing they have received. They are, however, prepared to consider limited borrowing on close to commercial terms (for example, through the AsDB's non-concessional window) for high-return infrastructure projects. Similarly, the government will avoid providing any substantial guarantees. The staff strongly supported this overall approach.

18. **Continued improvements in governance are vital for growth, competitiveness, and poverty reduction.** Although external confidence in increased political stability is gaining momentum, disorderly or indecisive national elections in 2008 could damage the investment climate and inhibit domestic policy making. The authorities responded to staff's concerns, stressing that recent elections, including the indecisive 2003 general election, have not led to any loss in macroeconomic stability and the Prime Minister committed not to allow any loosening of fiscal policy in the coming twelve months. In addition, the NSDP puts governance improvements at the heart of its strategy, with efforts to improve incentives.

- **Increase incentives for good performance**. The authorities are concerned about the disparity between the rapid pace of economic change and the weak capacity of the government. However, their plans for civil service reform, which focus on across-the-board increases in salaries, are at odds with the views of its development partners, who stress the need for more fundamental change in staffing structures and pay scales (see Chapter III of the Selected Issues paper).[4]

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[3] Supplement 1 details the latest joint Fund/Bank staff Debt Sustainability Analysis. Stress tests show that less prudent fiscal policies than assumed in the baseline do not significantly threaten debt sustainability.

[4] Basic civil service salaries are so low ($30/month) that a whole system of absentees, ghost workers, multiple jobs, and bribery has unfortunately evolved.

- **Increase disincentives for bad performance**. The anti-corruption unit established in 2006, is focusing its efforts on sectors with the most economic impact and has made some progress in publicly bringing to account, mostly mid-level, civil servants found to be engaging in corrupt activities. Nevertheless, the authorities acknowledged that passing the proposed Law on Anti-Corruption would provide a more robust institutional framework. Moreover, they recognize that actions to tackle illegal logging, land grabbing and fraud have to be taken.

B. Fiscal Policy

19. **Fiscal policy is prudent with the overriding principle to avoid domestic bank financing while improving the level and quality of revenue and expenditure.** Staff discussed a medium-term fiscal framework that sees the overall deficit remaining around 3 percent of GDP. Strong economic growth, improved enforcement, and policy measures will see revenue rising to 12 percent of GDP in the longer term, allowing further increases in capital expenditure. The continued build-up of domestic surpluses would also provide room to adjust to economic shocks and enable accumulation of foreign reserves. The authorities agreed with this framework but preferred to be cautious about revenue projections for the 2008 budget.

Fiscal Program (excluding MDRI transactions)

	2005	2006	2007	2008	2009
	Actual	Actual	Proj.	Proj.	Proj.
	(In percent of GDP)				
Total revenue	10.3	10.4	10.8	11.2	11.4
Tax revenue	7.6	8.0	8.2	8.6	8.8
Total expenditure	13.7	13.5	13.9	14.4	14.5
Current expenditure	8.1	8.0	8.5	8.8	8.9
Capital expenditure	5.6	5.5	5.3	5.6	5.6
Locally Financed	1.2	1.3	1.9	2.1	2.1
Current balance	1.8	2.3	2.1	2.2	2.3
Overall balance	-3.4	-3.1	-3.0	-3.0	-3.0
Overall balance (including grants)	-1.2	-0.6	-1.2	-1.6	-1.5
Foreign financing (net)	4.8	4.4	3.8	3.3	3.4
Domestic financing	-1.5	-1.3	-0.7	-0.1	-0.2

20. **The Ministry of Economy and Finance (MEF) is intending to accelerate expenditure markedly in the second half of 2007**, as teething problems with new budget execution procedures recede. Staff supported the authorities' intention to use additional revenue available after fully meeting budgets—including the within year wage increase announced in May—to clear up remaining domestic arrears.

21. **The authorities are currently developing a medium-term resource mobilization policy.** They agree in principle with staff that further policy measures are required to improve the efficiency and equity of the tax system.[5] However, with the general elections imminent, for the 2008 budget they intend to rely on continued revenue gains from improved

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[5] See chapter V of the Selected Issues paper for detail on the structure of the tax system.

administration rather than introducing measures such as broadening the VAT base and implementing property taxation. They believe that recent improvements in collection from an unchanged tax base reflect returns from previous administration reforms that will continue to accrue in future years. Further gains in customs performance are expected to come from the AYSCUDA-based automation beginning in early 2008 and enhanced risk management. Both of these though are dependent on the passage of the new customs law, now before parliament, and significant capacity building and investment in equipment.

22. **Expenditure policy aims to improve public services and increase investment.** Increases in revenue will be used in part to finance annual increases in public servants' base salaries of 20 percent.[6] The authorities indicated that non-wage allocations to priority expenditure programs will be increased at a similar rate while increases in other current expenditure will be limited to the rate of inflation, allowing them to devote increasing resources to financing public investment. These resources will include the proceeds of MDRI debt relief from the IMF, which are initially being spent on improving rural irrigation.[7] Staff urged the authorities to use realistic revenue estimates for the 2008 budget in order that expenditure increases, particularly in the capital budget, could be effectively programmed and inadvertent savings avoided.

23. **The authorities' PFM reform program is their flagship reform effort**. Significant progress has been made in the last twelve months, including through the introduction of the new chart of accounts and program budgets in priority sectors. However, staff and the authorities agreed that initial implementation problems with these procedures need to be addressed urgently with line ministries. Poverty-reducing spending will be identified in the 2008 budget and monitored through the year. The authorities have also begun to advance cash management reforms that should significantly improve expenditure efficiency but much remains to be done, particularly in rationalizing government bank accounts and increasing use of the banking system. The National Treasury computerization program also needs to be completed.

C. Monetary and Exchange Rate Policies

24. **The authorities' monetary policy is accommodating rising money demand**. Active monetary policy is currently precluded by the high level of dollarization, lack of indirect instruments, and considerable excess reserves in the banking system. Participation in the foreign currency market is therefore NBC's main monetary policy tool. Riels are supplied by foreign exchange purchases, largely in response to demand. Avoiding central bank fiscal

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[6] Base salaries are only around half of total remuneration with functional and other allowances playing a major role for many public servants. The pay increase will cost less than 0.1 percent of GDP in 2007 and 2008.

[7] The full value of debt relief showed in 2006 revenue. Budgeted spending for 2007 on irrigation is US$11million but may fall short of this target.

financing—a broad working rule the government has adopted for nearly a decade—has prevented excess riel liquidity, and thus exchange-rate depreciation and local-currency inflation. More recently, domestic fiscal surpluses have given rise to additional bank deposits in both riel and dollars, matched by increased international reserves.

25. **Exchange rate policy targets a stable nominal dollar rate.** Formally, NBC conducts a managed float of the exchange rate, intervening only to smooth market fluctuations. Staff noted, however, that the *de facto* policy is to maintain a stable nominal rate against the dollar. The authorities concurred and stressed its benefits in reinforcing confidence in the nascent financial sector and the national currency. Low inflation and relatively stable nominal exchange rates in neighboring countries enable the real effective exchange rate to support external competitiveness stemming from low dollar wages and continued agricultural productivity improvements.[8] Moderate, but increasing, unsterilized intervention supports this policy. Increasing demand for riel has led to marked increases in the level of foreign currency purchases over the last 12 months and there have been sales of only US$½ million in the last 2 years.[9]

D. Financial Sector

26. **The expansion in lending increases the vulnerability of an immature banking sector** (see Chapter IV of the selected issues paper). While neither the authorities nor staff believe rapid growth of monetary aggregates is a macroeconomic concern, it could endanger the small and segmented banking sector. The rapid growth in foreign currency deposits is concentrated in a few banks that cater for particular segments of the market. Credit, which is similarly concentrated, is almost entirely collateralized against the booming real estate market and appears to be also financing real estate and construction investment. Reported system-wide non-performing loans remain below 10 percent, but NBC acknowledged there are concerns as to the quality of asset classification. Many banks are exposed to a single sector and, in some cases, a few large customers. Given the dollar denomination of almost all loans and deposits, currency mismatches are not a major concern.

Average Prudential Ratios for Cambodia's Commercial Banks

Indicator	Prudential Benchmark	2005	Number of banks in breach	2006	Number of banks in breach
Number of Banks		18		20	
Liquidity	>50%	118%	0	108%	0
Net worth to risk-weighted assets	>15%	32%	1	26%	0
Loan to Deposit	<100%	61%	8	63%	7
Large exposure loans to net worth 1/	< 300%	88%	7	123%	2
Non-performing loans	...	7.5%	...	9.9%	...

1/ The prudential regulation was amended in November 2006.

[8] The dramatic changes to Cambodia's economy in recent years preclude estimation of an equilibrium exchange rate.

[9] These small sales took place recently through auctions conducted with the aim of testing market conditions.

27. **The expansion reinforces the critical importance of strong banking supervision.** The NBC acknowledged that, although enforcement of prudential regulations is improving, compliance with prudential regulations remains patchy. The central bank aims to bring banks into full compliance by the end of 2007, in particular those with systemic importance. Compliance should be improved as transitional exemptions to the new large-exposure regulation expire.

28. **The authorities are pursuing a number of initiatives to reduce impediments to financial intermediation.** The recently updated blueprint, formatted with the assistance of the AsDB, contains a broad range of reforms. Staff emphasized actions to establish a secure and reliable payments system and develop the recently introduced credit information system. New anti-money laundering legislation will provide a good framework for improving the integrity of the system. The authorities continue to implement the recommendations of the 2004 IMF safeguards assessment and intend, with staff's support, to request an update to contribute to the ongoing modernization of NBC operations.

E. Trade

29. **Trade policy reforms and improvements in facilitation are aimed at reinforcing Cambodia's strong external competitiveness.** With staff's support, the authorities' focus is now more on trade facilitation reforms than tax incentives to attract foreign investment. The new customs law will provide the legal framework for streamlining transactions and implementing commitments made under WTO accession. However, many other pieces of legislation required under these commitments remain behind schedule. Under ASEAN agreements, tariff rates under the Common Effective Preferential Tariff Scheme will be reduced to a maximum of 5 percent by 2010, and all items in the temporary exclusion list will be transferred to the inclusion list by 2007. The authorities agreed that tariff reductions should be made on a nonpreferential basis to avoid trade diversion and said that they planned to similarly reduce non-ASEAN tariffs.

IV. Staff Appraisal

30. **The Cambodian authorities' commitment to macroeconomic policies that promote domestic and external stability is commendable and should enable further inroads to be made into poverty**. Continued robust growth and growing domestic and international confidence combined with public administration reforms and sustained agricultural improvements should have a marked impact on rural poverty. The staff supports the approach of the authorities' NSDP to channel more resources to increasing agricultural productivity through rural irrigation, improved land allocation, and rural credit.

31. **The lead up to the 2008 elections should be a period of reform not delay.** Staff welcomes the authorities' commitment to maintaining stability through the election period. This is crucial for safeguarding increasing investor confidence in Cambodia's export sector, which remains concentrated and vulnerable to rapid reversals.

32. **Continued improvements in public services as well as tackling governance are crucial**. Addressing widespread corruption will enhance the business environment as well as strengthen revenue collection and expenditure quality. Staff continues to support the introduction of an appropriate anti-corruption law which will provide important rigor and transparency. In the meantime, existing institutions and laws should be utilized to guard against misuse of funds and to investigate irregularities as they come to light. Staff encourages further action to improve the transparency of state assets and concessions, which appear to be still assigned through uncompetitive processes.

33. **The authorities' caution with respect to commercial borrowing is welcome.** Reflecting the highly concessional structure of external debt, continuation of the current prudent borrowing policy—not using the recently acquired sovereign credit ratings in the short term—should safeguard debt sustainability and minimize risks of distress. Staff welcomes continued efforts to resolve outstanding arrears with official creditors.

34. **Oil production would improve prospects but also bring additional challenges and requires a clear legal framework.** A key building block is to strengthen the taxation regime for oil, making use of previous IMF technical assistance. Staff strongly supports the Prime Minister's decision to embed this within the existing law on taxation and encourages the authorities to endorse EITI. Careful consideration of the appropriate balance between saving, investing and consuming future oil revenues will be needed to ensure the benefits of oil wealth add to the hard-won macroeconomic stability.

35. **Continued revenue improvements are needed to finance public service improvement and, ultimately, reduce dependence on aid.** Recent revenue increases arising from administration improvements are commendable but challenges remain, particularly as the growth of customs department's tax base is restricted by administered prices and tariff reductions. Although, with sustained reform effort, further enforcement-based increases will be available, policy measures will also be needed to raise revenue and improve the structure of the tax system. Staff encourages the authorities to implement initial measures in the 2008 budget, despite its proximity to the elections.

36. **The authorities' plan to increase and reorient expenditure is welcome but not yet fully developed.** Staff supports the government's policy of steadily raising public sector wages as revenue increases allow. This is needed to improve performance and discourage corruption. However, the impact would be enhanced if it were embedded in a broader civil service reform strategy. Revenue increases need also to finance good quality poverty-

reducing spending, including productive capital investment, rather than only to increase domestic savings.

37. **Improved fiscal outcomes require continued progress in implementation of the PFM reform program.** The recent progress in PFM reforms have made the budget more credible and laid the foundations for more effective spending. Immediate priorities should be to continue to strengthen cash management and to clearly identify spending priorities in the 2008 budget.

38. **In the staff's view, dollarization has been, and will continue to be in the medium term, a valuable foundation for Cambodia's macroeconomic stability and financial sector growth.** These advantages currently outweigh the loss of seignorage and ability to use active monetary policy to adjust to domestic and external developments. The NBC should continue to accommodate increasing money demand without engaging in coercive measures to reduce the use of dollars. Nevertheless, wage and price developments should be carefully monitored for indications of inflation pressures.

39. **The exchange rate is broadly in line with medium-term fundamentals, with the underlying current account in equilibrium.** Staff supports the current exchange rate policy, which closely resembles a loose peg to the US dollar. The policy has been instrumental in external competitiveness, gradual reserve accumulation and low inflation and is appropriate as long as the expansion in local currency in circulation remains under control. The policy would need to be reviewed if there were significant movement in the exchange rates of neighboring countries. Given the need to supplement international reserves, sustained depreciation pressures, were they to arise, should not be resisted.

40. **Further improvements in NBC's banking supervision are crucial in preventing macroeconomic risks arising from the financial sector.** The impact of rapid private sector credit growth on banks' balance sheets needs to be closely monitored, to ensure that banks are weighing lending risks properly. Staff looks forward to further progress in enforcing prudential regulations and encourages NBC to rigorously enforce corrective actions for those banks that are out of compliance. Priority should be given to assessing asset quality and strengthening banks' credit risk management through the recently established credit information system. Also important will be implementing the recently passed Law on Anti-Money Laundering and working with the commercial banks to enhance the payments system.

41. **The Fund will continue to support the authorities' reform program.** If outstanding debt arrears issues are resolved, staff would support a request for a new PRGF arrangement. Until that point, staff will continue an intensive policy dialogue. Substantial IMF technical assistance will continue to support reforms in the fiscal, financial and statistical areas.

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

Table 1. Cambodia: Selected Economic Indicators, 2004–08

Nominal GDP (2006): $7254 million
GDP per capita (2006): $512
Population (2006): 14.2 million
Fund Quota: SDR87.5 million

	2004	2005	2006 Est.	2007 Proj.	2008 Proj.
Real economy	(annual growth rates, in percent)				
Real GDP	10.0	13.5	10.8	9.1	7.9
Real GDP excluding agriculture	15.2	8.7	17.0	11.3	9.5
Real agricultural output	-0.9	15.7	5.5	3.4	3.4
GDP deflator	4.8	6.1	4.7	4.0	3.9
CPI Inflation (end of period)	5.6	6.7	2.8	3.8	3.8
	(in percent of GDP)				
Domestic investment	17.7	20.1	21.5	21.5	23.7
Government investment	6.0	5.6	5.5	5.3	5.6
Non-budgetary grant-financed investment	4.3	3.1	2.7	3.2	3.3
Nongovernment investment	7.4	11.4	13.3	13.0	14.8
National saving	15.6	15.8	19.5	19.5	19.9
Government saving	1.4	1.8	2.3	2.1	2.2
Nongovernment saving	14.2	14.1	17.2	17.3	17.8
Money and credit	(annual growth rates in percent, unless otherwise indicated)				
Broad money	30.4	16.1	38.2	42.9	27.0
Net credit to the government 1/	-2.4	-4.9	-10.6	-0.6	-0.1
Private sector credit	35.9	31.8	51.6	44.7	35.0
Velocity of money 2/	5.4	5.4	4.9	4.0	3.4
Government operations	(in percent of GDP)				
Revenue 3/	10.3	10.3	11.5	10.8	11.2
Of which : Tax revenue	7.7	7.6	8.0	8.2	8.6
Expenditure	14.9	13.7	13.5	13.9	14.4
Current expenditure	8.9	8.1	8.0	8.5	8.8
Capital expenditure 4/	6.0	5.6	5.5	5.3	5.6
Overall budget balance	-4.6	-3.4	-2.0	-3.1	-3.2
Overall budget balance (incl. grants)	-2.9	-1.2	0.5	-1.3	-1.8
Foreign financing, net	4.7	4.8	4.4	3.8	3.3
Domestic financing 5/	-0.2	-1.5	-2.5	-0.7	-0.1
Balance of payments	(in millions of dollars, unless otherwise indicated)				
Exports	2,589	2,910	3,693	4,313	4,793
Imports	-3,269	-3,928	-4,749	-5,526	-6,243
Current account (excl. official transfers)	-436	-591	-525	-587	-795
(in percent of GDP)	-8.2	-9.4	-7.2	-7.0	-8.5
Current account (incl. official transfers)	-116	-266	-146	-170	-353
(in percent of GDP)	-2.2	-4.2	-2.0	-2.0	-3.8
Overall balance	49	65	193	246	165
Gross official reserves	809	915	1,097	1,400	1,600
(in months of prospective imports)	2.1	2.0	2.0	2.3	2.4
(in percent of uncovered dollar deposits in banks) 6/	179	146	113	90	78
Public external debt 7/ 8/	2,043	2,123	2,248	2,464	2,665
(in percent of GDP)	38.5	33.9	31.0	29.5	28.4
Public debt service (cash basis)	28	29	28	28	37
(in percent of exports of goods and services)	0.8	0.7	0.6	0.5	0.6
Memorandum items:					
Nominal GDP (in billions of riels)	21,343	25,693	29,809	33,822	37,905
(in millions of U.S. dollars)	5,308	6,271	7,254	...	...
Exchange rate (riels per dollar; end of period)	4,031	4,116	4,046	...	...

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

1/ Contribution to broad money growth.
2/ Ratio of nominal GDP to average stock of broad money.
3/ In 2006, includes transfer of MDRI proceeds as capital revenue transfer .
4/ Includes repayment of arrears in 2004 and 2005.
5/ Includes funds in transit and payment orders in excess of cash released.
6/ Dollar deposits in commercial banks net of their unrestricted reserves at NBC.
7/ From January 2006 includes the impact of debt forgiveness from the IMF under the MDRI.
8/ Russian Federation debt is valued at 0.6 USSR Roubles per US$ with the standard 70 percent discount.

Table 2. Cambodia: General Government Operations, 2004-08

	2004	2005	2006		2007		2008
			Original Budget	Est.	Budget	Proj.	Proj.
			(In billion of riels)				
Total revenue	2,209	2,653	2,873	3,431	3,261	3,637	4,254
Of which: Central government	2,116	2,559	2,781	3,240	3,142	3,419	3,997
Tax revenue	1,645	1,948	2,176	2,372	2,602	2,785	3,255
Direct taxes	158	222	205	331	340	408	497
Indirect taxes	895	1,075	1,206	1,276	1,397	1,468	1,711
Trade taxes	513	573	692	644	769	770	879
Nontax revenue	544	578	625	681	613	822	909
Capital revenue 1/	19	127	72	377	45	30	90
From MDRI capital transfer 2/	0	0	0	341	0	0	0
Total expenditure	3,183	3,514	3,778	4,016	4,546	4,692	5,453
Current expenditure	1,901	2,073	2,382	2,378	2,742	2,886	3,342
Wages 3/	755	835	863	975	1,075	1,091	1,222
Nonwage	1,036	1,108	1,519	1,391	1,667	1,677	1,984
Of which: interest	49	55	50	50	50	60	70
Provinces	110	130	93	11	118	118	136
Capital expenditure	1,282	1,441	1,304	1,639	1,685	1,806	2,111
Locally financed	296	315	446	381	526	650	800
From MDRI capital transfer	0	0	0	0	49	32	76
Externally financed	985	1,126	858	1,258	1,110	1,123	1,235
Current balance	289	453	327	676	355	721	822
Overall balance	-974	-862	-905	-585	-1,285	-1,055	-1,199
Financing	974	862	905	585	1,285	1,055	1,199
Foreign (net)	1,008	1,246	905	1,325	1,240	1,288	1,241
Grants	361	551	524	746	699	616	529
Loans	671	732	477	634	641	724	788
Amortization	-25	-38	-96	-55	-100	-51	-76
Domestic (net)	-34	-384	0	-740	45	-233	-42
Bank financing (net) 2/	-81	-212	0	-532	45	-40	-10
Other	47	-172	0	-208	0	-193	-32
Of which: Change in outstanding payment orders	-22	-36	0	-170	0	-193	-32
			(In percent of GDP)				
Total revenue	10.3	10.3	10.8	11.5	10.5	10.8	11.2
Of which: Central government	9.9	10.0	10.5	10.9	10.1	10.1	10.5
Tax revenue	7.7	7.6	7.3	8.0	8.4	8.2	8.6
Nontax revenue	2.6	2.2	2.1	2.3	2.0	2.4	2.4
Capital revenue	0.1	0.5	1.4	1.3	0.1	0.1	0.2
Total expenditure	14.9	13.7	12.7	13.5	14.6	13.9	14.4
Current expenditure	8.9	8.1	8.3	8.0	9.2	8.5	8.8
Capital expenditure	6.0	5.6	4.4	5.5	5.4	5.3	5.6
Current balance	1.4	1.8	1.1	2.3	1.1	2.1	2.2
Overall balance	-4.6	-3.4	-1.9	-2.0	-4.1	-3.1	-3.2
Financing (net)	4.6	3.4	1.9	2.0	4.1	3.1	3.2
Foreign	4.7	4.8	3.0	4.4	4.0	3.8	3.3
Domestic	-0.2	-1.5	-1.1	-2.5	0.1	-0.7	-0.1
Memorandum items:							
Defense and security outlays	2.0	1.8	1.7	1.7	1.6	1.7	1.7
Social spending 4/	2.8	2.9	3.0	2.8	3.6	3.3	3.5
Effective tariff rate 5/	13.7	13.1	15.2	13.0		13.0	13.2
Primary deficit excl. MDRI, incl. grants	-2.6	-1.0	0.0	-0.4	-1.6	-1.0	-1.4
Overall deficit excl. MDRI, incl, grants	-2.9	-1.2	-1.9	-0.6	-4.0	-1.2	-1.6
GDP (billion of riels)	21,343	25,693	24,211	29,809	31,137	33,822	37,905

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

1/ For 2005, includes MEF's share from the privatization of FTB equal to CR 65 billion.

2/ Capital revenue of CR85billion from MDRI proceeds included in the 2007 budget has been classified as bank financing.

2/ Data for 2004 and 2005 have been estimated to be consistent with the definition under the new economic classification used from 2006.

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

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

Table 3. Cambodia: Monetary Survey, 2004-08

	2004	2005	2006	2007		2008
	Dec.	Dec.	Dec.	April	Dec.	Dec.
					Proj.	Proj.
	(billions of riel)					
Net foreign assets 1/	4,797	5,475	7,224	8,345	9,297	10,755
National Bank	4,114	4,434	5,729	6,315	6,979	8,011
Deposit money banks	682	1,041	1,496	2,030	2,318	2,744
Net domestic assets 1/	-467	-450	-282	-369	626	1,841
National Bank	-1,450	-1,797	-2,346	-2,768	-2,864	-3,041
Deposit money banks	983	1,346	2,064	2,399	3,489	4,882
Domestic credit	1,608	1,972	2,676	2,862	4,257	6,084
Government (net)	-209	-421	-953	-1,303	-993	-1,003
Private sector	1,817	2,394	3,628	4,164	5,250	7,088
Other items (net)	-2,075	-2,423	-2,959	-3,231	-3,631	-4,243
Broad money	4,329	5,025	6,942	7,976	9,923	12,597
Narrow money	1,153	1,323	1,658	1,777	2,184	2,619
Currency in circulation	1,115	1,282	1,600	1,729	2,100	2,520
Demand deposits	38	41	58	48	84	99
Quasi-money	3,176	3,702	5,285	6,199	7,739	9,978
Time deposits	97	113	89	97	115	129
Foreign currency deposits	3,079	3,589	5,196	6,101	7,624	9,849
	(12 - month percentage change)					
Net foreign assets	19.1	14.1	31.9	26.1	28.7	15.7
Private sector credit	35.9	31.8	51.6	46.4	44.7	35.0
Broad money	30.4	16.1	38.2	34.9	42.9	27.0
Of which: currency in circulation	22.9	14.7	25.3	20.6	31.7	19.9
	(Contribution to annual growth of broad money - in percent)					
Net foreign assets	23.2	15.7	34.8	4.8	29.9	14.7
Net domestic assets	7.2	0.4	3.3	-1.8	13.1	12.3
Domestic credit	12.0	8.4	14.0	2.7	22.8	18.4
Government (net)	-2.4	-4.9	-10.6	-2.1	-0.6	-0.1
Private sector	14.5	13.3	24.6	1.6	23.4	18.5
Other items (net)	-4.8	-3.1	-10.7	-3.9	-9.7	-6.2
Memorandum items:						
Foreign currency deposits (in millions of dollars)	774	872	1,284	1,501	1,884	2,434
Foreign currency deposits (in percent of broad money)	71	71	75	76	77	78
Riel component of broad money	1,250	1,435	1,746	1,875	2,299	2,748
(in percent of broad money)	29	29	25	24	23	22
Credit to the private sector (in millions of dollars)	451	582	897	1,024	1,298	1,752
Velocity 2/	5.4	5.4	4.9	...	4.0	3.4
Money multiplier (Broad Money / Reserve Money)	1.6	1.9	2.1	2.1	2.4	2.5
Reserve Money (12 month percent change)	23.9	-1.0	19.0	19.0	18.6	19.6

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

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

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

Table 4. Cambodia: Balance of Payments, 2004-08
(In millions of U.S. dollars)

	2004	2005	2006	2007	2008
			Est.	Projection	
Current account (excluding official transfers)	-436	-591	-525	-587	-795
Current account (including official transfers)	-116	-266	-146	-170	-353
Trade balance	-681	-1,018	-1,057	-1,213	-1,450
Exports, f.o.b.	2,589	2,910	3,693	4,313	4,793
Of which garments	1,986	2,206	2,663	3,144	3,507
Imports, f.o.b.	-3,269	-3,928	-4,749	-5,526	-6,243
Of which garments sector	-1,010	-1,061	-1,254	-1,481	-1,651
Of which petroleum	-649	-842	-1,123	-1,249	-1,425
Services and Income (net)	69	217	217	282	299
Services (net)	290	471	506	645	722
Of which: Tourism (credit)	603	840	963	1,194	1,412
Income (net)	-221	-254	-290	-363	-422
Private transfers (net)	176	209	315	344	356
Official transfers (net)	321	326	379	417	442
Capital and financial account	165	330	339	415	518
Medium- and long-term loans	163	151	121	156	176
Disbursements	182	172	148	181	207
Amortization	-19	-21	-27	-25	-31
Capital transfers 1/	0	0	76	0	0
Foreign direct investment	121	375	475	557	619
Short-term flows and errors and omissions	-119	-196	-333	-298	-278
Overall balance	49	65	193	246	165
Financing	-49	-65	-193	-246	-165
Change in gross official reserves 2/	-60	-77	-138	-266	-186
Use of Fund credit	-10	-9	-82	0	0
Purchases/disbursements	0	0	0	0	0
Repurchases/repayments 3/	10	9	82	0	0
Debt restructuring 3/	0	0	6	0	0
Accumulation of arrears	21	22	21	20	21
Memorandum items:					
Trade balance (in percent of GDP)	-12.8	-16.2	-14.6	-14.5	-15.5
Current account balance					
Excluding official transfers (in percent of GDP)	-8.2	-9.4	-7.2	-7.0	-8.5
Including official transfers (in percent of GDP)	-2.2	-4.2	-2.0	-2.0	-3.8
Gross official reserves	809	915	1,097	1,400	1,600
In months of prospective imports	2.1	2.0	2.0	2.3	2.4
Net international reserves	713	834	1,097	1,400	1,600
Public debt service, including IMF (cash basis)	28	29	28	28	37
Public external debt 4/	2,043	2,123	2,248	2,464	2,665
Public external debt (in percent of GDP)	38.5	33.9	31.0	29.5	28.4
Public external debt (NPV in percent of GDP)	26.4	23.8	22.6	22.4	21.3

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

1/ Debt forgiveness of debt due after 2006, under MDRI.

2/ Excludes unrestricted foreign currency deposits at NBC and valuation changes.

3/ Reflects the impact of MDRI debt forgiveness.

4/ Russian Federation debt is valued at 0.6 USSR Roubles per US$ with the standard 70 percent discount.

Table 5. Cambodia: Medium-Term Macroeconomic Framework, 2005–12

(In percent of GDP, unless otherwise indicated)

	2005	2006	2007	2008	2009	2010	2011	2012
		Est.			Projections			
Real sector								
Real GDP (percent change)	13.5	10.8	9.1	7.9	7.5	7.5	7.5	7.5
GDP deflator (percent change)	6.1	4.7	4.0	3.9	3.5	3.5	3.6	3.7
Domestic savings (excl. transfers)	7.3	9.9	10.4	11.4	11.7	13.1	13.8	14.5
National saving	15.8	19.5	19.5	19.9	19.6	20.5	20.5	20.7
Government saving	1.8	2.3	2.1	2.2	2.3	2.5	2.6	2.8
Private saving	14.1	17.2	17.3	17.8	17.3	18.0	17.9	17.9
Domestic investment	20.1	21.5	21.5	23.7	24.0	24.8	25.0	25.2
Government investment	5.6	5.5	5.3	5.6	5.6	5.4	5.4	5.3
Non-budgetary grant-financed investment	3.1	2.7	3.2	3.3	2.9	2.7	2.4	2.1
Private investment	11.4	13.3	13.0	14.8	15.6	16.6	17.2	17.8
Fiscal sector								
Revenue 1/	10.3	11.5	10.8	11.2	11.4	11.7	11.9	12.2
Tax revenue	7.6	8.0	8.2	8.6	8.8	9.0	9.2	9.5
Nontax revenue	2.2	2.3	2.4	2.4	2.5	2.6	2.6	2.6
Expenditure	13.7	13.5	13.9	14.4	14.5	14.5	14.6	14.6
Current	8.1	8.0	8.5	8.8	8.9	9.1	9.2	9.3
Capital	5.6	5.5	5.3	5.6	5.6	5.4	5.4	5.3
Current balance	1.8	2.3	2.1	2.2	2.3	2.5	2.6	2.8
Primary balance (including grants)	-1.0	0.7	-1.1	-1.6	-1.4	-1.3	-1.1	-0.9
Overall balance	-3.4	-2.0	-3.1	-3.2	-3.1	-2.8	-2.7	-2.4
Overall balance (including grants)	-1.2	0.5	-1.3	-1.8	-1.6	-1.5	-1.3	-1.1
Domestic financing (incl. outstanding operations)	-1.5	-2.5	-0.7	-0.1	-0.2	-0.2	-0.2	-0.3
External financing, net	4.8	4.4	3.8	3.3	3.4	3.0	2.9	2.7
Monetary sector								
Broad money (percent change)	16.1	38.2	42.9	27.0	19.6	16.6	14.5	13.0
Velocity (GDP/M2)	5.4	4.9	4.0	3.4	3.0	2.9	2.8	2.7
Private sector credit (percent change)	31.8	51.6	44.7	35.0	25.0	25.0	20.0	20.0
External sector								
Domestic exports (percent change)	13.0	27.6	17.4	11.6	9.3	9.9	9.0	9.1
Retained imports (percent change)	20.7	21.1	16.7	13.3	10.2	9.2	9.0	9.6
Current account balance (excluding transfers)	-9.4	-7.2	-7.0	-8.5	-8.8	-8.4	-8.2	-7.9
Current account balance (including transfers)	-4.2	-2.0	-2.0	-3.8	-4.4	-4.3	-4.5	-4.5
Foreign direct investment (in millions of US$)	375	475	557	619	677	738	805	877
Overall balance	1.0	2.7	2.9	1.8	1.6	2.7	4.1	2.9
Gross official reserves (in millions of US$)	915	1,097	1,400	1,600	1,800	2,133	2,683	3,115
(in months of imports of goods and services)	2.0	2.0	2.3	2.4	2.4	2.7	3.1	3.3
Memo item: Net capital flows 2/	7.5	5.8	6.9	6.6	6.0	5.7	5.2	4.7
External debt 1/ 3/	34	31	29	28	28	27	26	25
External public debt-service ratio, accrual basis 4/	1.3	1.1	0.8	0.8	0.9	0.9	1.0	1.0
External public debt-service ratio, cash basis 3/	0.8	0.6	0.5	0.6	0.7	0.8	0.8	0.9

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

1/ From January 2006 includes the impact of debt forgiveness from the IMF under the MDRI.
2/ Net official disbursement, exceptional financing, and official transfers.
3/ Russian Federation debt is valued at 0.6 USSR Roubles per US$ with the standard 70 percent discount.
4/ As percent of domestic exports of goods and services.

Table 6. Cambodia: Millennium Development Goals

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

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

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

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

INTERNATIONAL MONETARY FUND AND
INTERNATIONAL DEVELOPMENT ASSOCIATION

CAMBODIA

Joint IMF/World Bank Debt Sustainability Analysis 2007[10]

Prepared by the staffs of the International Monetary Fund and
the International Development Association

Approved by Daniel Citrin and Adnan Mazarei (IMF) and
Vikram Nehru and Deepak Bhattasali (IDA)

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A. Introduction

External debt—of which almost 35 percent is owed to the United States and the Russian Federation—constitutes almost 95 percent of Cambodia's public debt. At end-2006, Cambodia's total external public debt was about US$2¼ billion (31 percent of GDP),[12] while domestic debt amounted to 2 percent of GDP, one third of which was denominated in foreign currency. The status of resolution of outstanding debt obligations with the Russian Federation and the United States has not changed since the last joint DSA, conducted in 2006 (Country Report No. 06/264).

This joint WB/IMF debt sustainability assessment concludes that Cambodia's debt is on a sustainable path and that it faces a moderate risk of debt distress. All baseline debt burden indicators remain well below their indicative thresholds, with only two thresholds—the NPV of external debt-to-GDP and the NPV of external debt-to-revenue ratios—being breached briefly in the standard stress tests. Provided debt rescheduling agreements are reached, the risk of debt distress will decline further, though low revenue collections will continue to pose risks to debt sustainability.

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[10] This DSA has been prepared jointly by the IMF and the World Bank staffs based on the framework considered by the Boards of the Fund and the Bank in April 2005 and revised in December 2006. The analysis has benefited from inputs provided by the Asian Development Bank and was discussed with the Cambodian authorities during the 2007 Article IV Consultation.

[12] Cambodia received debt relief from the Fund under the Multilateral Debt Relief Initiative (MDRI) of SDR57 million (US$82 million) in early 2006, as outlined in Press Release No. 05/291 (12/23/2005).

The assessment updates the previous DSA, presented to the IMF's Executive Board at the 2006 Article IV consultation, which concluded that Cambodia's debt at the time was still at high risk of distress. The change occurs for two main reasons: further higher-than-expected GDP growth enhancing long term projections and continued large-scale concessional financing from both traditional donors and new development partners. For this DSA, staff also applied the standard 70 percent discount to the nominal value of the debt to the Russian Federation for the past path of the debt.

The baseline assumes robust growth underpinned by agriculture, garment exports and tourism. Specifically, the analysis is based on the assumption that real GDP growth will be sustained at 6½ percent and exports will grow at around 10 percent a year. Business environment reforms are expected to help improve competitiveness. Foreign aid is assumed to remain broadly stable in nominal U.S. dollar terms through the medium term. Fiscal consolidation is expected to be underpinned by improvements in tax and customs administration. The primary deficit is expected to decline over the medium term, as spending increases only partly offset the improved revenue position. In the longer term, marginal primary surpluses are expected. New borrowing is projected to be somewhat less concessional than the existing debt.

It is expected that Cambodia will start producing oil from around 2011, but because of the uncertainty still surrounding the size of usable deposits and the timing of production, oil receipts are included only in an alternative scenario. Assumptions on oil production are moderate but would favorably impact growth and government revenues from 2011.[13] Under this scenario, real GDP growth would be somewhat higher and government revenues increased substantially. The fiscal deficit would widen somewhat in the early years of oil production to accommodate larger spending for development and poverty reduction. Nevertheless, the overall impact would be to reinforce the favorable trend in debt sustainability.

B. Context

Cambodia remains in arrears on debts to the two largest creditors—the Russian Federation and the United States. Cambodia is not servicing its debt to either creditor, but has made efforts to conclude agreements with both under the framework of the Paris Club. Since prospects for early resolution look remote, the current DSA assumes no restructuring in its baseline, where arrears continue to be built up to the United States and the Russian Federation throughout the projection period.

The current DSA includes the negotiated debt stocks for the debts to the Russian Federation. In discussing debt rescheduling, Cambodia and the Russian Federation have agreed that (i) after applying the stipulated exchange rate and the 70 percent upfront discount, the total debt would be US$457 million (from US$1.5 billion in the previous

[13] An FDI-financed, offshore operation without large domestic investments in shipping facilities or refineries. Production would begin in 2011. Fiscal revenues from oil would reach around US$1.5 billion or around 5 percent of GDP in 2017.

DSA),[14] and (ii) the interest rate for the pre-cut-off-date debt would be about 0.8 percent, with a concessional repayment schedule. However, the countries have disagreed on the classification of loans valued at US$40 million as either pre-cut-off-date or post-cut-off-date debt, and the interest rate on the post-cut-off-date debt. On the latter issue, while Cambodia has stated its desire to have a flat interest rate profile (at 3 percent), the Russian government has expressed its need to have rates approaching market rates at some point in the payment profile. The latest proposals from the two sides are very similar in NPV terms. Despite this, no agreement is in sight.

The United States and Cambodia have reached agreement on the total amount of principal due. After determining the total obligation to be US$162 million, the Cambodian government has received from its U.S. counterpart a draft bilateral agreement based on the 1995 Paris Club agreement (i.e., flow rescheduling on Naples terms assuming a 40-year maturity, 16-year grace period, and an interest rate of 3 percent). The draft agreement is still under review by the Cambodian government. The arrears that would arise as part of that agreement would need to be rescheduled in the context of the Paris Club.

Cambodia has normalized debt relations with other Paris Club creditors. Bilateral agreements were signed with France, Germany, and Japan, and payments resumed. In recent months, Cambodia has repaid outstanding debt owed to Japan under the Paris Club rescheduling, around US$4 million.

Cambodia recently received speculative-grade sovereign credit ratings of B+ from Standard and Poor's and B2 from Moody's, which could provide an opportunity for commercial borrowing. Although no plans have been announced, it is possible that bonds could be issued to finance infrastructure development, possibly for the oil sector. The authorities are also considering BOT operations with Chinese companies, several contracts for which have already been signed. Staffs of the Bank and Fund have not examined the contracts for the guarantees offered; thus, contingent liabilities from such contracts are not incorporated in this DSA. In this context, staffs have maintained that careful assessment is needed to plan for large infrastructure investments, and transactions should be monitored closely and transparently.

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

[14] The previous DSA (in Country Report No. 06/264) incorporated in its analysis the exchange rate to convert USSR Gosbank Ruble debt to U.S. Dollars, but the discount was applied only after the agreement to rescheduling the future path of the debt. The current DSA applies the 70 percent discount for both the past and the future path of the debt, consistent with the 1997 MoU between Russia and the Paris Club and with agreements reached in the context of bilateral negotiations between Cambodia and the Russian Federation.

C. External Debt Sustainability

Cambodia's external debt burden indicators remain below their indicative thresholds, and are likely to decline further, with two thresholds being breached in the standard bound tests. The ratio to GDP of the NPV of external debt will remain below the 30 percent indicative threshold in the medium term, barely breaching the threshold under only one stress test. With a 30 percent nominal depreciation relative to the baseline in 2008, NPV of debt-to-GDP ratio rises by almost 10 percentage points, but declining below the indicative threshold in the medium term. It should be noted, however, that the devaluation test overestimates the negative impact of depreciation since Cambodia is 90-95 percent dollarized.[15] The NPV of debt-to-export ratio, at 32 percent in 2007, is well below its indicative debt burden threshold of 100 percent under all scenarios. Debt service remains below 1 percent of exports throughout the entire projection period even under the most extreme stress test, and is well below the indicative threshold of 15 percent. The external debt-to-revenue ratio is also below the threshold for all years of the baseline, declining from 175 in 2007 to 137 by 2012, and further declining over the long term. It breaches its threshold only in the bound tests that project a sizable increase in debt or a large depreciation. The analysis of external debt in light of the joint guidelines thus shows that Cambodia is now at a moderate risk of debt distress.

Reaching debt rescheduling agreements with the United States and the Russia would further marginally reduce the risk of debt distress. An additional scenario is added to illustrate the case where Cambodia reaches debt rescheduling agreements with the two creditors and begins servicing debts in 2007.[16] It shows that NPV of external debt-to-GDP ratio would drop by 3 percentage points to 19 percent in 2007, and steadily decline to 7 percent of GDP in 2027. The debt service-to-exports ratio remains below 1 percent over the projection period.

D. Public Debt Sustainability

Given that most of public debt is external debt, the public debt dynamics closely follow the external debt dynamics. Under the baseline scenario, the nominal stock of public debt, which amounted to 33 percent of GDP at end-2006, is projected to decline to 30 percent in 2007. The NPV of public sector debt-to-GDP ratio would fall steadily from 23 percent in 2007 to 8 percent by 2027. The NPV of public debt-to-revenue ratio, which was 176 percent at end-2006, is also projected to decline over the projection period. The debt-service-to-revenue ratio also remains low in most scenarios because of the concessionality of the existing debts.

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[15] Contrary to the DSA, which assumes that nominal GDP in US$ would fall by almost as much as the depreciation, a depreciation in the case of Cambodia would affect nominal GDP in US$ only marginally.

[16] For the U.S. debt, the payment schedule based on the latest bilateral agreement sent by the United States (48 consecutive semi-annual back-loaded installments commencing in 2012 and an interest rate of 3 percent) is assumed. For the Russian debt, the disputed US$40 million loans are classified as post-cut-off-date debt, and the interest rates on the post-cut-off-date debt is assumed to rise gradually from 2.5 to 5.75 percent throughout payment period.

An additional bound test is performed to characterize one-time large-scale commercial borrowing to finance either onshore infrastructure development for the oil sector that does not significantly boost growth or a major bailout of the banking sector (Bound test B6 of Table A2).[17] This shows that the debt NPV ratios increase sharply and remain high until 2012. With the interest rate still below nominal GDP growth, the ratios fall over the long term.

Maintenance of prudent fiscal policies is key to continued debt sustainability. The historical scenario—in which real GDP growth and primary deficits are at historical averages (9.8 and 2.0 percent, respectively)—illustrates the case where the government runs significant primary deficits over the long term. Despite continued high GDP growth, deficit financing at less concessional terms leads to rising debt burden indicators. Debt sustainability would be at greater risk if the government borrowed at commercial terms.

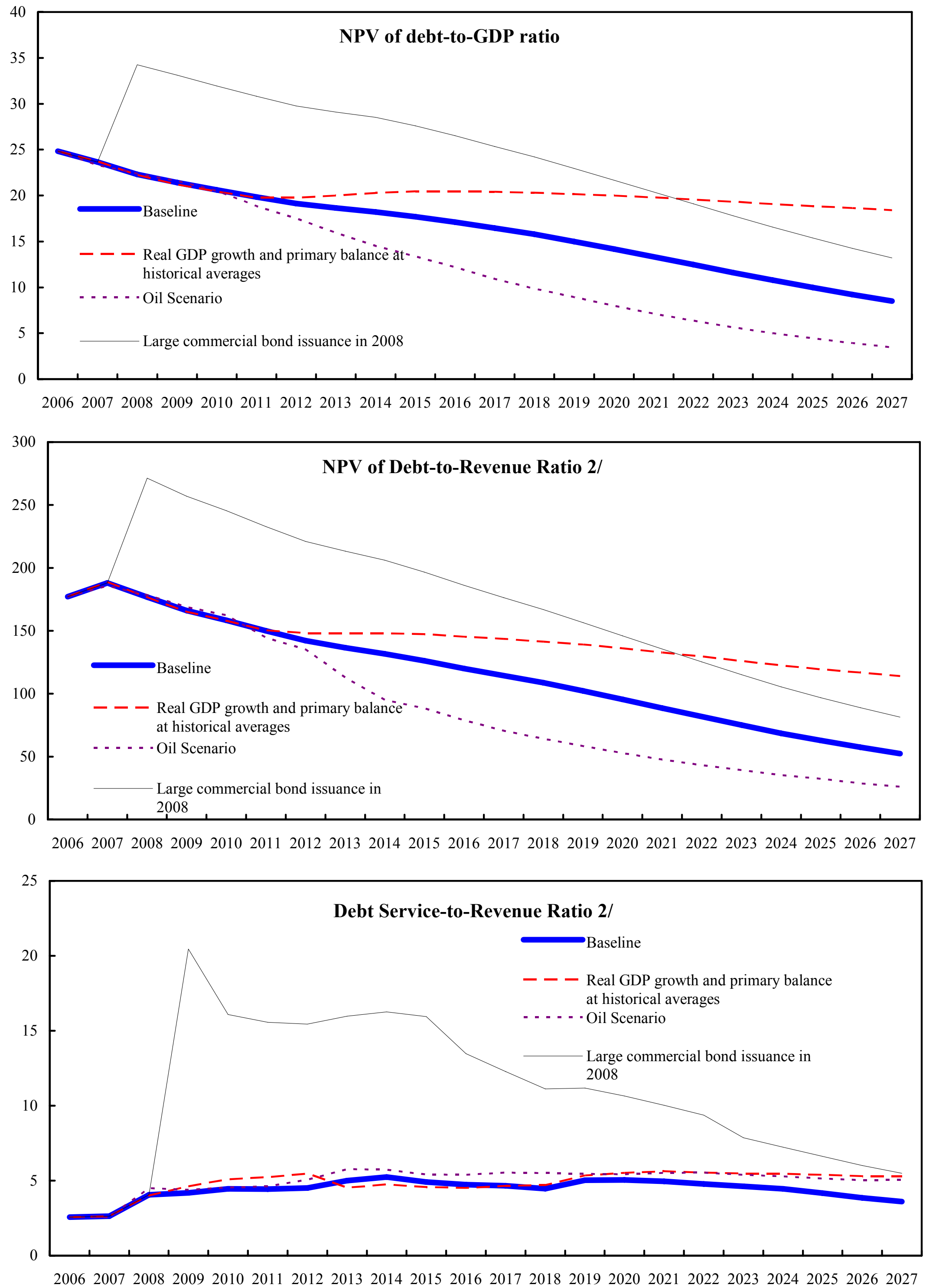
E. Conclusion

Staffs conclude that Cambodia's debt is sustainable, and it faces a moderate risk of debt distress. No distress thresholds are breached in the baseline, with only two thresholds being breached briefly in the standard stress tests. The moderate risk rating is also reinforced by two qualitative considerations: (i) the uncertainty over the contingent liabilities presented by contracts already signed with foreign operators in infrastructure sectors; and (ii) the existence of external arrears to the Russian Federation and the United States. Debt rescheduling agreements, when concluded, will reduce the risk even further if baseline assumptions—improved revenue performance and sustained growth—hold.

The risks to the debt path would seem to be fairly evenly balanced. On the one hand, the positive impact of oil production on growth, exports and fiscal revenues in the longer term would reduce the risks Cambodia faces. This would assume continued prudent economic policies—including strengthening its non-oil revenue base—and export diversification. On the other hand, borrowing against the uncertain future oil revenues could present problems. Staffs also note that while the situation may be sustainable, policy built on arrears accumulation may not be appropriate. Failure to reach the debt agreements over the medium term could also give rise to reputational damage and continue to preclude a financial arrangement with the Fund. Further, close attention needs to be paid to Cambodia's debt management strategy, especially regarding less concessional loans, as it could impair sustainability, especially in the presence of a low revenue base and weak institutions.

[17] This assumes that Cambodia issues a sovereign US$ bond with a face value of 10 percent of GDP in 2008, at 9 percent interest rate and 15-year maturity.

Figure A1. Cambodia: Indicators of Public Debt Under Alternative Scenarios, 2006-2027 1/



Source: Staff projections and simulations.
1/ Most extreme stress test is test that yields highest ratio in 2017 for each of the comparisons.
2/ Revenue including grants.

Table A1. Cambodia: Public Sector Debt Sustainability Framework, Baseline Scenario, 2004-2027
(In percent of GDP, unless otherwise indicated)

	Actual			Historical Average 5/	Standard Deviation 5/	Projections									
	2004	2005	2006			2007	2008	2009	2010	2011	2012	2007-12 Average	2017	2027	2013-27 Average
Public sector debt 1/	42.9	37.1	33.2			30.7	29.4	28.5	27.5	26.5	25.5		20.1	9.3	
o/w foreign-currency denominated	38.5	33.9	31.0			29.5	28.4	27.7	26.9	26.0	25.0		19.8	9.2	
Change in public sector debt	-0.5	-5.8	-3.9			-2.5	-1.3	-0.9	-1.0	-1.0	-1.0		-1.1	-0.9	
Identified debt-creating flows	-2.0	-5.0	-7.3			-2.4	-1.5	-1.2	-1.2	-1.4	-1.5		-1.2	-0.9	
Primary deficit	2.6	1.0	-0.7	2.0	1.6	1.1	1.6	1.4	1.3	1.1	0.9	1.3	0.3	-0.2	0.2
Revenue and grants	12.0	12.5	14.0			12.6	12.6	12.9	13.0	13.2	13.5		14.4	16.2	
of which: grants	1.7	2.1	2.5			1.8	1.4	1.5	1.3	1.3	1.2		0.8	0.2	
Primary (noninterest) expenditure	14.7	13.5	13.3			13.7	14.2	14.3	14.3	14.4	14.4		14.7	16.0	
Automatic debt dynamics	-5.1	-6.3	-5.4			-3.8	-3.1	-2.8	-2.7	-2.6	-2.5		-1.6	-0.7	
Contribution from interest rate/growth differential	-4.9	-6.1	-4.4			-3.1	-2.6	-2.4	-2.3	-2.2	-2.1		-1.4	-0.6	
of which: contribution from average real interest rate	-0.9	-1.0	-0.8			-0.4	-0.4	-0.3	-0.3	-0.3	-0.3		-0.1	0.0	
of which: contribution from real GDP growth	-4.0	-5.1	-3.6			-2.8	-2.2	-2.1	-2.0	-1.9	-1.9		-1.3	-0.6	
Contribution from real exchange rate depreciation	-0.2	-0.3	-1.0			-0.6	-0.5	-0.4	-0.4	-0.4	-0.4		...	...	
Other identified debt-creating flows	0.4	0.3	-1.1			0.2	0.0	0.2	0.2	0.1	0.1		0.1	0.0	
Privatization receipts (negative)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Debt relief (HIPC and other)	0.4	0.3	-1.1			0.2	0.0	0.2	0.2	0.1	0.1		0.1	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Residual, including asset changes	1.6	-0.8	3.4			-0.1	0.2	0.3	0.2	0.3	0.4		0.1	0.1	
NPV of public sector debt	30.8	27.0	24.8			23.6	22.3	21.4	20.6	19.8	19.1		16.4	8.5	
o/w foreign-currency denominated	26.4	23.8	22.6			22.4	21.3	20.6	20.0	19.3	18.6		16.1	8.4	
o/w external	26.4	23.8	22.6			22.4	21.3	20.6	20.0	19.3	18.6		16.1	8.4	
NPV of contingent liabilities (not included in public sector debt)	...	...	...			...	...	...	...	...	...		...	...	
Gross financing need 2/	3.2	1.5	-0.3			1.5	2.1	2.0	1.9	1.7	1.5		1.0	0.3	
NPV of public sector debt-to-revenue ratio (in percent) 3/	255.6	216.7	177.2			188.0	176.8	166.1	158.4	150.0	142.1		114.4	52.4	
o/w external	219.1	191.0	161.5			178.1	169.1	160.1	153.7	145.8	138.5		112.3	51.6	
Debt service-to-revenue ratio (in percent) 3/ 4/	4.4	3.7	2.6			2.6	4.1	4.2	4.4	4.4	4.5		4.6	3.6	
Primary deficit that stabilizes the debt-to-GDP ratio	3.1	6.8	3.2			3.8	2.9	2.3	2.3	2.2	2.0		1.5	0.9	
Key macroeconomic and fiscal assumptions															
Real GDP growth (in percent)	10.0	13.5	10.8	9.8	2.4	9.1	7.9	7.5	7.5	7.5	7.5	7.9	6.5	6.5	6.5
Average nominal interest rate on forex debt (in percent)	0.7	0.7	0.6	0.5	0.1	0.7	0.7	0.8	0.8	0.9	0.9	0.8	1.4	2.0	1.6
Average real interest rate on domestic currency debt (in percent)	...	...	-5.2	...	...	-4.3	-4.6	-4.6	-4.8	-5.1	-5.2	-4.8	-4.4	-4.4	-4.4
Real exchange rate depreciation (in percent, + indicates depreciation)	-0.6	-0.9	-3.3	1.0	4.3	-2.2	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	4.8	6.1	4.7	2.4	2.9	4.0	3.9	3.5	3.5	3.6	3.7	3.7	3.3	3.3	3.3
Growth of real primary spending (deflated by GDP deflator, in percent)	-0.5	4.0	9.5	10.0	6.9	12.3	11.9	8.4	7.5	8.0	7.7	9.3	6.7	7.5	7.2
Grant element of new external borrowing (in percent)	...	...	...			43.2	40.8	43.1	37.9	36.3	35.2	39.4	30.3	29.9	...

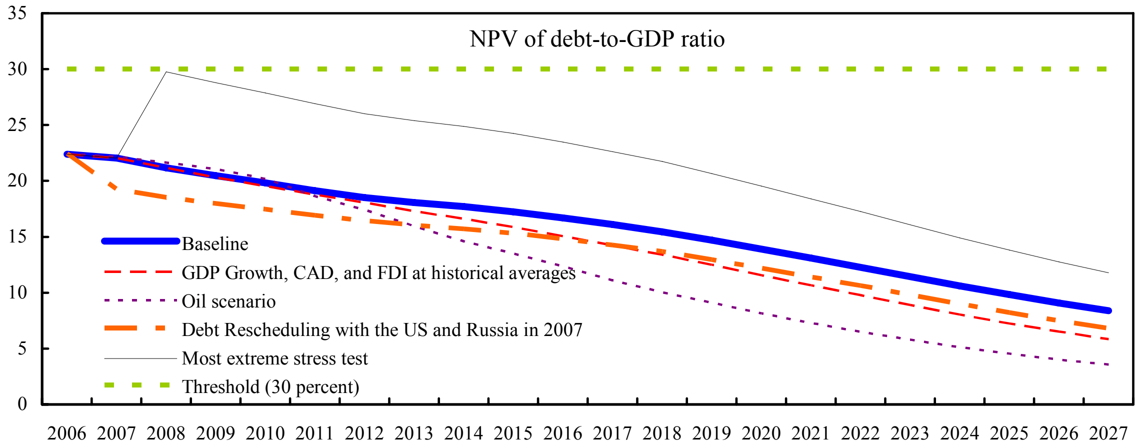
Sources: Country authorities; and Fund staff estimates and projections.
1/ General government gross debt is used.
2/ Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period.
3/ Revenues including grants.
4/ Debt service is defined as the sum of interest and amortization of medium and long-term debt.
5/ Historical averages and standard deviations are generally derived over the past 8 years, since the consistent balance of payments data are available only since 1999.

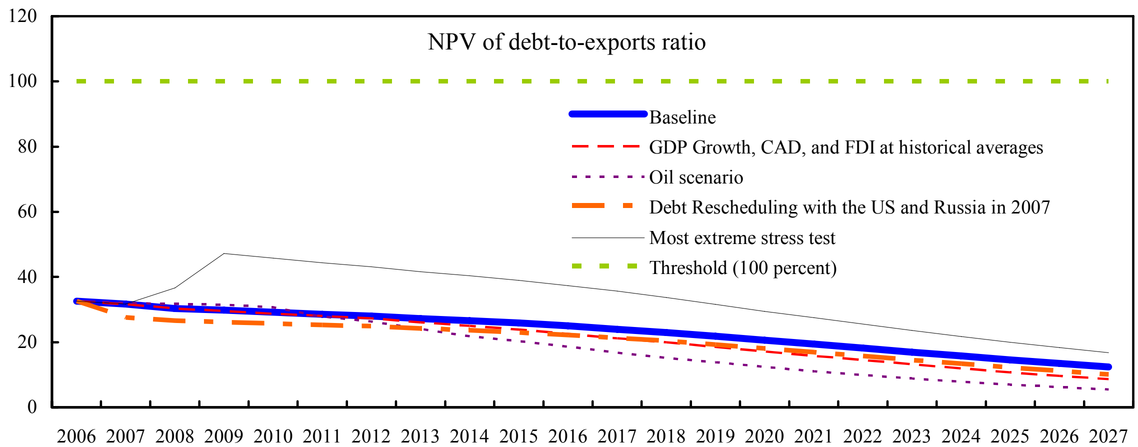
Table A2. Cambodia: Sensitivity Analysis for Key Indicators of Public Debt 2007-2027

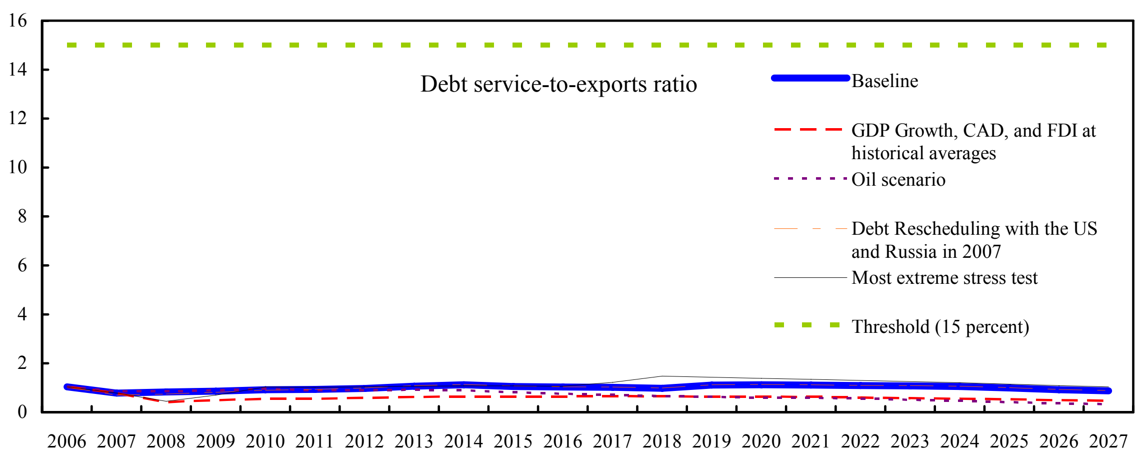
	Projections							
	2007	2008	2009	2010	2011	2012	2017	2027
NPV of Debt-to-GDP Ratio								
Baseline	24	22	21	21	20	19	16	8
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	24	22	21	20	20	20	20	18
A2. Primary balance is unchanged from 2006	24	22	21	21	20	19	16	8
A3. Permanently lower GDP growth 1/	24	22	22	21	21	20	19	17
A4. Oil Scenario	23	22	22	21	19	18	11	3
B. Bound tests								
B1. Real GDP growth is at baseline minus one standard deviations in 2008-2009	24	23	23	22	22	21	20	14
B2. Primary balance is at baseline minus one standard deviations in 2008-2009	24	24	24	23	22	21	18	9
B3. Combination of B1-B2 using one half standard deviation shocks	24	23	23	22	21	20	17	9
B4. One-time 30 percent real depreciation in 2008	24	31	29	27	25	24	20	11
B5. 10 percent of GDP increase in other debt-creating flows in 2008	24	34	32	31	30	29	22	10
B6. Large commercial bond issuance in 2008	24	34	33	32	31	30	25	13
NPV of Debt-to-Revenue Ratio 2/								
Baseline	188	177	166	158	150	142	114	52
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	189	177	165	158	150	148	144	114
A2. Primary balance is unchanged from 2006	188	177	166	158	150	142	114	52
A3. Permanently lower GDP growth 1/	188	178	168	162	156	150	134	107
A4. Oil Scenario	186	179	169	162	145	135	71	26
B. Bound tests								
B1. Real GDP growth is at baseline minus one standard deviations in 2008-2009	188	182	177	171	165	159	140	87
B2. Primary balance is at baseline minus one standard deviations in 2008-2009	188	187	184	175	165	156	124	57
B3. Combination of B1-B2 using one half standard deviation shocks	188	183	178	169	160	151	121	55
B4. One-time 30 percent real depreciation in 2008	188	243	222	207	192	179	140	67
B5. 10 percent of GDP increase in other debt-creating flows in 2008	188	266	251	240	227	216	152	62
B6. Large commercial bond issuance in 2008	188	271	257	246	233	221	176	81
Debt Service-to-Revenue Ratio 2/								
Baseline	2.6	4.1	4.2	4.4	4.4	4.5	4.6	3.6
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	2.6	4.0	4.6	5.1	5.2	5.5	4.6	5.3
A2. Primary balance is unchanged from 2006	2.6	4.1	4.2	4.4	4.4	4.5	4.6	3.6
A3. Permanently lower GDP growth 1/	2.6	4.1	4.3	4.6	4.7	4.9	5.7	6.7
A4. Oil Scenario	2.6	4.5	4.4	4.5	4.6	5.1	5.5	5.0
B. Bound tests								
B1. Real GDP growth is at baseline minus one standard deviations in 2008-2009	2.6	4.1	4.6	5.2	5.2	5.4	5.8	5.7
B2. Primary balance is at baseline minus one standard deviations in 2008-2009	2.6	4.1	5.8	6.4	5.1	5.0	4.9	4.0
B3. Combination of B1-B2 using one half standard deviation shocks	2.6	4.1	5.1	5.5	4.8	4.8	4.8	3.8
B4. One-time 30 percent real depreciation in 2008	2.6	4.4	4.9	5.2	5.2	5.3	5.6	4.4
B5. 10 percent of GDP increase in other debt-creating flows in 2008	2.6	4.1	13.6	6.7	5.8	5.7	5.4	4.9
B6. Large commercial bond issuance in 2008	2.6	4.1	20.5	16.1	15.6	15.4	12.3	5.5

Sources: Country authorities; and Fund staff estimates and projections.
1/ Assumes that real GDP growth is at baseline minus one standard deviation divided by the square root of 20 (i.e., the length of the projection period).
2/ Revenues are defined inclusive of grants.

Figure A2. Cambodia: Indicators of Public and Publicly Guaranteed External Debt Under Alternative Scenarios, 2006-2027 1/
(In percent)







Source: Staff projections and simulations.
1/ Most extreme stress test is test that yields highest ratio in 2017 for each of the comparisons.

Table A3. Cambodia: External Debt Sustainability Framework, Baseline Scenario, 2004-2027 1/
(In percent of GDP, unless otherwise indicated)

	Actual			Historical Average 6/	Standard Deviation 6/	Projections									
	2004	2005	2006			2007	2008	2009	2010	2011	2012	2005-10 Average	2017	2027	2012-27 Average
External debt (nominal) 1/	38.5	33.9	31.0			29.5	28.4	27.7	26.9	26.0	25.0		19.8	9.2	
o/w public and publicly guaranteed (PPG)	38.5	33.9	31.0			29.5	28.4	27.7	26.9	26.0	25.0		19.8	9.2	
Change in external debt	-0.4	-4.6	-2.9			-1.5	-1.0	-0.7	-0.8	-1.0	-1.0		-1.1	-0.9	
Identified net debt-creating flows	-4.9	-7.7	-9.1			-7.1	-4.9	-4.0	-3.9	-3.6	-3.3		-4.5	-5.1	
Non-interest current account deficit	1.8	3.9	1.7	2.6	1.3	1.8	3.5	4.1	4.1	4.2	4.3		2.3	0.8	1.8
Deficit in balance of goods and services	7.4	8.7	7.6			6.8	7.8	8.1	7.5	7.0	6.6		2.4	-1.3	
Exports	63.9	64.2	68.8			70.2	70.5	69.5	68.8	67.6	66.4		67.2	67.3	
Imports	71.3	73.0	76.4			77.0	78.2	77.5	76.2	74.6	73.0		69.6	66.0	
Net current transfers (negative = inflow)	-9.4	-8.5	-9.6	-10.4	1.2	-9.1	-8.5	-8.0	-7.4	-6.7	-6.1		-3.9	-1.4	-3.2
Other current account flows (negative = net inflow)	3.8	3.7	3.6			4.1	4.3	4.0	4.0	4.0	3.8		3.9	3.5	
Net FDI (negative = inflow)	-2.3	-6.0	-6.5	-4.2	1.9	-6.7	-6.6	-6.5	-6.4	-6.2	-6.1		-5.9	-5.5	-5.8
Endogenous debt dynamics 2/	-4.4	-5.6	-4.2			-2.2	-1.8	-1.7	-1.6	-1.6	-1.5		-1.0	-0.4	
Contribution from nominal interest rate	0.4	0.3	0.3			0.3	0.3	0.2	0.2	0.2	0.3		0.3	0.2	
Contribution from real GDP growth	-3.4	-4.4	-3.2			-2.4	-2.1	-1.9	-1.9	-1.8	-1.8		-1.2	-0.6	
Contribution from price and exchange rate changes	-1.4	-1.5	-1.4			…	…	…	…	…	…		…	…	
Residual (3-4) 3/	4.5	3.0	6.3			5.6	3.9	3.3	3.1	2.6	2.3		3.4	4.3	
o/w exceptional financing 8/	0.4	0.3	-1.1			0.2	0.0	-0.2	-0.2	-0.1	-0.1		-0.1	0.0	
NPV of external debt 4/	26.4	23.8	22.6			22.4	21.3	20.6	20.0	19.3	18.6		16.1	8.4	
In percent of exports	41.3	37.1	32.9			31.9	30.3	29.7	29.1	28.6	28.1		24.0	12.4	
NPV of PPG external debt	26.4	23.8	22.6			22.4	21.3	20.6	20.0	19.3	18.6		16.1	8.4	
In percent of exports	41.3	37.1	32.9			31.9	30.3	29.7	29.1	28.6	28.1		24.0	12.4	
Debt service-to-exports ratio (in percent) 7/	1.4	1.3	1.1			0.8	0.8	0.9	0.9	0.9	1.0		1.0	0.9	
PPG debt service-to-exports ratio (in percent) 7/	1.4	1.3	1.1			0.8	0.8	0.9	0.9	0.9	1.0		1.0	0.9	
Total gross financing need (billions of U.S. dollars)	0.0	-0.1	-0.3			-0.4	-0.2	-0.2	-0.2	-0.2	-0.2		-0.7	-2.4	
Non-interest current account deficit that stabilizes debt ratio	2.2	8.5	4.5			3.3	4.5	4.8	4.9	5.2	5.3		3.4	1.6	
Key macroeconomic assumptions															
Real GDP growth (in percent)	10.0	13.5	10.8	9.8	2.3	9.1	7.9	7.5	7.5	7.5	7.5	7.9	6.5	6.5	6.5
GDP deflator in US dollar terms (change in percent)	3.7	4.1	4.4	1.3	2.8	5.6	3.9	3.5	3.5	3.6	3.7	4.0	3.0	3.0	3.0
Effective interest rate (percent) 5/	1.1	1.0	1.2	1.1	0.1	0.9	1.0	1.0	1.0	1.0	1.1	1.0	1.5	2.1	1.7
Growth of exports of G&S (US dollar terms, in percent)	28.7	18.7	23.8	23.0	11.3	17.7	12.4	9.8	10.1	9.5	9.6	11.5	10.0	9.7	9.8
Growth of imports of G&S (US dollar terms, in percent)	22.0	20.9	21.1	19.2	8.5	16.2	13.8	10.3	9.4	9.1	9.1	11.3	8.7	9.3	9.0
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	43.3	40.8	43.2	38.0	36.4	35.3	39.5	30.3	29.9	30.6
Memorandum item:															
Nominal GDP (billions of US dollars)	5.3	6.3	7.3			8.4	9.4	10.4	11.6	12.9	14.4		22.9	57.7	

Source: Staff simulations.

1/ Includes both public and private sector external debt.
2/ Derived as [r - g - ρ(1+g)]/(1+g+ρ+gρ) times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, and ρ = growth rate of GDP deflator in U.S. dollar terms.
3/ Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes.
4/ Assumes that NPV of private sector debt is equivalent to its face value.
5/ Current-year interest payments divided by previous period debt stock.
6/ Historical averages and standard deviations are generally derived over the past 8 years, since the consistent balance of payments data are only available since 1999.
7/ Debt services are cash basis until 2006.
8/ Includes effect of MDRI debt relief.

Table A4. Cambodia: Sensitivity Analyses for Key Indicators of Public and Publicly Guaranteed External Debt, 2007-27
(In percent)

	Projections							
	2007	2008	2009	2010	2011	2012	2017	2027
NPV of debt-to-GDP ratio								
Baseline	22	21	21	20	19	19	16	8
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2008-27 1/	22	21	20	20	19	18	14	6
A2. New public sector loans on less favorable terms in 2008-27 2/	22	22	22	21	21	21	19	12
A3. Oil scenario	22	22	21	20	19	17	11	4
A4. Debt Rescheduling with the US and Russia in 2007	20	19	18	18	17	17	14	7
B. Bound Tests								
B1. Real GDP growth at baseline minus one standard deviation in 2008-09	22	22	22	21	20	20	17	9
B2. Export value growth at baseline minus one standard deviation in 2008-09 3/	22	24	29	28	26	25	21	10
B3. US dollar GDP deflator at baseline minus one standard deviation in 2008-09	22	22	21	21	20	19	17	9
B4. Net non-debt creating flows at baseline minus one standard deviation in 2008-09 4/	22	23	24	24	23	22	18	9
B5. Combination of B1-B4 using one-half standard deviation shocks	22	24	27	26	25	24	20	10
B6. One-time 30 percent nominal depreciation relative to the baseline in 2008 5/	22	30	29	28	27	26	23	12
NPV of debt-to-exports ratio								
Baseline	32	30	30	29	29	28	24	12
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2008-27 1/	32	30	29	29	28	27	21	9
A2. New public sector loans on less favorable terms in 2008-27 2/	32	31	31	31	31	31	29	17
A3. Oil scenario	32	32	32	31	28	26	17	5
A4. Debt Rescheduling with the US and Russia in 2007	28	27	26	26	25	25	21	10
B. Bound Tests								
B1. Real GDP growth at baseline minus one standard deviation in 2008-09	32	30	30	29	29	28	24	12
B2. Export value growth at baseline minus one standard deviation in 2008-09 3/	32	37	47	46	44	43	36	17
B3. US dollar GDP deflator at baseline minus one standard deviation in 2008-09	32	30	30	29	29	28	24	12
B4. Net non-debt creating flows at baseline minus one standard deviation in 2008-09 4/	32	33	35	34	33	33	27	13.5
B5. Combination of B1-B4 using one-half standard deviation shocks	32	34	39	38	37	36	30	15
B6. One-time 30 percent nominal depreciation relative to the baseline in 2008 5/	32	30	30	29	29	28	24	12
Debt service ratio								
Baseline	0.8	0.8	0.9	0.9	0.9	1.0	1.0	0.9
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2008-27 1/	0.8	0.4	0.5	0.5	0.6	0.6	0.7	0.5
A2. New public sector loans on less favorable terms in 2008-27 2/	0.8	0.4	0.5	0.6	0.7	0.7	1.0	1.0
A3. Oil scenario	0.8	0.8	0.9	1.0	0.9	0.9	0.7	0.3
A4. Debt Rescheduling with the US and Russia in 2007	0.7	0.8	0.8	0.9	0.9	1.0	1.0	0.9
B. Bound Tests								
B1. Real GDP growth at baseline minus one standard deviation in 2008-09	0.8	0.4	0.5	0.6	0.6	0.6	0.7	0.7
B2. Export value growth at baseline minus one standard deviation in 2008-09 3/	0.8	0.4	0.7	1.0	1.0	1.0	1.2	1.0
B3. US dollar GDP deflator at baseline minus one standard deviation in 2008-09	0.8	0.4	0.5	0.6	0.6	0.6	0.7	0.7
B4. Net non-debt creating flows at baseline minus one standard deviation in 2008-09 4/	0.8	0.4	0.6	0.7	0.7	0.7	0.9	0.8
B5. Combination of B1-B4 using one-half standard deviation shocks	0.8	0.4	0.6	0.8	0.8	0.8	1.0	0.9
B6. One-time 30 percent nominal depreciation relative to the baseline in 2008 5/	0.8	0.4	0.5	0.6	0.6	0.6	0.7	0.7
Memorandum item:								
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	33	33	33	33	33	33	33	33

Source: Staff projections and simulations.

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

INTERNATIONAL MONETARY FUND

CAMBODIA

Staff Report for the 2007 Article IV Consultation—Informational Annexes

Prepared by the Asia Pacific Department
(In Consultation with Other Departments)

July 10, 2007

Contents Page

ANNEX I
Cambodia: Fund Relations
As of May 31, 2007

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

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

III. **SDR Department**:	SDR Million	Percent Allocation
Net cumulative allocation	15.42	100.00
Holdings	0.11	0.71

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

V. **Financial Arrangements**:

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

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

	Forthcoming				
	2007	2008	2009	2010	2011
Principal	0	0	0	0	0
Charges/Interest	0.33	0.65	0.65	0.65	0.65
Total	0.33	0.65	0.65	0.65	0.65

VII. **Multilateral Debt Relief Initiative**

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

VIII. **Safeguards Assessment**:

Under the Fund's safeguard assessment policy, the NBC is subject to a full safeguard assessment with respect to the successor PRGF Arrangement. The assessment was completed in March 2004 and specific measures were proposed to address weaknesses in financial reporting, internal audit and internal control systems. An update is expected to be undertaken in the second half of 2007.

IX. **Exchange Rate Arrangement**:

Cambodia officially follows a managed float with no pre-announced exchange rate path, although in recent months the arrangement has resembled a de facto peg to the dollar. 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 and is used for accounting purposes by the National Bank of Cambodia. It is determined by the foreign exchange market, with the rate adjusted to be within 1 percent of the market rate on a daily basis. On May 31, 2007, the official exchange rate was CR 4,059 per U.S. dollar and the market rate CR 4,061 per U.S. dollar.

Cambodia accepted the obligations of Article VIII, Sections 2, 3, and 4 on January 1, 2002. Cambodia maintains an exchange system that is free of restrictions on the making of payments and transfers for current international transactions.

X. **Article IV Consultation**:

Cambodia is subject to the provisions on consultation cycles approved on July 15, 2002. The Executive Board concluded the last Article IV consultation on July 7, 2006 (Country Report No. 04/328).

XI. **Technical Assistance**:

There are currently two resident advisors in Cambodia: a Banking advisor and a multi-sector Statistics advisor. The Regional Technical Assistance Strategy sees continued substantial technical assistance being delivered to Cambodia, focused on public financial management, customs administration, the financial sector and economic statistics. The overall level of input will however decrease slightly as the emphasis moves further away from full-time resident advisors towards subject-specific short-term inputs. A summary of recent technical assistance inputs is at Table 1.

XI. **Resident Representative**:

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

Table 1: Cambodia—Summary of Technical Assistance Provided by the Fund May 2003-May 2007

Purpose	Assistance and Timing (person-months)
Fiscal	
• Customs administration	May 2003; (½)
• Budget advisor	July-August 2003; (½)
• Revenue mobilization	August/September 2003; (1)
• Tax policy and administration	August-October 2003; (2)
• Customs administration expert	October-November/Dec. 2003 (1½)
• Tax administration	November 2003; (¼)
• Budget advisor	December 2003; (7)
• Tax administration expert	February 2004; (2)
• Tax administration follow-up	February-March 2004; (½)
• Tax and Customs administration IT	February 2004-April 2005 (4 ¾)
• Customs administration	March 2004-May 2005 (4 ¾)
• Budget management	December 2003-June 2004 (6)
• Tax administration expert on audit circulars and training	July-November 2004 (4)
• Treasury advisor	June-November 2004 (6)
• Tax and Customs administration follow-up	Sept. 2004 (3/4); February 2005 (3/4)
• Treasury Advisor	January-August 2006 (21)
• Tax Policy (oil, gas)	June 2005 (1½)
• Tax administration mission	July 2005 (1½)
• Customs administration expert	October 2005, January 2006 (1½)
• Tax Computerization	October 2005 (1)
• Customs administration and computerization peripatetic visits	May 2006 – May 2007 (6)
• Petroleum Taxation	September 2006 (1)
• Public Financial Management Review mission	December 2006 (1)
• Chart of Accounts implementation	December 2006 (1)
Monetary	
• Banking, accounting and foreign exchange management	April 2003; (2)
• Banking supervision expert	November 2003; (6+12+2)
• Banking, accounting and foreign exchange management	December 2003; (1)
• Accounting	May 2004 (3/4)
• Mission on Central Bank internal audit	May 2004; February 2005; June 204 (3)
• AML/CFT Legislation	July 2004 (1/2)
• Prakas on AML/CFT	October 2004 (1/2)
• Banking supervision, reserve management and TA review	September 2004 (3)
• Central bank restructuring	January 2005 (1)
• Banking supervision	February 2005 (2)
• Seminar on Draft Law on Negotiable Instruments	March 2005 (1/4)
• Central bank operations and banking supervision mission	July 2005 (3)
• Banking advisor	July 2005 – July 2007 (24)
• Payment System Regulation	October, December 2005 (2)

Purpose	Assistance and Timing (person-months)
Monetary	
• Bank Supervision	October 2005; April 2006; December 2006 (3)
• Central Bank Restructuring	January 2006 (1)
• Monetary operations mission	August 2006 (1½)
• Internal audit visits	February 2006; August 2006; May 2007 (3)
• Payment system	April 2006 (1)
Statistics	
• Balance of payments compilation expert	March-May 2003; (3)
• Producer price statistics	July-August 2003; (1)
• Consumer price index	October 2003; (½)
• GFS follow-up	December 2003; (½)
• Multisector statistics advisor	January 2004; (6)
• Balance of payments statistics	March 2004 (½)
• Producer price statistics	June 2004 (½)
• Multisector statistics advisor	November 2004 – November 2007(36)
• Government finance statistics	April 2005 (½)
• Government finance statistics	February 2006 (½)
Legal	
• AML/CFT	December 2003; (¼) May 2006 (¼)
• Anti-Corruption	August 2005 (½)

ANNEX II. CAMBODIA: RELATIONS WITH THE WORLD BANK GROUP[18]

(As of May 2007)

The Royal Government of Cambodia's (RGC) *Rectangular Strategy for Growth, Employment, Equity and Efficiency in Cambodia* (2004) identifies improved governance as "the most important precondition to economic development with sustainability, equity and social justice." This analysis accords with that set out in the World Bank Group's 2005–2008 Country Assistance Strategy (CAS) (May 2005), which stresses the need to improve governance in order to maximize the impact of development efforts. The CAS activities are intended to contribute to six objectives, which are clustered under two over-arching pillars. Activities under Pillar 1 are intended to help implement improvements in governance that are needed if Cambodia is to meet the Cambodia Millennium Development Goals (CMDGs). To this end, the CAS establishes four objectives.

1. Addressing aspects of economic governance that raise the cost of doing business, deter investment and trade, and hold back broad-based private sector development.
2. Supporting policy and institutional reforms that help the rural poor receive more benefits from sustainable natural resources management, by improving transparency and accountability in the governance of natural resources and land in particular.
3. Addressing core issues of public financial management (PFM) as fundamental for improved service delivery, by supporting the Government's PFM Reform Program and the formulation of strategies for reform of civil service pay and employment.
4. Promoting accountability by supporting decentralization and promoting citizens' partnerships for better governance.

Pillar 2 of the CAS allocates World Bank resources to supporting the strategy development and investments needed to attain the CMDGs. To these ends, the Bank Group first will encourage the emergence of poverty-focused approaches to the formulation and implementation of public policy by supporting the new National Strategic Development Plan (NSDP 2006-2010). Second, where there are clear gaps in critical infrastructure and human development sub-sectors, the Bank Group will support the emergence of a nationally-owned vision and strategy through the provision of analytical and investment services.

V. PILLAR 1: IMPROVING GOVERNANCE TO ATTAIN THE CMDGS

A. Private Sector Development

The Government has made some significant progress in improving the private sector investment climate but more work needs to be done, particularly on the structural reforms needed to support sustainable, private sector-led growth In addition to providing private sector-related technical support to the Government through assistance to the Government Private Sector Forum, the Bank Group, including the IFC, the Foreign Investment Advisory Service, and the Public Private Infrastructure Advisory Facility, has continued to provide

[18] Prepared by World Bank staff.

inputs to the Government's Private Sector Development Strategy through an investment climate assessment and value chain analysis. The objective of this effort has provided focus on a three-fold strategy aimed at removing impediments to productivity growth, to help diversify the economy, and to increase the role of the private sector in service delivery. The 2004 Investment Climate Assessment findings identified overlapping trade facilitation, inspection, and licensing processes of various agencies as contributing to an excessive regulatory burden and a high incidence of corruption. In light of these findings, the Bank is focusing its efforts on operationalizing the reform recommendations through the 2005 Trade Facilitation and Competitiveness Project (TFCP) with participation from other donors, including the European Commission, AusAID, and IMF. Its key component will streamline import and export processes, and the Bank and Fund are working together on customs automation. Solid progress has been made in the customs automation work, resulting in part from joint Bank–Fund efforts. The Customs and Excise Department is expected to adopt a Single Administrative Document (SAD) in the third quarter of 2007 and to pilot the ASYCUDA Customs Automated System by end-2007. A sector-wide approach (SWAp) on private sector development is being reviewed in line with other donors to provide a unified input into supporting required reforms in private sector development.

Work is also being done on labor standards and relations with the objective of supporting stronger and more equitable private sector growth. Working conditions monitoring (Better Factories Cambodia) is being supported under the TFCP and a component on developing more effective labor dispute resolution processes is slated for inclusion in the forthcoming Demand for Good Governance Project (FY08).

At the level of micro-enterprise the Bank is developing a project called Empowerment of the Poor in Siem Reap (EPSR). The EPSR project seeks to improve incomes and capacities of the poor in Siem Reap by more effectively linking their livelihoods to the province's growth engine - the tourism industry.

B. Natural Resources Management

With 85 percent of the population living in rural areas, and 79 percent of the poor mainly depending on agriculture and natural resource for their livelihoods, economic growth and poverty reduction will to a large extent depend on reviving the rural economy. The objectives of the Land Management and Administration Project (2002) are to reduce poverty, promote social stability, and stimulate economic development. The specific objectives of the project are to improve land tenure security and promote the development of efficient land markets. These objectives are achieved through: (i) development of national policies, the regulatory framework, and institutions for land administration; (ii) issuance and registration of titles in urban and rural areas; and (iii) establishment of an efficient and transparent land administration system. A proposed Land Allocation for Social and Economic Development Project (FY08) is under preparation. In June 2005, the Bank completed a Rural Sector Strategy Note (RSSN), which aimed to identify critical rural development issues and options to address them.

C. Public Financial Management

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

The Government launched its Public Financial Management Reform Program (PFMRP) in December 2004. The PFMRP comprises a detailed, sequenced, and time-bound action plan, a performance management framework, and measures to address organizational reform, including staff incentives. Over the past two years the Ministry of Economy and Finance (MEF) has made good progress. Major reforms measures commenced implementation in January 2007, including: a significant streamlining of budget execution procedures, the introduction of program budgeting, and adoption of a new chart of accounts. These follow on significant reforms in 2005: the amount of customs revenue collected through the banking system increased (from zero in 2004 to nearly 1/3 in 2006); more than ¾ of all Tax Department revenue is now collected through the banking system; about ¾ of Treasury payments to suppliers in Phnom Penh and Sihanoukville are now made by check instead of cash; the stock of old expenditure arrears has been reduced by over 40 percent; the procurement process has been streamlined, tightened, and made more competitive with the passing of a new sub-decree in late 2006; the Government has set up internal audit departments in a dozen line ministries, and, for the first time in Cambodia, a pilot program has been launched to pay civil servants through commercial banks instead of by cash.

A joint effort of eleven of Cambodia's development partners committed to assist in strengthening the Government's ability to lead and implement this agenda and to provide fully coordinated support via a sector wide approach (SWAp). The Bank is supporting the PFMRP, including oil revenue management, through the Public Financial Management and Accountability Project (June 2006). In addition, the Bank leads the donor group and manages a Multi-Donor Trust Fund to support the program on behalf of AusAID, DFID, and the EC. The collaborative approach is supported by the Public Expenditure and Financial Accountability (PEFA) secretariat, as envisioned in the recent Bank-Fund board paper.[19] The Fund has provided extensive TA to the RGC in tax and customs administration and selected areas in budget management and Treasury operations. The Bank and Fund have established a productive working relationship on PFM.

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

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

However, despite the Bank's provision of a significant amount of grant funding in 2004 for the Council for Administrative Reform to carry out an agreed set of studies that would provide the analytical foundation for reform, progress has been minimal. The pace of civil service reform—and the resources that the Government has devoted to it—do not appear to match the seriousness of the problems caused by Cambodia's weak civil service. Donors believe that reform of public administration is essential if there is to be progress in implementing the Rectangular Strategy and NSDP, and are appealing to the Government to consider how this work can be reinvigorated.

The Bank is working with government ministries and other donors to pilot accelerated pay and employment reform in high priority sectors. The Merit Based Pay Initiative (MBPI), which is an official Government program, has recently been agreed and is now being implemented first in MEF. The MBPI provides for substantial increases in remuneration for a small group of officials in MEF (about 10 percent in 2007) selected based on merit and performance management. The MBPI aims to introduce the principles and practices of meritocracy into the Cambodian civil service.

D. Decentralization and Accountability

Cambodia's framework of accountability, derived from the Constitution, is based on three key relationships of accountability: (i) between elected officials and those responsible for delivering essential services to citizens; (ii) between citizens and the state; and (iii) between those who deliver services and the citizens who receive these services. The work under this objective is concerned with all three of these relationships. The primary investment vehicle will be projects at the commune level—the lowest level at which citizens interact with the state, elected representatives, and service providers. Analytical work and partnerships will support the evolving vision for deconcentration and decentralization and will contribute to establishing an enabling environment for civic engagement.

The Bank's primary investment support to decentralization is through the ongoing Rural Investment and Local Governance Project (RILGP, FY03-FY06), for which additional financing of about $36 million will be provided in FY08, and a future planned RILGP II. RILGP supports improved local governance as a foundation for sustainable development and poverty reduction by strengthening the newly decentralized development process at the commune level and providing grants for priority rural infrastructure and related public goods identified through this local planning process. RILGP II (2009) will be the Bank's main lending support to the new decentralized mechanisms once they are clarified. In addition, the Bank is developing a Demand for Good Governance (DFGG) project for FY08. The DFGG project's objective is to promote good governance by building the capacities of institutions, and supporting programs and coalitions that promote, mediate, respond to or monitor demand for good governance. In doing this the DFGG project will focus on: (i) governance at the sub-national level; (ii) labor dispute resolution; (iii) media; and (iv) legal awareness. The project will involve separate funding windows for state and non-state institutions and encourage partnerships across them to enhance effectiveness.

VI. PILLAR 2: SUPPORTING STRATEGY AND INVESTMENTS TO ATTAIN THE CMDGS

This work also falls under the following sub-components:

A. Poverty-focused Public Policy

Cambodia Equity Report and Related Initiatives. The Bank, with inputs from local research partners, CDRI (Cambodia Development Resource Institute), and IRL (Indochina Research Limited) has led the production of the Cambodia Equity Report, to be released at the forthcoming CDCF Meeting in June 2007. The topic for the Equity Report was suggested by the RGC following the March 2006 CG meeting at which the problem of rising inequality was discussed. The report will analyze dimensions of inequality in Cambodia, such as income and consumption, access to health and education services, control over assets and land, the impact of formal and informal institutions on inequality, the changing aspect of gender-based inequality, as well as examine inequality trends in urban and rural contexts. The analysis is based primarily on the 2004 Cambodia Socio-Economic Survey (CSES) and the 2006 Cambodian Health and Demographic Survey (CDHS), complemented by mixed methods research into local variations and household poverty dynamics (the Moving out of Poverty Study).

National Strategic Development Plan (NSDP). An NSDP Secretariat, chaired by the Ministry of Planning (MOP) with inputs from the Supreme National Economic Council (SNEC), is charged with coordinating the implementation, monitoring, and evaluation of the RGC's five year plan, the National Strategic Development Plan (NSDP, 2006-2010), approved by the National Assembly in May 2006. The NSDP, which constitutes the RGC's second poverty reduction strategy, guides the implementation of the vision laid out in the Government's Rectangular Strategy (RS) and the Cambodian MDGs. The WB and the UN Resident Coordinator serve as co-lead donor facilitators for the Technical Working Group on Planning and Poverty Reduction (TWG-PPR), and coordinate all donor inputs and advice to the MOP regarding NSDP implementation, such as producing the Annual Progress Report, developing the Ministry of Planning Strategic Plan (MPSP), and supporting capacity building initiatives for stakeholders involved in the NSDP process. The TWG-PPR is also contributing to aid effectiveness and donor coordination around the NSDP by initiating discussions on moving toward a Program Based Approach (PBA) for the Ministry of Planning.

B. Investment and Analytical Services for Infrastructure and Social Service Delivery

Social Sector Policy Dialogue. In the *health* sector the key policy issues under discussion are: (i) improved effectiveness of health financing through improved sector wide planning and budgeting processes, equity funds (access to health services for the poor), and contracting with NGOs for improved service delivery and outcomes; and (ii) pay and employment reform in the Ministry of Health. The recent joint health sector performance review established maternal and child health as health priorities. The Bank, along with other partners, is preparing a Health Sector Support Program (II) that will focus on these priorities. In the *education* sector the Bank has been an active contributor to the Education Strategic Plan and the Education Sector Support Program. The key policy issues the Bank is focusing on are: (i) disparities in education participation rates by different regions, income groups, and gender; (ii) inefficiency and poor quality in education service delivery at primary, secondary, and tertiary levels; (iii) weak local management capacity; (iv) lack of reliability in education finance disbursements; and (v) pay and employment reform. The Bank, along with other partners, is helping Cambodia access significant volumes of additional funding for basic education under the Education for All Fast Track Initiative for which Cambodia has recently become eligible. Both the education and health sectors have undertaken public expenditure tracking surveys, which provide insights into ensuring that these additional funds for health and education are spent in a transparent manner and reach the intended beneficiaries.

Energy Sector Strategy. Donors are currently supporting the Government to develop a coherent energy sector strategy and implementation plan. The work consists of three phases. The first phase focuses on the issues identification and was completed in 2006. The key findings are documented in the World Bank report "Cambodia--Energy Sector Strategy Review: Issues Paper," which reviews the issues in several subsectors including electric power, rural electrification, renewable energy, petroleum industry, and coal mining. Currently, a Hydropower Development Master Plan is being developed and the Power Development Plan was recently updated. The Bank has just completed preparation of a GMS Power Trade Project (FY07) that will enable Cambodia to buy electricity from Vietnam and Laos. Due to the urgency of the emerging oil and gas sector issues, the donor community has recently been organized to provide coordinated policy advice and technical support to the government. The proposed donor work program covers several aspects of the oil and gas sector, including sector policy, sector structure, legal framework, fiscal framework, transparency and revenue management. Oil and Gas 'Sector Policy Notes' have been prepared and distributed, and the Bank is supporting Cambodia's endorsement of the Extractive Industries Transparency Initiative (EITI) through the PRGO program.

The Poverty Reduction and Growth Operation (PRGO) Program

PRGO-1, the first in a series of three annual operations, selectively focuses on the key reform areas of private sector development (PSD), public financial management (PFM), and land and natural resources management (LNRM) (subsequent PRGOs would broaden the coverage to other priority sectors).[20] The PRGO process is designed to strengthen the linkage between results and donor assistance. The operation is supporting the implementation of the policy agenda laid out in the RS and the NSDP. The PRGO is linked closely to the joint monitoring indicators (JMIs) agreed at the 2004 and 2006 CG Meetings so that the reform program remains government-owned and led and supported by the entire donor community collectively (viz., the prior actions for PRGO-1 are a subset of the CG Meeting JMIs).

The prior actions for PRGO-1 focus on key issues in each of the three areas: in LNRM the prior actions address the issues of state land management and economic land concessions; in PSD the prior actions focus on trade facilitation and investment law; in public financial management the prior actions focus on budget process and treasury operations, procurement, and meritocratic pay and employment reform.

Staffs have coordinated closely on the Fund's policy dialogue and the PRGO program. Though there are several areas where the PRGO program and the Fund's dialogue overlap—

[20] Negotiations on PRGO-1 were successfully completed on April 24, 2007, and the Bank hopes to send the operation to the Executive Directors for approval in early FY08, after agreement has been reached with the Government on repayment on misprocured contracts.

LNRM, PSD, and PFM—the Bank and Fund have ensured that their interventions are complementary and mutually reinforcing, while not overlapping on any specific areas. Comprehensive consultations are on-going, most recently taking place during the Fund mission in May 2007, but continuing at the country office level on a regular basis.

Lending Operations and Non-lending Instruments

Proactive portfolio management continues to be a very high priority for the Bank Group. Following the 2004-2005 Fiduciary Review carried out in partnership with the Royal Government of Cambodia, the World Bank's Institutional Integrity Department (INT) carried out separate investigations in 2005-2006. The INT investigations substantiated allegations of corruption, collusion, and fraudulent practices on several contracts under seven projects (four active[21] and three closed[22]). As a result the Bank declared several contracts "misprocured" in June 2006. In addition the Bank temporarily suspended[23] disbursements under three projects (LMAP, PRIP and PPUWSSP) and established action plans for the concerned Government agencies to execute in order to lift the suspensions. These action plans were completed in January 2007 and the Bank lifted the suspensions on all three projects in the first half of February 2007. In addition, the Royal Government of Cambodia decided to establish and implement anti-corruption actions plans for all active and future Bank-financed operations. The Bank is actively assisting all concerned agencies to complete these actions plans by the end of June 2007. One of the strongest portfolio measures being implemented consists of the hiring of a specialized consultancy firm to act as a procurement agent for the Government.

Overall disbursement under the portfolio has been much lower than previous years due to the suspension of disbursement on three projects.

Non-lending instruments and operations (credits and grants) are described in the following tables.

[21] Biodiversity and Protected Areas Management Project (BPAMP); the Land Management and Administration Project (LMAP); Provincial and Rural Infrastructure Project (PRIP); and Provincial and Peri-Urban Water Supply and Sanitation Project (PPWSP).

[22] Flood Emergency and Rehabilitation (FERP), Forestry Concession Management and Control Pilot Project (FCMCPP), and Agricultural Productivity Improvement Project (APIP).

[23] Suspension is a remedial measure available under all World Bank legal agreements. It can be exercised by the Bank in a number of situations, including when the borrower is not fulfilling its obligations under the legal agreement. Suspension entails a temporary freeze on the Bank's financing of implementation; it does not mean that the Bank withdraws from the project. Rather, the Bank steps up its supervision, dialogue, and other activities to help the Government in its efforts to meet the conditions for lifting the suspension.

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

(Recently completed and ongoing, May 2007)

Issue	Instruments
Civil Service Reform	IFAPER (2003), and grant on civil service reform (closed).
Environment	Cambodia Environment Monitor (2003), Phase II Cambodia, Lao PDR and Vietnam Poverty-Environment Nexus Study (ongoing), Environment Monitor (2006).
Gender	Cambodia Gender Assessment (2004) and grant on gender (closed).
Governance	Annual Report to the CG Meeting (2004).
Human Development	Demand Side Incentives in Education Impact Evaluation (ongoing), Civil Service Reform for Teachers (ongoing), "Quality Basic Education for All" study on determinants of schooling participation (2005), Social Protection Policy Note (2006), Safeguards Research (2006), Child Labor Study (2006), Health Sector Study (ongoing), and Health Sector Wide Management Review (2006).
Infrastructure	Urban Water and Sanitation Strategy (2006).
Legal and Judicial Reform	Justice for the Poor phase one study (2006); Justice for the Poor phase two (ongoing).
Poverty Reduction and Economics	Poverty Reduction Strategy Trust Funds (ongoing), Moving out of Poverty study (2007), National Poverty Assessment (2006), Cambodia Equity Report (2007), and Sources of Growth (2008).
Private Sector Development and Trade	FIAS report on FDI (2001), Integration and Competitiveness Study (2002), Private Sector Development Strategy/Investment Climate Assessment (2004), Investment Climate Assessment (2007), and PPIAF grant to develop an interim regulatory framework (ongoing).
Public Financial Management	IFAPER (2003), IDF grant on public sector reform (closed), Country Procurement Assessment Report (2004), Fiduciary Review (2005), Public Expenditure Tracking Survey—Education (2005), Public Expenditure Tracking Survey – Health (2007), grant to assist the National Audit Authority (ongoing), ROSC on private sector accounting (2007), and grant to assist with development of private sector accounting capacity (closed).
Rural and Agriculture	Rice Value Chain Study (2002), PSIA on social land concessions (2004), Rural Sector Strategy Note (2005), Land Taxation and Valuation Study (2005), and Land Policy and Strategy (FY06).

IDA: Commitments and Disbursement to Cambodia
(In millions of dollars, as of May 9, 2007)

Project	Effective Date	Committed	Disbursed
Credits:			
Biodiversity and Protected Areas Management Project	May 3, 2000	1.91	2.00
Economic and Public Sector Capacity Building Project	February 10, 2003	5.50	1.40
Education Sector Support Project	August 17, 2005	8.00	2.91
Health Sector Support Project	August 14, 2003	17.20	6.77
Land Management and Administration Project	June 19, 2002	24.20	13.60
Provincial and Peri-Urban Water and Sanitation Project	November 16, 2003	16.90	6.98
Provincial and Rural Infrastructure Project	March 16, 2004	20.00	12.90
Rural Investment and Local Governance Project	September 16, 2003	21.90	17.90
Rural Electrification and Transmission Project	March 29, 2005	40.00	3.20
Road Rehabilitation Project [Closed]	June 14, 1999	44.31	44.47
Agriculture Productivity Improvement Project [Closed]	June 20, 1997	21.78	20.02
Cambodia: Flood Emergency Rehabilitation Project [Closed]	June 4, 2001	35.00	37.03
Forest Concession Management and Control Pilot Project [Closed]	October 20, 2000	4.82	4.68
Social Fund II Project -IDA31791[Closed]	September 27, 2001	10.00	10.61
Social Fund II Project - IDA31790 [Closed]	July 7, 1999	25.00	23.22
Social Fund Project - IDA27390 [Closed]	December 21, 1995	20.00	18.42
Education Quality Improvement Project [Closed]	December 20, 1999	5.00	4.87
Northeast Village Development Project [Closed]	November 11, 1999	5.00	4.68
Urban Water Supply Project [Closed]	June 2, 1998	30.96	30.10
Demobilization and Reintegration Project [Closed]	July 1, 2002	18.40	0.68
Structural Adjustment Credit Project [Closed]	March 28, 2000	30.00	30.00
Disease Control and Health Development Project [Closed]	June 23, 1997	30.40	26.80
Phnom Penh Power Rehabilitation Project [Closed]	December 20, 1995	40.00	35.13
Economic Rehabilitation Credit Project [Closed]	December 18, 1995	40.00	37.46
Technical Assistance Project [Closed]	March 23, 1995	17.00	15.98
Emergency Rehabilitation Project [Closed]	January 13, 1994	62.70	62.70
Total Credits		**595.98**	**474.51**
Grants:			
Provincial and Peri-Urban Water and Sanitation Project [H034]	November 16, 2003	3.00	0.39
Health Sector Support Project [H015]	August 14, 2003	7.80	4.92
Health Sector Support Project [016]	August 14, 2003	2.00	0.98
Education Sector Support Project [H161]	August 17, 2005	20.00	3.85
Cambodia Trade Facilitation and Competitiveness	December 12, 2005	10.00	1.60
Biodiversity and Protected Areas Project [GEF TF023524]	March 7, 2000	2.75	2.75
Renewable Energy Development Project [GEF TF053036]	March 29, 2005	5.80	0.40
Demand for Good Governance Project [Q5540]	January 15, 2007	1.10	0.10
Public Financial Management Reform Program [MDTF054547]	August 11, 2005	7.00	2.27
Cambodia Public Financial Management and Accountability [H2410]	May 14, 2007	14.00	-
Total Grants		**73.45**	**17.26**

Source: BW/Project Portal/ISR as of 05/09/2007 9:50 AM

ANNEX III. CAMBODIA: RELATIONS WITH THE ASIAN DEVELOPMENT BANK

From 1992 through 31 December 2006, the Asian Development Bank (AsDB) approved $960.4 million in low-interest loans (including $49.8 million in grants in 2005 and 2006) to Cambodia to finance 33 projects and 8 structural reform programs. To date 17 loan projects, for a total of $487.6 million, have been completed:

(i) the Special Rehabilitation Assistance Project [approved in 1992];
(ii) Power Rehabilitation Project [approved in 1994];
(iii) Agriculture Sector Program [approved in 1996];
(iv) Basic Skills Project [approved in 1995];
(v) Rural Infrastructure Improvement Project [approved in 1995];
(vi) Basic Education Text Book Project (approved in 1996);
(vii) Basic Health Services Project [approved in 1996];
(viii) Phnom Penh Water Supply and Drainage Project [approved in 1996];
(ix) Siem Reap Airport Project (approved in 1996);
(x) Financial Sector Program, Subprogram I [approved in 2001];
(xi) Financial Sector Program, Subprogram II [approved in 2002]
(xii) Education Sector Development Program [approved in 2001]; and
(xiii) Emergency Flood Rehabilitation Project [approved in 2000];
(xiv) Provincial Power Supply Project [approved in 2000];
(xv) GMS: Phnom Penh to Ho Chi Minh City Highway Project [approved in 1998];
(xvi) Primary Roads Restoration Project [approved in 1999]; and
(xvii) Rural Credit and Savings Project [approved in 2000]

The sector composition and loan/grant amounts of the remaining active portfolio is as follows: agriculture and natural resources ($73.6 million); education ($63.0 million); energy ($64.3 million); finance ($10.0 million); health, nutrition and social protection ($29.0 million); industry and trade ($35.6 million); law, economic management and public policy ($17.8 million); multi-sector ($43.2 million); transport and communication ($92.0 million); and water supply, sanitation and waste management ($44.3 million).

During the same period, the AsDB also designed and administered 141 technical assistance projects amounting to $ 91.4 million. They were financed through grants from AsDB's Technical Assistance Special Fund ($32.6 million), the Japanese Special Fund ($38.7 million), and other sources ($20.1 million). In 2006, the AsDB approved two loans: Second Power Transmission and Distribution ($20.0 million) and GMS: Rehabilitation of the Railway in Cambodia ($42.0), and one grant: Commune Council Development, Phase II ($7.8 million).

AsDB's overarching goal in Cambodia is sustainable poverty reduction. AsDB's Country Strategy and Program (CSP 2005-2009) will focus on: (i) broad-based economic growth through investments in physical infrastructure, development of the financial sector, sustainable development of small and medium-scale enterprises, and investments in agriculture and irrigation; (ii) inclusive social development through basic education, empowering vulnerable groups such as women and ethnic minorities, control of communicable diseases, the provision of rural water supply and sanitation facilities, and community-based sustainable management and conservation of natural resources in the Tonle Sap Basin; and (iii) good governance through improving accountability and service delivery, supporting legal, regulatory and policy reforms, strengthening institutional capacity building, and improving efficiency and effectiveness of project implementation. A focus on the Tonle Sap basin to address geographical disparities in development, and a subregional focus to benefit from the broader opportunities provided by AsDB's Greater Mekong Sub-region program are also included. Four cross-cutting themes, namely governance, private sector development, gender, and the environment are also proposed to support the poverty reduction objectives of the country strategy.

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

AsDB: Loan/Grant Commitments and Disbursements to Cambodia, 1992-2006
(In millions of U.S. dollars)
as of December 31, 2006

		Loan Approvals	**Contract Awards/ Commitment**	**Disbursements**
1	1992	67.7	0.0	0.0
2	1993	0.0	4.4	5.4
3	1994	28.2	35.9	12.2
4	1995	45.1	28.1	35.9
5	1996	105.0	15.3	32.1
6	1997	0.0	41.5	10.7
7	1998	40.0	29.1	29.3
8	1999	88.0	17.0	26.2
9	2000	109.6	114.4	50.8
10	2001	75.2	40.7	48.3
11	2002	116.5	64.4	78.9
12	2003	98.3	61.9	73.3
13	2004	65.0	62.4	76.7
14	2005	52.0[1]	96.4	84.5
15	2006	69.8[2]	44.7	55.8
17	2007 (Projected)	(79.0)[3]	(44.7)	(55.8)
	TOTAL:	**960.4**	**682.9**	**639.5**

1 Loans amount to \$10 million and grants to \$42 million
2 Loans amount to \$62 million and grants to \$7.8 million
3 Loans amount to \$47.0 million and grants to \$32.0 million

ANNEX IV. CAMBODIA: STATISTICAL ISSUES

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

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

National accounts and price statistics

45. Annual and quarterly official GDP estimates are produced with support from the AsDB's peripatetic expert and a long-term IMF advisor. The national accounts series was updated in 2006 incorporating new household survey data and leading to an upward revision in growth rates. Final estimates for the national accounts for 2006 were published in May, 2007 and first quarter estimates for 2007 were published in June 2007. Nevertheless, the quality of GDP estimates remains hampered by the lack of comprehensive and reliable sectoral information.

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

Government finance statistics

47. The Ministry of Economy and Finance provides monthly fiscal data (broadly based on *GFS* standards) with a four-week lag. There remain, however, certain weaknesses with regard to the reliability of source data, coverage, and the economic and functional classifications of expenditure. Data on donor-financed projects are available with a considerable lag. Some of these issues are currently being addressed. With the support of a Treasury advisor (FAD) and a Statistical Advisor (STA), in 2007 the authorities implemented a reform of the government accounting system and budgetary nomenclature based on the classification of the *Government Finance Statistics Manual 2001*. Initial teething problems with the implementation of these new procedures have slowed fiscal reporting in the first half of 2007. In addition, several STA missions to improve GFS compilation procedures and

assist with the implementation of the new methodology have taken place in recent years, the latest in February 2006.

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

Monetary and financial statistics

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

External sector statistics

50. The NBC is responsible for compiling balance of payments statistics. Customs data have substantial coverage and valuation problems arising from the nonrecording of no dutiable imports, underreporting of re-exports, and weaknesses in customs controls. While there have been improvements in the quality of foreign direct investment data, private capital flows are believed to be large and not fully captured in the official data. A range of international transactions by enterprises, such as payments for imported services, income payments, and portfolio investment abroad are not included in the data. In January 2003, the authorities implemented an International Transactions Reporting System (ITRS) to collect data on international transactions made through the banking system to improve balance of payments estimates. An STA balance of payments statistics mission in March–May 2004 reviewed source data used for compiling the balance of payments and recommended improvements; the multisector statistics advisor currently residing in Cambodia is assist in improving the external sector statistics. Gross external debt data are provided by the Ministry of Economy and Finance, but public and publicly guaranteed debt by maturity, the external debt service schedule, and timely information on disbursements by bilateral donors are not available.

Cambodia: Table of Common Indicators Required for Surveillance
(As of June 26, 2007)

	Date of latest Observation	Date Received	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of Publication[6]
Exchange Rates	May 2007	Jun. 2007	M	M	M
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	Dec. 2006	Jan. 2007	D	D, two day lag	N/A
Reserve/Base Money	Apr. 2007	May. 2007	M	M, 5 week delay	M
Broad Money	Mar. 2007	May. 2007	M	M, 5 week lag	M
Central Bank Balance Sheet	Apr. 2007	May. 2007	M	M, 5 week lag	M
Consolidated Balance Sheet of the Banking System	Mar. 2007	May. 2007	M	M, 5 week lag	M
Interest Rates[2]	May 2007	Jun. 2007	M	M, 5 week delay	M
Consumer Price Index	May. 2007	Jun., 2007	M	M, 5 week lag	M
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	Sep 2006	Nov. 2006	M	M, 6-12 week delay	M
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government	Jan. 2007	Mar. 2007	M	M, 6-12 week delay	M
Stocks of Central Government and Central Government-Guaranteed Debt[5]	Dec. 2004	April 10, 2005	M	M, 6-12 week delay	M
External Current Account Balance	Q4. 2006	Apr. 2007	Q	Missions, email	A
Exports and Imports of Goods and Services	Q4, 2006	Apr. 2007	Q	Missions, email	A
GDP/GNP	Q4 2006	June 2007	A	Missions, email	A
Gross External Debt	Dec. 2004	Mar. 2005	M	M, 3 month lag	A

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

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700 19th Street, NW
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IMF Concludes 2007 Article IV Consultation with Cambodia

On July 25, 2007, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Cambodia.[24]

Background

Strong macroeconomic policies have enabled Cambodia to achieve impressive growth and make inroads into poverty. Supported by prudent fiscal and monetary policies that have strengthened the economy's resilience to shocks, growth has averaged over 9 percent since 2000, accelerating in recent years. Anchored in part by the extraordinarily high degree of dollarization, inflation has remained low and confidence increased. Growth, however, has been narrowly based on the garment and tourism sectors, with the agricultural sector only making a sustained contribution in recent years. The overall poverty rate has declined markedly, but with a rise in inequality, and remains uncomfortably high in rural areas. Progress will have to be accelerated if Cambodia is to meet the Millennium Development Goals.

Macroeconomic performance in 2006 was impressive. Growth in 2006 was 10¾ percent, based on continued growth in agriculture, following the record-breaking year of 2005 and buoyant exports. Construction and services, particularly the financial sector,

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[24] 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 July 25, 2007 Executive Board discussion based on the staff report.

underpin a vibrant urban economy. Inflation has recently picked up slightly as a result of rising fish and petroleum prices, but is expected to remain around 4 percent, assuming broadly stable international oil prices for the rest of the year.

Garments and tourism exports grew by more than 20 percent in 2006 while imports increased on the back of strong GDP growth and high oil prices, leading to an external current account deficit (excluding official transfers) of around 7 percent of GDP. External financing came mainly from aid and foreign direct investment focused on garments, tourism, agriculture, and construction.

Fiscal policy continues to be prudent. The overall fiscal deficit in 2006 remained stable at around 3¼ percent of GDP (excluding the proceeds of debt relief from the Multilateral Debt Relief Initiative). Revenue collections exceeded expectations, particularly from domestic taxes, while expenditure restraint led to further increases in government bank deposits and significant reductions in domestic arrears. These trends continued in early 2007.

Money demand is accelerating, boosting the mainly dollarized financial sector. Broad money is growing at an annual rate of around 40 percent, mainly reflecting increases in bank deposits, almost entirely in dollars. Credit to the private sector, also in dollars, is growing even more rapidly but the level remains very low at only 12 percent of GDP.

The exchange rate is stable and reserve growth is healthy. The riel has remained broadly stable in bilateral and effective terms with some small nominal appreciation in early-2007. Increased demand for riel, in part as a result of improved tax compliance, has allowed the National Bank of Cambodia (NBC) to make larger-than-expected dollar purchases from the market. NBC's reserves now exceed US$1.2 billion, albeit with a continued small build up of external arrears with respect to the old debt outstanding to the United States and Russia.

Progress has been made on structural reforms but much remains to be done. Efforts in the fiscal and financial sectors are bearing fruit, with notable achievements being the implementation of new government expenditure and accounting procedures and strengthened prudential regulations for the banking sector. However, legal and judicial reform progress has been much slower. Efforts to strengthen the draft anti-corruption law halted pending review of the penal code and an anti-corruption unit in the Council of Ministers was created in the interim. The Law on Anti-Money Laundering and Counter Financing of Terrorism and Customs Law passed, but drafts of the Insolvency Law and the Law on the Status of Judges and Prosecutors are still being debated at the Ministry level.

Executive Board Assessment

Executive Directors commended the Cambodian authorities for their sound macroeconomic policies, which have promoted rapid growth with domestic and external stability, and allowed inroads to be made in reducing poverty. Cambodia's fiscal position is strong, public and external debt are sustainable, and inflation has remained low. To promote the diversification of the sources of growth and sustain poverty reduction, Directors encouraged the authorities to continue to make improvements in public services, the financial sector and the business environment, including by strengthening governance.

Directors commended the authorities' commitment to a continued prudent fiscal policy by avoiding domestic bank financing, while improving the level and quality of revenue and expenditure. They welcomed the intentions to reorient public expenditure toward the objectives of the National Strategic Development Plan, including with a view to tackling rural poverty. They encouraged the authorities to increase good quality poverty-reducing spending, including productive capital investment. Directors supported the government's policy of raising public sector wages to improve public services and discourage corruption, while emphasizing the need to embed wage policy in a broad civil service reform strategy.

Directors welcomed the recent progress made in public financial management reforms that have strengthened the budget process and laid the foundations for more effective spending. They noted the importance of enhancing cash management and identifying spending priorities in the 2008 budget.

Directors considered that achieving the expenditure policy objectives would require sustained increases in revenue. The recent impressive tax collection increases arising from administration improvements were acknowledged. Nevertheless, there continues to be a need for policy measures to broaden the tax base and improve the structure of the tax system. Directors encouraged the authorities to implement initial steps as soon as possible.

Directors considered Cambodia's current exchange rate policy to be appropriate. They noted the assessment that the riel is broadly in line with medium-term fundamentals and that the underlying external current account is in equilibrium. Given the need to supplement international reserves, were sustained depreciation pressures to arise, they should not be resisted.

Directors supported the National Bank of Cambodia's accommodative monetary approach, but cautioned that future wage and price developments should be monitored for indications of inflation pressure. They noted that the advantages of dollarization as a foundation for Cambodia's macroeconomic stability and financial sector expansion continue to outweigh the disadvantages from loss of seignorage and constraints on monetary policy. In the long run—and provided the appropriate capacity and policy conditions are in place—greater use of the riel would help strengthen the effectiveness of monetary policy.

Directors called on the authorities to strengthen banking supervision and enforce prudential regulations rigorously, to ensure that the financial sector continues to contribute to macroeconomic stability. They encouraged the authorities to work with the commercial banks to enhance the payments system and facilitate financial intermediation, and welcomed the recent passage of the Anti-Money Laundering Law.

Directors welcomed the authorities' commitment to good governance, as demonstrated by the establishment of an anti-corruption unit in the Council of Ministers. They stressed that continued improvements in governance will be crucial to enhance the business environment, strengthen revenue collection, and promote expenditure effectiveness. Directors encouraged the authorities to introduce appropriate anti-corruption legislation, and to improve the management of state assets and concessions.

Directors observed that oil production would improve Cambodia's economic prospects, but also present challenges to ensure an appropriate balance between saving, investing and consuming future oil revenues. They welcomed the authorities' recognition that a clear legal framework and strengthened taxation regime for the oil sector will be essential. Directors encouraged the authorities to endorse the Extractive Industries Transparency Initiative.

Directors welcomed the authorities' commitment to refrain from contracting nonconcessional loans following Cambodia's recently acquired sovereign credit ratings. They called on the authorities to continue their current prudent borrowing policy, which has ensured a highly concessional external debt structure that should safeguard debt sustainability.

Directors encouraged the authorities to continue efforts to resolve outstanding arrears with official creditors, noting that a successful resolution would pave the way for consideration of a Poverty Reduction and Growth Facility arrangement. They welcomed the Fund's intensive policy engagement with Cambodia, including through the provision of technical assistance.

Cambodia: Selected Economic Indicators, 2004–07

Nominal GDP (2006): $7,254 million
GDP per capita (2006): $512
Population (2006): 14.2 million

	2004	2005	2006 Est.	2007 Proj.
Real economy	(annual growth rates, in percent)			
Real GDP	10.0	13.5	10.8	9.1
Real GDP excluding agriculture	15.2	8.7	17.0	11.3
CPI Inflation (end of period)	5.6	6.7	2.8	3.8
	(in percent of GDP)			
Domestic investment	17.7	20.1	21.5	21.5
Government investment	6.0	5.6	5.5	5.3
National saving	15.6	15.8	19.5	19.5
Money and credit	(annual growth rates in percent, unless otherwise indicated)			
Broad money	30.4	16.1	38.2	42.9
Net credit to the government 1/	-2.4	-4.9	-10.6	-0.6
Private sector credit	35.9	31.8	51.6	44.7
Government operations	(in percent of GDP)			
Revenue 2/	10.3	10.3	11.5	10.8
Expenditure	14.9	13.7	13.5	13.9
Overall budget balance 2/	-4.6	-3.4	-2.0	-3.1
Foreign financing, net	4.7	4.8	4.4	3.8
Domestic financing 3/	-0.2	-1.5	-2.5	-0.7
Balance of payments	(in millions of dollars, unless otherwise indicated)			
Exports	2,589	2,910	3,693	4,313
Imports	-3,269	-3,928	-4,749	-5,526
Current account (excl. official transfers)	-436	-591	-525	-587
(in percent of GDP)	-8.2	-9.4	-7.2	-7.0
Overall balance	49	65	193	246
Gross official reserves	809	915	1,097	1,400
(in months of imports of goods and non-factor services)	2.6	2.4	2.4	2.6
(in percent of uncovered dollar deposits in banks) 4/	179	146	113	90
Public external debt 5/	2,043	2,123	2,248	2,464
(in percent of GDP)	38.5	33.9	31.0	29.5
Memorandum items:				
Nominal GDP (in billions of riels)	21,343	25,693	29,809	33,822
(in millions of U.S. dollars)	5,308	6,271	7,254	...
Exchange rate (riels per dollar; end of period)	4,031	4,116	4,046	...

Sources: Data provided by the Cambodian authorities; and Fund staff estimates and projections.
1/ Contribution to broad money growth.
2/ In 2006, includes transfer of MDRI proceeds as capital revenue transfer .
3/ Includes funds in transit and payment orders in excess of cash released.
4/ Dollar deposits in commercial banks net of their unrestricted reserves at NBC.
5/ From January 2006 includes the impact of debt forgiveness from the IMF under the MDRI.