

# CAMBODIA

## RECENT MACROECONOMIC AND FINANCIAL SECTOR DEVELOPMENTS



Hang Chuon Naron

February 2008

The front page photo is Shiva and Uma from Naron's collection. Shiva is a supreme god of all gods in Hinduism.

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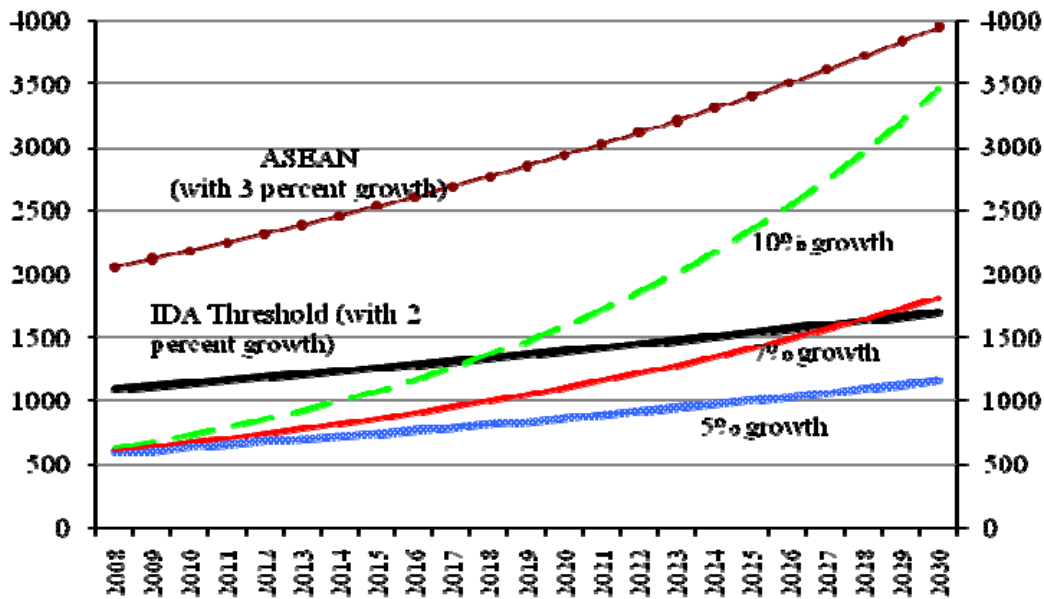
# 1. Introduction

This paper outlines the major aspects of Cambodia's recent macroeconomic performance, particularly the developments in 2007. It also reviews the policy developments and reform initiatives being undertaken in the financial sector and in public finance, particularly public financial management. The success in implementing financial sector reform will be crucial for integrating Cambodia's rapidly modernizing economy with the rest of the world. Effectiveness and efficiency in resource mobilization and public service delivery lie at the heart of the reform of public finance. The progress in achieving the MDGs and strengthening infrastructure can be sustained only if public finance reform proceeds as planned. Hence the prospects of sustaining Cambodia's economic growth are closely tied to the successful implementation of reforms in these two areas.

## 2. An Overview of Recent Macroeconomic Developments

After climbing to an all time record of 13.4 per cent in 2005, growth of real GDP slowed to 10.4 per cent in 2006 and was estimated at 9.6 per cent in 2007. Mainly due to the sustained high growth poverty incidence dropped from 35% in 2004 to an estimated 31% in 2007. During the decade ending 2007, Cambodia doubled the per capita GDP to US\$589. Nevertheless, the size of Cambodia's Gross Domestic Product is still relatively modest at US\$8.4 billion. Cambodia's per capita GDP is expected to reach the US\$1,000 by 2015, possibly even earlier when oil and gas production comes on stream. With continued real GDP growth of 10 per cent, Cambodia's per capita GDP is expected to reach US\$1,000 by 2014, US\$2,000 by 2023 and US\$3,000 by 2028. However, with real GDP growth of 7 per cent, Cambodia's per capita GDP is expected to reach US\$1,000 only by 2018 and US\$1,500 by 2025.

Figure 2.1. Illustrative Per Capita Real GDP Growth



Source: IMF Cambodia

Economic performance in 2007 though somewhat diminished compared with 2005-2006 was still impressive. This underscored the increasing resiliency of the economy and showed that the performance during 2005-2007 was not fortuitous but reflected the underlying strength of the country’s economic fundamentals. Important contributions for the strong economic performance in 2007 came from steady growth in agriculture (4.0 per cent), sustained growth of tourism receipts (10.2 per cent), the continued growth in garment exports (10 per cent) and the continued expansion of financial services (22.2 per cent) and construction activities (4.3 per cent).

Fiscal policy continued to be prudent in 2007. While the current budget surplus increased from 1.7 per cent in 2006 to 2.3 per cent in 2007, the overall budget deficit declined to 1.5 per cent reflecting ongoing budget consolidation. As the result of the steadfast implementation of the Public Financial Management Reform Program, domestic revenue increased by 1.5 per cent of GDP during 2006-2007 to reach 11.3 percent of GDP in 2007, while expenditure was maintained at a low level. Tax revenue

increased by 36%. Cash in the government coffers has increased by 200 times in early 2008, compared to 2003.

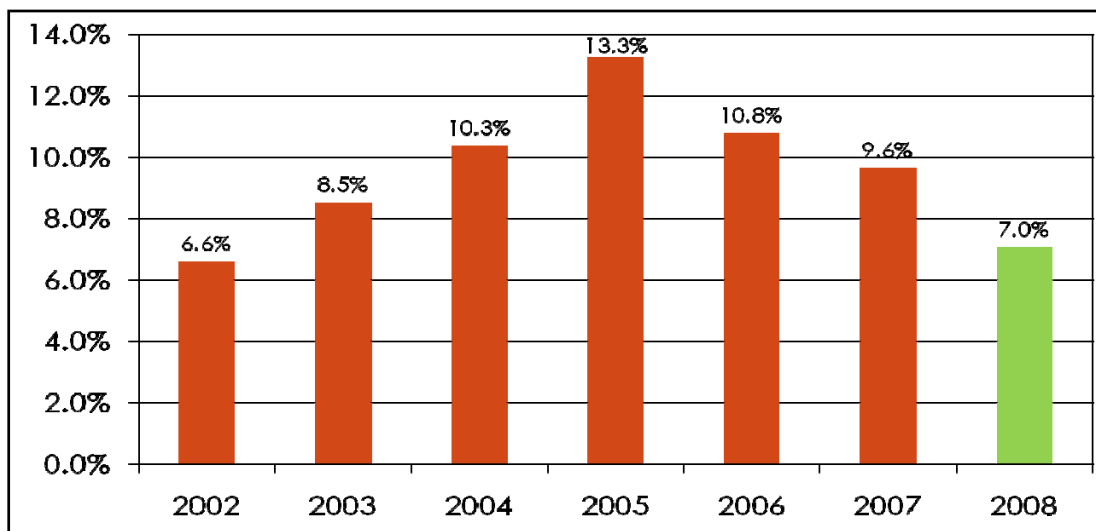
Monetary developments in 2007 reflected the continued improvement in external position. Credit to the private sector rose by 71 per cent while M2 increased by 63 per cent. The key objectives of monetary policy were maintaining price stability and bolstering international reserves. These were substantially achieved, as Cambodia's international reserves increased by US\$600 million in 2007 to US\$1.7 billion. Inflation was contained to an estimated 5.9 per cent, despite high oil prices.

The deficit in the current account of the balance of payments declined from 7.2 per cent of GDP in 2006 to 6.7 per cent in 2007. However, the surplus in the overall balance of payments continued to increase and amounted to US\$290 million or 3.4 per cent of GDP, mainly due to the strong inflow of capital receipts.

## 2.1 Real Sector Performance in 2007

Two key features of economic performance in recent years are the increasing diversity of the sectors contributing to economic growth and the robust contribution of the agriculture sector to economic growth.

Figure 2.2. Economic Growth in 1994-2007



Source: National Account, NIS

Real GDP growth averaged 11 per cent during 2004-2007. This performance is underpinned by the strong support extended to agriculture and the garment sector by the Royal Government of Cambodia. However growth has not been centered only on these two sectors. Tourism and construction are also emerging as important growth centers in the economy. Overall recent economic performance has been characterized by balanced contributions from agriculture, manufacturing, construction and services. This was clearly evident in 2007.

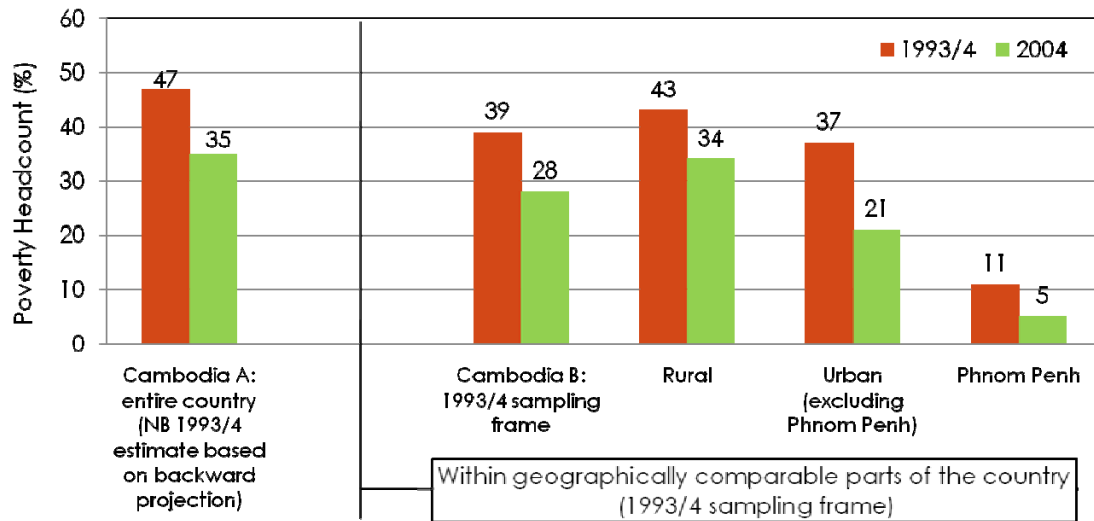
Overall, economic growth over the last decade has raised living standards and reduced poverty headcounts. When comparing living standards within the same geographical frame in 2004 and 1993/4, average per capita household consumption is found to have risen 32% in real terms (to 2,932 riels per day in 2004). In Phnom Penh and other urban centers the rise has been considerably more dramatic.

Thus, the decline in poverty has been significant and widespread. As average per capita consumption has risen, many more households now have per capita consumption values above the poverty line, resulting in falling poverty headcounts.

Within the geographical sampling frame of the first survey, the headcount fell from 39 to 28 percent. Backward projection on the basis of this observed trend suggests that the national poverty rate fell by 10-15 percentage points over the last decade (from a projected 45-50 percent in 1993/4 to a measured 35 percent in 2004). Moreover, poverty is very likely to have fallen further in 2005 and 2006 due to the exceptionally high growth rates of those years, especially in agriculture. Projections put the poverty rate at about 32.5 percent in 2006 and 31 percent in 2007.

At the same time, inequality in Cambodia has increased over the last decade. The Gini coefficient for per capita household consumption rose from 0.35 to 0.40. Inequality has been increasing during the years in several dimensions – between rich and poor; different regions; and urban and rural areas and also within the rural areas.

**Figure 2.3. Poverty has fallen in rural as well as urban areas, albeit much faster in urban areas**



Source: CSES 1993/4 and 2004; WB 2006; WB Program Document for PRGO

The average living standard of the richest fifth of Cambodians in 2004 was 45% higher than it was a decade ago; but living standards for the poorest fifth had gone up by only 8%. In addition, Cambodia has experienced regional differences in poverty reduction and urban-rural gap wideness. Poverty has fallen at much faster rate in urban areas such as Phnom Penh and costal provinces than in other regions of Cambodia. In some remote and mountainous areas poverty incidence has even increased.

## 2.2. Agriculture

After strong growth in 2005 (15.7%) and 2006 (5.5%) agriculture grew by 4.0 per cent in 2007. Rice production increased by 4.9%, mainly due to favorable weather conditions and measures taken by the RGC to build irrigation facilities and pumping stations for increasing the area under irrigation. Cambodia produced 6 million tons of rice, of which a rice surplus of 2 million tons in 2007 was exported.

Livestock grew by 6.7 per cent in 2006 and Fisheries by 0.8 per cent. The relatively low performance of fisheries is disappointing since the

government has put considerable emphasis on the revival of this key sub sector which provides livelihoods for the poor and marginal sections of society.

## **2.3. Industry**

Industry's growth continued to be strong at 7.5 per cent. The key contribution came from construction and mining activities, as well as the exports of textiles and garments. The textile and garment sub sector, which accounts for nearly half of the value added of the industrial sector grew at a slower pace.

In order to reduce the costs of doing business, the RGC has exempted the garment industry from the corporate tax. The tax foregone amounts to US\$100 million per annum.

The mining sub sector grew by 5.5 per cent. The major activities contributing to this growth were the exploration of oil and gas in the Gulf of Thailand, the exploration of bauxite and gold in the Northeast, and the establishment of an iron ore extracting company in Preah Vihear Province, in the northeastern part of Cambodia.

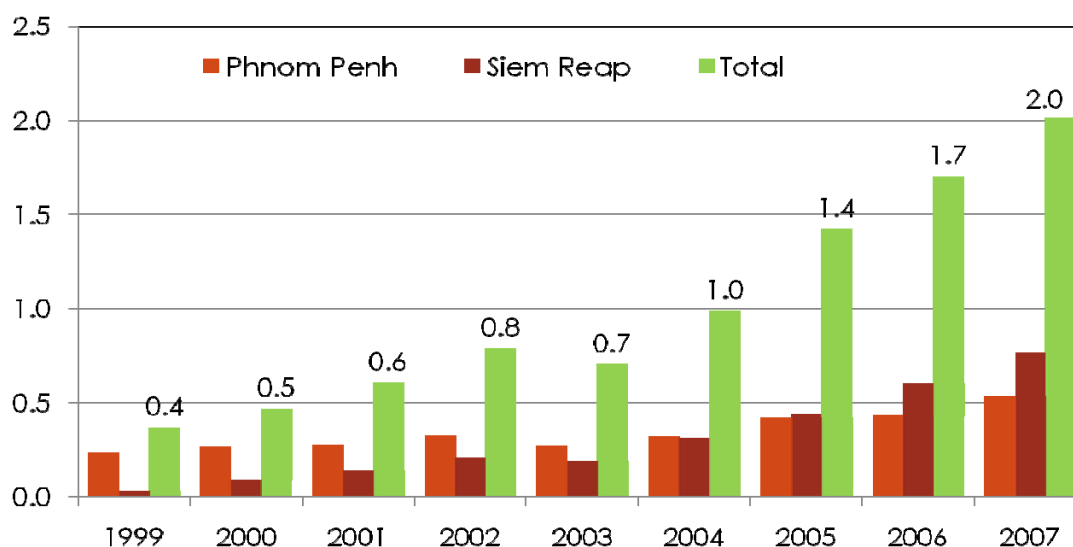
Construction activities showed signs of slowing down. Construction grew by only 4.3 per cent in 2007<sup>1</sup>. In particular, construction activities in Phnom Penh and Siem Reap continued to expand, albeit at a slower pace. New township projects and the planned construction of two bridges across the Tonle Sap River in Phnom Penh, as well as the establishment of Special Economic Zones would give a strong boost to construction in the medium term. The new township projects include the Koh Puos Development Project, the Camco City Project, the Boeung Snor Development Project, the Sunway City Project, the Boeung Kak Development Project and the Special Economic Zone developed by the Attwood Group.

<sup>1</sup>*Provisional estimate liable to be revised*

## 2.4. The Services Sector

Services grew by 10.0 per cent in 2007, the same rate as in 2006. All the sub sectors of services have shown robust growth. The expansion of the tourism and hotel industry continued, with a growth rate of 10.2 per cent. In 2007, a total of 2 million tourists visited Cambodia.

Figure 2.4. The Number of Tourist Arrivals (Millions)



Source: Ministry of Tourism

The RGC has put emphasis on strengthening the linkages between tourism and rural development so that the poor could benefit from the expansion of tourism. The RGC intends to transform the entire Siem Reap region into a green belt so that strong backward linkages of tourism with agriculture could be established.

The transport and communication sub sector grew moderately by 6.6 per cent. After completing the rehabilitation and reconstruction of the national road network, the RGC has turned its attention to the rebuilding of provincial and rural road infrastructure for bringing the rural areas of Cambodia into the mainstream of the economy.

The telecommunications sub sector showed a robust growth, especially the market of mobile phone services. However, the telephone tariffs in

Cambodia are high and discourage the rapid growth of telecommunications.

Financial services grew by 22.2 per cent. The main contributor was the rapid growth of commercial banking services. Real estate services increased by 10.7 per cent reflecting the surge in private sector construction. Trade services grew moderately by 9.4 per cent.

## **2.5. External Sector Performance**

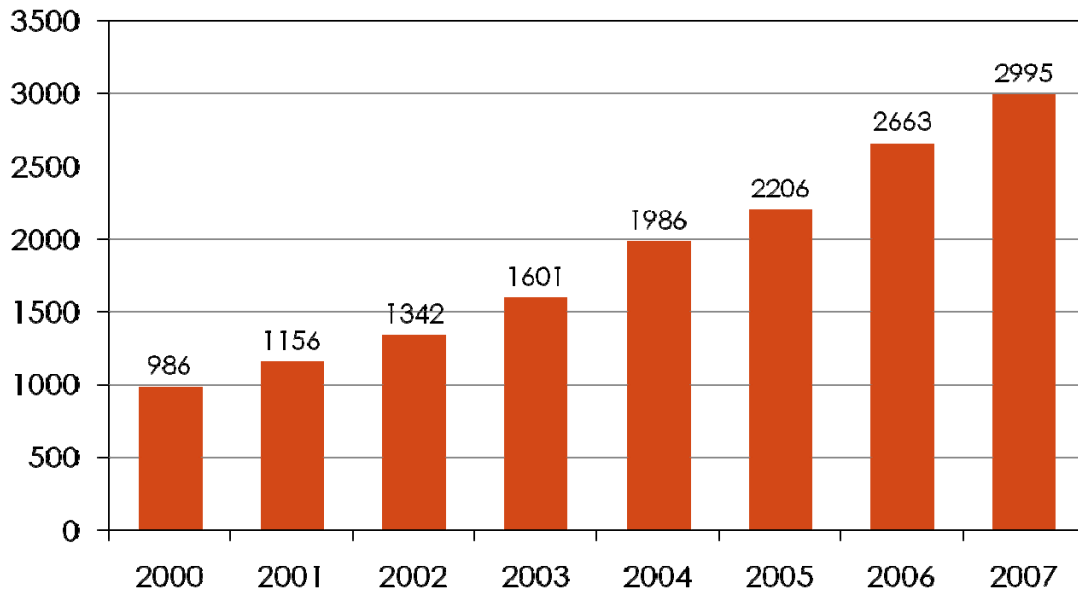
The main developments in the external sector in 2007 were the continued shrinking of the current account deficit as a proportion of GDP, a sharp increase in service receipts and foreign direct investments (FDI), and a substantial increase in foreign currency deposits held by commercial banks with the National Bank of Cambodia. Official transfers decreased slightly. As a result of these favorable external sector developments the overall balance of payments and the gross international reserves continued to improve in 2007.

### ***2.5.1. Exports and Imports***

Exports increased by only 3 per cent from US\$3.7 billion in 2006 to US\$3.8 billion in 2007. Garment exports experienced a slowdown in the fourth quarter of 2007. Even though garments exports continued to increase in 2007, the pace of growth has leveled out. Garment exports account for nearly 70 per cent of Cambodia's total exports. Innovative measures should be implemented in order to maintain the growth of garment exports.

The US remained the top export market, accounting for 70 per cent of Cambodia's total exports, followed by the European Union – 21 per cent and Canada – 4 per cent. Re-exports were estimated at US\$184 million. Vietnam has become a strong competitor for Cambodian garment exports to the US. Garment exports from Vietnam to the US have increased rapidly at the expense of China, which has started to rely increasingly on domestic markets for economic growth.

Figure 2.5. Garment Exports



Source: Ministry of Commerce

Total imports increased by 12 per cent from US\$4.7 billion in 2006 to US\$5.3 billion in 2007, mainly due to the growth in the imports of petroleum products and intermediate products for the production of garments.

### ***2.5.2. Trade Balance***

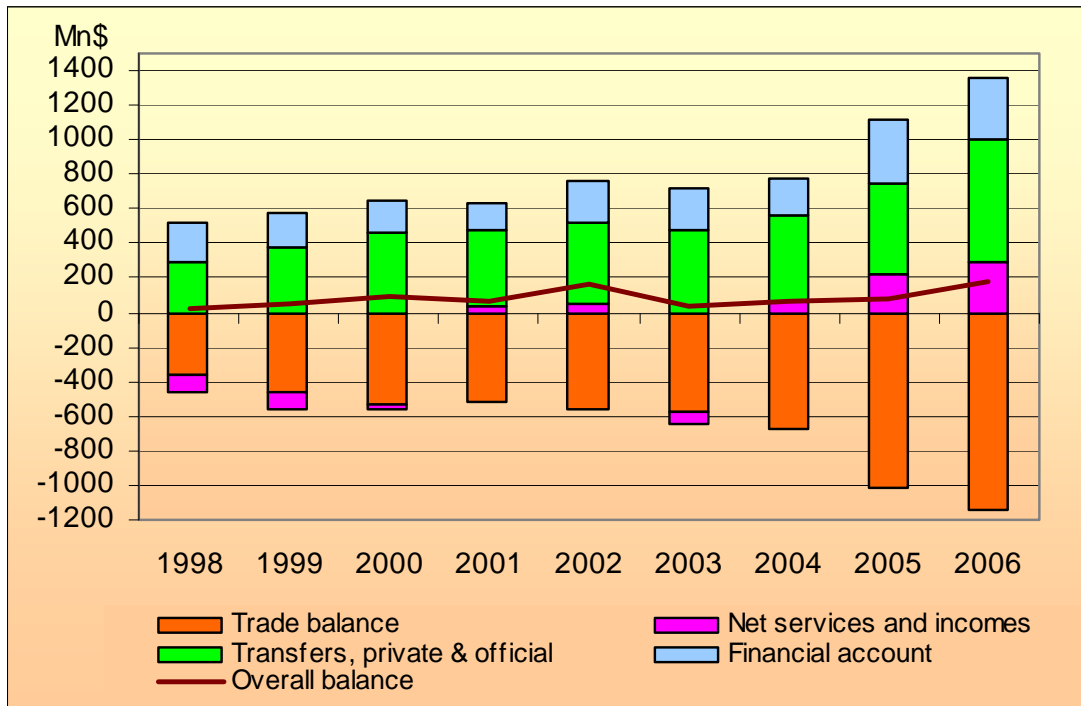
Cambodia's trade deficit in 2007 increased by 20 per cent to US\$1.5 billion, mainly due to the increase in the value of petroleum imports.

### ***2.5.3. Services and Transfers***

Services account increased by 27 per cent. Net services were estimated at US\$644 million in 2007, compared with US\$506 million in 2006. This increase was mainly due to the growth in tourism receipts (US\$1.1 billion).

Private transfers increased by 5 per cent from US\$315 million in 2006 to US\$332 million in 2007, while the official transfers in the form of grants, food aid and project aid declined by 7 per cent from US\$449 million in 2006 to US\$416 million in 2007.

Figure 2.6. Cambodia's Balance of Payments



Source: NBC

#### 2.5.4. Current Account

The current account deficit increased from 1 per cent of GDP in 2006 to 1.8 per cent in 2007. Excluding official transfers, the current account deficit decreased from 7.2 per cent of GDP in 2006 to 6.7 per cent in 2007.

#### 2.5.5. Capital Account

The financial account increased by 39 per cent from US\$324 million in 2006 to US\$451 million in 2007. The capital transfers in the form of medium and long term loans increased by 41 percent from US\$123 million in 2006 to US\$173 million in 2007.

The influx of private capital in the form of FDI increased by 50 percent, from US\$475 million in 2006 to US\$711 million in 2007. The increase in investments reflects the confidence of investors in the political and macroeconomic stability of the country.

### 2.5.6. Overall Balance

In 2007 the overall the balance of payments was in surplus by US\$290 million (3.4 per cent of GDP in 2007 compared with 2.8 per cent in 2006). This outcome was underpinned by the increase in tourism receipts (US\$1.1 billion), the surplus of both private and official transfers (US\$748 million), the increase in concessional loans, and the increase in foreign direct investment (US\$711 million).

## 3. Recent Financial Sector Developments

Cambodia's financial sector can be described as vibrant, competitive and rapidly expanding. The rapid increase in deposits in the commercial banks and sub sectors (note Table 1) attests to growing public confidence in the

**Table 3.1 –Key Indicators of the Financial Sector**

Indicator	Year	2000	2001	2002	2003	2004	2005	2006
<b>Real GDP Growth</b>		8.4	7.7	6.2	8.8	10.0	13.4	10.6
- Agriculture		(1.2)	4.5	(2.2)	12.1	1.2	16.6	5.3
- Industry		31.2	11.4	17.3	12.1	16.4	12.1	16.9
- Service		8.9	8.7	6.3	4.4	11.7	12.1	10.8
<b>Inflation in Riels (average % annually)</b>		0.5	(0.5)	3.1	0.5	5.8	6.6	3.4
<b>Interest Rates</b>								
- Riel Saving Deposits (per annum)		5.9	2.6	2.2	1.9	1.9	2.0	1.9
- Riel Term Deposits (per month)		0.5	0.4	0.4	0.3	0.3	0.3	0.3
- Foreign Currency Saving Deposits (PA)		2.3	1.6	1.5	1.3	0.9	0.9	1.0
- Foreign Currency Term deposits (PA)		3.7	2.7	2.8	2.6	2.4	2.4	3.3
- Foreign Currency Lending (PA)		17.4	15.0	18.6	18.2	17.3	17.3	16.2
<b>Money Supply % Annual Change</b>								
- Broad Money		26.9	20.4	31.1	15.3	30.0	16.1	38.2
- Velocity of circulation		7.9	7.7	6.4	6.0	5.4	5.4	4.8
- Financial Deepening (M2/GDP) %		12.6	13.0	15.6	16.5	18.6	18.7	20.8
<b>Private Sector Credit/Deposits % of GDP</b>								
- Credit		6.4	6.0	6.3	7.3	8.6	9.4	12.3
- Deposits		9.5	10.4	12.7	13.3	15.2	14.8	18.2
<b>Private Sector Credit/Deposits % Annual Change</b>								
- Credit		17.7	4.2	13.1	26.2	35.9	31.8	51.6
- Deposits		40.2	21.7	30.5	14.1	32.8	16.4	42.7
Loan/deposit ratio		67.3	57.6	49.9	55.2	56.5	64.0	67.9
Loan/assets ratio							42.9	45.6
<b>Commercial Banks</b>								
Number of Loans at December 31st				86,757	105,347	123,937	145,161	164,931
Amount of Loans as of December 31st in US\$ million				269.26	360.70	482.71	598.41	882.29
Non Performing Loans to total Loans %			8.0	15.00	14.00	10.00	8.00	9.80
<b>Microfinance</b>								
Number of Borrowers			409,963	328,295	265,044	322,056	366,962	471,009
Loans US Dollars millions			35.94	51.27	32.63	40.85	49.19	92.19

Key PA = Per annum

Source: ADB

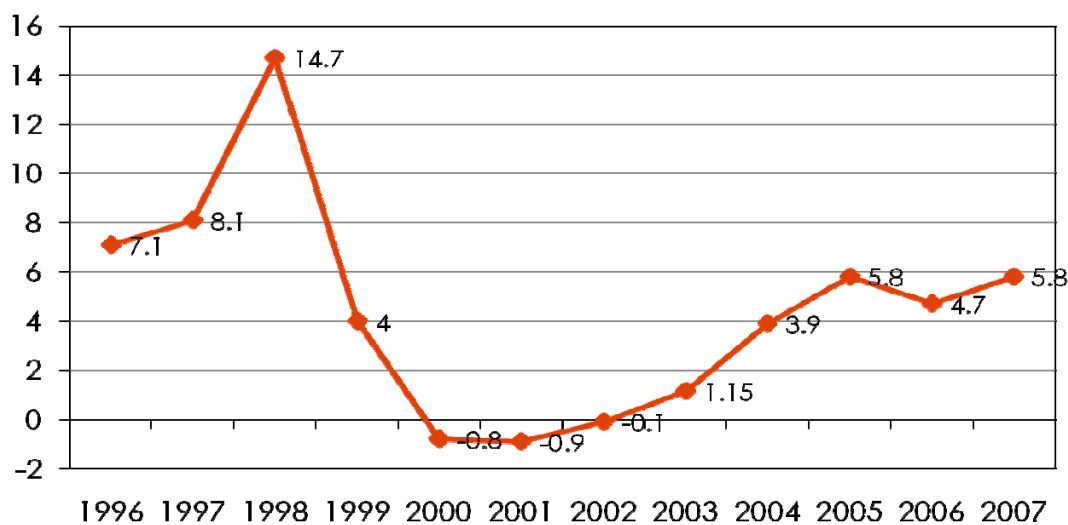
sector due to the transparency of financial sector policies and the level playing field for investors in the sector.

Real GDP growth has increased annually but inter-sectorally the growth in agriculture sector lags behind industry and service sectors. Interest rates for loans in US dollars (mainly urban and commercial) and riel loans (mainly microfinance and rural) have declined. The microfinance loan interest rate (not listed in Table 1) has decreased by 6% per annum recently as competition has increased. The key indicators for private sector credit and loans have shown strong growth as exemplified by the number of loans and the total amounts lent by both commercial banks and the microfinance institutions.

### 3.1. Inflation

Cambodia managed inflation effectively in 2007, notwithstanding the cost push pressures exerted by the high oil prices. Tight fiscal policies and the growing role of monetary policy in controlling money supply expansion have contributed to this performance. This moderate inflation can be mainly attributed to an increase in money in circulation from the demand side and the hike in transportation related costs and a moderate rise in food

Figure 3.1. Inflation in Cambodia

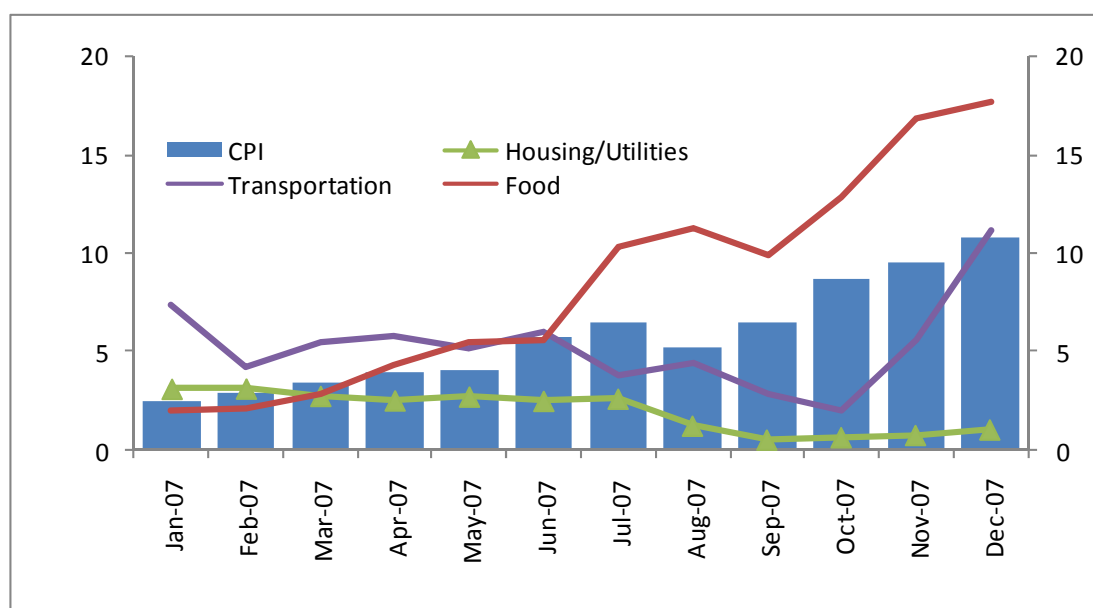


Source: National Institute of Statistics (NIS)

prices, especially rice, from the cost push side. The National Bank of Cambodia and the Ministry of Economy and Finance continued to be vigilant in monetary and fiscal management to curb inflation.

Inflation (yearly average) accelerated from 4.7 per cent in 2006 to 5.8 per cent in 2007. Rapid increase in oil prices, the hike in food prices, Thai Baht appreciation and US dollar depreciation contributed to the rising inflation. The retail price of rice increased by 16.8 percent from 1,410 riel to 1,602 riel per kilo for the high quality rice, reflecting supply constraints due to rising rice exports to neighboring countries. The pump price of petrol increased by 10 percent compared to 2006, while the prices of diesel increased by 18 percent. In order to prevent total pass-through to the economy, which could have resulted in higher inflation, the government provided fuel subsidies amounting to US\$170 million in the form of foregone revenue. The government also maintained electricity tariffs at the same level by directly subsidizing Electricity of Cambodia, which supplies power to the population and businesses. As Cambodia imports the bulk of consumer products from Thailand, Thai Baht appreciation also resulted in higher prices for consumer goods.

**Figure 3.2. CPI and Sub-Indices (Y/Y % change)**



Source: NIS

During 2007, measured by the 12-month change in the CPI, price increases were recorded in all the eight sub-groups of the overall CPI, with subgroup of Food, Beverage and Tobacco posted the highest annual increase of 19.7 per cent in December 2007. Meanwhile, sub-group of Transportation & Telecommunication also contributed significantly to the overall price increase, surging by 13.1 per cent. Other sub-groups increased moderately in December 2007, compared to December 2006, with Clothing & Footwear increasing by 4.6 per cent, House Furnishing and Household Operation—5.4 per cent and Medical Care—5.5 per cent.

Transportation & Telecommunication sub-group weighted with 8.7 after Housing & Utilities sub-group (33.3) and Food, Beverages and Tobacco sub-index (42.7). High degree of volatility in the Food, Beverages & Tobacco sub-group was observed in the rise especially in the prices of rice, fish, meat and fruits. Given that rice and fish are the main calorie intake for Cambodian people and have therefore one of the heaviest weights in the CPI basket, their impact on CPI food inflation is very significant. To deal with the supply issue, the government has recently put more and more emphasis on the development of the agricultural sector, while the Central Bank has increased its efforts to support the government agriculture and rural development policies by promoting microfinance and banks credit to SMEs.

The major factors impacting on inflation include the exchange rate, fiscal policy, seasonality, domestically induced cost push and inflationary expectations. A brief assessment of the various factors which should figure in a comprehensive anti-inflation strategy is given below:

- A stable exchange rate is crucial to manage inflation. The exchange rate of the riel has remained stable in the last few years. The level of dollarization seems to have peaked and does not appear to pose a major future inflationary threat, but this could be reversed;

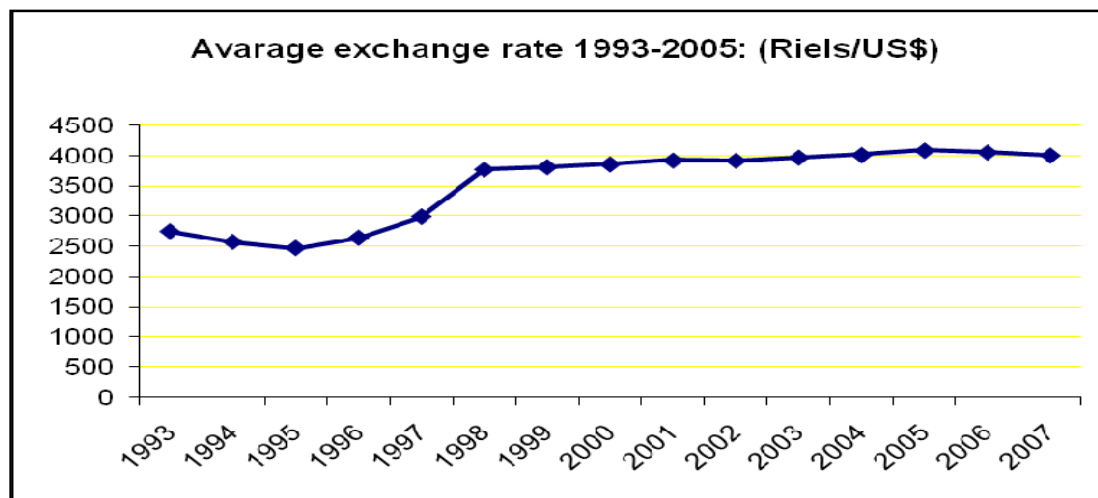
- The prices of fuels are transmitted to CPI through transportation and production costs. The input-output structure of Cambodia oil market and the transmission mechanisms should be better understood for considering options such as the restructuring of taxes for controlling inflation;
- The overall budget deficit would have a significant impact on inflation. However, the tight fiscal policy pursued by the government in recent years as the main instrument of its macroeconomic management strategy, has virtually eliminated this risk. In view of the critical role of fiscal policy in demand management in the dollarized environment, there can be no relaxation of this strategic approach;
- Domestic prices tend to rise during June-October (lean season) and decline during November-December (harvest season). The seasonal impact could be reduced through more investments in market and storage infrastructure;
- Cambodia is still vulnerable to weather shocks, although the government has made substantial investments in the irrigation facilities. As a long run measure to curb inflation, Cambodia should expand its production base, particularly in agriculture which contributes to much of the consumption of the poor. The development of technologies which render agriculture less vulnerable to extreme weather conditions and well-planned measures to mitigate or cope with unexpected disasters will be helpful to contain inflation and its adverse impacts;
- Finally, a trusted government with a proven track record in macroeconomic management and fighting inflation will help abate inflationary expectations. This will facilitate an orderly transition

to a riel based economy which could be then managed by using the standard techniques of monetary policy.

### 3.2. Exchange Rate

Prudent monetary and fiscal policies helped moderate inflation and maintain a stable exchange rate. In 2007, the riel appreciated by 1.2 per cent against the US dollar in nominal terms. Through interventions in the foreign currency market, the National Bank of Cambodia managed to maintain the stability of the exchange rate, while augmenting the international reserves by US\$600 million in 2007.

Figure 3.3. Average Exchange Rate, 1993-2007

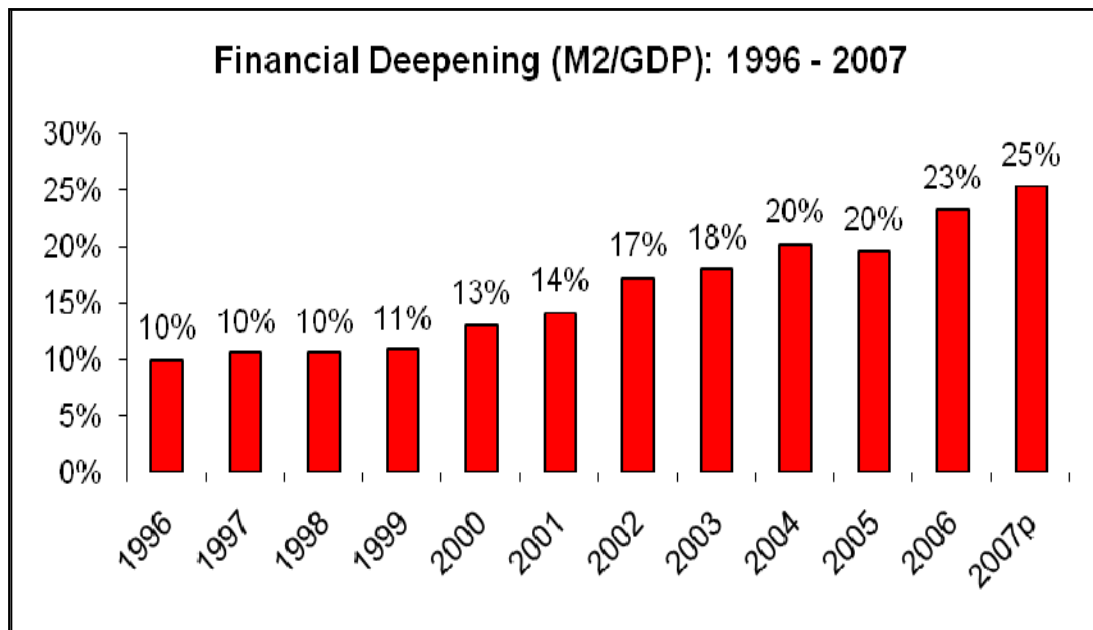


Source: Ministry of Economy and Finance

### 3.3. Monetary Developments

Monetary policy is aimed at maintaining price stability. NBC targets inflation at less than 5 per cent in the near-term and at about 3 ½ per cent over the medium-term. During 2006 and 2007, the banking sector's liquidity (M2) continued to expand sharply. The growth rate of M2 in 2006 (38.2 per cent) was more than double of 2005(16.2 per cent) and estimated to reach 63 per cent in 2007. The growth of M2 in 2007 was mainly driven by rapid growth in the net foreign assets of the banking system; however a somewhat lower growth in the net domestic assets also

Figure 3.4. Financial Deepening (M2/GDP)



Source: NBC & NIS

contributed to the growth of M2. In 2007, liquidity M2 expanded remarkably in the year, as compared to the previous year, with both components of its counterpart, the net foreign assets and net domestic assets of the banking sector also recorded increase. Expansion in net domestic assets was mainly brought about by the sharp rise in private sector credit, while net claims on government continued to decline remarkably.

The key monetary developments during 2007 included the following:

- Domestic credit grew by 71 per cent.
- Credit to the private sector increased by 76 per cent.
- Liquidity was up by 63 per cent.
- Net foreign assets of the banking system rose by 49 per cent.

The growth in domestic credit was mainly due to the increase of government deposits (90%) and expansion of credit to the private sector

(76%). The substantial expansion in liquidity reflected the healthy improvement in Cambodia’s external position. The liquidity expansion supported the high growth of GDP and further contributed to financial deepening. The net foreign assets rose by more than 34.2 per cent, in parallel with the increase in credit to the private sector, which grew by 51.6 per cent. Cambodia experienced rapid financial deepening during the last decade, with broad money M2 to GDP ratio increasing from 10% in 1998 to 25% in 2007.

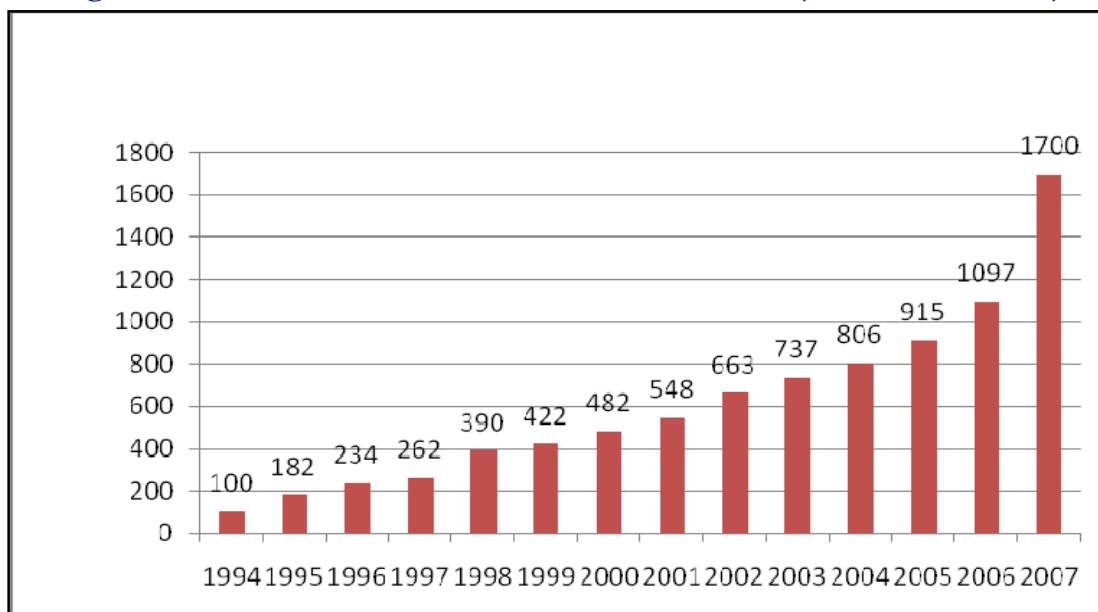
A more detailed outline of these developments is given below.

### 3.4. Gross International Reserves

The gross international reserves increased from US\$1.1 Billion in December 2006 to US\$1.7 billion in December 2007 – an increase of US\$600 million for the whole year reflecting continued good export performance, increase in foreign direct investments and acceleration of capital inflows.

Domestic credit increased by 71 percent from US\$659 million in

**Figure 3.5. Gross International Reserves, 1994-2007(in million dollars)**



Source: NBC

December 2006 to US\$1.1 billion in December 2006, mainly due to the rapid increase in government deposits (by 70% to US\$527 million) and the acceleration of domestic credit (by 76% to US\$1.6 billion).

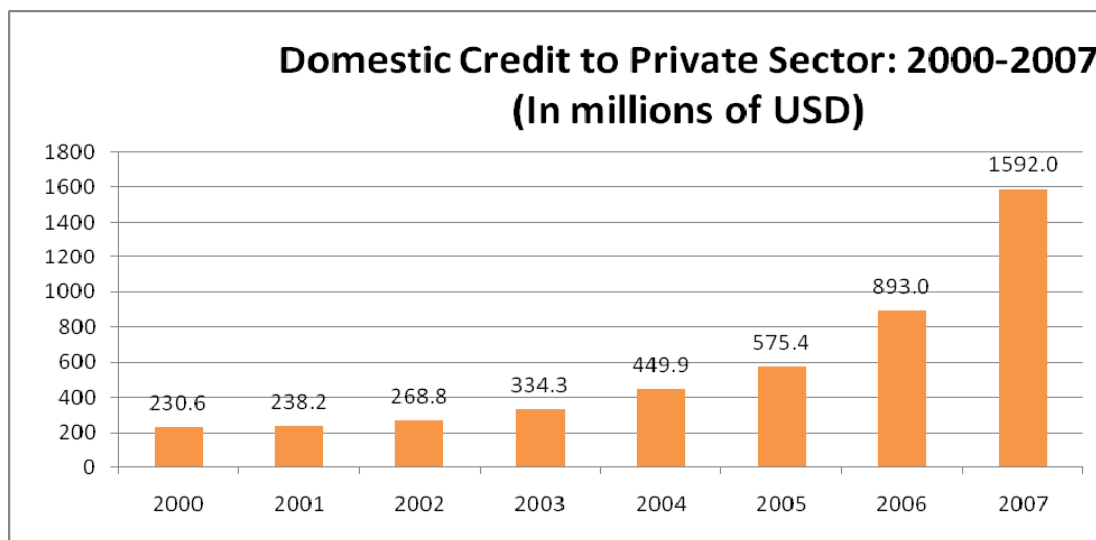
### 3.5. Net Claims on Government

The net claims on government expanded by 90 per cent, from -US\$234 million in December 2006 to -US\$453 million in December 2007. The key underlying factor was the increase in government deposits at the National Bank of Cambodia (NBC) which rose from US\$305 million in 2006 to US\$527 million in 2007. In the same period government debt to the banking system increased slightly by 3.6 per cent and amounted to US\$74 million. Thus, the financial resources that became available to the government in 2007 amounted to US\$527 million.

### 3.6. Domestic Credit

Credit extended to the private sector by deposit money banks recorded a faster growth in 2007 compared with 2006 and 2005. The exchange rate remained broadly stable, indicating an increased demand for the riel in the economy. This increase in the demand for riel was not reflected in the level of the net domestic assets of the banking sector because it was partly offset by the strong growth in the deposits of the government with the

**Figure 3.6. Domestic Credit to the Private Sector 2000-2007**

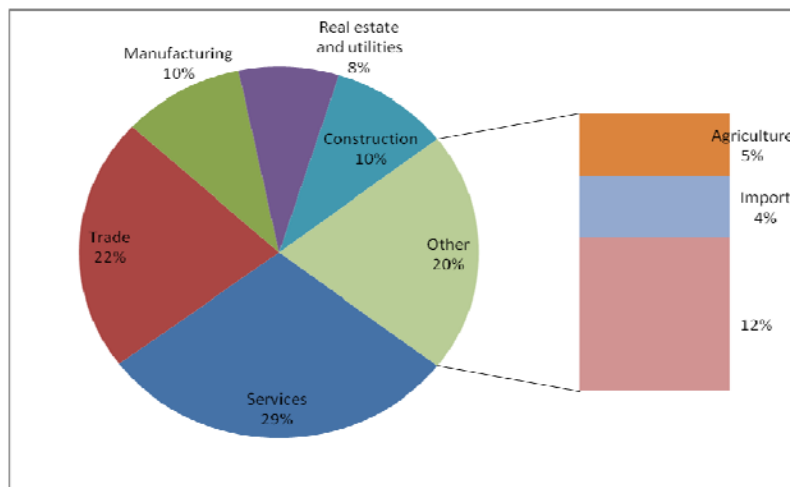


Source: NBC

banking system associated with the debt cancellation by the IMF, coupled with an increase in the capital base of banks operating in Cambodia. At the same time, the annual rate of growth of banks' foreign currency deposits also posted a much higher increase over the 2006 level, while the balance sheet of the NBC also showed a remarkable growth in foreign assets.

Credit to the private sector accelerated by 76 per cent on top of a 52-percent increase in 2006, rising from US\$893 million in December 2006 to US\$1.6 billion in 2007 mainly for financing trade and investment.

**Figure 3.7. Sectoral Allocations of Credit**



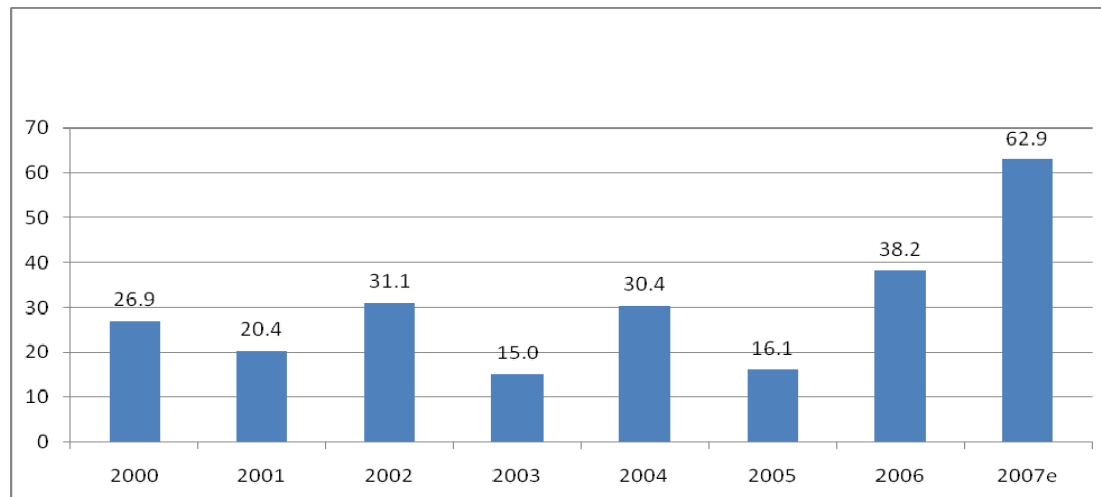
Source: NBC

Domestic credit was allocated to the following economic sectors: services – 29 per cent; trade – 22 per cent; manufacturing – 10 per cent; construction – 10 per cent; real estate and public utilities – 8 percent; agriculture – 5 percent; imports – 4 per cent; and other sectors 12 per cent.

### 3.7. Liquidity

Liquidity or money supply increased by 63 per cent from US\$1.7 billion in 2006 to US\$2.8 billion in 2007, mainly due to the growth in foreign currency deposits and money in circulation.

**Figure 3.8. Growth of Broad Money: 2000 – 2007 (% change; end of period)**



*Source: NBC*

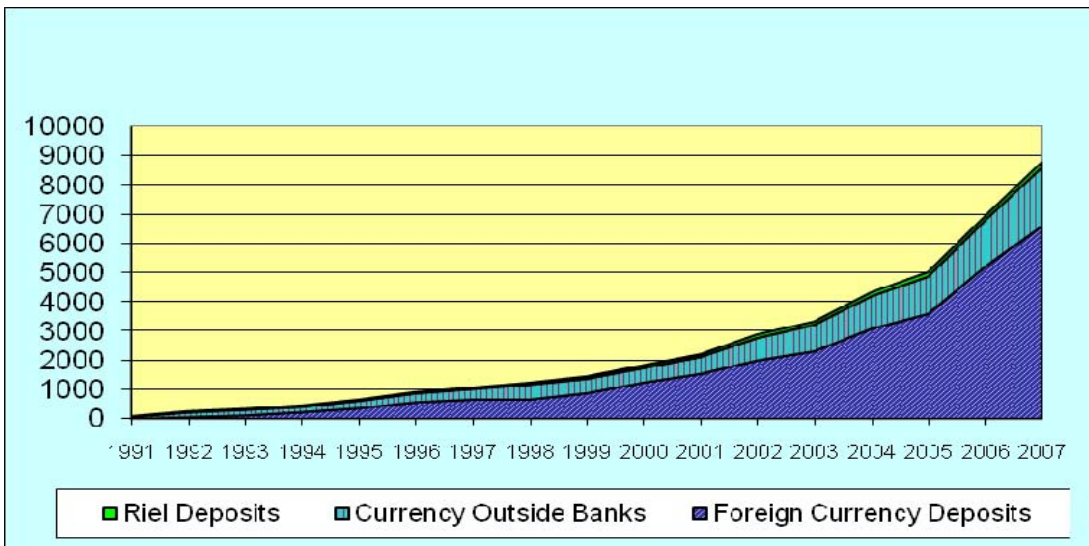
This large increase in money supply is designed to support the economic growth, which as estimated at 9.6 per cent in 2007. The continued increase in dollar deposits emphasizes the growing dollarization in Cambodia.

The growth in money supply in 2007 was accounted largely by increase in quasi-money (75%), while narrow money M1 also contributed to some extent to the overall change in liquidity.

Indeed, narrow money increased from US\$408 million as at end December 2006 to US\$512 million at end December 2007, a rise by 24 per cent. The increase reflected mainly the expansion in currency outside banks (24%); the growth of demand deposits was marginal (7%). The growth in resident demand deposits denominated in local currency also accelerated. However, due to its very low base position, the contribution of this item to M1 was marginal.

In Cambodia, growth in narrow money is generally highly correlated with movements of currency outside banks, reflecting the high degree of cash economy, whereas demand deposits accounts remained small due to low returns on such savings.

Figure 3.9. Composition of Broad Money



Source: NBC

In 2007, quasi money<sup>2</sup>, comprising time and saving deposits in local currency and foreign currency deposits increased by 75 per cent in 2007 over end 2006 level to reach US\$2.3 billion at end 2007. Both, in absolute and relative terms, the expansion in foreign currency deposits of residents was the major contributory factor to the increase in quasi money during the year, and thus also the driving force of M2 growth in 2007. In 2007, the foreign currency component of broad money posted the highest growth ever recorded during the previous 12 years. On a year-on-year basis, banks foreign currency deposits rose by 76 per cent to US\$2.27 billion in December 2007. While foreign currency deposits continued to drive the growth in broad money during the 2007, all of its components – foreign currency savings, time, and current deposits found favor with investors.

Overall, the monetary development in 2006 and 2007 show evidence of a remarkable increase in the use of banking services by the public, following the entry of new banks in the system, the gradual modernization of the payment services by the major commercial banks, and the initiatives of

<sup>2</sup> Broad Money (M2) comprises of Quasi Money and Narrow Money (M1) – currency outside banks and demand deposits.

the government to promote the use of the banking services under the public financial management reform program.

### **3.8. Deposits**

Deposits with the banking system increased by 45 per cent from US\$1.3 billion in December 2006 to US\$2.3 billion in December 2007. These deposits comprised foreign currency deposits - US\$2.27 billion; time and saving deposits - US\$30.2 million and demand deposits – US\$15.53 million. The above distribution of deposits reflects the economy's high dollarization.

### **3.9. Money in Circulation**

Money in circulation increased by 24 per cent from 1,500 billion riels in 2006 to 1,989 billion of riels in 2007, to accommodate the higher transactions demand associated with economic expansion.

### **3.10. Net Foreign Assets**

In 2007, the structure of the money supply showed that liquidity growth was provided for mainly by an increase in net foreign assets of the banking system. This was a continuation of the pattern of monetary developments observed over the recent years, with vigorous increase in net foreign assets of the banking system being the main contributor of monetary growth.

The vigorous growth in net foreign assets of the banking system was the main contributor to monetary growth in the 2007 as this item increased by 49 per cent from US\$1.8 billion at the end of December 2006, and ended in December 2007 at a level of US\$2.6 billion. The purchase of the US dollar from the market, the majority of which occurred during earlier months of the 2007, where the value of the riel was relatively strong, helped greatly boosting the NBC's foreign exchange holdings.

Meanwhile, net domestic assets of the banking sector showed an increase at an accelerated pace over the course of the period under consideration, reaching US\$144 million in December 2007, an expansion of 304 per cent

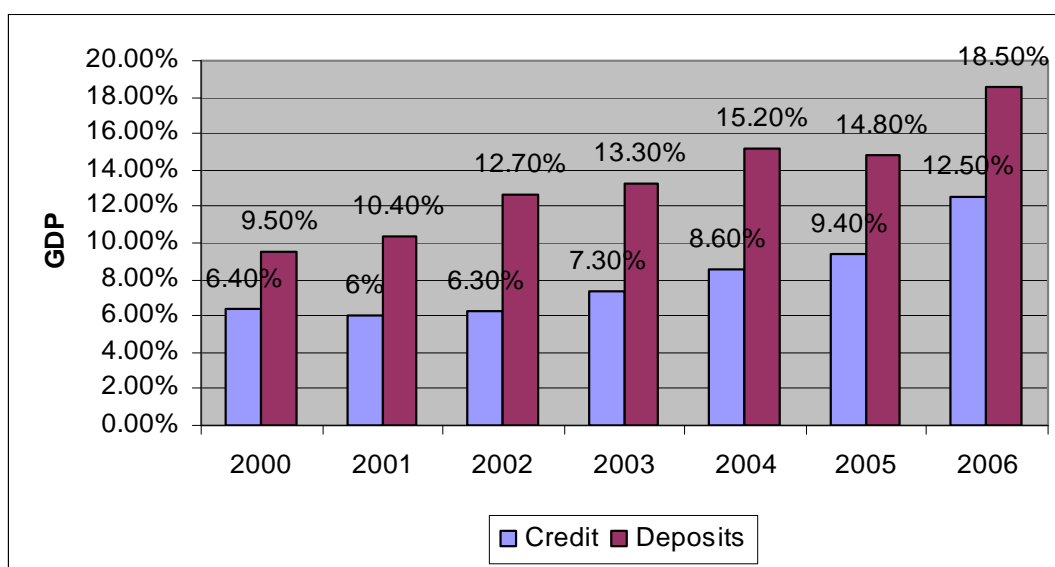
on December 2006 position. This was a reversal of the downward trend observed so far in the previous years. The large rise in net domestic assets was a result of an exceptional increase in domestic credit which significantly outpaced growth in Other Items Net. The acceleration in borrowing by the private sector with a growth to December 2007 of 76 per cent was the principal source of such development.

## 4. The Commercial Banking Sector

The commercial banking sector is vibrant, competitive, innovative and is rapidly expanding, playing its part in a high growth economy. The commercial banking sector now consists of 15 fully licensed and 6 licensed specialized banks. Most banks have established additional branches in other urban centres and are continuing to planning to establish more offices in other urban centres. Currently on average each bank branch provides full banking services for 120,000 customers.

Commercial banking involvement in the Cambodian economy is currently small but growing rapidly, with the more aggressive and progressive banks attaining a growth rate ranging from 40 to 100 percent in deposits

**Figure 4.1. Growth of Credit and Deposits**



Source: NBC

annually. The Figure below shows the rapid increase in bank credit and deposits during 2000-2006.

While underlying cash flows of the proposed project should be the basic consideration in evaluating a loan, practically no loan is approved by the bank unless registered land is offered as collateral. An important reason for this conservative approach is that according to bank reports as much as 90 percent of SMEs do not maintain written financial records and can not provide clear explanations of the financial aspects of the proposal. To manage the risk the banks have to seek high quality collateral such as registered land. Banks now encourage customers and SMEs seeking working capital to compile and maintain financial records.

The government, the economy and the banking sector will all benefit significantly when the land registration initiative is completed. The banks will gain from having a greater pool of collateral assets based on which they can lend, the government from increased taxes from higher banking profits, but more importantly individual bank clients who will save US\$2,000 to \$3,000 which they now pay on average to the registration authority to obtain title documents, should they wish to expedite land registration for raising a loan from the bank. The unscrupulous practice of multiple lending against a single asset can also be avoided when land registration is firmly institutionalized.

NBC's tight supervision and regulation of banks and the high costs and time involved in resolving foreclosures in the court have discouraged delinquency among borrowers. This has in turn ensured that most banks have few or no non-performing loans. Most have expressed support for improvements to the court system and would welcome the establishment of a commercial court. Commercial banks eagerly await the adoption of a number of laws that have been submitted to the National Assembly as they see business growth opportunities due to the greater degree of certainty in commercial transactions from having a clearly determined juridical structure on which to base business decisions.

Like all growing industries, the lack of experienced persons in commercial

banking at all levels has restricted planned growth and caused an increase in emoluments due to inelastic supply and escalating demand for the available, scarce resource. Capacity building in banking and other financial sector activities is therefore crucial for sustaining the high growth of the financial sector.

As public confidence has grown in the banking system cheques are emerging as the preferred instrument for payment and transfer of wealth. In response five banking institutions have collaborated to establish an unofficial inter bank clearing house for clearing cheques. This arrangement is functioning well. As a consequence there is wide support to officially establish a clearing house for cheques, supervised and regulated by NBC The commercial banking sub sector would benefit significantly by extending the cheque clearance system to other urban centres where the volume of business and demand for the service exist.

While there is growing support for the establishment of a money market, the volume of bonds and other negotiable short term instruments remains too small to support a sustainable money market in the near future. A capital market focused on the trading of company shares is more feasible as the principal institutions and supporting procedures have been developed and largely implemented. What remains is determining the rules of trading and the establishment of a regulatory body to oversee fair and transparent trading. However as seen from the experience of all established capital markets, when they are newly established, traders and investors will go through a learning period. During this time market volatility and associated risks will be substantial until the market reaches an adequate level of maturity.

It is clear that the commercial banking sector is well established in Cambodia. But it not fully matured. Conditions ensuring the sustainability of the banking system must be firmly embedded in the regulatory and supervisory mechanisms Strengthening the legal infrastructure, electronic automation of NBC processes, establishment of an inter bank and capital (stock exchange) market and further capacity building will all help to

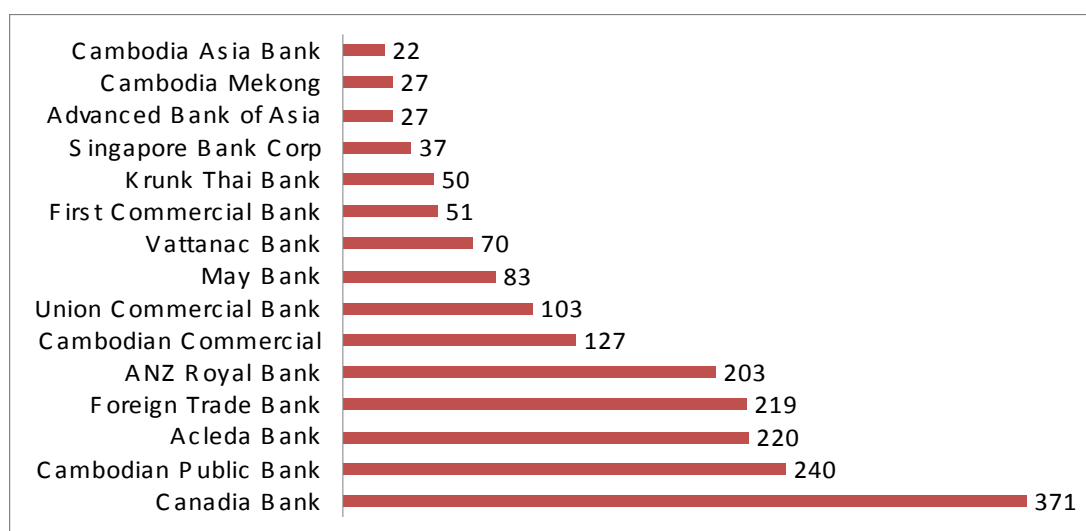
sustain the development of the banking system.

Cambodia's banking system is well capitalized and highly liquid. The solvency ratio (net worth/ risk-weighted assets) amounted to 26%, far exceeding the regulatory ratio of 15%. The liquidity ratio (liquid assets/ total assets) was equal 50%. Non-Performing Loans represented only 6.5% of total loans in March 2007. The profitability of the banking system has doubled. However, the concentration of the banking sector has accelerated during the last few years, with 71% of all loans granted by the largest five banks while 35% of the loans were granted to the services sector (tourism and hotels).

#### 4.1. Assets

The total assets of the banking system increased by 43 per cent to US\$587 million in 2006, compared to 2005. Almost 98 per cent of the banking assets were denominated in US dollars, reflecting a very high degree of dollarization. The rapid expansion of the banking system can be attributed to the following factors: political stability which has promoted public confidence in the banking system; robust macroeconomic developments, with average GDP growth of 11 percent during the last four years; and improvement in bank supervision and control by the NBC. Transparency

**Figure 4.2. Commercial Bank Assets (in million US dollars)**



Source: National Bank of Cambodia. Annual Report 2006. Banking Supervision Department

in bank management and strict regulations have been crucial in promoting the growing public confidence in the banking system.

## 4.2. Concentration

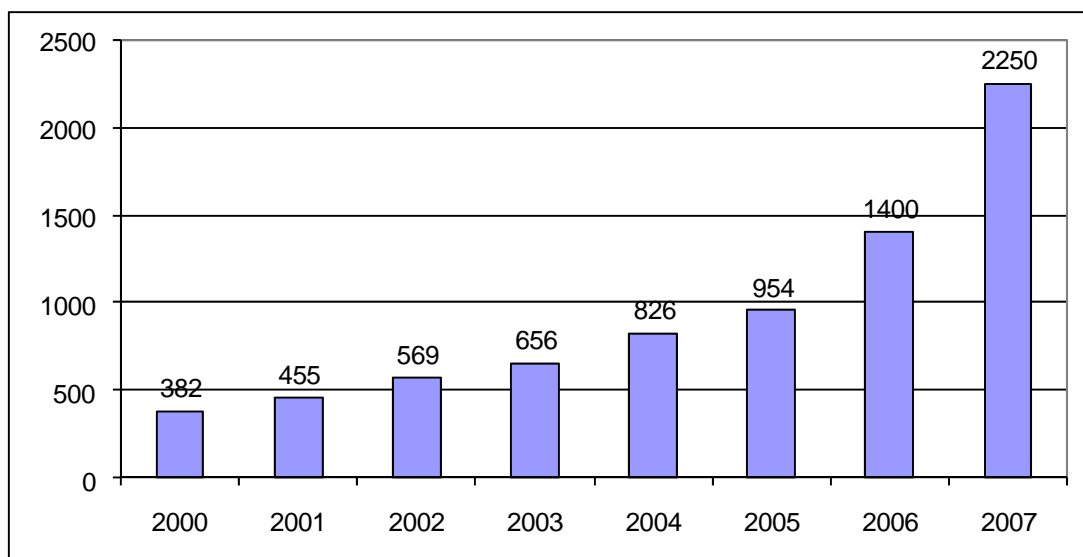
Bank concentration is measured by the proportion of the major commercial banks in banking operations. The concentration of the largest five banks rose in 2006 with the largest first five banks accounting for 67% of assets amounting to US\$1.26 billion, a 57 per cent increase (or US\$439 million) over 2001.

The level of deposit and loan concentration has remained high. At the end of 2006, the largest three banks (Canadia, ACLEDA and Cambodia Public Bank) accounted for 49% of all deposits and 61% of all loans of the banking system. Foreign currency deposits are dominated by US dollar deposits, which accounted for 95% of all bank deposits.

## 4.3. Deposits and Loans

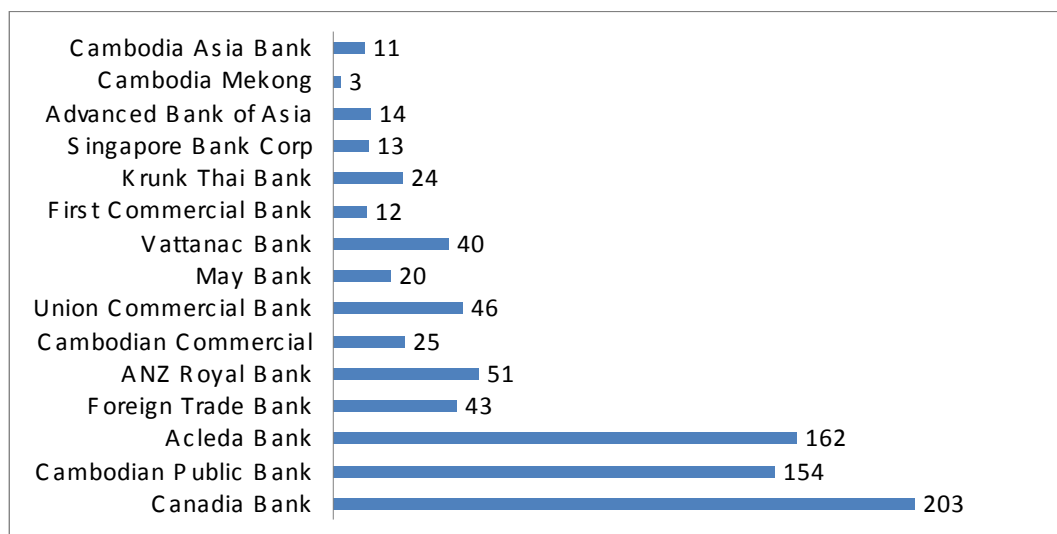
Cambodia's bank deposits increased faster than nominal GDP growth. Growth in bank deposits since 2000 increased from \$382 million to \$2.25 billion in 2007, an increase of almost 6 times, mainly due to the increase in dollar-denominated deposits. During this period nominal GDP only

**Figure 4.3. Commercial Bank Deposits (in million US\$)**



Source: NBC

**Figure 4.4. Credit to the Private Sector (in million US dollars)**



*Source: National Bank of Cambodia. Annual Report 2006. Banking Supervision Department*

doubled. The presence of internationally recognized banks and the increase in confidence in the banking sector also contributed to the increase in bank deposits.

The banking system, however, still provides a narrow range of financial instruments, usually limited to demand, saving, and time deposits on the liability side. The majority of deposits have been made by individuals but it is of interest to note that commercial business deposits have been rapidly increasing.

Credit to the private sector increased seven folds, from US\$230 million in 2000 to US\$893 in 2006 and US\$1.6 billion in 2007. The number of depositors and borrowers increased by 16% in full fledged commercial banks and by 24% in microfinance institutions (MFIs).

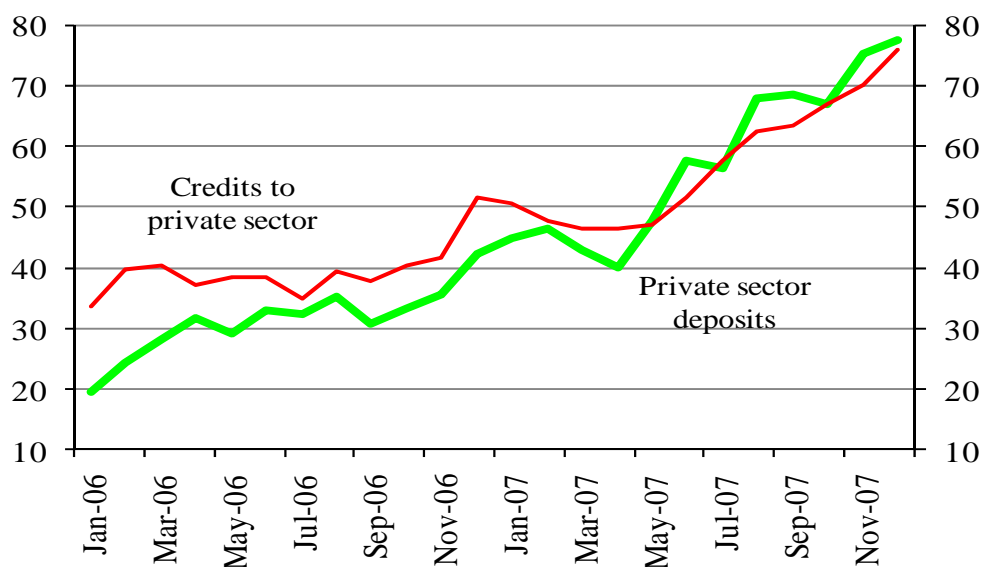
Deposit growth outpaced loan growth in 2007. Deposits grew 72 per cent, while loan grew 64 per cent in 2007. The outlook for the banking sector growth in 2008 will remain positive, with estimated deposit growth of 40-50 per cent and loan growth of 50-60 per cent.

The objective of the credit function is to create value for the bank. It is therefore important to ensure appropriate and prudent risk management.

The above figure provides sectoral allocation of bank loan portfolio in the private sector. The services sector (tourism and hotels) accounted for 33% of all bank loans; wholesale and retail trade – 23%; manufacturing – 12%; and real estate – 9%. Construction represented only 8% of all bank loans; and agriculture – 4%. For all sectors, loan portfolios have increased in volume.

During the last five years, commercial banks have rapidly enlarged their presence in the provinces by broadening their branch networks. The number of bank branches increased to 116 and banking services now cover all the urban areas of the country. However, banking services in the rural areas have remained under-developed even though 80% of the

**Figure 4.5. Credits and Deposits of private sector growth in 2007  
(Y/Y % change)**



Source: NBC

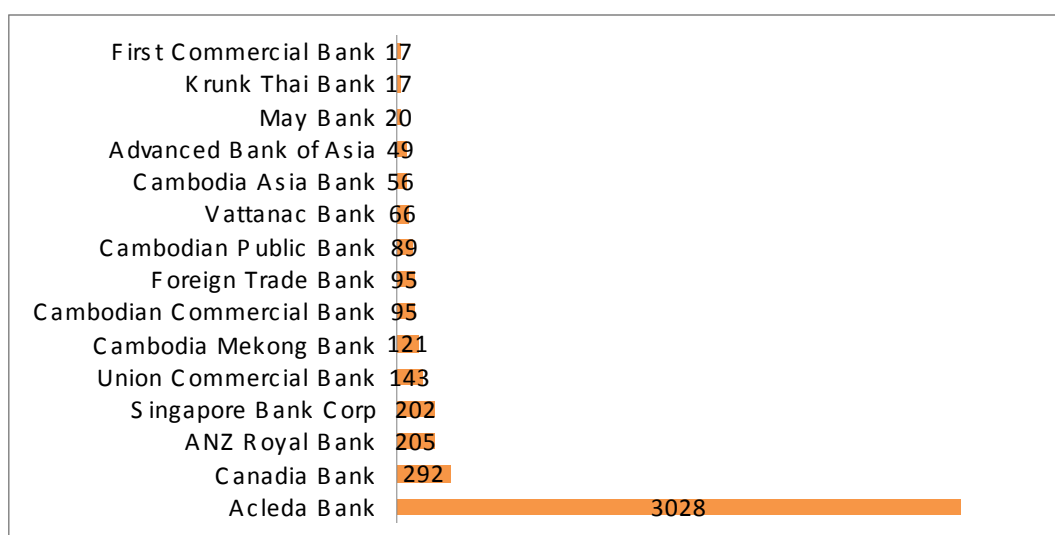
population lives in the rural areas. An encouraging sign in the development of rural banking is that microfinance loans increased by 90% in 2006. Another sign of commercial bank activity expansion is the multiplication of ATMs, which increased by 17 to reach 86 in 2006.

Continued strong growth of the financial sector is critical to economic growth. However, increasing access to credit is hindered by the lack of financial statements published by the companies. Poor transparency and disclosure standards prevents commercial banks from adequately assessing potential opportunities. Moreover, the recently introduced Commercial and Bankruptcy Laws have not been tested, making it difficult for commercial banks to enforce claims. Measures to increase access to credit include:

- Broadening the requirement and enforcement of tax returns by requiring companies to publish financial statements;
- Increasing the pool of land against which banks can reliably lend again by reducing the costs of obtaining land titles;
- Strengthening the court system and judicial process, and introducing commercial court to ensure certainty in commercial transactions.

ACLEDA Bank, which is a graduate from the group of MFIs, ranked first in terms of the number of employees. The bank has 157 branches and employed more than 3,000 staff in 2006. This increased to about 5,000 in 2007, as ACLEDA Bank strengthened its branch network.

**Figure 4.6. Personnel of the Banking Sector**



*Source: National Bank of Cambodia. Annual Report 2006. Banking Supervision Department*

## 4.4. Liquidity

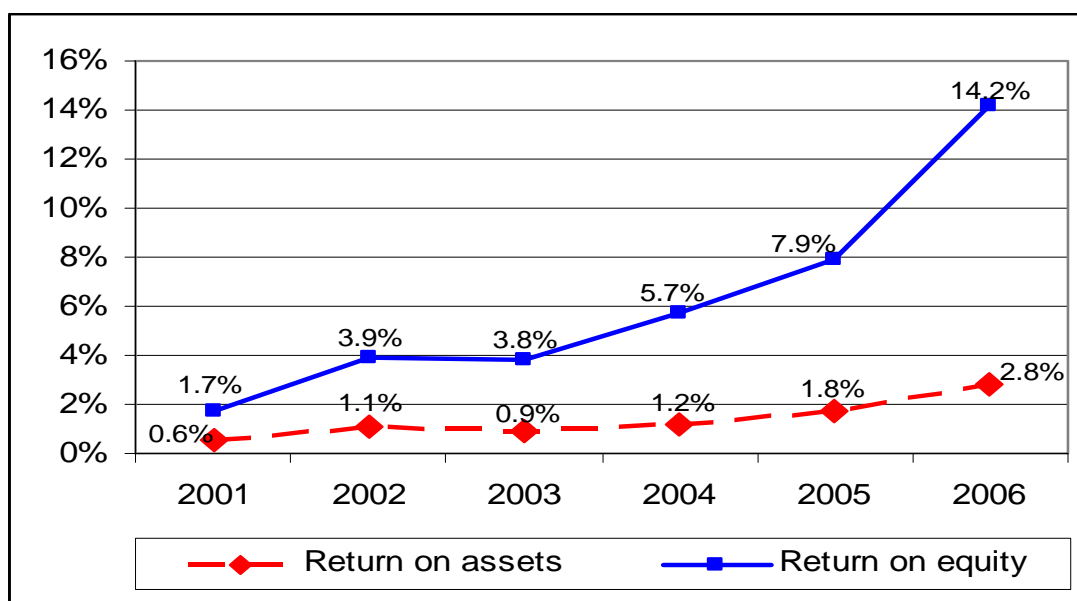
Banks still maintain a high level of liquidity indicated by the liquidity ratio for all commercial banks. The Basel measure is based upon being fully enabled banks to manage their liquidity; at this stage the financial system in Cambodia is not developed to enable banks full enablement. In 2001 the liquidity ratio was 1852% but by December 2006 was 108.03%. The supervisory measure for commercial banks is 50 percent.

## 4.5. Profitability of the Banking System

Two methods can be used to analyze bank profitability: The Return on Equity (ROE) ratio and the Return on Assets (ROA) ratio. ROE – the financial profitability ratio – is measured by dividing net profit by capital. It expresses the return from the shareholders' point of view by highlighting the profitability of their investments. However, this ratio can give a false indicator of profitability, as a high profit ratio can be achieved by possessing a low level of capital.

Pricing for the overall risks is not occurring with ROA and ROE at developed country levels. Total profit improved rapidly by 126 per cent in

Figure 4.7. Return on Assets and Equity



Source: National Bank of Cambodia. Annual Report 2006. Banking Supervision Department

2006, compared to 2005. The rapid increase in deposits has provided banks with additional earning opportunities and a means to fund expansion. It is seen in Figure 4.7 that ROA is low in Cambodia, but increasing rapidly. The average return on assets for banks has increased from 0.6 percent in 2001 to 2.8 percent in 2006, even though the level of loans was high. This is attributable to high lending costs in Cambodia. The increase in returns on investment (equity plus accumulated surplus) is larger for those banks that have significantly increased their deposits. Increased returns have made banking a more attractive investment. Banks that have captured a larger share of the increase in deposits have improved returns to their shareholders.

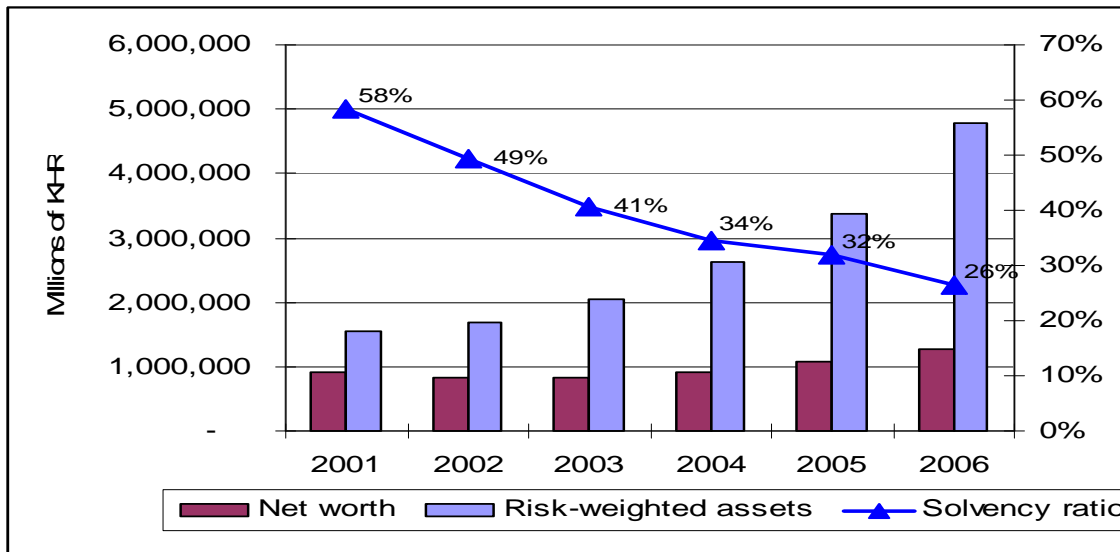
While ROA is an important measure the return on investment after tax is one often used by investors. In 2001 banks after tax return on equity averaged 1.7 percent. ROE of banks increased from 1.7% in 2001 to 14.2% in 2006. This increase was attributable to the increase in interest income (47 percent) and recoveries (16 per cent). However, the disadvantage of this indicator is that it does not distinguish between risk-differentiated assets. Apart from this general shortcoming of the measure, in the case of Cambodia off-balance sheet liabilities of banks have also increased during the last few years. This results in the ROE overstating the profitability since de facto the equity is lower than what is stated in the balance sheet. Examination of a number of banks financial results for 2004 to 2005, indicate after tax returns on equity ranging from negative to as high as 23% with the average 14.2% for 2006. Those that achieved higher than average growth rates in deposits significantly improved their return on assets.

## **4.6. Prudential Ratios**

### **4.6.1. Solvency Ratio**

New bank accounting standards were adopted in 2006. The solvency of the banking system can be assessed from the performance of the banks against the prudential measures. The solvency ratio (or Capital Adequacy

Figure 4.8. Solvency Ratio



Source: National Bank of Cambodia. Annual Report 2006. Banking Supervision Department

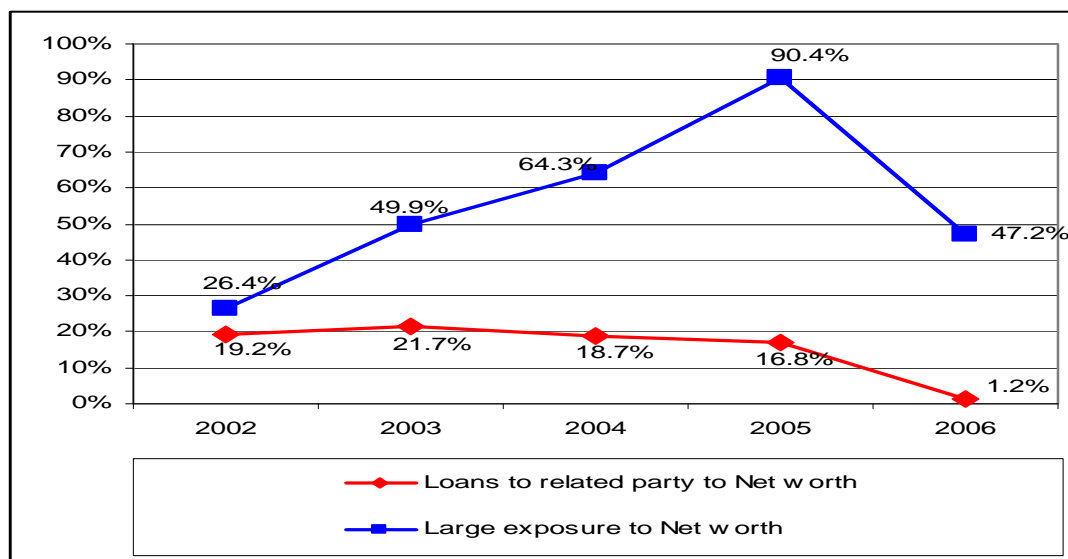
Ratio) of Cambodia’s commercial banks exceeded the regulatory requirements. The solvency ratio decreased from 32% in 2005 to 26% in 2006, but was still above the prudential standards required by the NBC, set at 15%. The declining trend is due to the increase in lending and the increase in risk weighted assets. This development is being closely monitored.

#### 4.6.2. Large Exposure

Overall bank risk can be analyzed in terms of credit risk, liquidity risk, interest rate risk etc. A commercial bank that manages well its credit risk, everything else being equal, can get a high score in risk management. It can therefore be considered as the most prudent in risk management. The banks that manage poorly their credit risk would have a low score. Overall the risk exposure of commercial banks which peaked in 2005 in terms of related party lending and large borrower lending, declined in 2006.

Large exposures and loans to related parties greatly decreased compared to previous years. Loans to related party decreased from 16.8 per cent in 2005 to 1.2 per cent in 2006, as a result of repayment and change in ownership.

Figure 4.9. Large Exposure



Source: National Bank of Cambodia. Annual Report 2006. Banking Supervision Department

Large exposure increased from 26.4 per cent in 2002 to 90.4 per cent in 2005, but decreased to 47.2 per cent in 2006, largely due to the change in the calculation method. A few large banks have exposed themselves to lending exceeding the regulatory limit.

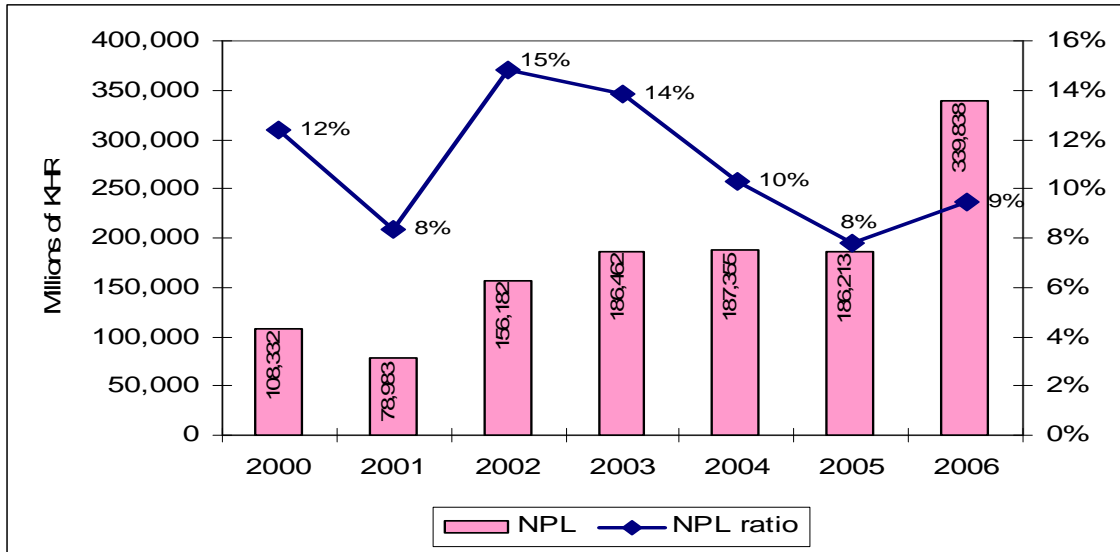
#### 4.6.3. Non-Performing Loans

The evaluation of the risks for commercial banks should be made based on a number of ratios: capital to risk-weighted assets ratio, the ratio of non-performing loans to risk-weighted assets and the NPL covered ratio. Fixed assets have been used as collateral for lending. The real estate bubbles have made this ratio crucial from the supervisor's point of view, as the burst of the bubbles would make it impossible to recover the loans.

The NPL ratio increased from 7.5% in 2005 to 9.8% in 2006, due to the introduction of tighter international accounting standards introduced by the NBC. This increase is consistent with increase in lending over the past few years and in line with the NBC's strategy to improve the assessment of the borrowers in loan classification.

The NPL ratio of Cambodia's commercial banks declined to 6.5% in 2007

Figure 4.10. Non-Performing Loans (in million riels)



Source: National Bank of Cambodia. Annual Report 206. Banking Supervision Department

as the banks adjusted to the new accounting requirements. This level of the NPL ratio is considered reasonable. Provisions also decreased by 16.5 percent during 2005-06, due to the high recovery rate of 18 percent for NPL.

## 4.7. Exchange and Money Changers

The NBC has recently commenced registration of these businesses throughout Cambodia. These activities are conducted outside the formal banking arrangements and provide a 24 hour service that commercial banks currently do not provide. There are 2,158 exchange bureaus in Phnom Penh and 1,895 in the provinces.

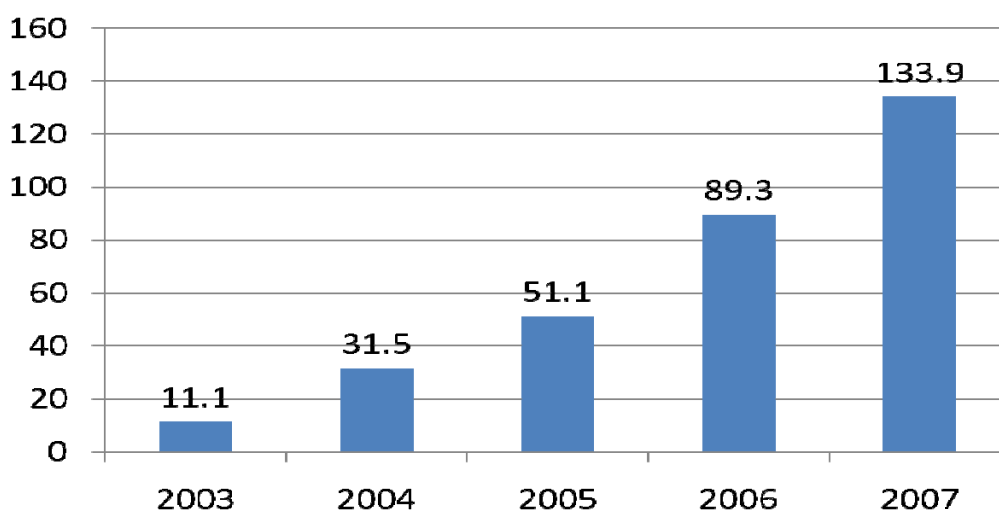
Any form of supervision should be limited to inspections probably both on a random spot basis as well as on any complaint or information on bad practice provided by market participants. The supervision should be focused on consumer protection and the promotion of good conduct. To facilitate such a regime the participants could be registered (as the money changers are being registered today). The main purpose of such registration is to provide assurance to the customer that the registered

business has not been found to have carried out unacceptable practices.

## 4.8. Microfinance

The micro finance sub sector is characterized by high levels of motivation, vibrancy, competition and commercial innovation. Microfinance is expanding rapidly. In 2007 volume of micro finance lending rose by about 50 per cent from US\$89 million in 2006 to US\$134 million in 2007. However, since 2003 the microfinance lending increased by 12 times. This rapid expansion is allowing microfinance to support growth in the remote and poverty stricken areas where the commercial banks are unwilling or unable to lend due the high credit risk.

**Figure 4.11. Microfinance Loans (in million US\$)**



*Source: NBC*

There are 25 registered Microfinance Institutions (MFIs) and 60 non-registered MFIs operating in Cambodia. A number of these have evolved from donor supported NGOs but some have been set up as commercial, profit oriented MFIs from the outset. Most have plans to continue expanding rapidly with the establishment of more branches and more lending at existing branches. At the end of 2006, MFIs had a total number of 471,026 loans outstanding. In this period, microfinance deposits

increased by 61% to 12 billion riels owed to 113,277 depositors. The total number of poor families in Cambodia is estimated at about 2 million. While substantial development of MFIs has taken place, most of the poor, particularly the rural poor, are still beyond the coverage of the formal financial sector including MFIs.

However, MFIs lack funding with the demand for loans far exceeding the supply, due to the lack of deposits and the under-developed banking system in the rural areas. The microfinance loan portfolio amounted to US\$134 million in 2007, which is much less than the estimated demand of US\$200 million.

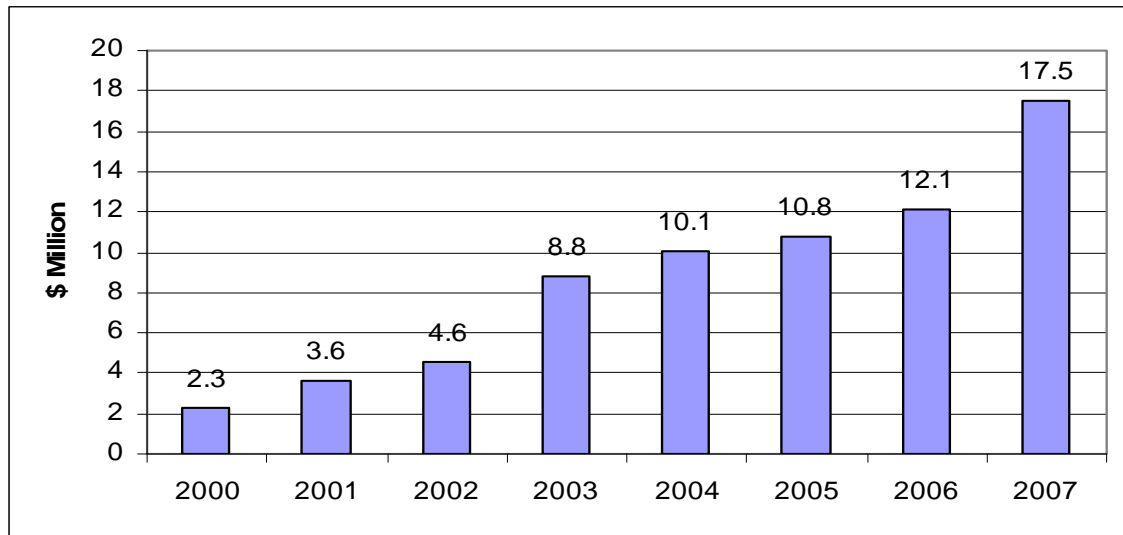
An encouraging feature of MFI development is that notwithstanding the rapid pace of their expansion, no case of financial misdemeanor on their part has come to notice. This is partly attributable to the tight supervision and regulation of the MFIs by NBC and also the realization on their part that they have to maintain high prudential standards in a highly risky operational environment.

The MFIs have adopted a wide range of business models to deliver their services and products. All these are consistent with good corporate governance practices and orderly market development. The track record of the MFIs in managing their lending and minimizing bad debts and non-performing loans has been exemplary with total losses well below 1 % of the portfolio. The loan delinquency ratio declined from 0.8% in 2005 to only 0.3% in 2006. Cambodian MFIs won 4 out of 20 worldwide awards for Financial Transparency given by the CGAP (Consultative Group to Assist the Poor) which illustrates the high standards of MFI operations in Cambodia.

## 5. Insurance Sector

The insurance industry in Cambodia is of recent origin and is evolving. The pricing and risk structure of the industry is still not clearly understood and there are calls for relaxation of some of the regulatory requirements.

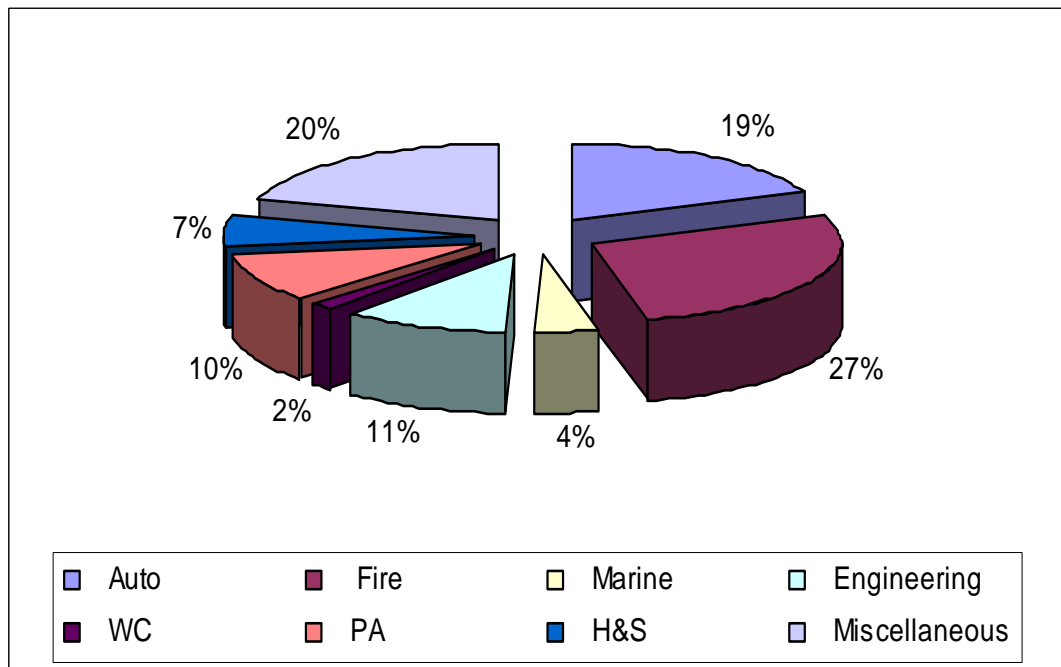
**Figure 5.1. Gross Insurance Premiums**



Source: MEF

Growth of the industry has been steady (11 to 42% per annum in the last 7 years.). The industry offers a limited range of insurance products. The gross premiums amounted to \$17.5 million in 2007, an increase of \$5.4

**Figure 5.2. Insurance Lines of Business**



Source: MEF

million over 2006, with Oil & Gas industry mainly contributing to the increase. There are 5 insurance companies operating in Cambodia– Forte, Asia Insurance, Caminco, Infinity Insurance, and Long Pac Insurance – and one reinsurance company – Cambodia Re.

The main insurance products available in the market are commercial fire (27% of the total value of policies issued) and Motor Vehicle insurance (19%). Miscellaneous items (20%) include : hospital and surgical, personal and accident, marine cargo and travelers insurance. Oil and gas insurance has emerged as one of the most active insurance business lines.

## 6. Fiscal Performance

The Ministry of Economy and Finance (MEF), together with its development partners, has established a best practice performance management framework for the Public Financial Management Reform

**Table 6.1. Budget Performance in 2006-2007 (in million US dollars)**

	2006	%GDP	2007	%GDP	Change
<b>Domestic revenue</b>	794.3	10.92%	968.7	11.30%	22.0%
<b>Current revenue</b>	702.3	9.65%	942.3	10.99%	34.2%
<b>-Tax revenue</b>	553.4	7.61%	754.9	8.81%	36.4%
<b>Tax</b>	187.2	2.57%	261.0	3.05%	39.4%
<b>Customs</b>	366.2	5.03%	493.6	5.76%	34.8%
<b>-Non tax revenue</b>	148.9	2.05%	187.4	2.19%	25.9%
<b>Capital revenue</b>	92.0	1.26%	26.4	0.31%	-71.3%
<b>Total expenditure</b>	994.0	13.66%	1,168.7	13.64%	17.6%
<b>-Current outlays</b>	576.8	7.93%	741.4	8.65%	28.6%
<b>Current surplus</b>	125.5	1.72%	200.9	2.34%	37.5%
<b>-Capital outlays</b>	417.3	5.74%	427.2	4.98%	2.4%

Source: MEF

Program (PFM). The PFM reform has yielded major achievements in the three years of its implementation, 2005-2007. A detailed outline of the PFM is given section 8.

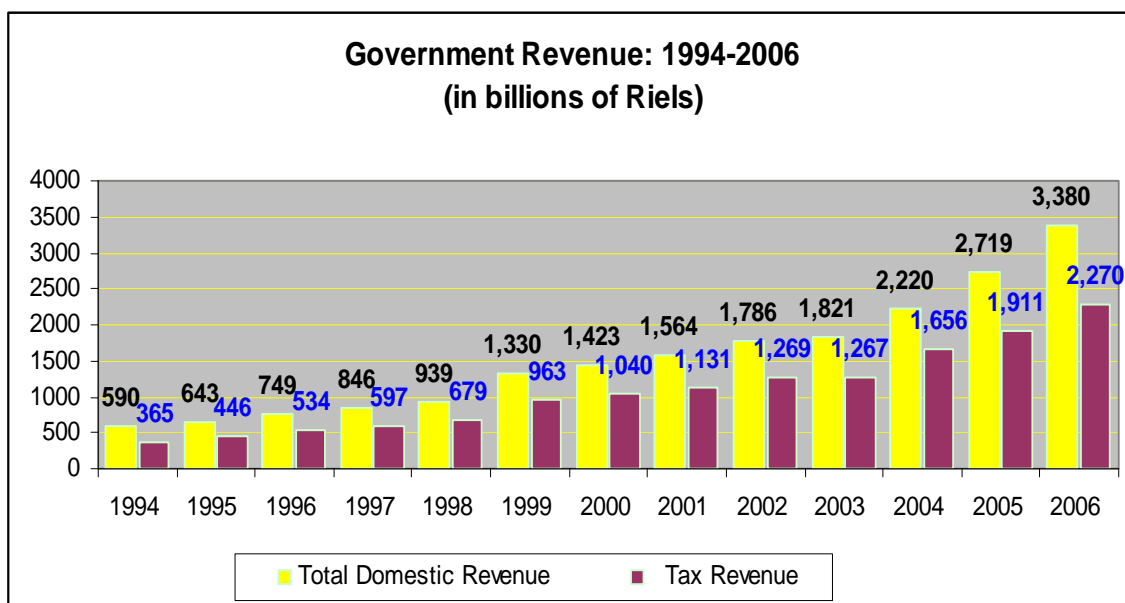
The implementation of major reforms measures commenced in 2007 including streamlining of budget execution procedures, the introduction of program budgeting, and adoption of a new chart of accounts. These measures follow on significant reforms in 2005 and 2006, in particular: customs and tax revenues collected through the banking system; Treasury payments to suppliers by check instead of cash; elimination of the stock of old expenditure arrears; streamlined procurement process; and strengthening of internal audit departments in the line ministries.

As a result of the PFM reform, fiscal consolidation continued to progress in 2007. Revenue collection improved substantially while expenditure was tightly managed, as seen in the Table below.

## 6.1. Revenues

Domestic revenue increased by 22 per cent from US\$794 million in 2006 to US\$969 million in 2007 (11.3 per cent of GDP). This increase was

**Figure 6.1. Government Revenue Collection**



Source: MEF

mainly due to the growth in tax revenue, which rose by 36 per cent from US\$553 million in 2006 to US\$755 million in 2007, and the improved collection of non-tax revenue, which increased by 26 per cent from US\$149 million in 2006 to US\$187 million in 2007. Capital revenue reduced by 71 per cent in 2007, compared to 2006, as the government sold less assets in 2007 than the previous year.

Revenue collected by the Tax Department increased by 39 per cent (US\$187 million) in 2006 and 39 per cent (US\$261 million) in 2007. The increase was attributable to the following:

- Strong government's support, especially by the Prime Minister;
- Stringent implementation of the Public Financial Management (PFM) Reform Program;
- Improved services for the taxpayers;
- Improved tax audit and tax administration;
- Increased recovery of tax debts;

The revenue collected by the Customs and Excise Department (CED) increased by 11 per cent (amounting to US\$366 million) and 35 percent (amounting to US\$494 million) in the same period. Non-tax revenue increased by 26 per cent from US\$149 million in 2006 to US\$187 million in 2007.

## **6.2. Expenditure**

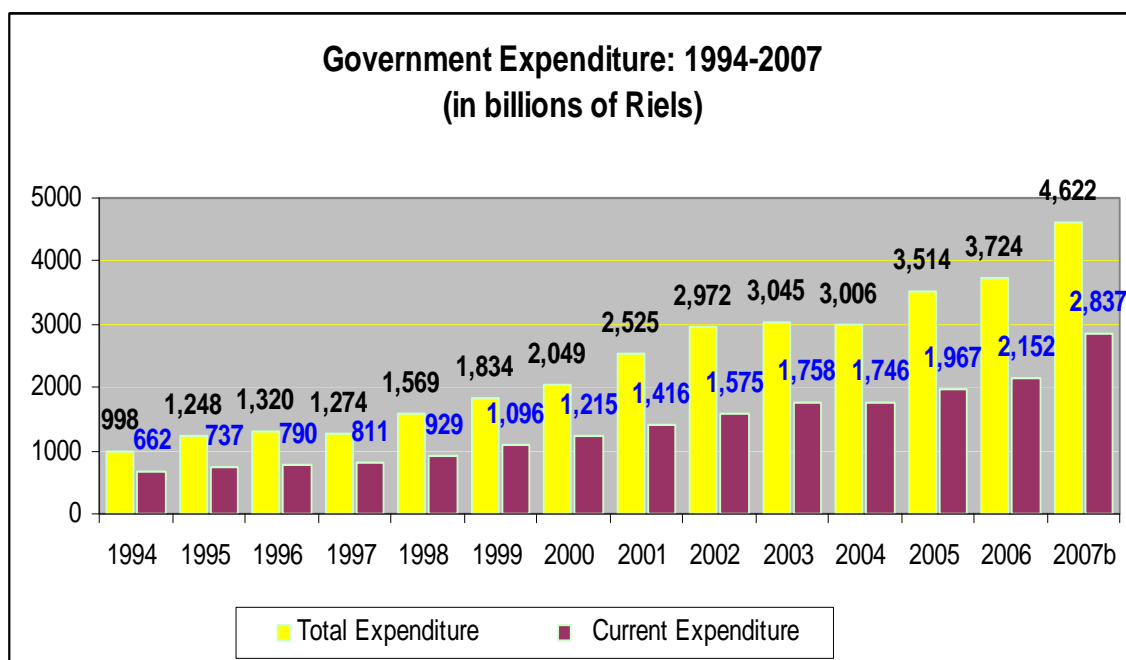
Rising incomes and gradual improvements in service delivery have started to result in improved human development indicators. However, in many areas Cambodia's human development indicators are lagging other countries in the region.

Health and Education ministries are in the vanguard of developing sector-wide strategies; aligning policy, planning, budgeting and monitoring and evaluation processes with these strategies; and gradually reorienting priorities in a pro-poor direction. These fundamental improvements in core systems are starting to result in improved outcomes.

Increases in social spending in recent years have resulted in positive trends in education and health outcomes. Development of sector strategies and matching systems for planning, budgeting and M&E have provided a framework within which investments in physical infrastructure (schools and clinics) and increasing numbers of professionals and workers in the social development areas (teachers, doctors and nurses) and to some extent improved quality of front-line service delivery staff have started to shift a number of human development indicators upward. Primary enrollment has increased significantly. Net primary enrollment rates have improved along with net lower secondary enrollment rates. Similarly in health, there has been remarkable success in controlling and then reducing the spread of HIV and there has been a significant decline in infant and under-five mortality rates.

The improving revenue performance is opening up fiscal space for higher expenditures in agriculture, irrigation, roads, and energy, as well as growth in social sector spending. The Government has indicated its intention to significantly increase spending on rural infrastructure, and is beginning by

**Figure 6.2. Government Expenditure**



Source: MEF

allocating a large share of the IMF's Medium Term Debt Relief Initiative (MDRI) funds (US\$ 33 million) to fund small rural irrigation projects in eastern provinces during 2006-2008.

*Total expenditure has more than tripled during the last decade.* Total expenditure increased by 18 per cent from US\$994 million in 2006 to US\$1,169 million in 2007.

### 6.2.1. Current expenditure

Current expenditure increased from US\$577 million (7.93 per cent of GDP) in 2006 to US\$741 million (8.66 per cent of GDP) in 2007. Payroll accounted for 34 per cent of current expenditure (2.8 per cent of GDP).

Budget performance improved substantially in 2007, due to the implementation of the PFM reform program, reflecting improvement in fund disbursement and tighter budget preparation.

### 6.2.2. Capital expenditure

Capital expenditure comprises locally financed expenditure, i.e. financed by domestic revenue and externally financed capital expenditure, i.e. expenditure financed by bilateral and multilateral development partners in the form of grants and concessional loans.

**Table 6.2. Government capital expenditure by types (in billion Riel)**

Capital Expenditure	2000	2001	2002	2003	2004	2005	2006	2007
Road & bridges	124.2	118.4	255.8	112.5	33.5	57.5	60.2	51.2
Irrigation	-	-	-	1.4	5.3	18	38.0	51.8
Others	239.2	221.6	98.4	132.9	15.5	6.8	8.5	16.0
Total commitment	363.4	340.0	354.2	246.8	59.3	82.3	106.7	119.1
Total disbursement	217.8	201.6	232.9	204.8	145.1	148.1	194.6	

Source: MEF

Capital expenditure incurred through the National Treasury increased from US\$417 million (5.74 per cent of GDP) in 2006 to US\$427 million (4.98 per cent of GDP). The drop in capital expenditure was due to lower disbursement of Overseas Development Assistance (ODA) projects. Externally financed capital expenditure amounted to about US\$280 million (3.5 per cent of GDP). The externally financed capital expenditure is incorporated *ex post* into the budget. It is disbursed directly by the development partners.

Capital spending funded by the government is concentrated on only three ministries: the Ministry of Public Works and Transport, the Ministry of Water Resources and Meteorology and the Ministry of Rural Development.

The current budget surplus increased from 1.8 per cent of GDP in 2006 to 2.34 per cent in 2007 due to a sharp increase in revenue and restrained budget expenditure. The overall budget deficit declined to around 1.5 per cent of GDP. The overall budget deficit was financed by concessionary loans and grants provided by Cambodia's development partners. The fiscal strategy of Cambodia does not allow domestic financing of the fiscal deficit.

## **6.3. Expenditure by sectors**

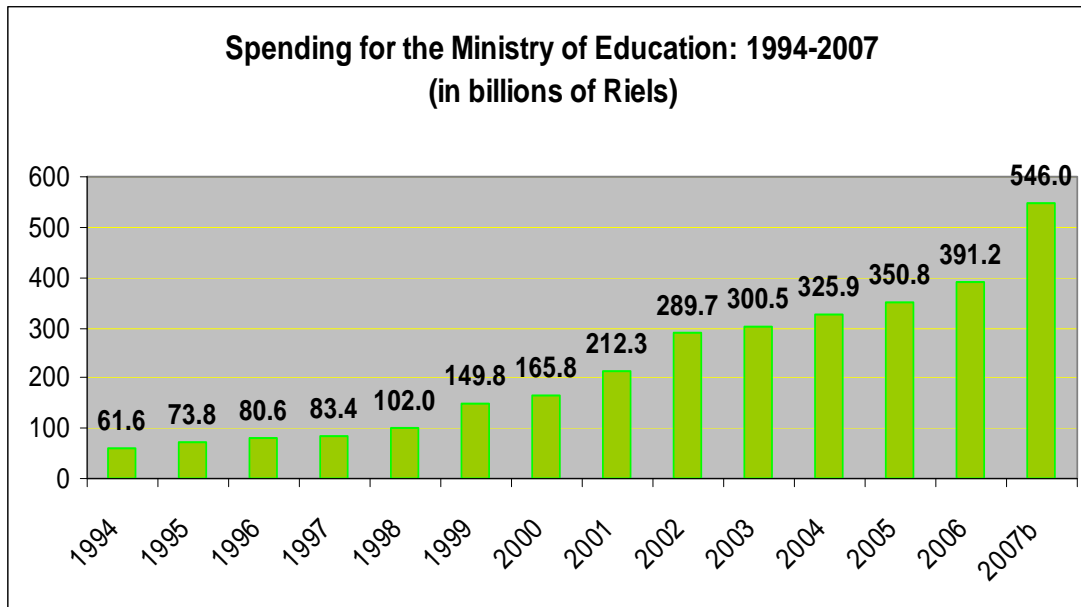
### **6.3.1. Education**

During 1998 to 2007, spending on education increased more than five times in nominal terms, from 102 billion CRs to 546 billion CRs (\$134 million).

Starting from a low base, the Cambodian education system has made impressive gains. Estimated net enrolment rates at the primary level are up significantly from 65% in 2000 to 76% in 2004 (CSES). Lower Secondary (grades 7-9) net enrollment has more than doubled since 1997, increasing from 7.6% to 16.4%.

Advances in important indicators such as literacy, repetition rates and years of schooling for younger age cohorts are further positive signs that

Figure 6.3. Education Spending



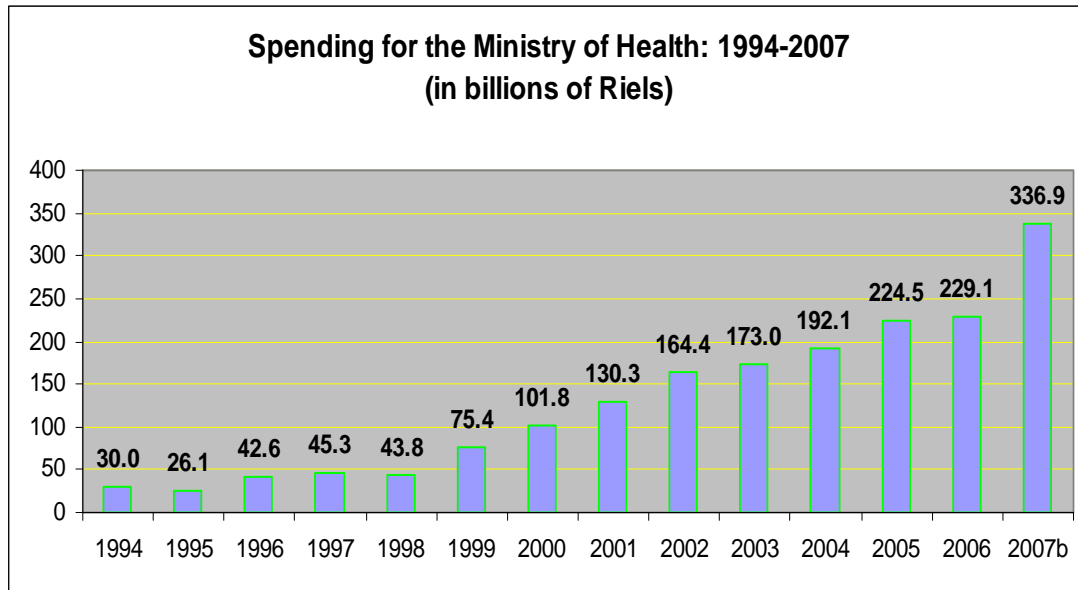
Source: MEF

the rebuilding of the national education system is taking root. Progress has also tended to be pro-poor. While socioeconomic, rural and gender gaps in educational attainment exist, these gaps have generally been reduced significantly in recent years, particularly at the primary level.

### 6.3.2. Health

During the last decade, health spending rose more than sevenfolds from 44 billion CRs in 1998 to 337 billion CRs (\$82 million) in 2007. Recent data suggest progress on a number of health indicators, reflecting rising average levels of consumption and falling poverty rates as recorded in the household living standards survey of 2007. Findings from the 2005 Cambodia Demographic and Health Survey (CDHS) suggest significant progress on a number of output and outcome measures relative to the previous (2000) CDHS. Health service delivery has improved in a number of critical areas (notably rates of childhood immunization and the percentage of births attended by a trained professional). Health practices are also changing, with a dramatic rise in exclusive breastfeeding of children aged under six months.

Figure 6.4. Health Spending



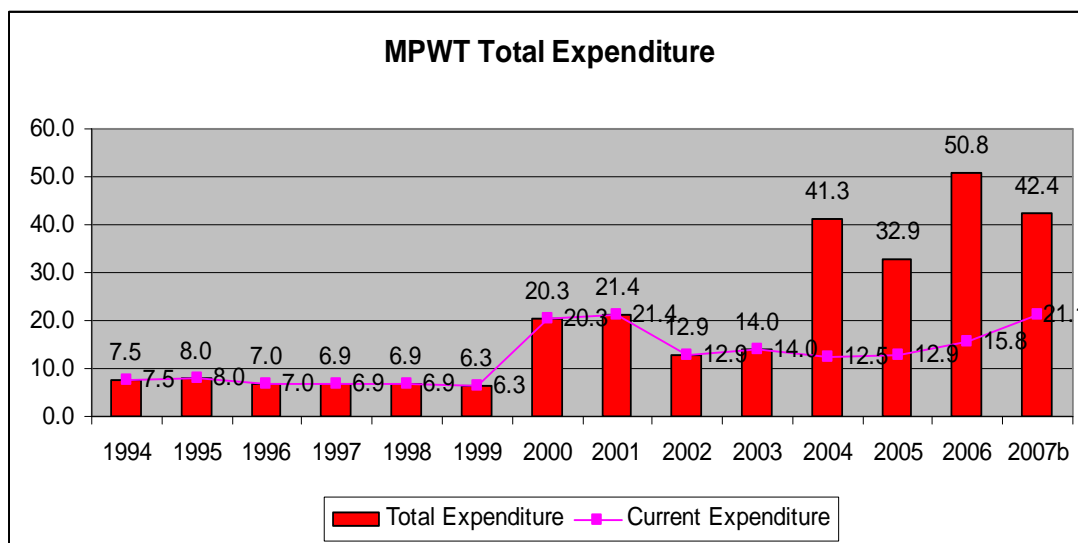
Source: MEF

These improvements in service delivery and utilization are feeding into a number of health outcomes. Falling fertility rates, better (though still extremely inadequate for the poor) childhood nutrition, and significant improvements in childhood survival (with infant mortality rates falling from 95 to 65 per 100,000 live births, and under-five mortality falling from 124 to 83) are some of the noteworthy achievements. Maternal mortality (per 100,000 live births) has also decreased, from over 437 in 2000 to 343 in 2005. While births at home are slowly giving way to births at a facility (up from 32% to 44%), progress is starting from an extremely low base, and there is a long way to go. Although Cambodia has still the highest prevalence of HIV/AIDS in the region, it has been successful in arresting and reversing the growth of the epidemic (the estimated prevalence rate for the percentage of adults aged 15-49 years fell from 3.0 in 1997 to 1.9 in 2003). Similarly, the TB epidemic has shown a declining trend.

### 6.3.3. Road Infrastructure

The Government’s Rectangular Strategy places great importance on the rehabilitation of the country’s existing infrastructure and the construction of new infrastructure assets to meet the demand of the growing economy. The road sector continues to be a high priority.

**Figure 6.5. Infrastructure Spending**

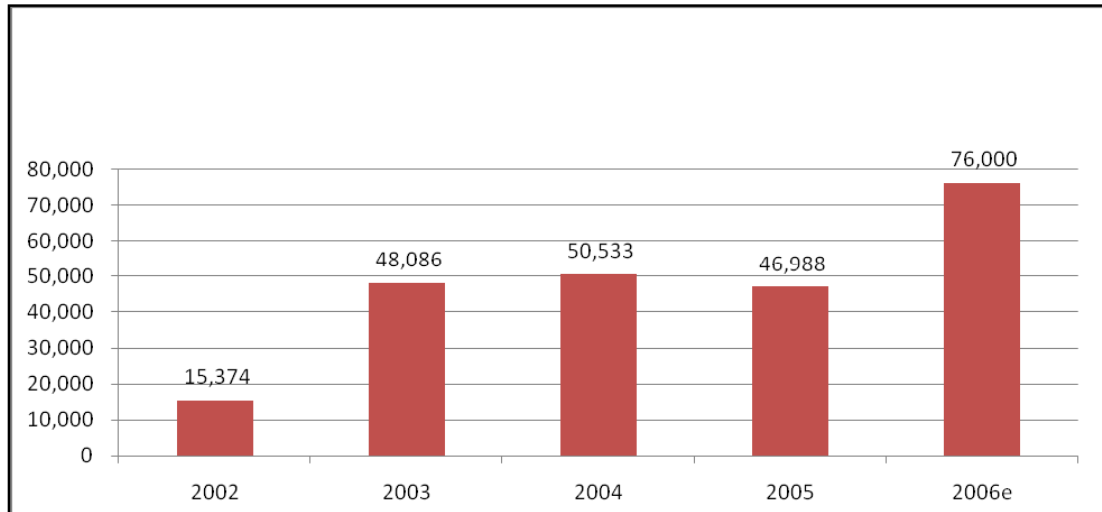


Source: MEF

It is estimated that decreasing the distance from the village by providing a good road will enhance productivity by about 30 thousand riel per hectare per kilo meter . Land with access to irrigation facilities during the dry season has 15 percent greater rental value and 10 percent higher sale value than land without irrigation. During 2000-2006 the disbursement for road infrastructure and its maintenance amounted to about 1,400 billion riels or US\$350 million.

An important priority is to scale up maintenance expenditures on the road network. Maintenance spending has been quite low compared to needs, resulting in a deterioration of the capital stock beyond normal depreciation. The RGC has also stressed the need to continue to expand funding for health and education, and would allocate PRGO funds for these sectors.

**Figure 6.6. Road Fund**



*Source: MEF*

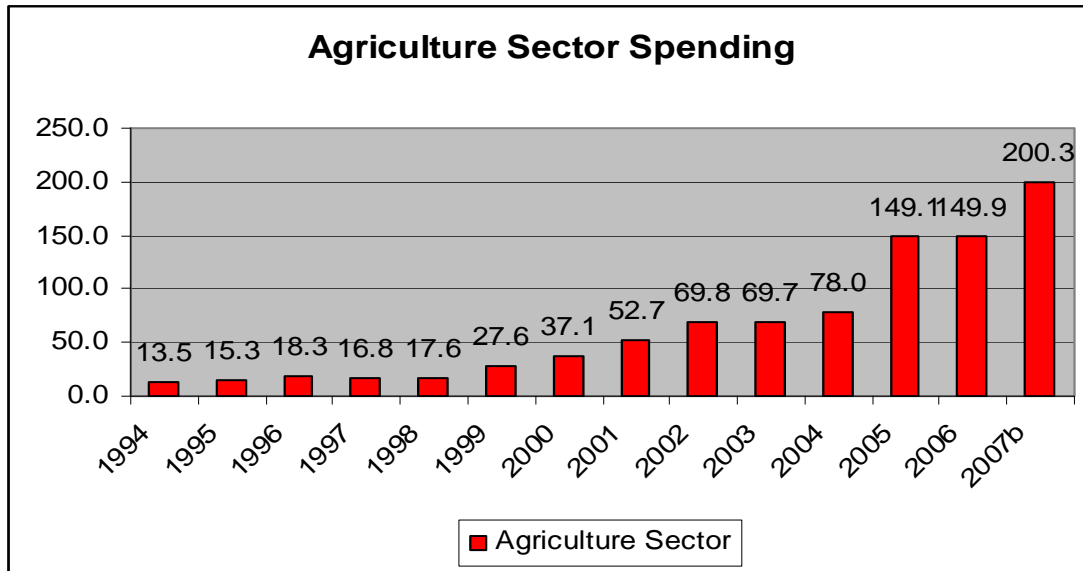
#### **6.3.4. Agriculture Sector**

Agricultural performance is volatile and yields are strongly correlated with weather conditions. The growth rate of agriculture averaged 3.3% per annum during 1994 -2004. The average rice yield has increased gradually every year from 1.5 tons per ha in 1993 to 2.5 tons per ha in 2007.

The use of high-yielding seeds supplied by the fledgling seed companies, improved disease and pest control, good weather conditions, the initiatives of the government to provide irrigation facilities for dry paddy farming and the increasing popularity of the System of Rice Intensification (SRI) have been the main reasons for the improvement in land productivity of rice. However, in absolute terms productivity is low and far behind other major agricultural producers and exporters in the region. There is high potential for significant increase in agricultural incomes through effectively directed investment, and proactive and progressive policies learning from the experiences of neighboring countries.

Current spending on agriculture (Ministry of Agriculture, Forestry and Fisheries, the Ministry of Rural Development and the Ministry of Water Resources and Meteorology) has doubled from 52.7 billion riels in 2001 to

Figure 6.7. Agriculture Spending



Source: MEF

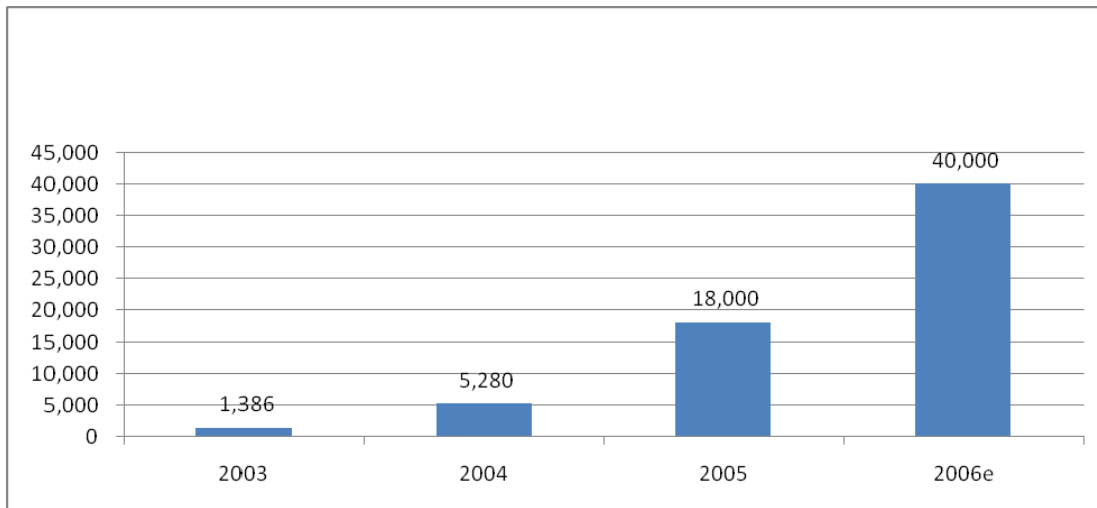
118.6 billion riels in 2007. The spending has tripled since 2000. This figure does not include capital spending, which was mainly for the construction of rural roads and irrigation facilities.

Total spending on agricultural sector (both current and capital expenditure) increased more than 10 fold during the last decade from 18.6 billion riels in 1997 to 200 billion riels (or US\$50 million) in 2007.

Government investment in irrigation increased by annual average of 2% during 2003-2006 and reached about US\$10 million in 2006. Irrigation investment is not attractive due to its low financial returns even though economic returns may be higher. From a social perspective irrigation investment would not benefit much the landless poor, households which are nearly landless and farmers practicing rain-fed farming or located in the tail end of the water distribution systems. However, commercially oriented farmers might benefit from crop diversification made possible by assured irrigation.

A recent sample survey found that less than 20% of the irrigation systems had a strong organization for water management and maintenance, which

Figure 6.8. Irrigation Expenditure



Source: MEF

resulted in substantial capacity under utilization. The survey concluded that pumping stations are more efficient in delivering irrigation in Cambodia. The potential conflicts between upstream and downstream users of water in gravity-fed irrigation systems are avoided in the pumping-based irrigation systems. Irrigation using mobile pumping sets is becoming increasingly popular in Cambodia for saving the rice crop from drought.

High yielding seeds and correctly applied fertilizers and pesticides in combination with carefully managed irrigation increase crop yields and financial returns. Cambodian farmers, particularly those practicing subsistence agriculture, tend to use their own seeds despite the poor germination rate. Even though farmers pay for the high quality seeds supplied by the seed producing firms, the crop yields triple with their use.

## 7. Financial Sector Reform

### 7.1. Financial Sector Development Strategy 2006–15

The ten-year sector blueprint for financial sector reform “*Vision and Financial Sector Development Plan for 2001-2010*”, was adopted by the Royal Government of Cambodia on the 24<sup>th</sup> August 2001. The blueprint

envisages the development of a sound, market-based financial system that will enhance resource mobilization and sustainable economic growth. The blueprint was updated with the technical assistance of ADB. The Prime Minister launched the “*Financial Sector Development Strategy 2006–2015*” on 7 June 2007. This strategy will guide financial sector reform in the next 10 years with the aim to increase competitiveness in the sector. The key ingredients of the strategy include the adoption of the Law on Negotiable Instruments and Payment Transactions. The Law aims to simplify payment transactions, eliminate legal uncertainties, and reduce payment system risks. Another important initiative under the strategy is the introduction of the Credit Information Sharing System which provides commercial banks with credit-related information on prospective customers, thus lowering delinquency rates and loan defaults. However the development of a national payment system and a comprehensive information technology system for banking functions has become pressing sectoral challenges.

In promoting integration and soundness of the financial system, the RGC is committed to greater openness in policymaking and integrating Cambodia’s financial sector with the region and the rest of the world. For deepening integration and strengthening the financial system the following approaches will be emphasized:

- First, the achievement of a sound policy framework that can deliver macroeconomic stability and lay the foundation for sustainable growth.
- Second, fostering an environment that promotes a competitive, integrated, and efficient banking system. This should be based on sound regulation and supervision so as to create a healthy financial sector for mobilizing adequate savings to support the growth of the private sector. A reliable payment system and a banking safety net are important ingredients of a healthy banking system.
- Third, a viable, pro-poor microfinance system is necessary for providing affordable financial services to the poor to enhance rural income and reduce poverty.

- Fourth, an insurance sector that protects businesses and individuals from catastrophic events should be developed. Cambodia is developing a life insurance sector in order to meet the needs of the Cambodian population, which will also act as a pension system that provides for secure retirement and a supplier of capital for long-term investment in the real sectors of the economy.
- Fifth, an efficient and transparent capital market with a critical mass of issuers that mobilizes funds for long-term investment should be developed. RCG is working in partnership with the Korean Stock Exchange to prepare a study and develop the infrastructure for launching the first Cambodian Stock Exchange in 2009.
- Sixth, legal and accounting systems for commercial and financial transactions based on the rule of law which support good governance by promoting transparency, accountability, and predictability should be developed as soon as possible. The MEF is training up to 70 Chartered Public Accountants a year in order to improve the financial statements and disclosure standards of the corporate sector. This capacity building initiative is crucial for the development of the stock market.

## **7.2. Legal Infrastructure**

Cambodia's legal reform process in the financial and commercial areas is aimed at improving the enabling environment for the financial sector and for economic growth generally. Cambodia has taken several important steps to prepare, adopt and implement key legislation in the financial sector. In the next stage the experience in implementing the legislation in place should be evaluated and additions and refinements made to the legal framework.

An enabling legal framework for financial and commercial transactions could be strengthened by continued support for Cambodia's process of legal reform, including the adoption and implementation of the necessary set of core financial and commercial laws, harmonized and aligned with Cambodia's overarching legal system. There has been significant progress

in legal reform in a relatively short time. Additional draft laws are now either now before the National Assembly or being prepared. These laws will improve business opportunities and provide greater certainty for financial and commercial transactions. They include the Law on Secured Transactions, the Law on Financial Leasing and the Law on Insolvency. A new Law on Commercial Contracts will provide rules for business agreements. There are others at the conceptual stage of development.

During a recent assessment of the functioning of Cambodia's dispute settlement system, stakeholders in the financial sector emphasized that the law should be "certain and transparent". The current court process for the enforcement of collateral on land is seen as lengthy, uncertain and subject to delays, including the uncertainty in appeal steps.

The strengthening of Cambodia's dispute resolution system should be broadly supported. This is critical for the effective working of the emerging financial and commercial legal framework. The introduction of commercial arbitration under the new Law on Commercial Arbitration will be a key mechanism to consistently enforce contracts and resolve commercial disputes in a fair manner. The new Commercial Court has the potential for improving transparency and finality under clearly set court procedures.

The introduction of more innovative financial products and services in a dynamic financial sector, balanced with a risk-based approach to supervision, should be assisted by support for a comprehensive review of the relevant banking and insurance laws. This may include the key elements of Cambodia's financial safety net, including the introduction of a form of depositor protection.

The revision of the law for the handling of conflict of interest will strengthen corporate governance particularly for banks and financial institutions receiving deposits and other payments from the public. New market conduct rules for the protection of banks' customers will also help build public confidence. In general, future donor assistance could address the preparation of new laws and the revision of those that require updating to reflect the changing business conditions.

### 7.3. Capital Market Development

The “Financial Sector Development Strategy 2006-2015” envisages the development of a sound, market-based financial system. Capital market and banks function complementarily to enhance the efficiency of financial system which is crucial for stimulating economic growth. The vision for the capital market sub-sector is to have an efficient and transparent capital market with a critical mass of issuers that mobilize long term investment funds. The market will appropriately address risks, remove obstacles to financial development and support risk management and financial resource accumulation and allocation.

The development of the securities market will yield the following benefits:

- In addition to bank deposits which are basically held on short-term basis, capital market will increase the mobilization of savings, by providing an array of attractive saving instruments, which can be used for financing long term investments. Capital market also provides a convenient mechanism for channeling foreign savings into portfolio investment. At present Cambodia can only attract foreign direct investment since capital market and the associated securities exchange infrastructure do not exist yet. Foreign portfolio investment will become a possibility once the securities exchange is established and rules are framed for foreigners to invest in Cambodian securities onshore
- It will lead to a more rational allocation of resources because funds, which would otherwise be spent on consumption, or kept in idle demand deposits with banks, are mobilized and redirected to promote productive business activities;
- Investors are usually reluctant to participate in long-term investment projects, even those with high return. With a capital market, investors can stay liquid while investing long term.
- Securities market improves corporate governance through information disclosure requirements which ensure better management standards and efficiency;

- Public companies owned by a multiple of stock holders through the stock exchange and subject to regulation tend to have better management records than privately-held companies;
- Companies can acquire other companies through the securities market for expanding product line and market share, increasing distribution channels, hedging against volatility, and acquire other necessary business assets.

Securities exchange will provide a marketplace that:

- Enhances the liquidity of securities and promotes fair trading prices that reflect the relative strength of supply and demand. With this function, investors can invest in securities with full information and enterprises can raise funds smoothly by issuing securities;
- Published market clearing prices will be the correct indicators of company performance on a rational basis and can be used for assessing the collateral value or the asset value of underlying securities;

For investors of listed securities, the advantages are the following:

- Opportunity to buy and sell securities at market determined, fair price;
- More choices of savings instruments;
- Participation in ownership of a company satisfying strict corporate governance norms;
- Higher trust and higher name value.
- The market value of the securities can be used with more assurance as an indicator of the underlying corporate value;
- The securities of listed companies can be used as currency in Merging and Acquisition dealings;

### **7.3.1. Phases for Capital Market Development**

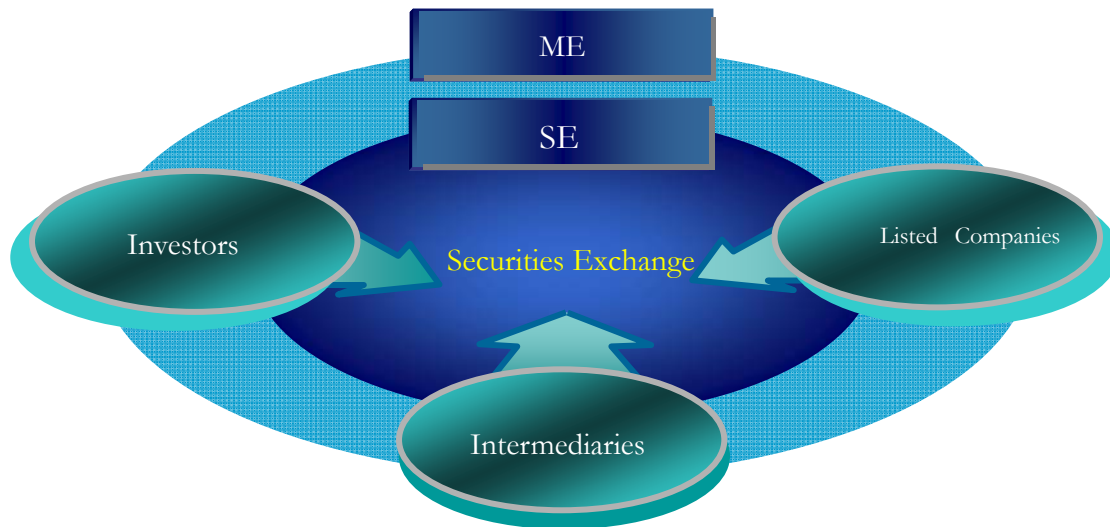
The capital market development plan under the strategy consists of three sequenced development phases as discussed below. The vision is to achieve a capital market structure described in the Figure.

#### **Phase 1 (2006-2009): comprising**

- Enactment of Law on Government Securities. This was accomplished on 10 Jan. 2007. MEF is preparing the sub-decree and Prakas under the law;
- Operation of government securities market should precede the establishment of a private securities market. This will help gain public investor confidence and get the investors to familiarize themselves with the functioning of the securities market.
- Development of appropriate regulatory framework relating to insolvency, and the progressive company framework;
- Enactment of Law on Issuance and Trading of Non-Government Securities. The law was adopted in 2007;
- Continuing improvement of accounting / auditing capacity;
- Implementing the MOU with the Korean Exchange (KRX);
- Training to raise public awareness, investor education and human resource development to support financial market development.

#### **Phase 2 (2009-2012): comprising**

- Implementing progressive, graduated framework for companies;
- Launch of the Cambodian Securities Exchange in 2009;
- Opening a securities depository in the CSE for all public companies in operation and a public company registration authority;



- Implementation of rules on financial governance and regulation;
- Continuing development of financial information and company regulation;
- Ensuring that public offerings of securities will be permitted only through the securities exchange;
- Design of investor compensation scheme to address risks of failure of securities intermediaries holding client assets.

### **Phase 3 (2012-2015): comprising**

- Development of investment funds;
- Development of pensions/provident fund schemes;
- Development of securitization framework/institution;
- Development of derivatives market;
- Provide tax incentives to attract investors in government securities.

### **7.3.2. Key Issues of Capital Market Development**

The major issues in capital market development relate to the steps required to be taken to establish the capital market under the Law on the Issuance and Trading of Non-Government Securities including:

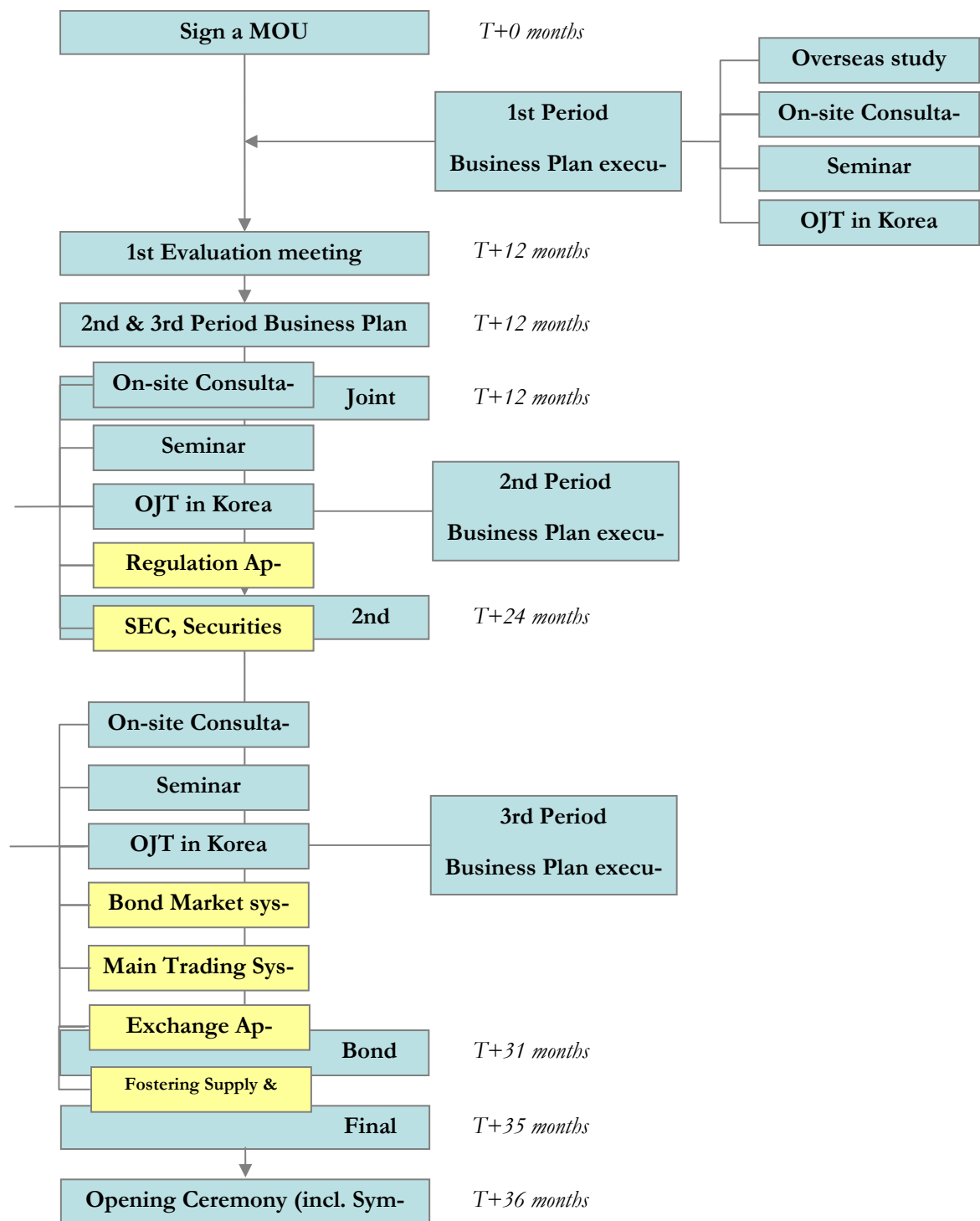
- Establishment of Cambodian Securities and Exchange Commission – the only regulatory body regulating and supervising all kind of securities businesses;
- Establishing a primary market for offering and issuing new securities to public investors;
- Establishment of a securities exchange, and a system of securities intermediaries, clearing and settlement, and a securities depository;
- Regulations for a fair, efficient and transparent securities market and investor protection.

### **7.3.3. Implementation of the Cambodian Securities Market Project**

The Ministry of Finance and Economy of Korea and the Ministry of Economy and Finance of Cambodia signed an MOU on May 4, 2006, indicating their intention of collaboration in the establishment of a securities exchange in Cambodia. A Roadmap was prepared to guide the implementation of the project.

The purpose of this road map is (i) to define the role of each party for establishing a securities exchange in Cambodia and preparing for the operation of the newly established securities exchange; (ii) to specify the core tasks to be carried out by each party for the establishment of a securities exchange; and (iii) to propose a time table for the completion of the core tasks. The activities will be carried out during 36 months following the signing of the MOU by the KRX and the MEF.

An appropriate legal framework is essential for the establishment and nurturing of capital market. The MEF will prepare for and introduce a



legal framework necessary for the establishment of a securities exchange in Cambodia. The KRX will provide suitable experts to assist the preparatory work.

The schedule for the establishment of the Cambodian Securities Market has been agreed as follow.

MEF will give priority to the following activities in the implementation of the capital market development strategy:

1. formulate and implement laws and regulations for the establishment of SEC, a securities exchange and securities firms;
2. formulate and execute laws and regulations for fostering potential listed companies and investors; and
3. enforce accounting and auditing standards.

#### **7.4. Reform of Insurance sector**

The insurance industry needs to perform a number of specialized st roles that are not required in other finance institutions. As insurance is young in Cambodia these specialists' skills are not available but these should be developed (e.g. underwriters, actuarial, loss adjustors, fund managers).

*The immediate development priorities of the insurance industry are:*

- Review of the entire industry to verify adherence to international best practices;
- Developing financial reporting standards: Financial reporting standards for insurance companies should be based on clear rules regarding the establishment of loss reserves for claims which may arise in future; and audit requirements for insurance companies should be clearly defined;
- Matters relating to activities of the supervisor: this should include capacity building of MEF staff, including comprehensive training; cooperation and resource sharing in the region;

increased reliance on professionals, including adopting a file-and-use approach to reporting; introduction of IT support; and obtaining membership in the International Association of Insurance Supervisors (IAIS);

- Privatization of CAMINCO: The privatization of this company will complete the process of privatizing the insurance sector in Cambodia;
- Inter-Ministerial Collaboration: the group responsible for making insurance sector policy, including concerned MEF staff should participate in Inter-Ministerial committees with representatives of the Ministry of Public Works and Transport, Ministry of Land Management, Urban Planning and Construction, Ministry of Tourism and Ministry of Interior to examine ways to promote better compliance with the rules on the mandatory insurance of vehicles and construction sites;
- Commencing support for the development of life insurance through feasibility studies and legal and regulatory development. A study will be undertaken to assess the potential market for life insurance business in Cambodia, including using microfinance approach;
- Micro-insurance: Introduce a mechanism for regulating and supervising the activities of microfinance institutions that seek to offer insurance protection to their members. Rules should be less restrictive than those that apply to standard insurance companies, and include the conditions defining the types of institutions that may offer micro-insurance products and set appropriate limits on the scope of their operations.;
- Life insurance: Develop an appropriate strategy for life insurance development, including necessary elements of legal framework and the preparation of feasibility studies relating to legal and regulatory development. A study will be undertaken to

assess the potential market for life insurance business in Cambodia, including micro insurance Cambodia should revise its regulatory framework to enable the licensing and operation of companies that sell life insurance policies.

*Medium term priorities are:*

- Life insurance: Authorize life insurance contracts as a funding vehicle for pension and retirement savings plans;
- Actuarial requirements: There are no actuaries functioning in Cambodia at present and the likelihood of a cadre of professional actuaries establishing business in Cambodia in the near future is remote. Until there is adequate life insurance and pension business, it is unlikely that actuaries will find it attractive to locate in Cambodia. Actuaries supply the technical expertise necessary to evaluate long-term obligations in insurance and pension business. In most developing markets, necessary actuarial skills are obtained through the services of international bureaus situated in major centers. The introduction of life insurance operations will necessitate the establishment of rules for using expatriate actuaries for evaluating life insurance and pension proposals;
- Training institute: At present, there is no insurance training institution. Capacity-building is required for both staff of the private insurance companies and the supervisory staff. Provided the industry demonstrates robust growth, in the medium term it will be appropriate to consider the creation of an insurance training institute based in Cambodia. This institute could contribute to training of sales representatives as well as supervisors and office managers;
- Consumer protection and customer awareness: Insurance is a business of contracts. For the insurance business to take root, the contracting parties should be fully knowledgeable regarding

the implications of the terms of the contract before entering into it. Settlement of any claim arising under the contract should strictly follow the terms of the contract. Any difference of opinion with respect to that settlement should be resolved through the courts or some formal alternate dispute resolution system. In order to support development, Cambodia could consider establishing a consumer affairs entity separate from the supervisor. Further, Government and industry, working together should adopt measures to raise public awareness of insurance business and what services can be expected from an insurance policy. Consideration could also be given to legal and judicial training;

- **Tariff requirements and uniform policy wordings:** The General Insurance Association of Cambodia (GIAC) should develop and propose a schedule of minimum prices to be charged for the most common insurance products. Tariffs proposed should be supported by independent professional assessment to ensure that they will be adequate to support the claim payments that could arise under the policies. The insurance supervisor would accept the tariffs and prescribe that the rates charged by companies should not be less than those specified in the tariff schedules. Arrangements must be made for enforcement of tariffs. Uniform policy wordings could be specified such that all companies would be expected to define coverage and nature of indemnity and loss in the same terms. The use of these wordings would should be mandatory and enforced;
- **Feasibility study for the development of a private, voluntary pensions system in Cambodia:** Private pension plans, organized on a voluntary basis, are institutional investors much like insurance companies. Whereas social security programs and any mandatory program for retirement savings would fall within the purview of the Ministry of Social Welfare, voluntary pension

schemes and their supervision should be the responsibility of the MEF. Promotion of voluntary savings for retirement will be greatly assisted if there are attractive fiscal incentives for individuals (or employers) to set aside a portion of current earnings as savings for retirement. The development of pension plans as institutional investors will also be a catalyst for the evolution of local securities markets.

*Longer term objectives include:*

- Implementing the social security law, including issuing the appropriate supporting instruments;
- Developing a regulatory system to deal with private pensions. It will be necessary to include vesting rules for employer contributions; funding requirements for guaranteed benefits; actuarial certification for defined benefit plans; and investment rules that stress yield without sacrificing safety and liquidity;

Examining the advantages of including a mandatory savings plan for formal sector workers, perhaps as a part of the social security system. Such a program may not be necessary in Cambodia, given the relatively young age of the majority of the population and the fact that the extended family concept of support is still very strong. However the extended family as a social safety net could break down in the future with greater urbanization

## **7.5. Micro Finance Institutions**

Rapid expansion has put pressure on many aspects of MFI business. The most pressing is finding adequately trained and skilled professionals to meet the needs of a growing industry. Capital funding, both term debt and equity, are a constraint. Funds that can be raised at prices that allow profitable business growth are being on-lent as quickly as they are mobilized. Business systems, particularly information technology (IT), are under strain to keep up with the growth.

MFIs are not contributing much to the mobilization of savings, particularly from the poor in a significant way. The inability of the financial sector institutions to motivate the poor to save more and invest more in improving their livelihoods is a major short coming.

Foreign exchange risk management is another area where MFIs lack the tools and the know how. The currency mismatch inherent in lending in local currency in a dollarized economy has led to a number of sub-optimal management practices which could put some MFIs at risk, if they continue to grow without effective foreign exchange management policies.

The MFIs have shown a high level of adherence to the supervision and regulatory instructions of the NBC. The NBC has adopted a firm stance in respect of interpretation and enforcement of the regulations. While this is laudable, there are a number of regulations that could be reviewed and amended to allow further expansion of services, products and more rapid rural savings mobilization.

While not presently an issue, when an inter institutional money market develops in Cambodia qualified MFIs which meet the required prudential standards should be allowed to participate in it. MFIs should not be ab initio debarred from participation in view of the much higher credit risk they face compared to the commercial banking institutions.

The microfinance sector is well established and is growing robustly. To sustain the pace of the growth several supportive measures are needed including establishment of a foreign exchange hedging market, and accelerated capacity building both of finance professionals who run the business and the poor who are the bulk of the clients of MFIs.

## 8. Public Finance Reform

Since 1998, the Government has significantly improved the alignment of resources with its developmental objectives by increasing allocations for priority sectors, notably education and health. Government-executed

spending on the priority sectors increased from 1.4 percent of GDP in 1998 to 3.2 percent in 2001. Furthermore, as indicated in the National Poverty Reduction Strategy (NPRS) the Royal Government of Cambodia (RGC) intends to continue this strategy, with ambitious targets for growth in priority sector spending. The reallocation to the priority sectors was financed through increased growth and revenues, and reduced expenditures in defense and security.

There are considerable sectoral differences in the effectiveness of expenditures in improving social welfare outcomes which suggests uneven capacity within the government in expenditure management. In education the steady progress made since 1999 in expanding educational opportunities is reflected in increasing total enrolment. There have also been significant achievements in the health sector, including a decline in the incidence of some deadly communicable diseases and expansion of physical coverage of the public health system. However, the general access to the public to health services needs to improve. Access to health services remains low and uneven and the imbalances in the incidence of spending need rectification. In the roads sector, though a start has been made on reconstruction and rehabilitation, the state of the rural road network remains poor. Significant increases in maintenance expenditure are required. In the agricultural sector the lack of both clear sector policy and input-output information makes evaluation of impact difficult.

Recent experience suggests that in order to reach stated poverty reduction goals, it will be necessary to improve the effectiveness of spending by linking it more closely to desired priority outcomes. Increased effectiveness can be attained by improving the pro-poor targeting of resources through more tightly targeted sector plans and budgets. Public expenditure and financial management have thus emerged as the first priority of the reform program. Without expenditure management reform, the impact of further improvements in expenditure policy will be limited.

However, the RGC has recognized that the public financial management system in Cambodia is still weak. Good governance in managing public

finance is still a major concern of the RGC. Therefore it is necessary to continue promoting the implementation of a deeper, systematic, and comprehensive public financial management reform program. In this context, the “Rectangular Strategies for Growth, Employment, Equity and Efficiency in Cambodia” which has been set out by Samdech Prime Minister Hun Sen as an economic policy agenda of the RGC within the third legislature of the National Assembly has reemphasized the necessity to continue improving the public financial management system in Cambodia.

Under the Rectangular Strategy the Ministry of Economy and Finance has embarked on a systematic review and evaluation of the state of the administration’s public financial management system by drawing upon on all available information including assessment reports, analytical and evaluation reports, as well as other related reports in the area of public financial management, and experience from RGC’s reform programs, especially the Strengthening Economic and Financial Management program, also known as the Technical Cooperation Assistance Program (TCAP), and the Integrated Fiduciary Assessment and Public Expenditure Review (IFAPER) which were the technical cooperation programs supported by many donor agencies and countries. The important goal of this initiative is to develop a comprehensive public financial management reform program with a clear long-term vision; and a stage-by-stage program with clear and realistic action plans for each stage toward achieving the vision endorsed by the RGC.

These efforts have been recognized and strongly supported by Cambodia’s development partners, including bilateral partners and international agencies, through a common agreement on adopting a “Sector Wide Approach (SWAp)” as the modality for the preparation and implementation of this important and comprehensive public financial management reform program. The SWAp identifies the actions and activities needed to achieve the program objectives and the responsibilities of the various stakeholders including the donors to carry these out.

With the strong support of international development partners, the RGC has prepared a public financial management vision document which will serve as a guide for the stage by stage implementation of a comprehensive and systematic public financial reform program which will be completed in 2015. The most important improvement of this reform program over the earlier ones is that this program was constructed with a clear structure and a realistic action plan developed stage by stage with strategies to build institutional capacity and human resources, including the provision of equipment and other necessary supports as well as appropriate technology.

## **8.1. Public Financial Management Reform**

In accord with the NPRS, the RGC has reformulated its public financial management (PFM) improvement and reform strategy. The long term objective of PFM reform program is the adoption of generally accepted best international standards in public financial management practice. The reform strategy involves transforming the traditional cash-based budget system into one which provides for the proper management of all government assets and resources. This will involve the eventual introduction of generally accepted standards for accrual accounting.

The aim is to install much higher standards of management and accountability in the mobilization of all government current and capital resources and effectiveness and efficiency in the use of resources in their application to the operation of the Government's NPRS and other priority programs.

A sound public finance system comprises a set of interlocking operational sub-systems. These are: (a) accounting and transaction processing systems, (b) budgeting systems, (c) revenue systems, and (d) access systems. A brief description of the main features of these operating subsystems is as follows:

### **Accounting and transaction processing systems**

1. Consistent approach to accounting across government as a

whole based initially on accounting for cash payments made within the fiscal year.

2. Future considerations to be given to possible change to accounting on an accrual basis relating to the consumption of resources in a year - staff inputs, goods and services.
3. Empowerment of budget holders to implement transactions, unhindered, in accordance with budget (as revised during the year). Greater reliance on post payment review and internal audit rather than pre-payment scrutiny by MEF.
4. Separate capture and control of information about commitments entered in to, but not yet liquidated.

### **Budgeting systems:**

1. Annual budgets of all budget holders set in the context of realistic multi-year estimates published alongside these.
2. Roll-over of multi-year estimates so that second year in one cycle becomes starting point for the budget in the next cycle.
3. Comprehensive in that all significant deployments of public resources, however financed, are captured.
4. Encompasses program based analysis of resource deployment and monitoring of the use of resources.
5. Decentralized and conveys both authority and responsibility to budget implementers.

**Resource mobilization systems:** (Tax and non tax revenue, external assistance and debt financing)

1. Effective use of revenue raising capacity in Cambodia through balanced approach to use of taxation (direct and indirect), levy of user charges to the public and other financing sources available to the public sector (including external assistance and

external and domestic borrowing).

2. Ensure full compliance with the prevailing laws and regulations (including the Law on Taxation, Customs Law and Law on Investment) and prudent and transparent management of external assistance and debt financing, whilst minimizing cost to the taxpayer and to the Royal Government, and optimizing the amount of revenue available for the Royal Government to implement its policies through public expenditure programs.

### **Access systems:**

1. Common access of all budget implementers to the same accurate and reliable data on a timely basis based on integrated use of modern IT.
2. Open to scrutiny by all interested parties, inside and outside of Government, to view performance compared to budget based on a clear and transparent data trail.
3. An effective system of both external and internal audit in which audit supports rather than hinders management to make effective use of resources.

The Royal Government is in the process of developing a monitoring and evaluation sub-system to enable regular monitoring and assessment of the public financial management system.

The key features of the targeted vision of PFM reform program are consistent with international standards and best practices, which will cover the following aspects:

- Budget Realism: The budget is realistic and implemented as intended in a predictable manner (e.g. composition of expenditures compared to approved budget, actual amount of funds received by service delivery units etc.).
- Comprehensive, Policy-based Budget: The budget captures all

relevant fiscal transactions, and is prepared in an orderly, predictable way with due regard to government policy (e.g. single budget process fully coordinating budgeting for investment and recurrent expenditures, budget ceilings informed by government's relative spending priorities defined at political level).

- Fiscal Management: Aggregate fiscal position and risk are monitored and managed (e.g. few or no expenditure arrears, adequate system for management of domestic and foreign debt).
- Information: Adequate fiscal, revenue and expenditure records and information are produced, maintained and disseminated to meet decision-making, control requirements and management purposes (e.g. budget reports, with classification allowing comparison with budgets, are made available to ministerial management in a timely manner say after the month/ quarter end; regular, high quality reconciliations of bank accounts).
- Control: Effective control and stewardship is exercised in the use of public funds (e.g. effective internal audit system; public procurement system based on clear, consistent and enforced rules; payroll records and nominal rolls linked through computerized system to which MEF has access).
- Accountability and Transparency: Effective external financial accountability and transparency arrangements are in place (e.g. communities have regular access to information on budgets allocated to and funds received by service delivery units; external audit covers all major public sector entities and a full range of financial audit).
- Clarity and accountability: Clear legal and institutional frameworks for functional and spending responsibilities across government levels, and for budget holders' management accountability (e.g. Program managers have maximum allowable

flexibility in selection, mobilization and use of resources to achieve program objectives accompanied by a system of accountability to deliver the results. Accountability to national assembly and people for use of resources is transferred to line ministries, which are also publicly accountable for program performance).

- Value for money: in use of public resources (e.g. negotiated decrease in price of items procured regularly by the government; unifying procurement by different agencies to obtain discounts associated with larger purchases).
- Responsiveness: of fiscal and budget management (e.g. institutionalized mid-year review of budget performance feeding into implementation during the first half of the second budget year and preparation of subsequent budget).
- Professionalism: in the civil service and incentive systems (e.g. build a core group of technical experts).

The reform program will progress in four stages: Stage One: comprises short term action plans including all necessary activities for achieving Platform One, plus activities with long lead times and necessary for later Platforms; Stages Two and Three: Medium term, planned for towards the end of Stage One, when Platform One objectives are within sight; and Stage Four: Long term while well on the way to achieving the vision.

- Platform 1 - More credible budget: In the first instance, the Royal Government will strive to achieve a position in which the budget becomes more credible as an instrument of strategic and day to day management of public resources, because it delivers a reliable and predictable resource to individual budget managers. This means that the budget reflects mobilization of all significant public resources and their deployment. It thereby enables steps in subsequent stages to hold budget managers

more accountable for the proper, efficient and effective use of resources.

- Platform 2 – Effective financial accountability: Having secured compliance with budget practices established in Platform 1 and eliminated inappropriate practices by budget stakeholders, the Royal Government will turn to tightening the accountability of the budget stakeholders and rewarding good practice. This will require initial improvements in internal control and accountability systems at all levels. It will focus on the monitoring of resources by providing better data, effective discipline, and greater internal transparency.
- Platform 3 – The RGC’s policy agenda becomes fully affordable and prioritized: From the base established in previous stages, by which the budget is now established as a credible instrument for policy implementation, the Royal Government will focus on developing techniques and capacities for analyzing the budgetary impact of policies and for connecting policy priorities and service targets to budget planning and implementation, thereby assuring that government policies are fully affordable and prioritized. This will enable greater accountability for program performance.
- Platform 4 – RGC managers become fully accountable for program performance: Having reinforced the stability, soundness and policy orientation of budget planning and management practices, the Royal Government will start to hold budget managers accountable and rewarding them for achieving agreed objectives and standards of performance. Processes of accountability and review for both financial and performance management will be fully integrated, resulting in greater external transparency and more effective feedback from implementation into policy formulation.

Achieving the vision of Public Financial Management will require long term government commitment and willingness to plan and devote resources, financial and human over the long haul. In addition, the success of the Public Financial Management reform program depends on progress made in other key pillars of good governance including Legal and Judicial Reform and Civil Service Reform, and active participation of Development Partners including donor community, private sector, civil society, and all levels of government officials.

The government has given high priority to the timely and orderly implementation of the PFM reform program since it is required for the effective and efficient use of the scarce public financial resources, so crucial to the achievement of the ultimate goals of enhancing growth, employment, equity, and efficiency of the Rectangular Strategy

The PFM Reform Project has the following components:

- Budget and Treasury Operations Reform: This component will support the modernization of Treasury management to improve budget execution and control, including establishing a Financial Management Information System (FMIS). Sub-components include: (i) mapping current budget process in detail (from budget release to commitment and to payment) and developing transition plan for new streamlined processes; (ii) increasing payments to and from Government through the banking system in terms of tax collections and Government payments to civil servants and contractors; (iii) designing and implementing measures to improve budget discipline by limiting accumulation of payment arrears; (iv) obtaining technical guidance on quality assessment of FMIS system framework and procedures, with an emphasis on streamlining and improving the transparency of key business processes before computerization commences; (v) obtaining technical advice on appropriate policy, system design, and content, taking into account capacity and technology constraints and including a program of phased roll-out; (vi) IT

system software and hardware, including testing and quality assurance; (vii) building sustainable capacity in the Ministry of Economy and Finance (MEF) for operating the FMIS and use the reports that it will generate; and (viii) training and capacity development in line agencies as appropriate to allow use of system generated information. This component would also require working with line ministries, which are at different stages of readiness to implement the reforms.

- Procurement: This component will support the development of improved arrangements for processing of procurement actions, in order to improve transparency, economy, and efficiency, streamline spending processes, and accelerate fiscal de-concentration. It will also facilitate implementation of the revised procurement procedures resulting from expected improvements in the legislative and regulatory framework for procurement, including use of the procurement manual and harmonized standard bidding documents that are currently under development. Sub-components include: (i) revising procurement processing arrangements in light of new budget transaction processes, (ii) assisting with the drafting of a sovereign procurement law, (iii) decentralizing procurement to line ministries and provinces, and (iv) appropriate capacity building, which will also include training of procuring entities, contractors, and suppliers for implementing the improved procurement procedures. This component would also require working with line ministries, which are at different stages of readiness to implement the reforms.
- Tax Administration Reform: This component will support modernization of the Tax Department through capacity development based on institutional and organizational reform. Measures are likely to focus on the headquarters office. As an initial step the project would review the Tax Department's

reform program. Such a review would also provide an opportunity to build greater ownership through staff participation and to consult taxpayers on issues of concern. Attention would be paid to the incentives faced by staff in the institutional and organizational milieu in which they operate. Sub-components include: (i) transforming the organizational structure to a functional structure, (ii) development and implementation of a capacity development program for the Tax Department, (iii) improved service delivery focusing on enhanced taxpayer registration and taxpayer account management, improved audit and coverage, and enhanced taxpayer services, and (iv) development of mechanisms to improve transparency and accountability, including possibly the establishment of a taxpayer ombudsman function and a private sector oversight board.

- Merit-based Pay and Employment Initiative (MBPI): Both the RGC and its DPs acknowledge that addressing the incentive problem, which consists both of the lack of meritocratic management and extremely low pay levels, is a prerequisite for reform and longer term capacity development. The lack of adequate incentives and meritocratic management framework means that many civil servants are tardy and, if they do turn up for work, are ill-motivated to carry out their official duties. Previous attempts to reform the PFM system have floundered due to the lack of a mechanism to address the pay and employment problem. The MBPI reflects an agreement between MEF, the Council for Administrative Reform, and DPs to pilot a pay and employment reform program in MEF. Core elements of the MBPI include: (i) funding from DPs (on a declining basis) and the RGC (on an increasing basis) for increased remuneration for selected staff; (ii) selection and management of staff for the MBPI based on merit and performance; (iii) payment through the payroll; (iv) parallel work on functional

analysis leading to a rightsizing exercise; (v) complementary work on human resource management reform, including setting up an establishment register; and (vi) agreement to phase out salary supplements.

- Strengthening the Budget Oversight Capacity of the National Assembly<sup>3</sup>: This component would assist the Finance and Banking Committee (FBC), including through a more informed understanding and review of the budget law, to hold the RGC to a higher standard of accountability. Thus far, the FBC has had very limited influence on the budget. This component would assist the FBC to better analyze and monitor the implementation of the budget law, thus playing a greater role in budget decision making and in overseeing the use of public funds. To this end, a capacity development program specifically targeting the FBC would be developed. Such a program would be tailored to meet the needs of the FBC and its staff members and would concentrate on a set of activities designed to strengthen the Committee's oversight capacity, through local, regional, and international budget-related events and workshops, study tours, and the development of relevant study guides/tools. The program would address such topics as: (i) the National Assembly and the budget cycle, (ii) budget review and oversight, (iii) the role of National Assembly in measuring the impact of public expenditures, and (iv) transparency and participation in the budget process.
- Change Management: This component will provide support for education and advocacy about the project, including for extensive consultation with relevant stakeholders in MEF and line ministries, capacity development to design and implement a transparent and participatory change management process, and a

<sup>3</sup> This component is not included in the formal PFM reform program, which pertains exclusively to the executive branch of government.

communications strategy. Given the sensitivities likely to be roiled with such a significant and important overall of key business practices in MEF and eventually the line ministries, serious attention to a change management strategy will be critical to the project's success.

- Capacity development: MEF's Consolidated Action Plan recognizes, at a broad level, the need for a combination of technical and capacity building activities in support of achieving each of the platforms for long-term reform of public financial management. Activities foreshadowed to support achievement of Platform 1 (and later platforms) include broadly-described capacity building, motivational and organization measures. However, much more work needs to be done, especially regarding the activities needed to support Platform 1. There is a risk that capacity development activities get sidelined by complex technical activities. There is also a risk that the Economics and Finance Institute (EFI) will not be able to implement the capacity development program. Mitigation measures include: the planned motivational and organizational measures, and rapid movement on both the capacity development plan for Platform 1 and an institutional assessment of EFI.

## **8.2. Tax Reform Program**

Three areas have been identified as priority areas for implementing tax reform namely (i) Change process, (ii) Tax policy, and (iii) Tax administration. The activities under each of these areas are briefly described below.

Change process includes establishing a formalized and transparent approach to the reform process through the use of an Organizational Technology Framework and identifying the essential elements; providing the linkage between all the essential elements as they are interdependent; establishing the Departmental vision and communicate that vision within

and outside the Department; conducting a review of the current Tax Department's functional roles and responsibilities and providing advice and assistance in taking appropriate action to establish formal roles and responsibilities of Headquarters, Regional or Provincial Offices and District Offices (the functional model).

Tax policy reform involves identifying and rectifying anomalies in the tax laws and recommend changes based on the need for modernizing the tax policy linked to fiscal direction and policy of the central government with regard to the tax regime including tax on profits for the Assessment Regime, tax on salaries, local taxation, value added tax, turnover tax, excise, and tax policy analysis.

Tax administration reform involves improving headquarters' management capacity; implementing the Real Regime in the five main regional offices; establishing a solid management information system with appropriate data to meet the needs of the MEF, head office, and the field or district offices; developing an operational procedures manual for all levels of tax administration and setting performance standards at the divisional and individual staff level; establishing LTU and MTU in Phnom Penh to improve administration of the largest taxpayers; establishing a system of monthly statistical reports; ensuring that the Real Regime covers all large and medium sized business by dividing Real Regime Unit into a Large Taxpayer Unit and a Medium Taxpayer Unit with an integrated administration of all taxes and organized along functional lines; implementing the Real Regime in the remaining provinces in the medium term; establishing formal audit manuals and procedures and a modern management information system for the audit operation, developing an audit strategy that provides for a broader coverage of taxpayers and utilizes new selection techniques based on risk analysis; and ensuring information on importations from registered/non-registered taxpayers is received from the Customs Department..

In addition, there are measures to alter and improve the structure of tax and its administration which will also improve revenue performance. The

following are the various measures which are under the management of the MEF to improve tax performance:

### **8.2.1. Broaden Tax Base**

For a major impact on revenue mobilization it will be important to broaden the tax base. As stated above, taxes in Cambodia are heavily trade oriented. As the economy develops and the service sector expands and deepens, there will be more activities on which taxes can be levied. Therefore, it is very important to enlarge the tax base to other sectors as the economy expands and diversifies to avoid unduly burdening a particular sector.

### **8.2.2. Personal Income Tax**

This tax has yielded relatively little revenue in Cambodia as the number of individuals subject to this tax (especially at the highest marginal rate) has been small. The rate structure of the personal income tax is the most visible policy instrument available to most governments in developing countries to underscore their commitment to social justice and to gain political support for their policies. Cambodia has adopted a progressive tax so that families with low income are not taxed.

In response to the need to improve equity in taxation, the Department of Taxation will study and recommend to MEF the scope for effects of reducing the threshold of annual profit tax and monthly salary. Correspondingly, the Department will enhance its efforts to collect strictly mandated salary taxes from schools, NGOs, and employees of international institutions.

### **8.2.3 Corporate Income Tax**

Tax policy issues relating to the corporate income tax are numerous and complex, but particularly relevant for developing countries are the issues of multiple rates based on sectoral differentiation and the incoherent design of the depreciation system. Therefore the Ministry of Economy and Finance will simplify the corporate income tax by unifying multiple corporate income tax rates.

Moreover, allowable depreciation of physical assets for tax purposes is an important element in determining the cost of capital and the profitability of investment. Since restructuring the depreciation systems is important for revenue performance, the Tax Department will reform the depreciation allowance as follows:

- Assets will be classified into three or four categories and only one uniform depreciation rate will be applied to each category.
- Depreciation rates will generally be set higher than what is warranted by the actual physical lives of the underlying assets, to compensate for the lack of a comprehensive inflation-compensating mechanism as in most tax systems.
- Depreciation will be computed using the declining-balance method rather than the straight-line method, simplifying the administration of the system. The declining-balance method allows the pooling of all assets in the same asset category and automatically accounts for capital gains and losses from asset disposals, thus substantially simplifying bookkeeping requirements.

#### **8.2.4. Value-Added Tax (VAT)**

Although the performance of the VAT has been satisfactory there are several concerns that should be addressed in the near term, such as the improvement of VAT registration, VAT refund procedures, compliance with the VAT, and the VAT threshold. Collection of indirect taxes through VAT could be improved substantially by streamlining tax exemptions and incentives. The VAT is considered as a less regressive tax instrument than the previous consumption (turnover) tax.

In response to these VAT issues, the Ministry of Economy and Finance will take the following actions:

- The VAT threshold<sup>4</sup> will be reviewed, especially relative to the coverage of the real regime, so that the base of VAT taxpayers is defined in terms of the ownership structure of businesses.
- The VAT Sub-Decree on electricity and the amendment to the VAT Sub-Decree for reducing taxpayers threshold in order to increase the coverage of taxpayers in the self assessment system will be reviewed and modified if necessary to ensure that it is consistent with the objective of mitigating the impact of the tax on low-income households.
- The VAT refund system will be reviewed and modified to reduce its complexity and increase its ease of use by applicants.

### **8.2.5. Tax Incentives under the Law on Investment**

The provisions under the Law on Investment regarding profit tax and customs duty exemptions severely limit the scope of the tax base and the dutiable imports in Cambodia.

While granting tax incentives to promote investment is common in most countries evidence suggests that their effectiveness in attracting incremental investments—above the level that would have been reached had no incentives been granted—is often dubious. Those exemptions that do not clearly and unambiguously increase investment should be deleted. Tax incentives, such as exempting raw materials and capital goods from the VAT, are prone to abuse and are of doubtful effectiveness in increasing investment. Furthermore, collection of the VAT may not improve with elimination of exemptions, if these exemptions were at the intermediate stage of production. Exempting raw materials and capital goods used to produce exports, from import tariffs is somewhat more justifiable as the exemption would level the playing field for Cambodian

<sup>4</sup>The MEF recognizes that lowering of the VAT registration threshold could increase the administrative workload for the tax department and adversely affect tax compliance while department already struggling to control the compliance of existing large and medium-size taxpayers. In order to cope with this matter, tax administration capacity will be further strengthened along with introduction of full automatization of tax administration operations.

exports in the international markets. Still, the difficulty with this exemption lies in ensuring that the exempted purchases will in fact be used as intended by the incentive. Establishing export production zones whose perimeters are secured by customs controls is also a useful, though not entirely foolproof, remedy for this abuse.

Tax incentives can be justified if they address some form of market failure, particularly those involving externalities (economic consequences beyond the specific beneficiary of the tax incentive). For example, incentives targeted to promote high-technology industries that promise to confer significant positive externalities through enhanced worker skills or lowering input costs on the rest of the economy are usually justifiable. By far the most compelling case for granting targeted incentives is for meeting regional development needs of these countries. Nevertheless, not all incentives are equally suited for achieving such objectives and some are less cost-effective than others. Frequently, the most prevalent forms of incentives found in developing countries tend to be the least meritorious.

The cost-effectiveness of providing tax incentives to promote investment is generally questionable. Not all tax incentives are equally effective, and some are more justifiable and cost-effective than others in terms of their demonstrable impact on investment. The best strategy for sustained investment promotion comprises a few simple but tested elements including:

- Provide a stable and transparent legal and regulatory framework;
- Put in place a tax system in line with international norms;
- Encourage balanced regional development;
- Implement a simple but comprehensive system of accelerated depreciation;
- Limit investment allowances or tax credits;
- Avoid tax holidays and investment subsidies.

As a general rule, indirect tax incentives should be avoided, and discretion in granting incentives should be minimized. Reduction of tax exemptions is also very important as a measure to enlarge the very narrow tax base, and to reduce the current dependency on a few number of companies. It is desirable to unify all exemptions in a single law covering all fiscal incentives. Government will adopt the above approaches in promoting investments.

The following supporting Revenue policy and administrative measures will be implemented to address the weaknesses in the taxation system:

1. Improving Headquarters' management capacity;
2. Further promoting human resource development through in-house and overseas training programs;
3. Strengthening the organizational structure of the Tax Department by improving institutional capacity of staff at all levels, especially at the level of offices and provincial and municipal branches;
4. Improving staffing policy in the areas of personnel, training, taxpayer's services, audit and debt recovery;
5. Consolidating the "real regime" at the provincial office level;
6. Enhancing management information system with appropriate data to meet the needs of the MEF, head office and district offices;
7. Developing operational procedures and manuals at all levels and performance standards at the divisional (and later individual) staff level;
8. Strengthening the capacity of the Large Taxpayer Unit (LTU) and the Medium Taxpayer Unit (MTU) in Phnom Penh to improve administration of the largest taxpayers;
9. Improve the system of monthly statistical reports;

10. Ensuring that the “real regime” covers all large and medium-size businesses
11. Enforce the collection of gambling taxes;
12. Expand taxation on unused land;
13. Expand and strengthen the collection of excise tax;
14. Improve the collection of the Capital Gains Tax;
15. Conduct research and prepare recommendation to MEF for amendments to gas and natural resources tax law;
16. Strengthen forecasting and tax revenue analysis; due to complexity of analysis and the lack of time series data, it is important to provide caveats about the dependability and stability of such forecasts<sup>5</sup>;
17. Prepare and study tax treaty on Double Taxation Agreement (DTA) and negotiate with other countries;
18. Improve the implementation of tax arbitration;
19. Expand tax collection payments through the banking system by medium-income taxpayers in both provinces and cities outside Phnom Penh;
20. Implement and strengthen the accommodation tax;
21. Strengthen the self-assessment system in provinces and cities outside Phnom Penh;
22. Improve the audit program and prepare a comprehensive manual comprising the 54 circulars, bringing the new model statement to an operational level;

<sup>5</sup> *Despite these difficulties which must be explicitly noted, these forecasts must be developed for each of the different tax categories (conditional on intended administrative improvements as well as on sectoral forecasts), both as an input into the general budgeting process and as monitorable performance indicators.*

23. Strengthen the use of taxpayer invoices as indexed by the Census of Taxpayers at province and cities outside Phnom Penh;
24. Implement tax collection enforcement measures to be applied to tax delinquents debtors/delinquents, creating tax-debtor classes based on risk, income and debt levels;
25. Improve rules for addressing administrative protests, policies, strategies, guideline circulars so that dealing with them is systematized and made transparent;
26. Strengthen the network system management in using IT system at tax branches in both in Phnom Penh and cities outside Phnom Penh;
27. Strengthen the support taxpayer services, including return processing, audit, strategic planning, personnel, training, tax debt, inquiry and cross-checking and transportation;
28. Improve Tax Department webpage with a new server supporting a network (Web server, file server, application server, back-up server) and protection system;
29. Continue training programs for staff, both in-country and abroad;
30. Prepare all equipments for new department building with its library, create new divisions and tax branches in provinces and cities outside Phnom Penh;
31. Improve the incentive system for tax officers based on performance;
32. Increase tax on luxury cars and transportation cars;
33. Expand the Real Regime tax system to other provinces<sup>6</sup>;
34. Strengthen the enforcement and collection of tax in all cities and

<sup>6</sup> So far 17 provinces have been integrated into the Real Tax Regime.

provinces by providing proper notice, and using deterrents against tax evaders such as blocking the accounts in banks, stopping the import-export documents, and other appropriate measures;

35. Strengthen the cross check of tax payer information with other departments, such Customs Department, CDC and others.

36. Continue the flow of tax payments into the TSA (Treasury Single Account) at the National Bank of Cambodia.

### **8.3. Customs Reform**

In spite of declining tariff rates brought about by trade liberalization, revenue mobilization and control functions of customs still remain substantial, for several reasons: (i) the fiscal dependency on customs revenues in light of difficulty in broadening the tax bases; and (ii) imports constitute a major tax base for levying VAT. Moreover, customs continues to be responsible for effective and efficient border management to facilitate trade. Customs administration takes on a larger role in ensuring national security and law enforcement.

Improving customs administration, therefore, is crucial for raising revenues, providing domestic producers with protection, providing supply chain security, facilitating trade, preventing importation of prohibited or unsafe imports, and combating the trade of narcotics through the implementation of laws and regulations that are in line with WTO commitments.

For customs administration to improve, the following reform measures have been implemented in customs administration:

#### **8.3.1. The New Law of Customs**

In its reform and modernization plan, the Customs and Excise Department (CED) focuses on the development and implementation of a modern Law on Customs and concerned regulations which are fundamental to customs operations to comply with international

standards and practices. The new law of Customs was promulgated by the king on 20th July 2007. To implement this new law, 37 supporting regulations will be issued soon. The Law and its supporting regulations are compliant with the international standards and best practices. The Manual on Law on Customs and Its Related Regulations is being prepared and will be published and distributed.

### **8.3.2. Customs Valuation**

As part of its WTO accession, the RGC requested the delaying of the full implementation of the provisions of the WTO Valuation Agreement for up to five years (Article 20 of the Valuation Agreement) as elaborated in the transition plan (Table 7 of Working Party Report). This transition period was intended to allow the CED time to develop its internal capacity and to ensure traders were ready for the new system and avoid leakage of revenue.

The implementation of the WTO Valuation Agreement goes side by side with the reform and modernization of the CED. In preparation for the implementation of the WTO valuation agreement, progress has been made in the following areas:

- The Law on Customs (LOC) was promulgated (20 July 2007), and the CED is finalizing the 37 implementing regulations
- One of these regulations deals with customs valuation. In preparing this regulation, provisions of the Agreement on the Implementation of Article VII of GATT 1994 have been taken into account (definitions, valuation methods etc.) Accordingly, the Cambodian customs valuation regulation is fully consistent with WTO rules and concept;
- Imports of large multinational and local companies with well-established compliance records hence with low-risk and imports by investment companies and other duty exempt entities, are valued using the WTO methods. These importers would be required to provide CED with information on the price actually

paid, freight, insurance charges, and to agree to participate in Post-Clearance Audit program and maintain and make available company records;

- Cambodia still uses Pre-shipment Inspection service (PSI). The PSI provider (BIVAC) is obliged to follow Cambodia's commitments under WTO, particularly on customs valuation. The PSI contract includes a requirement for an exit strategy under which BIVAC is committed to provide the CED with technical assistance; training and IT support to enable the CED to assume its full responsibilities at the conclusion of the contract. To date BIVAC has assisted the CED introduce the valuation reference database (VeriVALUE), including provision of the computer hardware and software, and direct access to the database through the local BIVAC office.

### **8.3.3. Decentralization**

To gradually implement WTO Valuation Agreement, the CED has prepared a decentralization policy on Customs Valuation. The decentralization process of customs valuation is being carried out side by side with both manual system and with the implementation of customs automation project --ASYCUDA. The strategies are as follows:

- WTO Valuation Agreement is applied to approximately 80% of the total duty paid imports by the PSI company (BIVAC);
- Decentralization process of Customs Valuation from the HQs (Customs Technique Office -CTO) to Customs check points will be implemented step by step, and would be fully implemented in Sihanoukville port along with ASYCUDA;
- Valuation Officers from within the CTO and from other customs offices have been selected and being trained as the specialized customs valuation officers;
- From 1st January 2008, a number of the selected specialized

customs valuation officers will be sent to work at Sihanoukville port and a few other major checkpoints for facilitating a smooth transition from the current system to the WTO system.

#### **8.3.4. Risk Management**

Risk Management is a major component of the 2003-2008 Plan of Action and Modernization of Customs and Excise Department (CED) to enhance revenue collection, expedite trade documentation, improve control procedures and strengthen enforcement activities through risk based targeting of assesses. This framework has been specified in Chapter 6 and Standard 6.4 the Revised Kyoto convention.

Progress achieved in implementing Risk Management include:

- Approval of Sub-Decree No 21 ANK. BK on Facilitation of Trade through Risk Management on 01 March 2006. Its guidelines are in place;
- The Risk Management Steering Group has been created consisting of 15 Customs officials. They are working with JICA exports to develop the Risk Management model;
- The draft templates of the inter-agency agreement on Risk Management are under final stages of preparation. They were prepared by AUSAID experts and discussed in an inter-agency technical seminar held on 6-7 Feb 2007 at CED headquarters;
- The Office of Risk Management and Audit in CED has been established by Prakas No. 607 MEF/CED of the Ministry of Economy and Finance. The assignment of staff has been finalized;
- The Traders' Credibility Management System (TCMS) has been established and installed under technical assistance from JICA;
- The initial 28 key indicators to assess trader's compliance with the relevant laws and regulations. The preliminary scoring

method and levels of risk including Standard Criteria for the model have also been established. This will be included in a Ministerial Prakas to provide the legal basis for implementing the Risk Management system.

- Survey of about 1700 companies has been completed by RMA, Control, Export and PP municipality Customs Offices. Data on the 28 risk indicators have been keyed into TCMS based on the surveyed results, import/export statistics, and VAT-TIN CD Package provided by the Tax Department;
- JICA has provided 2 overseas training events for the Customs Risk Management Steering Group. In addition JICA also provided 4 local workshops on Risk Management for Customs officials. Ausaid had earlier also provided six workshop and training courses on Risk Management for customs officials and ministries officers;
- Nine selection criteria namely Rank of Trader, New Importers, Unknown Importers, New Items, GSP Applicable Goods, High Customs Duty Amount, High Customs Duty Rate, High Customs Value, and Country of Origin have been developed, to categorize assesses. The random ratio has also been established as a basis for calculation in the ASYCUDA Selectivity Module;
- Information exchange between the RMA Office and ASYCUDA has been established. It includes Memorandum of Understanding, Type/Format/and Content of written correspondence, and maximum time allowed to complete the information exchange. A method of how to arrive at a Selectivity Decision from the given selectivity criteria has also been agreed;
- Data on the 9 Selectivity Criteria has been delivered to the ASYCUDA Team. The data are based on the results of TCMS, trade statistics, IL list from ASEAN Department, and other

available sources;

- Tariff Book 2007 provided the input into ASYCUDA. However, some selectivity criteria especially those relating to HS Codes are not compatible with the system because they were extracted from import/export statistics of previous years that use tariff 2004 version. The updating of the codes for ASYCUDA is ongoing;
- The Inter-Ministerial Committee on Risk Management was established comprising 10 senior customs officials. The first meeting of the Committee was conducted on 05 Feb 2007 at CED headquarters to speed up the preparation of the prohibited / restricted list of high risk goods and solve other technical issues
- CED has requested all ministries concerned as specified by the Sub-decree No 21 to send prohibited and restricted lists of goods to CED. CED has received some lists from Ministry of Industry, Mine, and Energy (MIME), by Ministry of Agriculture, Forestry and Fishery (MAFF), Ministry of Commerce (CAMCONTROL), Ministry of Health (MOH), Council for the Development of Cambodia (CDC)/special Economic Zone, and others. The consolidation and coding of these items have been made resulting in about 3,000 lines of tariffs headings/sub-headings. However this number was found to be too large. During the meeting of the Inter-Ministerial Committee on Risk Management held on 18, 19, and 26 Oct 2007, the draft of Prohibited and Restricted Goods was finalized and it was agreed to reduce the total tariff lines to 1537. The meeting also decided on the authority responsible for administering each product in the list;
- An annex to the Prohibited and Restricted List has been developed to explain prohibited/restricted items that cannot be

included in the list due to technical difficulties. The Annex also explains the "Treatment Code" of each product and some other technical issues.

### **8.3.5. Customs Brokers**

The introduction of the institution of the Interim Customs Broker into customs clearance operation was approved by the MEF inletter N° 2664 dated 25 May 2007. Subsequently,

- Qualifications and criteria of the legal persons to engage in the business of customs broking have been prescribed;
- A working group consisting of 5 senior customs officials has been established to oversee the work of the customs brokers. This unit functions under the direct guidance of the Risk Management and Audit Office;
- The announcement of the new system of Interim Customs Broker has been widely publicized with more than 100 companies responding by applying for interim customs broker license;
- To ensure the sound process of clearance of goods, non customs brokers can also clear goods from customs (the existing practice) even after the Customs Broker System came into effect. The dual system will be abolished at an appropriate time.

### **8.3.6. Single Administrative Document-SAD**

The Prakas on SAD was issued under the Law on Customs. This Prakas has been finalized and but is not yet approved. The progress on this matter is as follows:

- The format of the SAD (UN-Layout key, consistency with WCO data model), its Explanatory Notes and General Declaration Processing Path have been finalized and are Annexes to the Prakas on SAD;

- Training courses on SAD have been provided to both customs officers and private sector such as freight forwarders and interim customs brokers;
- The manual SAD will be put into use from 15 January 2008 and the electronic SAD from 2nd quarter of 2008.

### **8.3.7. ASYCUDA**

The developments in implementing ASYCUDA are as follows

- Technical requirements for pilot data platforms such as Reference Tables, Procedures for Decentralized Exemption and Valuation Management have been finalized;
- The new Cambodia Customs Tariff 2007 which is consistent with AHTN 2007 was put into use on 15 July 2007;
- The Prototype Version 1.0 was endorsed in May 2007 at the end of phase 1;
- Training courses on SAD and AHTN 2007 have been delivered to both customs officers and private sector during the second phase which started since early June 2007;
- Training for the National Project Team (NPT) members has been organized;
- Translation of ASYCUDA World into Khmer by NPT members has been completed;
- Sihanoukville Port refurbishment has been completed;
- The procurement of pilot site computer equipments and communication is being processed;
- The mechanism of information exchanges between ASYCUDA and Risk Management Office has been established.

## 9. Conclusion

According to the base-line scenario developed by SNEC, the Cambodian economy is expected to grow at a somewhat lower rate of about 8-9 percent per annum over the next several years, but growth will likely accelerate thereafter when oil production commences in 2010 or 2011. A non-trivial portion of growth over the past decade was due to the post-conflict ‘catch up’ phenomenon, which will likely level off over the next few years. As Cambodia confronts stiffer competition from globalization (e.g., Vietnam’s entry into WTO), the high cost of doing business—characterized principally high energy and transport costs—will also become binding constraints. As a result of these effects, growth in the currently growth leading sectors will likely become less buoyant. In the near term the economy will likely continue to be led by tourism, the garment industry, and construction, with agriculture providing periodic but volatile growth spurts depending on weather conditions.

Beyond the near term, however, Cambodia will need to diversify its sources of growth to sustain 7.0 percent from higher annual non-oil growth rates. As private sector development reforms take root, sectors other than garments and tourism should increasingly contribute to growth. Agriculture is also expected to improve its performance when reforms, including those pertaining to land management, are implemented and when investment in infrastructure increases. The external current account deficit is projected to decline in the medium term. Inflation is targeted to fall to about 3 percent in the medium term program.

The continuation of growth supporting policies will be crucial for sustaining high growth rates. The main overarching policy thrusts include financial sector reform and public financial management reform. The design of policies in these two vital areas has been described in earlier sections. Other reform areas include diversification of the economy by encouraging investments in new manufacturing activities, supporting agriculture and agro-business and developing physical, social and

economic infrastructure, particularly the expansion of new tourism sites, which will have major multiplier effects on the rest of the economy.

Acceleration of rural economic growth will have a tangible impact on poverty reduction. A key aspect of Cambodia's rural development strategy is channeling more public investment to irrigation and increasing the budget allocation for agriculture extension services. The rural focus of public expenditure should continue if agriculture is to sustain its performance in the medium term.

Cambodia can not afford to rest on its laurels. It will continue to emphasize sound macroeconomic management, particularly a prudent approach to monetary and fiscal policies and an outward looking growth strategy based on gaining competitiveness in international markets. Improving the quality of public institutions and the public investment program through the vigorous implementation of the Public Financial Management Program and governance reforms such as improvement of the judicial system are other areas of priority in the government's policy agenda. Cambodia strongly supports globalization and the ASEAN. The way forward for Cambodia is integrate itself even more strongly with the international economy. Cambodia is seeking more partners in development who will join hands with her to pull the country out of poverty and underdevelopment.

Looking to the future, to sustain the improvements made over the last decade, Cambodia should undertake further measures to reduce and prevent structural inequalities to take root. The Royal Government of Cambodia has been long aware of the situation as reflected in the priorities of the Rectangular Strategy for Growth, Equity, Employment and Poverty Reduction, and sought to have a strong strategy to rectify this trend, by emphasizing the development of rural economies where 85% of the population live. The government is committing itself to the enhancement and better implementation of pro-poor growth policies. In this connection the following approaches will be actively pursued by the government:

- Increasing connectivity between rural and urban areas will reduce urban –rural inequality. The prosperity in cities appears to have limited spill-over effects on the rural areas suggesting weak rural-urban linkages and poor connectivity between rural and urban sectors. Moreover the high positive correlation between poverty incidence and remoteness strongly implies that the poor in remote rural areas have inadequate access to basic infrastructure and public services such as roads, education, health facilities and urban markets.
- Policy shift aiming at accelerating of rural economic growth will have a tangible impact on inequality and poverty reduction. A key aspect of Cambodia’s rural development strategy is channeling more public investment for further development of rural infrastructure and increasing the budget allocation to improve the quality of public services in the countryside.
- Reduce the vulnerability of becoming poor – there is a high risk of the non-poor who are marginally above the poverty line to fall below the poverty line during times of adversity. In particular in the rural areas, poor farmers may be forced to sell their assets, including land during times of health distress and calamities. The government will look at the possibility to establish social health insurance and safety nets, particularly for those who are the most vulnerable.
- Provide secure land tenure – Land is the basis of wealth, especially in an agricultural society such as Cambodia: patterns of land ownership will have a very great influence on whether Cambodia follows a path of shared growth in the future, or sees a growing gap between rich and poor. Hence, the authorities will exert further efforts to secure land tenure through expediting and extending titling to remoter, poorer areas where land disputes are more serious and find ways to provide poor landless families with access to unused land.

- Broaden the base of economic growth. The significant economic dependence on the garment industry poses a high risk to macroeconomic management. If growth of garment exports were to falter due to external factors, there will be major job losses in the economy. This could be socially disruptive since garment workers transfer a substantial part of their wages to their families in rural areas to supplement farm-based incomes. Phasing out of safeguard restrictions on textiles will be destabilizing. The “safeguarded” exports constitute 80% of Cambodia’s total garment exports which could be severely affected when the safeguard restrictions are removed after 2008. The potential loss of market share to more competitive countries could be painful for Cambodia. Diversification of the industrial sector is therefore of great urgency. The government will introduce further measures to bolster competitive advantage by lowering costs including port and other transport charges, electricity tariffs, and informal payments which are high in Cambodia, to pursue industrial restructuring based on market principles.
- Employment generation will be of high priority. The traditional role of agriculture as the main source of additional employment has diminished. At the present, the role of the garment industry as a source of employment and income generation is becoming more crucial. However, the rapid expansion of employment in the manufacturing sector could not fully compensate the inadequate employment absorption in agriculture. More robust agricultural development can revive the role of agriculture as a significant contributor to employment and income generation. However, the volatility of agricultural production is not only a cause of widening income and asset inequality and immediate obstacle to poverty reduction, but is also a major constraint to sustainable, broad-based development of the non-farm economy. The Government has increased investment in irrigation infrastructure reducing to some extent the vulnerability of agricultural outputs to weather condition.



# Appendix 1: List of financial institutions in Cambodia

## List of Commercial Banks (as of 31 March 2007)

1. Advanced Bank of Asia Ltd.
2. Cambodia Asia Bank Ltd.
3. Canadia Bank Plc
4. Cambodian Commercial Bank Ltd.
5. Cambodia Mekong Bank Ltd.
6. Cambodia Public Bak
7. First Commercial Bank Phnom Penh Branch
8. Foreign Trade Bank of Cambodia
9. Krung Thai Bank Public Co. Ltd. Phnom Penh Branch
10. May Bank Phnom Penh Branch
11. Singapore Banking Corporation
12. Union Commercial Bank Plc.
13. Vattanak Bank
14. ACLEDA Bank Plc.
15. ANZ Royal Bank Cambodia

## Specialized Banks

1. Rural Development Bank
2. Specialized Bank PENG HENG SME. Ltd.

- 3.Cambodia Agricultural Industrial Specialized Bank
- 4.First Investment Specialized Bank
- 5.ANCO Specialized Bank
- 6.CAMCO Bank

## **Microfinance Institutions**

- 1.AMRET Co. Ltd.,
- 2.HATTHAKADSEKAR
- 3.TONG FANG Micro finance Ltd.
- 4.THANEAKEA PHUM CAMBODIA
- 5.Cambodian Entrepreneur Building Ltd.
- 6.SEILANITHIK Ltd.
- 7.Angkor Microheranh vatho Kampuchea
- 8.VISION FUND (Cambodia) Ltd.
- 9.CREDIT Co. Ltd.
- 10.PRASAC MICROFINANCE Institution Ltd.
- 11.FARMER UNION DEVELOPMENT FUND
- 12.Cambodian Business Integrate in Rural Area
- 13.Maxima Mikroheranhvatho
- 14.INTEAN POALROATH RONGROEURNG
- 15.CHC Limited

16.PISETH Akphiwat Sethakech

## **Representative Office**

1.STANDARD CHARTERED

2.VIETNAM BANK FOR AGRICULTURE AND RURAL  
DEVELOPMENT





## Dr. Hang Chuon Naron

is currently the Secretary General of the Supreme National Economic Council (SNEC), a government think tank, and the Secretary General of the Ministry of Economy and Finance.

He studied International Economics at the Kiev State University and the Moscow State Institute of International Relations (MGIMO) from 1982 to 1991. After receiving Masters and Ph.D. degrees in International Economics at the Moscow State Institute of International Relations, he worked in various diplomatic missions and research institutions as a political and economic analyst. He also worked as a World Bank consultant to the Royal Government of Cambodia. In 2004, he attended an Executive Program at the JF Kennedy School of Government, Harvard University. In 2007, he received an Advanced Diploma in Insurance from the Malaysian Insurance Institute and the Chartered Insurance Institute (CII), United Kingdom. He is a member of the CII.

He held various positions at the Ministry of Economy and Finance, such as Research Coordinator of the Economic Advisory Team and First Deputy Director of Budget and Financial Affairs Department. Then he was appointed Deputy Secretary General in charge of Policies, including fiscal and financial policies, ASEAN, financial industry, economic analysis as well as negotiation with the IMF and the World Bank. He is author of a number of government policy papers and books on Cambodian economy and public finance.

He also serves as member and chairperson of the Board of Directors of a number of State-Owned Enterprises, such as Cambodian National Reinsurance Company, Telecom Cambodia and Electricity of Cambodia (EDC), as well as research institutes and NGO, such as CDRI, Cambodia's leading research institute, the Community-Based Natural Resource Management Learning Institute (CBNRMLI) and Youth Star Cambodia.

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