



Cambodian Economy:

Charting the Course of a Brighter Future
A Survey of Progress, Problems and Prospects



HANG Chuon Naron



2009

The front page photo is **“Cambodia’s Great King—Jayavarman VII”**

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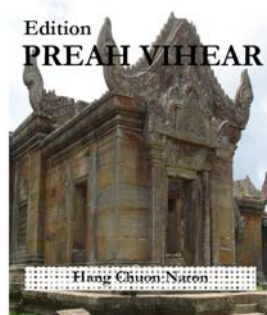
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Preface

The overthrow of Prince Sihanouk by the Lon Nol coup d'état on March 18, 1970, plunged Cambodia into the horrors of war, genocide, and unbridled violence. The two decades that followed dramatically transformed the society and economy of Cambodia. The seizure of power by the Khmer Rouge on April 17, 1975 set Cambodia on a course of genocide and self-extermination of its people. Cities were evacuated, hospitals emptied, schools closed, factories shut down, currency abolished, monasteries sealed off, and libraries destroyed. Life in Cambodia remained this way for three years, eight months, and twenty days. Cambodia's human resources were decimated. The Cambodian people were first kidnapped, and then besieged. The Khmer spirit was broken; its points of reference vanished.

The day of national redemption arrived on January 7, 1979, when the Front uni national de salut du Kampuchea (National United Front for the Salvation of Kampuchea), assisted by Vietnamese forces turned the tide against the Khmer Rouge. For many Cambodians this date celebrates the resurrection of Cambodia.

The Front immediately proclaimed the advent of the People's Republic of Kampuchea. The Cambodian people redoubled their efforts to reconstruct the country, organize the economy, set up the school system, reopen hospitals, and train management level staff. The first school to reopen its doors was Chaktaumuk, followed by Phnom Daun Penh (now Sisowath) Secondary School. The generation of my parents and parents-in-law worked ceaselessly to restore the educational system and save the Khmer culture. Furthermore, Fortunately many university students had left to continue their higher education abroad, especially in Eastern Europe. Many of them have returned to participate in rebuilding the nation.

Cambodia had to endure an economic embargo following the demise of the Khmer Rouge regime. The country had no access to international financial institutions; its currency was not convertible. Foreign aid from the Soviet Union, Viet Nam, and other countries of the Soviet bloc, as well as from some fifteen Western non-government organizations enabled the People's Republic of Kampuchea to begin the reconstruction of the economy and society. Despite these efforts it was not possible to fill the immense void in human resources caused by the Khmer Rouge regime. The first priority, in development was provision of training. The formation of the People's Republic of Kampuchea (PRK) in 1979 marked a new stage in the rehabilitation and reconstruction of the country in all sectors.

Even after the Khmer Rouge regime ended in 1979 civil strife continued. After a series of meetings on October 23, 1991, in Paris, 18 governments along with the

four Cambodian factions signed the Agreement on a Comprehensive Political Settlement of the Cambodian Conflict, with France brokering the peace deal. However, even after the general elections of 1993 following the peace agreement, unrest continued. The prerequisites for any serious development had yet to be established. A sense of insecurity prevailed in the country. The Khmer Rouge were routed but were still a presence in many parts of the country. The “win-win” policy of national reconciliation in 1997 initiated by Prime Minister Hun Sen finally ended the Khmer Rouge regime and dismantled its political and military organizations.

Nonetheless, Cambodia has paid a heavy toll for war and international isolation. In particular, the social costs have been heavy. In the early 1990s, Cambodia had the highest infant mortality rate in the world; the mortality rate for pregnant women and women in childbirth was double that seen in Africa and India. Cambodia also had the highest rate of disabled people in the world and the highest incidence of tuberculosis. Only 12% of the rural population had access to potable water. In some rural areas, barely 30% of the population had been enrolled in school.

In order to promote sustainable economic growth and rapid alleviation of poverty, the Royal Government of Cambodia (RGC) has given priority to investments in agriculture, physical infrastructure, with a special focus on transportation and telecommunications, electrical energy, human resources development, labor-intensive industries, as well as to manufactured exports and tourism. The goal of this policy is to lay the foundations for sustainable development.

Since 1993, the Cambodian economy has undergone a dramatic and rapid transformation. The traditional economy, based on agriculture is now driven increasingly by the industrial and the tertiary sectors. With the return of peace, a sense of confidence and pride pervades the country, a feeling that bodes well for bright prospects for economic growth and job creation and a concrete vision of a promising future. The government strategy is to help realize this vision by reinforcing Cambodia’s comparative advantages both regionally and internationally.

The RGC attaches great importance to private investment for laying the foundation for economic takeoff. The government’s strategy aims to make Cambodia a focal point for foreign investment and encourage the export of goods and services. This will enable Cambodia as a nation to shape its economic destiny by responding to market forces. The Cambodian people are capable of achieving this goal provided they are not denied market access and the government and other development partners are supportive,

Proud of its glorious past and recent achievements, Cambodia is managing to find the strength and will to undertake the decisions and actions necessary to speed up development. The Cambodian people are determined to fulfill their inherent

potential and make their dreams come true. No single individual or group can make development happen; development has to be a collective effort, through concrete contributions of all members of the society. If all work together, Cambodia can win the fight against poverty and achieve progress.

With the restoration of peace economic results have improved dramatically. During the last decade GDP rose at an average annual growth rate of 9.3%, thanks to prudent budgetary policy, healthy monetary management, and appropriate structural reforms. Though Cambodia has made much progress, the reform effort must be sustained and strengthened in key areas in order to promote sustainable development.

Cambodia, with annual per capita GDP of US\$700, remains one of the least developed countries. Much remains to be done in order to ensure strong and lasting economic growth in the future in a global and regional climate increasingly fraught with challenges. The economic success of recent years has been accompanied by rural and agricultural stagnation, growing inequality between urban and rural sectors, social problems of landless farmers, and the challenge of a young population in search of employment.

It is essential that all stakeholders in Cambodia agree on common objectives for pursuing their development and reform efforts. First, political stability, governance and respect for public order must be strengthened and law enforcement must be guaranteed. In the area of democracy and the promotion of human rights, Cambodia has adopted systems of governance appropriate for its cultural and historical heritage. Elections are organized regularly and with transparency and fairness. Individual and collective freedoms are assured. Political parties, labor unions, and the press function freely in this young democracy. Cambodia has also signed and ratified most of the international agreements on human rights protection. Education of citizens about their rights and responsibilities is an important area of government action. However, the pursuit of political liberties should not be at the cost of risking political and social stability achieved after decades of turmoil and bloodshed and should not lead to overstressing the capacities of the fragile political, social, and governance institutions of the nascent democracy. Also, the fruits of development must be shared equitably between the rich and the poor for preserving social stability.

Second, much remains to be done to correct social injustice despite the great freedom enjoyed by the press, including the foreign press, total freedom of worship, and the latitude given, in many respects exceptional, to the multitude of non-government organizations both national and foreign that are working in diverse areas. The top issues are human trafficking in women and children and the deprivation of landless farmers.

Third, the capacity to implement policy must be improved. Several institutional and policy reforms were undertaken during 1993-2008. Much more effort is needed to ensure that institutions function effectively and concrete actions emerge from approved strategies and policies. The reforms must strengthen the efficiency of the State's political and economic institutions. The top priorities are the implementation of an effective education policy along with provision of technical and vocational training, improving access to good quality health care and swiftly propagating the latest advances in information and communications technologies to the public in such a way that they can serve the cause of progress. The RGC is committed to identifying and implementing strategies and programs in these areas.

Fourth, protecting and developing natural resources will be crucial for sustaining development. Fair and equitable access to resources must be ensured to sustain social stability. Measures in technical, financial, cultural and academic sectors as well as in the area of political and institutional cooperation must reflect the political will to achieve sustainable development through protection of the environment. A transparent mechanism must be put in place to implement the sub-decree on social concessions to address the problem of landless farmers.

Fifth, in the area of capital accumulation, emphasis should be put on domestic resource mobilization and in the selection of efficient investment projects. Human resource development at all levels needs to be encouraged. Skilled entrepreneurs and administrators and technical knowledge are key factors of production and are as important in the production mechanism as physical capital. Investments for raising labor productivity and introduction of improved technology should be given priority. Cambodia has seen a middle class emerge in recent years; this is a welcome development which will contribute to social stability. The middle class should strengthen its capacity to benefit fully from the opportunities of development. The capitalist class of Cambodia needs to catch up with its comparators in the rest of the region as far as institutional and technical capacity is concerned.

Sixth, globalization and foreign economic relations must support development through: (i) official development assistance; (ii) direct foreign investment; and (iii) foreign trade. The activities and outcomes of the Cambodian Development Forum (CDF), advice of the IMF, World Bank, Asian Development Bank, and other donors of bilateral funds, along with deliberations in ASEAN, ASEAN Plus Three, and the World Trade Organization (WTO) must also be duly considered. Cambodia is committed designing projects, conducting debates or negotiations, and concluding agreements within these mechanisms which is conducive to economic takeoff.

Reports and analyses of the performance of economic and social infrastructure, public services such as education, health, transportation, communications, water and energy supply, irrigation and drainage systems, and favorable assessments of the

quality of institutions, and good governance, play a pivotal role in attracting private investment and mobilizing broad based international support for Cambodia's development effort.

This book attempts to take a broad look at Cambodia's struggle to promote sustainable development and shared prosperity, the strategies and policies for reform in essential sectors which underpin them, and the results they have produced. The emphasis is on Cambodia's achievements in the last decade and the problems that must be addressed in the future.

The book is organized on the following major themes: (i) an overview of Cambodia's geography and climatic conditions; (ii) Cambodia's demographics; (iii) the macroeconomic framework; (iv) agriculture and rural development; (v) industry and development of the private sector; (vi) the non financial service sector; (vii) infrastructure; and (viii) human resources development (ix) financial sector (x) Public Finance (xi) international economic relations. The book concludes with a discussion of issues in institutional and human capacity building which is the immediate challenge facing Cambodia.

I have had the personal satisfaction of having been intimately involved in Cambodia's development process almost since inception. This has given me insights which I have attempted to reflect in the book. I remain convinced that the motivation for the development of Cambodia at the grass roots level must come from the people of Cambodia. It is thus essential that they are fully informed of the achievements of their country and the challenges that remain. This book is a contribution to improving the information on Cambodia so that Cambodian public could better prepare itself to confront the challenges of development.

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HANG CHUON NARON

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INTRODUCTION

“Development is by definition a process of change. The increase in productivity and intensification of agriculture, the abandoning of farming activity in favor of employment in industry and services, and the consequent rural exodus, are all decisive factors in this process.”

Nicholas Stern

After more than three decades of civil war, Cambodia has experienced relative peace since 1998 and has been rebuilding its infrastructure, economy, and social fabric, and thereby enabling the country to redirect its resources and strengths toward sustained, equitable development. The country's achievements during the 20 years of reconstruction from January 1979 onward show what the Cambodian people are capable of doing when they put their talents and ingenuity to work for a peaceful cause. Cambodia is now back on track to achieve its destined place in the vanguard of the community of nations.

Three significant phases in the recent economic history of Cambodia can be discerned: A period of rebuilding from 1979-1990, a transition and reconstruction phase from 1991-1998, and a development phase beginning in 1999. Cambodia's economy grew steadily in all the three phases.

Cambodia had to virtually start from the scratch to rebuild the country after the defeat of the Khmer Rouge regime. At the very outset, the country had to face the harmful consequences of the economic embargo imposed in 1979. The annual rate of economic growth did not exceed 3.4% during 1988-1991, even though average annual growth in the manufacturing sector reached 6.3%.

Growth has been particularly strong since the early 1990s, with the implementation of macroeconomic reforms and normalization of economic and trade relations with the countries of the region. An annual average rate of 6.3% was achieved during 1994-1998, despite the upheaval caused by the Asian financial crisis of 1997-1998.

Since 1999, Cambodia has been working towards accelerating development. Growth was 11.9% in 1999, although slowing to 6.6% in 2002, with an annual average rate of 8.8% for the five-year period of 1999-2003. This growth is attributed to two flourishing sectors: garments and tourism. Despite this record, in 2005 questions arose on the capacity of Cambodia to sustain high growth due to its lack of competitiveness. The Multi-Fiber Agreement (MFA) expired in December 2004, which allowed WTO member countries, primarily China, to export clothing on a worldwide basis with no quotas imposed. It was anticipated that while the larger and more efficient textile manufacturers in Cambodia would be able to survive the global competition, the smaller ones would perish as they would be unable to compete.

From the early 1980s until 1991, Cambodia's economy was centrally planned. There were some attempts at reform in 1985, but economic deregulation effectively commenced after 1992. During the 1990s, Cambodia underwent a transition from a command economy to a market economy. Reforms and policies intended to encourage development of the private sector adopted in 1989 and 1990, liberalized the economy by dismantling price controls and encouraged private sector development including foreign investment. During this period, growth was achieved mainly from the production and service sectors. Agricultural production, on average, remained lower than population growth.

During 1993-1998, the RGC of Cambodia (RGC) had not yet been able to bring together the political and security conditions necessary for a stable, unified government. The Khmer Rouge were still a viable military force, a menace weighing heavily upon the security of the country, and the political fabric of the country was still fragile. Moreover despite government efforts growth slowed in 1997-1998 owing to political events and the Asian financial crisis.

It was only after the successful implementation of the “win-win” policy put forward by Samdech Hun Sen in 1998 that the RGC was able to finally dismantle the politico-military organization of the Khmer Rouge, thus bringing about the reestablishment of peace throughout the Kingdom, and the physical and political unification of the country. The government could take steps to strengthen the spirit of national reconciliation. The elections of 1998 created the conditions necessary for creating political stability in the country and allowed the government to focus on macroeconomic management.

Following the July 1998 elections, RGC adopted the triangular strategy with the objective of promoting sustainable development in Cambodia. Restoration of peace and stability, as well as maintenance of security for the country and its people—the first axis of the “triangle”—are now accomplished facts. The integration of Cambodia into the region and the normalization of its relations with the international community—the second axis of the “triangle”—had also been substantially achieved. Cambodia had regained its seat at the United Nations, which had been lost following the armed confrontations of July 1997, and became the tenth member of the Association of Southeast Asian Nations (ASEAN). The country joined the World Trade Organization (WTO) in October 2004. The third axis of the government's “**Triangular Strategy**” was to promote socio-economic development through an extensive reform program addressing public administration, decentralization, remobilization of the military, legal and judicial reform, gender equality, public finance, eradication of corruption, and sustainable management of natural resources. The triangular strategy was by and large successfully implemented as seen in higher growth and investment, improved monetary and fiscal policy management resulting in lower inflation and strengthened

foreign exchange reserves, larger inflows of foreign official transfers and private capital; and faster private sector development.

Nevertheless, Cambodia found itself at a crossroads at the conclusion of the second political mandate of the government in 2003. Following the elections of 2003 the country clearly wanted to proceed faster on the path of modernization. At the opening meeting of the Council of Ministers on July 16, 2004, Prime Minister Hun Sen launched the “**Rectangular Strategy for Growth, Employment, Fairness and Effectiveness in Cambodia.**” The core of the strategy is good governance. The successful implementation of the strategy depends on establishing a conducive environment in four critical areas: (i) peace, political stability, and social order; (ii) partnership for development, particularly partnership with the private sector, donor community, and civil society; (iii) economic and financial stability; and (iv) integration of Cambodia in the region and in the world. The four sides of the rectangle addressing reform are: (i) eradicating corruption; (ii) legal and judiciary reform; (iii) public administration reform, including decentralization and deconcentration; and (iv) reform of the armed forces, notably demobilization. Finally the four sides of the rectangle for creating growth are: (i) promotion of the agricultural sector; (ii) development of the private sector and job creation; (iii) rehabilitation and reconstruction of physical infra-structure; and (iv) capacity building and human resources development.

Cambodia must prove its ability to reform. The country has committed to a significant decentralization reform. These reforms were undertaken to allow the Cambodian people to live in a modern civilized society with basic amenities. The government is in the process of reforming the education and health sectors to ensure social justice and improve the quality of life of all Cambodians. These reforms are necessary so that Cambodian society can face the future confidently.

Cambodia must not only overcome impediments to growth through the reform process, but must also create the conditions for sustainable growth through equitable distribution of costs and benefits of development. For a start business costs, costs that weigh upon employment are being cut down. The country must map out a clear strategy and implement it in order to enhance its attractiveness as an investment destination.

Stability and prosperity depend upon the ability of Cambodians to strengthen good governance. The promotion of transparency, fairness, efficiency, and accountability requires first of all an updating of the government’s agenda of liberalization, globalization, and building partnerships within the country and at the international level.

The agenda for achieving growth in Cambodia is clearly defined in the Rectangular Strategy. But the challenge lies in making growth the process work for the poor.

Poverty reduction requires appropriate measures, such as: (a) a public finance policy that will raise revenue in an equitable manner and incomes through pro-poor public expenditures; (b) maintaining macroeconomic stability; and (c) formulation and implementation of appropriate sector policies including increased investments in health and education, addressing gender issues, development of ethnic minorities, land reform, sustainable management of fisheries resources and protection of the environment.

While commune councils could move forward with the identification and resolution of the causes of poverty at the local level, sustainable poverty reduction requires increased investment in the economy. The development strategy must give high priority to attracting foreign investment by creating and maintaining a favorable environment. Cambodia has taken significant measures for improving the investment climate but it should ensure that its incentive structure is competitive with its neighbors and comparators in the region..

The RGC has strengthened economic and financial management with the help of its development partners and is working to accelerate the momentum of the reform process by improving services in tax and customs administration, budget and public treasury management, central bank transactions, economic statistics, and development of the legislative framework for monetary and financial reforms. For accelerating social development, the RGC has allocated a large part of the budget to the education, health, agriculture, and rural development sectors, which have huge payouts by way of social benefits. Over the last five years, the government has more than tripled budgetary spending for health, and almost doubled public expenditure on education. But much remains to be done to improve the efficiency of public expenditures and the quality of public services. More importantly, Cambodia must ensure that the increase in budget funding is accompanied by improved performance in the concerned sectors.

The RGC has been working on an effective strategy for improving transportation infrastructure, in particular roads and bridges—the very foundation of the national economy— for creating a more extensive and operational road network allowing Cambodia to promote economic and tourist activities, facilitate the movement of goods and services, promote local and foreign investment, and open up the potential of the rural economy. Reducing the cost of transportation will encourage private business investment and employment.

Cambodia has made giant strides in development in the last decade. In particular, under the Rectangular Strategy of the second mandate of the government, Cambodia has achieved a profound transformation of the Cambodian society. But with each stage of development accomplished, new challenges arise. Cambodia's economic performance has been severely affected since late 2008 by the yet

unresolved global economic crisis. The government has acted swiftly to counter the social impact of falling incomes and employment from declining garment exports, tourism and construction pursuant to the crisis. Over the long haul, economic reforms have to be accelerated to build greater resilience in the economy to withstand external shocks. The country has to be firm in its resolve to achieve progress and bring about better living conditions for the people. There is yet a long way to go, and no one knows this better than Cambodians themselves.

Symbols and abbreviations

ACLEDA	Association of Cambodian Local Economic Development Agencies
ADB	Asian Development Bank
ADD	Accelerated District Development
AFD	Agence française de développement (French Development Agency)
AFTA	ASEAN Free Trade Area
ASEAN	Association of Southeast Asian Nations
BDR	Bank of Rural Development
BOT/BOO	Build, operate, transfer / Build, own, operate
CAR	Council for Administrative Reform, Council of Ministers
CARDI	Cambodian Agricultural Research and Development Institute
CDAF	Council for the Demobilization of the Armed Forces, Council of Ministers
CDC	Council for the Development of Cambodia
CDRI	Cambodia Development Resource Institute
CDV	Village Development Committee, Ministry of Rural Development
CG	Consultative Group
CIB	Cambodian Investment Board
CRDB/CDC	Cambodian Rehabilitation and Development Board of the Council for the Development of Cambodia
EDC	Électricité du Cambodge
EU/ EC	European Union/ European Commission
FAO	Food and Agriculture Organization of the United Nations
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
GMS	Greater Mekong Sub-region
GSP	Generalized System of Preferences
HRMIS	Human Resources Management Information System
IPP	Independent Power Producer
IIPP	Integrated Investment Priorities Program
ILO	International Labor Organization (United Nations)
IMF	International Monetary Fund
MAFF	Ministry of Agriculture, Forestry and Fisheries
MDG	Millennium Development Goals
MEF	Ministry of Economy and Finance
MEYS	Ministry of Education, Youth and Sports
MFIs	Microfinance institutions
MFN	Most-Favored Nation
MIME	Ministry of Industry, Mines and Energy
MLMUPC	Ministry Land Management, Urban Planning and Construction
MoE	Ministry of Environment
MoH	Ministry of Health
MoP	Ministry of Planning
MoPT	Ministry of Posts and Telecommunications
MoPWT	Ministry of Public Works and Transport
MoRD	Ministry of Rural Development
MoWRM	Ministry of Water Resources and Meteorology
MoWVA	Ministry of Women's and Veterans' Affairs
MPA	Minimum Package of Activities, Ministry of Health
MW	Megawatt
NAA	National Audit Authority
NBC	National Bank of Cambodia
NGOs	Non-government Organization

NPAR	National Program for Administrative Reform
NPRDC	National Program for the Rehabilitation and Development of Cambodia
NR	National Road (Highway)
OD	Operational District, Ministry of Health
ODA	Official Development Assistance
OECD	Organization for Economic Cooperation and Development
PAP	Priority Action Program
PEP	Public Expenditures Program
PIMS	Public Investment Management System
PIP	Public Investments Program
PMG	Priority Missions Group
PSI	Pre-shipment inspection
RCAF	Royal Cambodian Armed Forces
RGC	Royal Government of Cambodia
RH	Referral Hospital (Ministry of Health)
SEDP	Socio-economic Development Plan 1996-2000
SEILA	Khmer word for “foundation”, a government rural development program
SMEs	Small and Medium-size Enterprises
SWAP	Sector-wide Approach
TOFE	Tableau des Opérations Financières de l'État (Table of Government Financial \ Operations)
UN	United Nations
UNAIDS	United Nations Fund for Aids Prevention
UNDP	United Nations Development Program
UNESCO	United Nations Educational, Scientific and Cultural Organization
UNFPA	United Nations Fund for Population Activities
UNICEF	United Nations Children's Fund
VAT	Value-Added Tax
WB	World Bank
WFP	World Food Program
WTO	World Trade Organization

PART I

GEOGRAPHY AND POPULATION

Chapter 1. Geography

Chapter 2. Population and Demographic Structure

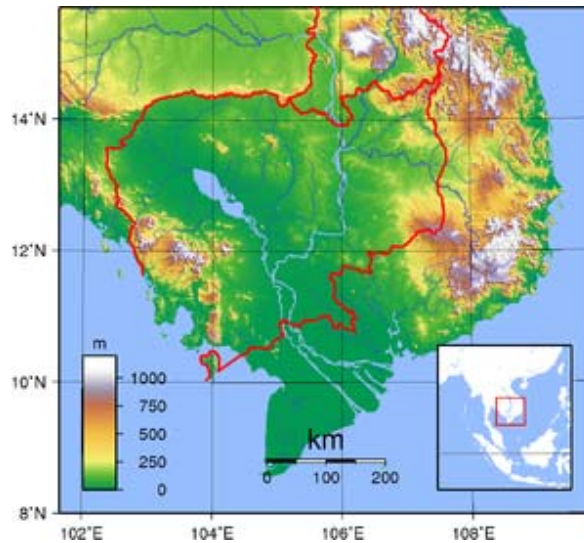


Chapter 1

Geography

Cambodia is located in South East Asia. It lies between the 10th and 15th degrees north latitude, and between the 102nd and 108th degrees east longitude. It has a tropical climate and receives monsoon rains. With an area of 181,035 square kilometers, Cambodia is polygonal in shape, with its center located near Kampong Thom Province. Thailand and Laos border it on the north, Viet Nam on the east, Viet Nam and the Gulf of Thailand on the south, and Thailand on the west. Land borders comprise five sixths of the 2,600 kilometers of Cambodia's international boundary with its neighbors.

Map 1.1. Detailed map of Cambodia



Source: Wikipedia, the free encyclopedia

1.1. Topography

Cambodia resembles a basin, with flat plains in the middle and surrounded by mountains, hills and plateau. On the south, the elevations of the Cardamom Mountains fall gradually as they approach the Gulf of Thailand. Cambodia has numerous plains and low-level plateaus. Cambodia's territory can be divided into five large natural regions: the Cardamom Mountains, the hill region, the central plain, the Northern highlands and the plateaus.

1.1.1. The Cardamom Mountains

The Cardamom Mountains (*Kravanh* in Khmer) covers the southwest of Cambodia, extend in a southeast-northwest direction and divides the coastal areas from the central plains. The Cardamom ranges run parallel to the coasts, extending from Pailin to Kampot Province. This is a chain of many long and steep ridges, the highest of which is Mount Aural (1,813 meters). The Cardamom Mountains are among the most pristine forests in Southeast Asia.

1.1.2. The Hill Region

The hill region encircles the Cardamom Mountains, a peneplain with scattered massifs, the principal ones being the following:

- Phnom Runtea (sandstone), Phnom Sampov, Phnom Serey Sophoan (limestone) and Phnom Veng in Battambang province;
- Phnom Komreng (sandstone) and Phnom Krainlvea (volcano rocks) in Pursat and Kompong Chhnang provinces;
- Phnom Chumreay, Phnom Pis, Phnom Kraol and Phnom Reachea Kong in Kompong Speu Province;
- Phnom Chang-Or (722 meters), Phnom Preah (780 meters), Phnom Thvear, Phnom Kompong Trach, Phnom Laang (limestone) and the Phnom Tonle Bati (sandstone) in Takeo and Kampot provinces; and
- Chumneap Hills and Veal Rinh Hills in Sihanoukville Province.

These hills are no more than 800 meters high.

1.1.3. The Central Plain

The central plain or lowlands covered with fertile alluvium covering an area 500 km long and 110 km wide, stretches from Banteay Meanchey Province at the Thai border to Svay Rieng Province at the Viet Nameese border. The **Tonle Sap Lake** is located at the heart of the central plain and the **Mekong River** divides the lowlands by its estuaries – the arteries that feed the central plain. Some 6 million Cambodians live in the central plain, making the area the most populated with the highest population density. Economic activities in the central plain are the most vibrant. It is remarkable for its soil fertility. It includes a zone of silt deposits along the banks of its water courses, a wetland and marshland, and extensive

rice fields, which makes it the rice basket of the country. The central plain is divided into three parts:

- The areas adjacent to rivers, lakes and coastal zones stretching from 10 meters to hundreds of meters, with very fertile alluvium;
- The zones close to the above areas, usually the inundated forests, the mud plain and the areas with small lakes and rivers;
- Rice fields stretching afar interspersed with small hills and degraded and dense forests.

1.1.4. The Highlands of the North

The highland of the north is a plateau with an average altitude of 150 meters stretching across the provinces of the north and northeast. Its altitude of the escarpment rises gradually from the central plain to reach the borders of Thailand, Laos and Viet Nam. It is formed of ancient alluvial deposits and covered with scattered forest. In the province of Kompong Cham, blankets of basalt or volcano rocks have decomposed to become fertile red earth, in some cases supplanting the older alluvial deposits, which are favorable for rubber plantation.

1.1.5. The Edges of the Plateaus

The edges of the plateaus of the surrounding area are extensions of the plateaus and massifs descending from neighboring countries. The highland region of Rattanakiri is a carryover of the Kontum Plateau in Viet Nam, while the plateau of Chhlong Leu is a continuation of the massif of South Annam also in Viet Nam .

1.2. Hydrology

Hydrology plays an important role in Cambodia's socio-economic development. Cambodia's hydrology can be grouped into three principal basins: the Mekong basin, Tonle Sap basin, and Gulf of Thailand basin.

1.2.1. The Mekong Basin

The Mekong Basin is crucial for the Cambodian economy. The Mekong is one of the longest rivers in the world, with a length of 4,200 kilometers and flowing through China (Kunming province), Thailand, Myanmar, Laos, Cambodia, and Viet Nam. Its course through Cambodia measures 500 kilometers. The Mekong is a perennial, all-season

navigable river. During the rainy season, it deposits a fertile layer of silt over the land that it floods. Agriculture and fishing activities are governed by the water level of the Mekong and the widespread flooding it causes. As a result the flooded forests serve as breeding grounds of fish and fish sanctuaries. In general, fish catch increases dramatically in the years following the flooding. The Mekong River, its tributaries and streams are the arteries that pump economic lifeblood into Cambodia.

1.2.2. The Tonle Sap Basin

The Tonle Sap Basin serves both as an inland waterways system and a reserve of freshwater fish, which constitutes the main source of protein intake for Cambodians. The Tonle Sap Great Lake is located at the heart of Cambodia, and is surrounded by six provinces: Kampong Thom, Siem Reap, Battambang, Banteay Meanchey, Pursat, and Kompong Chhang. The lake is a source of prosperity for the entire country, since agriculture, fishing, forestry, trade, and family life are all shaped by the ebb and flow of the lake. The lake is also a precious reserve of freshwater fish, for entire Southeast Asia. The Tonle Sap Basin and the Mekong Basin merge to form an efficient system of inland waterways, which plays a crucial role in river transportation and economic development of Cambodia.

The Tonle Sap ecosystem is extraordinary, due to its biological richness and demonstrating a healthy balance between man and nature. The Tonle Sap Lake which harbors a rich variety of fish is partially formed by a flooded forest ecosystem, which is favorable to the reproduction of fish. Moreover, this vast lake environment with its interaction of water and plant life is home to a variety of birds. The hydrology of Tonle Sap Lake and Mekong River is a unique **natural phenomenon** as the flow of water from the river to the lake reverses when the water level in the lake exceeds that of the river. Every year at the beginning of the rainy season in June, the Mekong rises, owing to the snowmelt in the **Himalayas** and the monsoon rains that swell up its hydrographic system. Its waters are pushed up into the Tonle Sap River as far as the Tonle Sap Lake. At this time the depth of the lake can reach 9 meters, and its area increases fivefold, covering 1.25 million ha and totally flooding the surrounding forests and wetlands. This represents a 70-fold increase in the lake's volume.

The water course reverses in October, at the end of the monsoon season, when the waters recede and waters flow from the Tonle Sap Lake into the Tonle Sap River and the South China Sea. This reversal of the flow of the Tonle Sap River acts as a safety valve, lessening the risk of flooding on land downstream. During the dry season its area shrinks to 2,700 square kilometers, with an average depth of one or two meters. The receding waters leave rich sediment deposits in the region, which make the land ideal for agriculture during the rest of the year.

The Tonle Sap ecosystem is categorized as a flooded forest ecosystem. This seasonal flooding creates an ideal environment for fish reproduction. Some 200 species have been recorded, a veritable providence and a rich source of protein for the six million Cambodians who live in the provinces surrounding the Tonle Sap Lake. The Tonle Sap Great Lake and its tributaries make up a navigable network of inland waterways which is of great economic significance.

The periodic flooding of the central plain has important economic consequences and a considerable impact on human activities in the Tonle Sap basin. More than 2 million of ha of land surrounding the Tonle Sap Lake are flooded periodically. The flooding determines the types of crops that can be grown on the banks of the waterways and in the surrounding areas. Flooding replenishes the fertility of the soil, increases fish productivity and facilitate navigation. Sometimes excessive flooding causes loss of human and animal life and crops.

The hydrology, ecology, and biological productivity of the Tonle Sap make it one of the most fascinating ecosystems on earth. It is the largest freshwater lake in Southeast Asia, and a site of paramount importance from an ecological point of view. In 1997, UNESCO included it on its list of biosphere reserves due to its ecological, economic, and cultural importance.

The Royal Decree Respecting the Establishment of the Tonle Sap Biosphere Reserve was adopted in 2001. The decree addresses crucial issues for each zone in the Tonle Sap basin (central zone, buffer zone, and transitional zone), and establishes an interministerial coordinating agency and institutional arrangements concerning the management of the Tonle Sap Biosphere Reserve.

The Sub-decree on the Creation, Role, and Functions of the Secretariat for the Tonle Sap Biosphere Reserve was subsequently adopted also in 2001. The Secretariat's main function is to facilitate coordination and strengthen cooperation between national and international agencies, provincial authorities, and civil society for the preservation and sustainable management of the Tonle Sap Biosphere Reserve. The Secretariat acts as an information clearinghouse and facilitates exchanges between the different stakeholders and institutions concerned. The Secretariat designs and coordinates integrated strategies for the sustainable development and preservation of the natural resources of the Tonle Sap Biosphere Reserve.

1.2.3. The Gulf of Thailand Basin

Besides the Mekong, some 20 minor rivers flow into the Gulf of Thailand often experiencing torrential flows and flash flooding. The principal ones are the Stung Metuk, Prek Tatey, Stung Chai Areng, Prek Piphat, Prek Kompong Som, and Kampot River. The Sihanoukville port can handle deep-sea vessels and is a major maritime asset for Cambodia.

1.3. Climate

1.3.1. Seasons

Cambodia has a tropical monsoon climate, generally hot and humid, but the level of heat and humidity varies according to regions and seasons. Cambodia's climate is characterized by two major seasons:

- **Wet season** — humid with high rainfalls from May to October; and
- **Dry season** – dry and hot from November to April.

The unique characteristic of Cambodia's climate is that the temperature has two maxima in April and August and two minima in December and July. In Phnom Penh the average maxima temperature is 35°C and the average minima is 21°C. The climate is cool in the plateaus, such as Mondulkiri and Rattanakiri provinces.

The rainfall pattern is closely connected with the monsoon regime spread over two seasons. The two monsoons are the dry season monsoon and the rainy season monsoon. The monsoonal airflows are caused by annual alternating high pressure and low pressure over the Central Asian landmass.

The wet season corresponds to the southwest and southern monsoon, from May to October. This monsoon brings hot, moisture-laden air drawn landward from the Indian Ocean to central Siberia. The southwest monsoon brings in the rainy season. During the rainy season, precipitation is generally good for agricultural production, although it has also been the primary major cause of flooding. Flooding generally occurs first in July and recurs more heavily and over a greater area in September when the waters of the Mekong rise to higher than normal levels. Drought and the late arrival of rain can have a harmful effect on rice production. Drought can trigger attacks of pests such as the brown leafhopper, grasshoppers, borers, and rats. As a consequence, preparation of the land and nurseries, sowing, and transplanting can be delayed. Sometimes, the lower volume of floodwaters from the Mekong system, which seems to be occurring frequently in recent years results in inadequate supply of water in dams, reservoirs, and canals, resulting in reduced rice production during the dry season, when most fields have to be irrigated. Thus, the rice yield depends heavily upon rainfall.

The dry season corresponds to the northeast monsoon originating from Siberia, from November to April. The monsoonal air flow is reversed during the winter, as the northeast monsoon sends back drier and cooler air. This monsoon does not carry much rainfall. The

dry season can be divided into two short seasons: “a windy season”, from November to January when the real dry season monsoon originating from Siberia creates a cool climate; and “a hot season”, from February to April, when tropical monsoon originating from the central continent creates a hot climate.

Cambodia receives more than a meter of rainfall per year in all parts of the country. The rainfall has two maxima and two minima. Two annual rainfall peaks occur, one rather heavy in October (252 mm), with the other somewhat lower in July (165 mm), and two minima, one in January (7 mm) and the other in August (157 mm).

Regular rainfalls are crucial for agricultural production, especially rice. Precipitation peaks during three months, from August to October. However, rice yield depends on the three random or “in-between” seasons:

- First, if the early rainfall, in March and April, is too abundant, proliferation of pests will destroy rice production. Late arrival of rainfalls delays preparation of the land and nurseries, sowing, and transplanting, leading to reduction in rice yield;
- Second, there is usually a short dry season of about 10-15 days in July. If this short dry season is protracted, rice crop will be damaged. In July-August when rice needs more water for growing, rains could fail. Drought during this sensitive period of rice production creates hazards for Cambodian farmers who practice rain-fed farming and are not supported by irrigation.
- Third, the late rain is crucial for rice yield. If rains end earlier than expected, farmers are required to irrigate their rice fields in order to prevent damage to rice crops.

In this regard, irrigation facilities play an important role in ensuring food security in Cambodia. Rice production has increased steadily following the commissioning of government-financed irrigation facilities across the country.

1.3.2. Climatic Regions

The following factors make climate in Cambodia vary from one region to another:

- The main variable factor is the influence of the monsoon regime generating cool or hot; dry or humid air, and creating climatic perturbation and precipitations;
- The other factors are: the influence of the latitude, the sea, the distance from the sea for inland locations and the landscape.

The coastal zone – extends from Kampot to Koh Kong provinces. The temperature in this area is high, but humid, with an annual average of about 25°C and the average annual rainfall ranging from 2,500 mm to 3,500 mm. The climate is cool created by mainland and maritime winds during the day time. The average annual rainfall is about 3,826 mm in Sihanoukville, 3,725 mm in Koh Moul and 2,328 mm in Sre Ambel. Kampot province receives average annual rainfall of about 2,000 mm; the Koh Tral island blocks the monsoon, thus only limited rainfall reaches the Kampot shore.

The plains – The Tonle Sap and the Mekong plains have a quasi-continental climate, associated with the cumulative impacts of the landscape and the dry season monsoon. This region has two distinct seasons: the dry season and the rainy season, with the temperature on average 4°C to 5°C higher than the coastal zone. The common feature of the plains is that temperatures and the length of both dry and rainy seasons are fairly uniform throughout the Tonle Sap basin plains. However, rainfall varies according to the location: Siem Reap receives 1,431 mm (120 days of rain); Battambang 1,376 mm (130 days); Krokor in Pursat 1,481 mm and Phnom Penh 1,370 mm (127 days).

The northern and northeastern plateaus – has a central continental climate, influenced by the altitude, with the average annual temperature of 27°C and abundant rainfall like in the plains. Average annual rainfall is 2,000 mm, but varies according to location: Chamcar Andong (2,432 mm), Prek Chhlong (2,369 mm), Chop (2,149 mm), Memot (1,939 mm), Stung Treng (1,822 mm) and Rattanakiri (2,500 mm).

The maximum mean temperature in Cambodia is about 28°C; the minimum mean, about 22°C. Maximum temperatures higher than 32°C are common and just before the start of the rainy season, they may rise to more than 38°C. Minimum temperatures rarely fall below 10°C. January is the coldest month, and April, the warmest.

1.4. Natural Resources

Cambodia possesses abundant natural resources including forests, coastal and inland fisheries, rich biological diversity, and a great variety of agricultural areas suitable for a broad spectrum of crops and types of animal husbandry. The vast alluvial basin of the Tonle Sap Lake, the area of which can double during the rainy season, shapes the country's ecology and economy. The Mekong and the Tonle Sap lake provide important reserves of water which are essential for crops during the dry season. The lake is a most valuable freshwater fish resource.

Cambodia's rich wildlife includes elephants, tigers, crocodiles, and the rarely sighted wild buffalo or *Ko prey*. The country is home to many species of birds, some of them very rare, that nest around the Tonle Sap Lake. Cormorants, cranes, egrets, grouse, herons, pelicans,

and wild ducks breed here. Cambodia is also home to fearsome poisonous snakes, including the cobra, king cobra, and Russell's viper.

The central plain, with its largest concentration of human population, is essentially occupied by rice fields with intermittent stretches of wasteland overgrown with reeds and tall weeds, as well as wooded areas. Along the coastline are found forests of mangrove and evergreen trees. At high altitudes, pine forests dominate. The intermediary plateaus host prairies and broadleaved forests, with occasional orchid plants.

On the northwest side of the Tonle Sap lake is a vast flooded forest, home to the Prek Toal Reserve. Every year during the dry season, thousands of birds migrate to this area to nest, making this site one of the most critical habitats in Southeast Asia for the protection of threatened species such as cranes, marabouts, ibis, and pelicans.

Birds of rare species feed by the hundreds along the shores of the lakes and riverbanks of the inundated forest, perching on trees or wheeling and turning overhead in flocks. At the edge of the flooded forest, lively human communities have settled in floating houses, a practical adaptation to the seasonal changes in the water level.

Cambodia can be divided into three main natural regions: the plateaus, the plains and the coastal zones.

1.4.1. The Plateaus

The plateaus can be further categorized as the northern plateau – the Dangrek Mountains and the northeastern plateau – the Rattanakiri Plateau, and the Mondulkiri Plateau.

The Dangrek Mountains are located on the southern edge of the sandstone Nokor Reach Plateau running from Thailand and consist of a steep escarpment with an average elevation ranging from 300 to 500 meters. Atop a 525-meter cliff in the Dangrek Mountains, the Khmer Kings built and successively rebuilt the internationally famous **Prasat Preah Vihear** dedicated to the Hindu god Shiva in his manifestations as the mountain gods Sikharesvara and Bhadresvara. The Preah Vihear Temple has the most spectacular setting of all the temples built during the six-century-long Khmer Empire. Construction of the first temple on the site began in the early 9th century, continued during the 10th century, when the empire's capital was the city of Koh Ker. Elements of the Banteay Srei style of the late 10th century can be seen, but most of the temple was constructed during the reigns of the kings Suryavarman I (1002–1050) and Suryavarman II (1113–1150). Other temples can be found on the Dangrek Range, such as Prasat Tamoan and Prasat Ta Krobey. Besides the Dangrek Mountains, there are Anlong Svay Mountains (457 meters) and Makkay Mountains (537 meters). This region has a low population

density, as it is covered by dense forests and some of the populations practice slash and burn agriculture, collecting and hunting.

The Rattanakiri Plateau adjoins the Kantum Plateau in Viet Nam, which divides Cambodia from Laos and Viet Nam. The Borkeo Plateau is located between the Sesan and Sre Pok river valleys and Viet Nam, and constitutes a sandstone plain and basalt plateau, with average elevation of around 300 meters. It is an extinct volcano, with a lava plain and basalt soil. Some other volcanoes located in the plateau were transformed into lakes, such as the Yakloam Lake.

The Mondulkiri Plateau is an extension of the Dak Lak Plateau of Viet Nam. Mondulkiri province consists chiefly of sandstone plains. The elevation increases from the Mekong River (40 meters) to the Chhlong Loeu Plateau (200 meters). The Dak Lak Plateau with an average elevation of 800 to 1,000 meters is populated by an ethnic minority hill tribe speaking the Khmer-mon languages. The Chhlong Loeu Plateau consists of basalt rocks, which were partly transformed into red soils.

The plateaus are covered by dense forests of great value, such as beng, thnong, neangnuon, srolao, chhoeal, koki, phdeak, krongoung, chhoeukrom etc., and some degraded forests. The habitat is rich in wild life including wild buffalo or *Ko prey*, elephants, tigers, rhinoceros, snakes, bears etc. The northeast region consists mostly of rivers, which serve as major communication routes to major waterways such as the Mekong, the Sesan, the Sekong and the Sre Pok. Feasibility studies have been conducted to build hydro-power stations on some of the rivers.

1.4.2. The Plains

The plains are divided into the lakeside plains, such as the Tonle Sap plain and the Chaktomukh (Four Faces) River plains, with the Mekong River as the main river.

The lacustrine plains – extend from the north at the Northern Plateau, with elevations ranging from 25 to 200 meters to the west and extensions from the hills near the Cardamom Mountains, to the Tonle Sap Lake and the adjacent small lakes, oriented in a northwest-southeast direction. The plains are 22 kilometers long from the Great Lake to Kompong Pluk near Bakheng Mountains (Siem Reap Province); 15 kilometers long from Kompong Luong to the Kompeng Mountains (Pursat Province); 105 kilometers long from Prek Thnol to Kuttasat (Battambang Province); and 63 kilometers long from Phat Sanday to Taing Krosang (Kampong Thom Province). The vast plains in Battambang and Kompong Thom provinces are located in the lowland areas, partially inundated, and considered as Cambodia's rice basket. However, a small part of the plains in Siem Reap and Pursat provinces are permanently inundated areas.

Flooding of the plains commences from August to October. These areas are endowed with lakes, with total surface of 3,000 sq. kilometers during the dry season. These lakes are surrounded by Siem Reap, Battambang, Pursat, Kompong Chhnang and Kompong Thom provinces. The major lakes are:

The Tonle Sap Lake (*Boeung Thom*) – located in the north is 75 to 80 kilometers long and 32 to 35 kilometers wide. In the dry season, the depth of the lake reduces to around 2 meters. Its width at the juncture between the delta of Pursat River in the south and the delta of the Chikreng and Stung rivers in the north is only 12 kilometers.

The Small Lake (*Boeung Toch*) – is 35 to 40 kilometers long and 28 kilometers wide. To the south, the lake converges at Chhnok Trou, near the cascades of Stung Sen, Cambodia's largest stream. The Small Lake is connected to the Tonle Sap Lake by the mud plains.

The marshlands (mud plains) – are located between Chhnok Trou and Kompong Chhnang Province, the convergence of many tributaries of the Tonle Sap river with many sand islands. As the level of the Tonle Sap lake drops deposits a new layer of sediments occur. The annual flooded area, combined with the mud plains is 40 kilometers long and 12 kilometers wide. The water never dries up even during the dry season.

The network of inland waterways is of critical importance for the economy. Rivers and tributaries in this area flow from the Northern hills, the Dangrek Mountains or the Cardamom Mountains into the Great Lake from all directions, such as Stung Sangke, Stung Monkul Borey, Stung Serey Sophorn, Stung Svay Chek, Stung Sreng, Stung Mong, Stung Pursat, Stung Boribo, Stung Chinit, Stung Sen, Stung Stong, Stung Chikreng and Stung Siem Reap etc. Stung Sen with a length of 450 kms is the longest tributary. Apart from these tributaries, there are numerous streams that dry up from January to May.

The Chaktomukh (*Four Faces*) **River plain** – the Mekong River flows southward from the Cambodia-Laos border to Kratie Province, then turns southwest to Kompong Cham and Phnom Penh. At Phnom Penh four major river courses meet at Chaktomukh (*Four Faces*), including the confluence of the Mekong and the Tonle Sap rivers. Below the Chaktomukh point, the two rivers divide into two parallel courses: the Mekong River and the Bassac River. The Mekong River carries different names according to its location:

- The Tonle Thom (big river) between Kratie and Kompong Cham provinces;
- The Tonle Kandal (middle river) between Kompong Cham Province and Phnom Penh;

- The Tonle Krom (lower river) from the south of Phnom Penh to the Viet Nameese border.

The middle Tonle Thom – is 85 to 90 kilometers long and 0.8 to 7 kilometers wide (at Koh Sotin and Koh Lvea). The water depth at this point is around 30 meters and increases to 50 meters near Kompong Cham.

The lower Tonle Thom – is 100 kilometers long, running from Phnom Penh to Cambodia-Viet Nam border and is 0.9 kilometer to 4 kilometers wide (at Peam Ror).

The Bassac River – is about 100 kilometers long and 0.4 to 0.6 kilometer wide on average, but increases to 2.5 kilometers wide at Koh Thom.

The Tonle Sap River – emanating from the Tonle Sap Lake – is located between the Kompong Chhnang Province and the Chatomukh, and is 95 to 100 kilometers long.

These plains abound with water resources, fisheries, fertile soil, cultivated areas and degraded forests, which provide good locations for residential settlements and provincial capitals. Phnom Penh and many other provincial capitals, such as Kompong Cham, Kompong Chhnang, Kompong Speu, Takeo, Kandal, Prey Veng and Svay Rieng are located on the western sides of the Mekong River.

1.4.3. The Coastal Zones

The coastal zones border the Gulf of Thailand, with elevations rising sharply from the sea shores to the Cardamom Mountains. This area abounds with small hills, such as the Veal Rinh Hill, and includes islands, such as Koh Kong (410 meters). Waterways are abundant consisting of minor rivers, characterized by torrential flows and flash flooding. The principal ones flow from 500- 600 meter altitude in cascades and flow into the Gulf of Thailand. These are the Stung Metuk, Prek Tatey, Stung Chai Areng, Prek Piphat, Stung Kampot and Stung Tukmeas etc.

Cambodia has a 435 km of coastline along the Gulf of Thailand, accounting for one sixth of the total borders. Cambodia's coastline is no more than 56 meters deep, with two peninsulas: the Smach Peninsula and the Veal Rinh Peninsula. Natural endowments and climatic conditions are favorable to develop the coastal provinces, such as Sihanoukville, Ream, Koh Kong and Kep into international resort centers. Along the coastline, there are freshwater and marine mud plains, which create favorable conditions for mangrove forests – the most important buffer zones for the marine ecosystem.

Natural resources in the coastal zones – the coastlines are divided into two parts: the mangrove forest and the rear mangrove forest. The marine wetlands are acidic and suitable for coconut and palm oil plantations. Mangrove forests and chak grow in abundance in this soil. A number of foreign companies have explored oil and gas in Cambodia's off-shore blocks. The Cambodian shores are no more than 75 meters deep with flat seabed. Tropical cyclones or typhoons never cause damage to coastal Cambodia creating ideal conditions for coastal fishermen.

The Cardamom Mountains – The Cardamom Mountains are divided into:

- **Western Cardamom** – extending from Pailin to Stung Pursat, consists of rocks and sandstone, with the highest elevation called the Tumpor Mountain (1,516 meters);
- **Central Cardamom** – a massif extending from Mong in Battambang Province to Koh Kong, with elevations of more than 1,000 meters, the highest one is Phnom Samkoh (1,744 meters);
- **Eastern Cardamom** – is divided into: (i) **The Kchol Mountains** located between Pursat and Kompong Speu provinces. The highest elevation is Phnom Oral (1,813 meters); and (ii) **The O Mlu Mountains**, with elevations of not more than 1,000 meters, located between Sre Ambel and Kompong Speu, such as the Kirirom Plateau (700 meters), which abounds in pine trees (*sral*).

The Elephant Range – divided from the O Mlu Mountains by the Pich Nil Pass and National Route Number 4 from Phnom Penh to Sihanoukville. These mountains end at the Bokor escarpment (1,075 meters). This area is covered by dense forests along the coastline and receives abundant rainfall (more than 4 meters a year).

1.5. Agro-Ecological System and Soil Classification

1.5.1. Agro-Ecological System

Cambodia's arable land and land suitable for cultivation can be divided into four major types for growing perennial and annual crops:

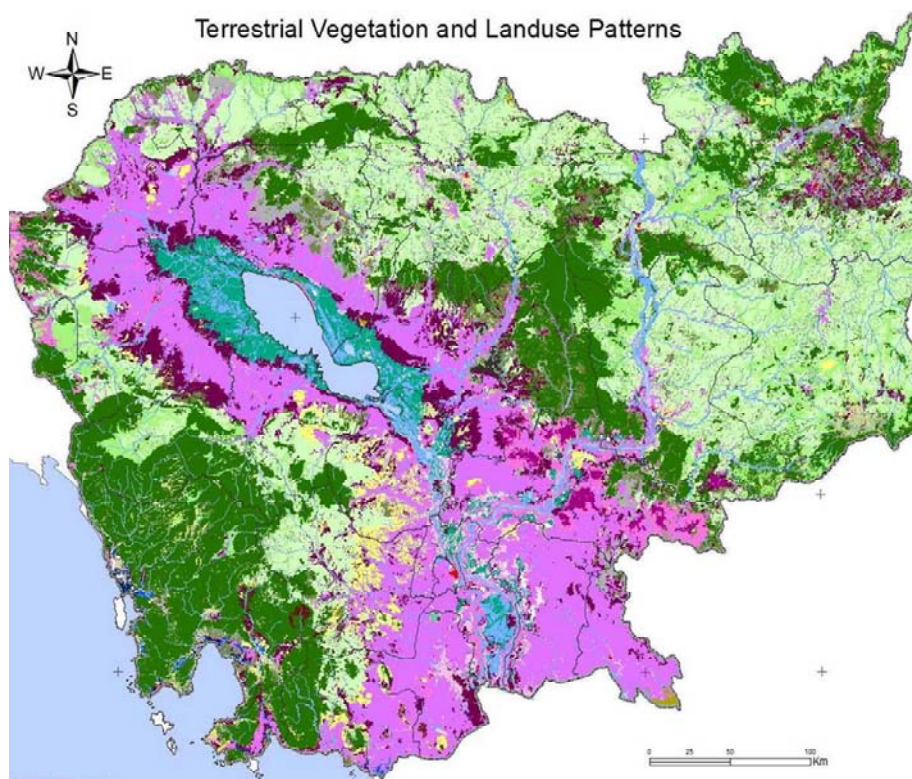
- **Rain-fed agriculture on the plateaus/hills.** In these areas, perennial crops include rubber trees, cashew trees, fruit trees, etc. Annual crops include corn, soybeans, rainy season rice, cotton, and pasturage.

- **Rain-fed lowland rice growing on sandy plains** (strictly rain-fed). In these areas rice growing can coexist with cattle and buffalo husbandry. Both perennial and annual rain-fed agriculture are possible.
- **Rain-fed lowland rice growing on hydromorphic plains** (“veal” flooded). In these regions rice growing also coexists with animal husbandry.
- **Floating rice or rice growing in heavily flooded zones.** In such areas, off-season rice crops are grown (using various methods: prek, diking, etc.)

1.5.2. Soil Classification

Soils in Cambodia vary across regions. Soil classification depends on the soil cover that virtually determines the pattern of crop production. Rice growing areas in Cambodia can be classified into three major categories, according to physical features of the soil (i) Old alluvial and colluvial; (ii) Soils developed *in situ* from underlying parent materials; and (iii) Soils of the active floodplains.

Map 1.2. Landuse Map of Cambodia



Source: World Bank (2009). *Sustaining Rapid Growth in a Challenging Environment*. Annexes. P. 115.

1.5.2.1. Old Alluvial and Colluvial

Old alluvial – this type of soil is found in all of Cambodia’s rice growing provinces. The concerned areas were originally rivers, lakes or marine floodplains, but now are above the water level. The soil was generated from sediments of alluvial carried by the river flow or lake water that occasionally flooded the areas. Soil nutrients are no longer being added by alluvial associated with the annual flood. However, the soil underwent oxidation, with the soil nutrients and clay seeping to the bottom, resulting in the loss of fertility on the soil cover. This type of soil can be found around the lakes or the flooded areas adjacent to the rivers.

Alluvial-colluvial – is the result of soil erosion in the areas surrounding mountains or hills, or the erosion of soils moving the nutrients to the lowland areas, creating a fan-like landscape. The lacustrine soils extending from alluvial-colluvial can be found in the lowland areas, where the soils consist mainly of alluvial. Colluviation is very important for Cambodia’s rice cultivation, especially in Battambang, Banteay Meanchey and Siem Reap provinces and in some parts of Pursat, Kompong Thom, Kompong Cham and Svay Rieng provinces. In some areas, the erosion of mountains or hills created plateaus of uneven height.

1.5.2.2. Soils Developed in Situ from Underlying Parent Materials

These soils were developed from the erosion and decomposition of underlying parent materials. Even though the soils were developed on the top of parent materials, in some cases, the soils are found on low-level mountain slopes. In Cambodia, these soils originated from two main parent materials: sandstones and volcanic magma. Soils developed from these materials are new soils, very fertile, especially the soils of basaltic rocks. Soils developed from new volcanic magma create important rice growing areas. These soils can be found in Kompong Cham, Kompong Thom, Rattanakiri, Stung Treng and Battambang.

1.5.2.3. Soils of the Active Floodplains

In Cambodia soils of the active floodplains consist of three main categories:

- **Meander floodplains** – are found along the course of rivers, river channels, natural levees, backslopes and basins. These floodplains are inundated in the wet season. The flooding of rivers and streams creates various degrees of sediments along the flow of water. Big grains of sediments (big grain sand and small gain sand) are found in the water courses while fine sand and silt are found in natural levees and clay in the basins. Levees and backslopes are used chiefly for the construction of homes, vegetable growing and cash crops or for rice cultivation. Backslopes are located between the

levees and the floodplains. Soils in the basin show clear hydromorphic properties and are used mainly for rice cultivation when floods recede. In the Mekong and the Bassac, river banks are eroded by the water or the water course is blocked creating sediments or new soils. In the southern part of Kandal, Takeo and Prey Veng provinces and the Tonle Sap floodplains, the soils extend to meet large floodplains.

- **Expansive floodplains** – occur along the lower part of water courses and take the form of marine floodplains. These floodplains can be found along tributaries, where river banks were transformed from alluvial into clay, extending to vast flat floodplains of various types. Expansive floodplains can extend many kilometers from the tributaries in Takeo province. Every year most plains and river banks are flooded, with the flooding level reaching 2 meters and remaining at that level for a long time. The expansive floodplains can be found in many places, such as half of the southern part of Takeo and Prey Veng provinces and the areas surrounding the Mekong and Bassac rivers.
- **Marine floodplains** – are found in the coastal areas. Rice cultivation in these areas is conditioned by tidal currents and intrusion of marine water. The marine floodplains are secondary rice growing areas.
- **Lacustrine floodplains** – in Cambodia lacustrine floodplains such as the floodplains surrounding the Tonle Sap Lake share common features with the expansive floodplains and are a common geological feature.

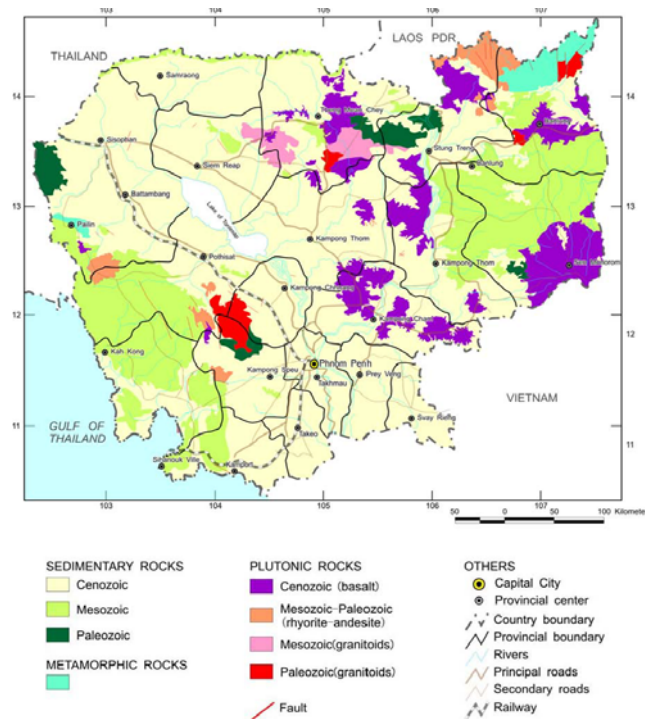
1.6. Mineral Resources

The underlying rock structure of Cambodia comprises metamorphic, sedimentary and granitic igneous rocks from the Precambrian to Mesozoic Jurassic ages with overlay of Quaternary basaltic lava and alluvium. The geological features extend into neighboring Thailand, Laos and Viet Nam in the Indo-china region, indicating that Cambodia has a high potential for mineral resources like its neighbors.

The geological mapping in the 1960's confirmed mineral occurrences at 145 sites. Additional geological surveys and exploration conducted during the 1970's and 1980's identified more than 10 gold occurrences. Based on a survey carried out from 1966 to 1970, the Department of Geology of the Department General of Mineral Resources reprinted in 1980s mineral maps, in which twenty-five kinds of mineral resources have been identified. While Cambodia's mineral resources remain largely unexplored, several important minerals have been discovered, which include bauxite, copper, zinc, gold, iron ore, nickel, granite, gemstones and tungsten. Minerals currently extracted include gemstones and gold - mostly mined by small-scale operators - marble, granite, sand, limestone and salt.

The high potential of mineral resources will be fully understood only after full-scale reconnaissance and exploration work. Below are some of the mineral resources of Cambodia:

Map.1.3 Geological Map of Cambodia



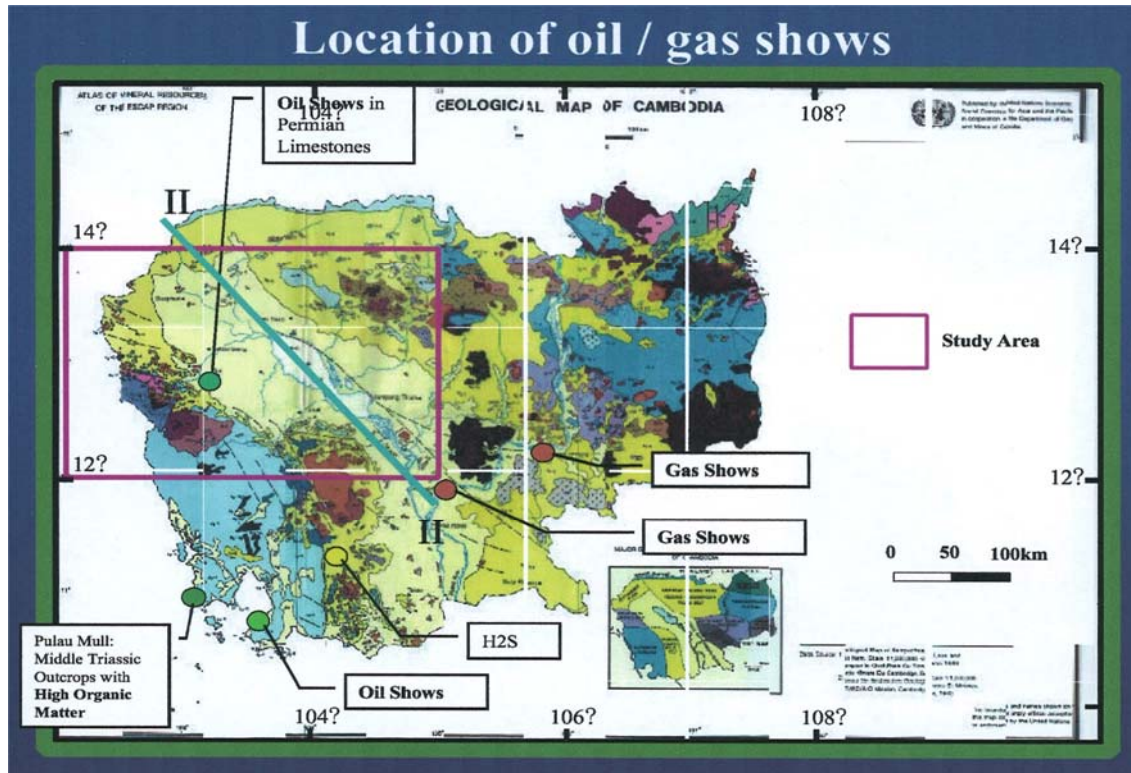
Source: Mitsui Mineral Development Engineering Co., Ltd (2008), *Cambodia – Mining as a Source of Growth*, Paper prepared for the “Sustaining Rapid Growth” report prepared by the World Bank. Draft.

Metallic mineral – including: silver (Ag), bauxite (Al), arsenic (As), Bismuth, coal (C), calcium (Ca), Chrome (Cr), copper (Cu), fluorine (F), iron ore (Fe), dolomite (Mg), pirolusite (Mn), molybdenum (Mo), phosphorus (P), sulfur (S), stibine (Sb), silicium (Si), calciterite (Sn) and wolframite (W). Important reserves of metallic mineral occurrences such as gold, copper, zinc, magnesium, iron, bauxite, tin etc., have been identified so far in Cambodia. The mineralization derives from a series of igneous activities in the sedimentary rock formation in various stages. Areas with such mineral aspects are regarded as the most promising areas for mineral deposits.

Oil and gas – Oil and gas exploration has been conducted in Cambodia’s off-shore blocks. Chevron Texaco announced in December 2004 the discovery of three wells, i.e. a reserve of 400 million barrels of oil and five billion cubic meters of natural gas, located 90 miles off the coast of Sihanoukville, Cambodia. Drilling was slated to begin in 2007. Oil and gas

discovery in the off-shore block A has attracted a number international companies to invest in oil and gas exploration in Cambodia.

Map.1.4. Location of Oil/ Gas Shows



Source: Cambodian National Petroleum Authority

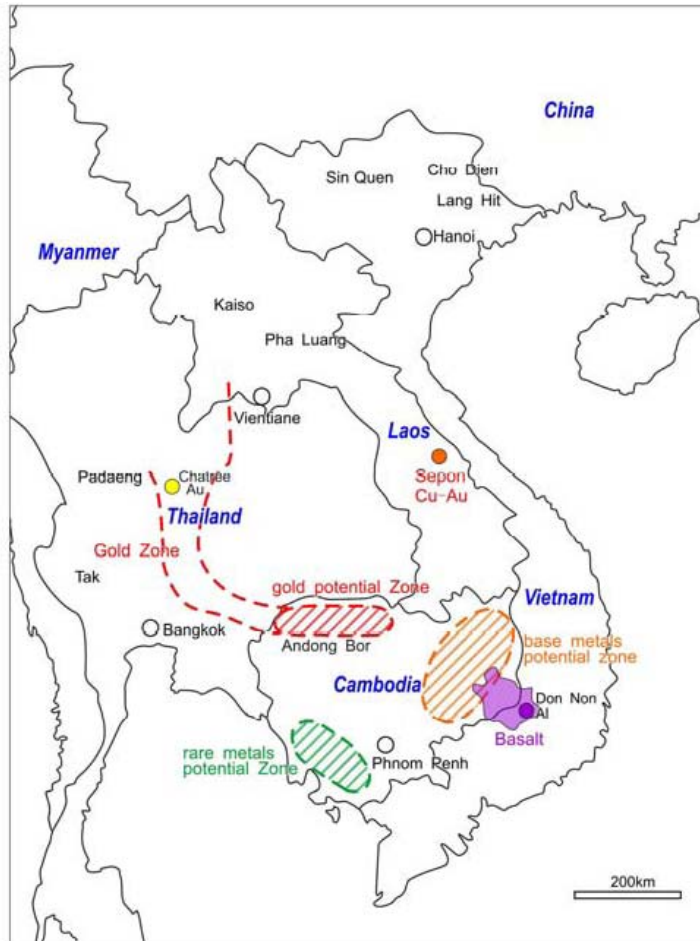
Cambodia has been divided into onshore and offshore blocks for oil and gas exploration. As of now the following offshore blocks were awarded to the following consortium of companies:

- Block A : Chevron 55%, Moeco 30%, GS Caltex 15%;
- Block B : PTTEP 30%, SPC 30%, Resourceful Petroleum 30% & Cooper Energy 10%;
- Block C : Polytex 100%;
- Block D : China Petrotech 100%;
- Block E : Medco 60%, Kuwait Energy 30% and JHL 10% ;

Development Area); and a defined maritime border for the northern Area I of the OCA (the Area to be Delimited).

Bauxite – The remarkable bauxite-bearing Quaternary basalts lava are hosted in the Dac Non area in southern Viet Nam which continues into eastern Cambodia.

Map.1.6. Mineralogical Setting of Cambodia

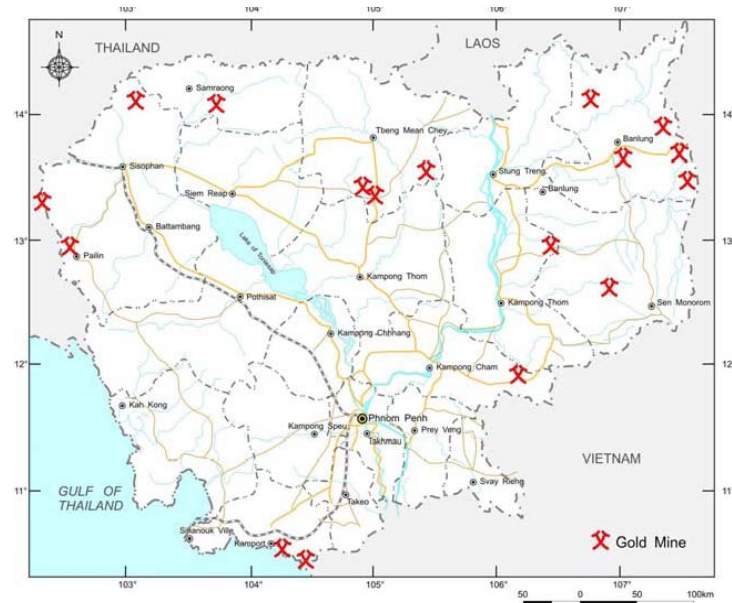


Source: Mitsui Mineral Development Engineering Co., Ltd (2008), **Cambodia – Mining as a Source of Growth**, Paper prepared for the “Sustaining Rapid Growth” report prepared by the World Bank. Draft.

Gold – the gold bearing belt of the Chatree gold mine in Thailand extends southeastward to the northern part of Cambodia. Both these potential areas in Cambodia have recently become the focus of exploration and the number of applications for licenses by foreign companies has been increasing. As for gold deposits, some artisanal mining has been occurring throughout the county as shown in Fig. 1.5.

Iron—Four Chinese steelmakers have established a joint venture to explore and develop iron ore mines in Cambodia. Some early estimate shows that Preah Vihear region may have 2.5 billion tons of iron ore reserves.

Map 1.7. Locations of Gold Mines



Source: Mitsui Mineral Development Engineering Co., Ltd (2008), **Cambodia – Mining as a Source of Growth**, Paper prepared for the “Sustaining Rapid Growth” report prepared by the World Bank. Draft.

Copper – Triggered by the discovery and development of the world-class Sepon copper mine, western companies are exploring for porphyry copper-gold deposits in eastern Cambodia near the Sepon mineralized zone. Mineral deposits of porphyry copper (Cu-Au, Mo), poly-metallic (Au, Cu, Pb, Zn) and skarn (Pb, Zn) are currently expected to be found in Cambodia.

There is also geological evidence for other kinds of non-metallic raw materials, including industrial minerals, gemstones, and fuel resources, and some of which are being artisanally extracted.

Gemstones and marble – gemstones and decorative rocks have been extracted in Cambodia: jade (J), marble (M), pagobit (P), amethyst (quartz Qa), hyaline quartz (Qh), zircon (Z), sapphire, rubies etc. Cambodia is rich in construction rocks: basaltic rocks and volcanic rocks, found in Kompong Cham and Kompong Speu; sandstone found in Takeo, Stung Treng and Siem Reap provinces and clay, gravel and sand found in the rivers and streams.

In terms of location, important mineral reserves are found in the following provinces:

- Pailin: reserves of sapphire and rubies are proven;
- Rattanakiri: in Borkeo important reserves of amethyst and gold have been discovered;
- Kompong Thom: iron ore (Phnom Dek), gold (in alluvium) and tin around Phnom Chi and Phnom Loeung;
- Kampot and Battambang: limestone and phosphate.
- Pursat: decorative stone at Phnom Tasay.

There is currently a total of 20 Korean, Vietnamese (Vinacomin), Chinese and other foreign companies, which together have received 42 exploration licenses; these companies together hold concessions for half of the surface area of eastern Cambodia. Six Australian companies possess 24 licenses in total, 4 Chinese companies 4, a Vietnamese company, Russian company and a Korean company possess 1 each, and 6 Cambodian companies possess 6 exploration licenses. Australian companies accounts for 30% of the total licensed area, Cambodian 35% and Chinese 20%. As to the number of licenses, Australians possess 57%, Cambodians 35%, and Chinese 10% of the total. All projects are still in the early exploration stage, and these companies have survey-exploration plans to start development within 5 or 6 years.

There are very few Western companies operating in Cambodia. They include the Australian exploration companies Oxiana Cambodia, Southern Gold, and Liberty Mining, and the mining company BHP Billiton. The Australian companies are mainly focusing on the minerals of Al, Au, Cu, Zn. Some Cambodian companies are targeting coal.

Oxiana Cambodia established an office in Phnom Penh in April 2005, and acquired concessions to start exploration in 2006. The company was subsequently merged and changed the name to Oz Mineral. It has 4 mineral concessions targeting metals such as gold, silver, molybdenum and zinc, and conducting exploration in joint ventures with other companies which have minor shares. Its exploration period is 6 years, and it can renew licenses with reduced areas every 2 years thereafter according to the results. The exploration is still ongoing and the possibility of feasibility studies has not been determined yet. The company has plans for air-borne magnetic survey and RC-drilling.

Southern Gold established an office in autumn of 2006, and started exploration the following autumn. It targets also metals such as copper, gold and zinc. It has 8 concessions

in 6 areas. All the projects are still in the exploration stage, and it has plans for air-borne geophysical survey (air-borne magnetic exploration to detect intrusions) and RC-drilling. Its annual exploration budget is US\$ 1.5- 3 million, and it intends to carry out feasibility study in a few years to develop a mine 5 to 6 years later. It signed a joint venture (JV) exploration contract with the Japan Oil, Gas and Metals National Corporation (JOGMEC) for the northern and southern parts of the Kratie area in 2007. It will start a 3-year exploration project in 2008 targeting metals, with a total budget of US\$ 1.3 million. Three licenses are to be offered for joint ventures.

Liberty Mining collected information on mineral occurrences in Cambodia, and established an office in 2005 to start exploration. Its targets are copper and gold. It has 5 concessions in 3 areas (total area: 1,400 sq. km). Three concessions are wholly owned, the rest are with JV partners. It has carried out geochemical and air-borne geophysical surveys and trenching so far. It will implement an IP geophysical survey and drilling based on the results. Its annual budget is US\$2 million, and it intends to develop a mine within 3 to 4 years.

BHP Billiton and Mitsubishi Corporation have concessions for area of about 1,000 sq. km and are exploring for laterite.

Indochine Resources Ltd., listed on stock exchanges in Switzerland and England, possesses 14 exploration licenses targeting Au, Cu and Zn. Indochine has so far confirmed high-grade Pb-Zn deposits through ground surveys. The basic data were obtained from individual mine owners and compiled into a database of the entire area of Cambodia.

Vinacomin, which is a state-owned company of Viet Nam set up a local office in Cambodia in 2007; it possesses 3 exploration licenses targeting bauxite, copper and iron. The promising areas are selected based on data from DGMV (Department of Geology and Minerals of Viet Nam), and previous surveys conducted by China and France.

1.7. Landholding System

The landholding system prevalent in Cambodia is having a strong influence on the economic development strategy. The basic rules of land tenure have a major impact on the well-being of the rural family. A second major impact is that it affects political stability. Families who own the land they farm tend to see themselves as having a stake in the established political order. Agricultural workers and landless farmers have no comparable fascination with the established order. The history of many nations having large populations of landless and near landless farmers is marked with farmer revolts. Land tenure systems also have a major impact on agricultural productivity. A person who owns

land realizes that working harder or improving his skills will also improve his income. This outcome is absent when the land belongs to someone else.

1.7.1. Legal Framework

Private land ownership was abolished when the Khmer Rouge came to power in 1975. The right to own land ownership has only been recognized since 1989, when the State of Cambodia (SOC) restored private ownership of property and introduced economic reforms, aimed at promoting national reconciliation between various Cambodian warring factions. This land policy was subsequently formalized by the 1992 Land Law. The formation of the Coalition government of the first legislature of the National Assembly after the July 1993 general elections paved the way for establishing the foundations for democracy, governance reforms and the development of the private sector in Cambodia.

With the consolidation of the foundations of democracy, strengthening of political and social order, integrating the political and military organization of the Khmer Rouge into the mainstreams of Cambodia in 1998, the RGC has established a sound policy framework to govern the land sector. A new Land Law was adopted in 2001 to determine the types of land and real estate ownership in the Kingdom of Cambodia. The major thrusts of the Land Law are as follows:

- **Types of Ownership** – Ownership by a person, whether natural or legal, is **individual ownership**. Ownership by a group of persons exercising their rights through a legal arrangement for such ownership is **collective ownership**. Collective ownership includes all the rights and protections of ownership enjoyed by private owners. Ownership by several identifiable individuals collectively exercising their rights over the entire property is **undivided ownership**.
- **Property of the State** can be divided into the public property of the State and private property of the State. The public property of the State includes: forests, courses of navigable or floatable water, natural lakes, banks of navigable and floatable rivers and seashores, quays of harbors, railways, railway stations and airports, roads, tracks, oxcart ways, pathways, gardens, public parks and reserved land, public schools, educational institutions, administrative buildings and all public hospitals, and archeological, cultural and historical patrimonies. State public property is inalienable and ownership of those properties is not subject to prescription. When State public properties lose their public interest use, they can be listed as private properties of the State under the law on transferring of state public property to state private property. The private property of the State and of properties of public legal entities may be the subject of sale, exchange, distribution or transfer of rights as determined by law.

- **Immovable Property of Indigenous Communities** – The lands of indigenous communities are lands where these communities have established their residences and carry out traditional agriculture. The lands of indigenous communities include not only lands actually cultivated but also reserves necessary for shifting cultivation which is required by their traditional agricultural practice as recognized by the administrative authorities. The State grants rights to these properties to the indigenous communities as collective ownership. However the community does not have the right to dispose of any collective ownership of property acquired from the State to any person or group. No entity outside the community may acquire any rights to immovable properties belonging to an indigenous community.
- **Reconstitution of ownership** – Any person who, for no less than five years prior to the promulgation of the Land Law, enjoyed peaceful, uncontested possession of immovable property that can lawfully be privately possessed, has the right to request a definitive title of ownership. In order to transform into ownership of immovable property, the possession should be unambiguous, non-violent, well recognized by the public, continuous and in good faith.
- **Land Concessions** – Land concessions granted for meeting a social or economic purpose. Land concessions responding to a social purpose allow beneficiaries to build residential constructions and/or to cultivate lands belonging to the State for their subsistence. Land concessions responding to an economic purpose allow the beneficiaries to clear the land for commercial agriculture.

Since the restoration of the Kingdom of Cambodia in 1991, the land tenure system has the following characteristics:

- **Family farms**, where the independent farmer-owner possesses land on which family-supplied labor is engaged.
- **Plantation agriculture**, a system in which a large area is devoted to the growing of commercial crops e.g. rubber trees for tapping and processing, palm oil plantations, cashew nut plantations or other large-scale farming. Large-scale plantations have been mostly developed through economic land concessions granted by the State as long-term leases to private developers. However, some family-scale rubber plantations also exist.
- **Tenant farming** occurs when a family works land belonging to someone else and to whom it pays rent.
- **Sharecropping** is a type of tenant farming in which the farmer shares his harvest with the land owner.

After introducing a liberal land-ownership policy, Cambodia found that it still had to deal with the problem of landless farmers, which if left unaddressed could imperil the social and political stability of the country. In Cambodia, land is an important marketable asset available to farmers. The hotel industry boom has driven up the price of land, prompting some farmers to sell their land. According to Oxfam and the Cambodia Development Research Institute (CDRI), landless Cambodians comprised 5% of the population in 1984, 12% in 2000, and 15% in 2004. In 2004, the majority of the landless belonged to families that had never been landowners. The remaining 40% had owned land, but lost it through expropriation or selling it off on their own accord. Land conflicts have become a major cause for lawsuits in Cambodia, accounting for 60% of the cases brought before the Supreme Court. Till end 2008 over 3,000 property ownership disputes have been listed for court adjudication for the entire country. If the proportion of landless people climbs further say to 25-30%, the problem will certainly become critical and assume political dimensions. Rural discontent fed by rising inequalities between cities cashing in on the economic growth and the countryside, unable to do so, has increased noticeably.

1.7.2. Land Policy

To implement the 2001 Land Law, the government adopted a series of draft regulations and sub-decrees:

- The sub-decree prescribing procedures for land surveying and preparing land registry (May 2002);
- The sub-decree on spot land registry (May 2002);
- The sub-decree on social land concessions (March 2003); and
- The sub-decree on the organization and functioning of the land registry commission;
- Sub-decree on public land management and economic land concessions;
- Statement on Land Policy;
- Policy and Sub-decree on Procedures of Land Registration of Indigenous Minority Communities;
- Sub-decree on Procedures for Communal Land Use Planning;
- Draft Spatial Planning Policy;

- Draft National Housing Policy.

In addition, the Ministry of Land Management, Urbanization, and Construction, with the assistance of the Ministry of Interior, prepared working papers on the procedures and conditions for the rigorous demarcation of rural commune/sangkat boundaries. Since 90% of farmers do not have ownership titles, possession of ownership certificates is crucial for an preventing land disputes. Till end 2008, more than 1 million land ownership titles have been issued by the project for land administration and management.

An opaque policy of granting economic concessions to large timber and agro-industry corporations—most of them foreign—exacerbates the perception of exclusion on the part of the landless: of Cambodia's 18 million ha, nearly 5 million ha of forest and 1 million ha of agricultural land have been handed over to concessionnaires. The rights of residents of the zones in question are supposed to be taken into account, but in reality they are largely ignored.

The RGC is aware of this problem, and has taken measures to remedy it. The key policies include:

- Pursuing rigorous enforcement of the Land Law to promote an effective and equitable system of land management, distribution, and use, including the registration and distribution of land; securing the right of enjoyment by those in lawful possession; elimination of illegal settlements and land grabbing; and discouraging land hoarding for purposes of speculation.
- Survey of unoccupied or undeveloped public lands, and public lands illegally occupied by private businesses, in contravention of regulations in force.
- Strengthening the right to the enjoyment of land for people in need of small plots of land for housing or for family-scale production, within the framework of social land concessions,
- Pursuit of demining activities in compliance with international safety standards and international obligations in order to make increase the extent of land safe for cultivation.

Systemic Land Registration: The government has collected data on land parcels of 1.5 million parcels, completed the data entry into the data base and has issued 1.15 million property titles to land owner by mid 2009 with the view to guarantee the right to ownership, reduce land disputes, and improve access of farmers to bank credit. These

targets have been substantially achieved. The government is continuing to accelerate progress in land registry and reduce informal real estate transactions, thus encouraging the emergence of effective and transparent services. The Ministry of Land Management, Urbanization and Construction (MLMUC) is mandated to carry out the following activities:

- Development of a system for land evaluation.
- Continuing development of the policy defined in the document “Circular on Co-ownership Registration and Right of Way”.
- In the area of social land concessions, preparing directives on identification of lands and beneficiary groups and for integrated and coordinated development of land.
- Setting up a regulatory framework of data management viz. National Spatial Data Infrastructure (NSDI).
- Continuing studies and research on land issues, such as the economics of public land, a basic land study, and evaluation of social impact of land policy.
- Adoption of the joint declaration on the role and responsibilities of commune administrations regarding the land registry office.
- Drafting of a manual on the “Management of Land Issues, Land Administration, and Construction by Local Authorities.”
- Continuation of the procedures for commune/sangkat boundary demarcation and printing of commune/sangkat maps;
- Pursuing a program for issuing property titles and development of land registry and land dispute resolution mechanisms:
- Augmenting income sources by means of taxes on the transfer of land ownership, undeveloped land and value added in the case of a change of activity; and land registry fees.
- Creation of both horizontal and vertical geodesic networks throughout the country, and an ortho-photographic mapping of the country.
- Registry of specific sites of public interest, such as the Angkor site. And,

- Strengthening the mechanisms for amicable resolution of land disputes (through the Land Registry Commission), including legal assistance for those least able to pay for legal assistance, and a countrywide system of evaluation and monitoring of the implementation of the land policy.

Land management: The government (MLMUC) is improving the investment climate thanks to efficient management of public land and zoning policy; integrated regional, urban, and national planning; and pilot projects in two districts for the mapping of public land. The ministry is continuing to support the development and coordination of strategic development programs in four districts located in border zones and in 20 other districts; and is finalizing master plans and zoning projects for adoption by the concerned local government. The Council for Land Policy advises the government on land development and land conversion issues, and also contributes to the zoning of the Angkor protected area.

Land concessions: On the basis of existing pilot projects and the conclusions of Evaluation Study of the Impact on Poverty prepared under the social land concessions project, the Council for Land Policy, in cooperation with development partners, is currently developing the Program for Land Grants for Economic and Social Development (LASED). This program will help promote job creation efforts and improve access to land ownership for landless people. It will strengthen links between small-, medium- and large-scale landowners through the promotion of agri-food and industrial programs and other measures that will contribute to job creation in agricultural and non-agricultural sectors through Public and Private Sector Partnerships (PPP). The RCG has signed 90 contracts with private companies covering 1,178,160 hectares located in 16 provinces and municipalities. However, some concessions were cancelled and only 53 companies are active, while covering 845,920 hectares.



Chapter 2

Population and Demographic Structure

2.1. Overview

War, social breakdown, and genocide exacted a heavy toll on the people of Cambodia. Before World War II, the population of Cambodia numbered just over 3 million. According to the 1962 census, the total population was 5.7 million. Prud'homme estimated the total population to be 6.9 million people in 1970, and 7.9 million in 1975. The population in 1979 was estimated at 6.3 million. If the two estimates in 1975 and 1979 were correct, more than a million Cambodians perished during the Khmer Rouge period.

Table 2.1. Population of Cambodia

Year	Population			Remarks
	Total	Male	Female	
1920	2,600,000			
1962	5,728,771	2,862,939	2,865,832	Population census
1970	6,800,000			
1975	7,900,000			
1980	6,589,954	3,049,450	3,540,504	General Demographic Sur-
1993-94	9,870,000	4,714,000	5,156,000	Socio-Economic Survey
1996	10,702,329	5,119,587	5,582,742	Demographic Survey
1998	11,437,656	5,119,587	5,582,742	Population census
2004	12,824,000	6,197,000	6,627,000	Demographic Survey
2008	13,388,910	6,495,512	6,893,398	Population census

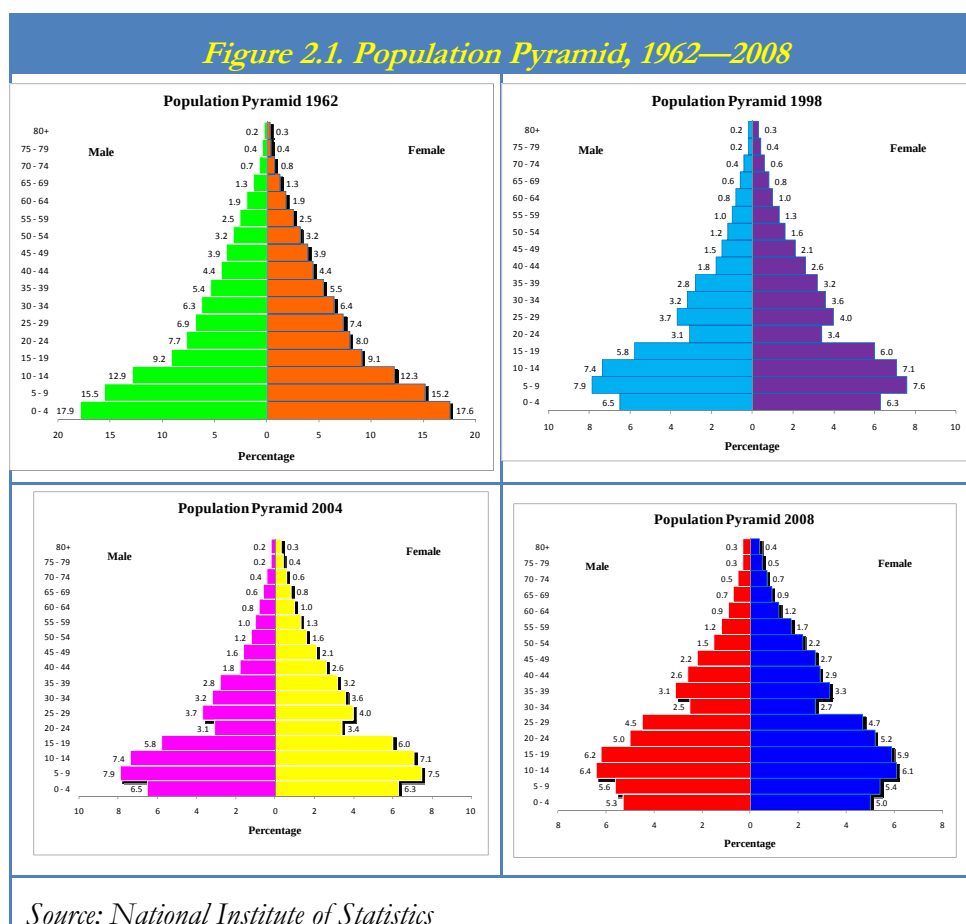
Source: Migozzi, Mysliniec, Cambodia Soir, November 5-7, 2004.

However, owing to one of the highest birth rates in the world, the population number has rebounded to the level preceding the demographic catastrophe, and has even exceeded it. As after all conflicts, there was a veritable “baby boom” in the early 1980s. The United

Nations, charged with organizing the 1993 elections, registered only voters, i.e. only Cambodians aged 18 or over. On this basis, in May 1993, 4,764,430 voters were registered. On the same date, the United Nations Transitional Authority in Cambodia (UNTAC) estimated that there were 8,820,766 inhabitants. According to the 1999 census, the total population of Cambodia was 11.4 million people. During the last decade Cambodia's population grew by 1.95 million to 13.3 million, according to the 2008 population census.

2.2. Population Structure by Age and by Sex

A country's population structure could be represented by a pyramid based on sex and age composition. The pyramid for Cambodia (1962-2008) shows the combined outcome of fertility, mortality, migration, as well as famine, war and genocide in the past. Cambodia's population pyramid shows the effect of wars during 1970-1975 and the mass murder of the Cambodian population by the Khmer Rouge during 1975-1979, reflecting high mortality, especially for male population, and low fertility rate. As a result, Cambodia has a young population with children (aged 0-14) forming 42.9% of the population. The sex and age structure beyond age 25 reflects the high levels of mortality during the Khmer Rouge regime and the internal strife during the 1970s. The effect of high mortality and large scale



out migration of adult males from the country during the Khmer Rouge period is revealed by very low sex ratios in the age groups 40-44 onwards.

The population pyramid shows very high proportion of the population aged under 20, reflecting the impact of the “baby-boom” period during the 1980s. Women make up 52% of the population, and youths (under 20 years of age) 55%. The pyramid also shows low proportion of people aged 40 and over. The proportion of men is lower than those of women for all the age groups, as men suffered higher mortality than women during the civil strife. The outcome is that there is high proportion of women-headed households in Cambodia.

2.3. Population Growth

2.3.1. Population Growth Rate

Cambodia’s population growth rate dropped from 2.4% in 1998 to 1.86% in late 2006, then to 1.54% in 2008, but remains higher than the average population growth rate in South-east Asia of 1.3%. Only Lao PDR has population growth rate higher than Cambodia, at 1.7%. The population growth rate in Thailand is 0.5% and in Viet Nam – 1.4%.

There is a trend in the Cambodian population toward a reduction in average family size, in both cities and rural areas. Single women head 29.2% of the 2.5 million families in the country.

2.3.2. Fertility Rate

Life expectancy is estimated at 54.5 years for men and 58.3 for women. The fertility rate dropped from 6 children in 1984-1988 (the baby boom period) to 4 in 1994-1998, to 3.4 in 2008. With the declining fertility rate, the average size of a Cambodian family declined from 5.2 in 1998 to 4.7 persons in 2008

2.3.3. Mortality Rate

Increased investment in the health sector during the last decade reduced the infant mortality rate from 95 per 1,000 live births in 2000 to 66 in 2005. In the same period, The mortality rate among infants less than five years old declined from 124 to 83. However, maternal mortality rate remains high at 473 per 100,000 live births in 2005.

2.3.4. Population Density

The geographic distribution of the population is uneven. This has structural consequences for agriculture, which divides the country into “rice-growing Cambodia” and “forest Cambodia.” Central Cambodia is much more populous (12 million inhabitants) than peripheral Cambodia, which is relatively sparsely populated (2 million inhabitants). In the central zone, 55% of the total area is devoted to agriculture; in the peripheral zones, where population density barely reaches 15 people per square kilometer, only 5% of the total area is devoted to agriculture.

Population density in the central plain was 261 per sq. kilometer in 2008; it was 62 per sq. kilometer for the Tonle Sap area, 47 per sq. kilometer for the coastal zones and 22 per sq. kilometer for the mountainous and plateau areas. The average density was 74 inhabitants per square kilometer in 2008, compared to 37 in 1981 and 63 in 1998.

2.3.5. Urban and Rural Population

The rate of urbanization in Cambodia is low. However, urban growth has accelerated in recent decades and the share of urban population in the total rose from 9.5% in 1962 to 19.5 % in 2008, an increase of more than 200% mainly because of an extensive rural exodus.

Table 2.2. Urbanization in Cambodia

	1962		1998		2008	
	Inhabitants	%	Inhabitants	%	Inhabitants	%
Total population	5,728,771	100	11,437,656	100	13,388,010	100
Urban population	546,865	9.5	1,795,575	15.7	2,614,440	19.5
Rural population	5,181,906	90.5	9,642,081	84.3	10,774,470	80.5

Source: Migozxi. General Population Census of Cambodia 1999. Analysis of Census Results. Report 3. Labor Force and Employment.

Despite the growing industrialization, Cambodia is predominantly an agricultural country, with the majority of the people eking out their livelihoods from agriculture. The urban population is more involved in trade and handicraft manufacture.

2.3.6. Active Population

The country's economically active population or labor participation rate grew rapidly from 44% of the population in 1962 to 45% in 1998, and to 53% in 2008 or 7 million people, of which 43% live in rural areas and only 10% in urban areas. The unemployment rate has shown a downward trend during the last decade, declining from 5.34% in 1998 to 1.68% in 2008. The unemployment rates are lower in the rural areas than in the urban areas owing to the absorption of a large number of workers in the agricultural sector in the countryside.

Table 2.3. Economically Active Population

	1962		1998		2008	
	Inhabitants	%	Inhabitants	%	Inhabitants	%
Total population	5,728,771		11,437,656		13,388,010	
Total active population	2,500,000	44%	5,118,945	45%	7,053,398	53%
Urban active population	475,000	8%	857,233	7%	1,291,511	10%
Rural active population	2,025,000	35%	4,261,712	37%	5,761,887	43%

Source: Migozxi. General Population Census of Cambodia 1999. Analysis of Census Results. Report 3. Labor Force and Employment.

About 52% of the total employed population has a secondary activity besides their main activity. The most favored secondary occupation is unpaid livestock farming (26%), followed by unpaid crop farming (15%).

2.3.7. Human Development

Illiteracy rate tends to decline from time to time. In 1998, two thirds of Cambodians surveyed said they could write and read. At present, this ratio has increased to three fourths. Female literacy rate increased rapidly during the last 6 years from 50% to 70%. Literacy rate of children aged between 10 and 14 years increased from 67.6% in 1998 to 87.6% in 2008. This rapid increase was attributable to the improvement in enrollment rate.

The access to clean water increased from 29% of the population in 1998 to 44% in 2008; the rate of use of toilets increased from 14.5% to 21.9%; and the rate of use of kerosene lamps dropped from 80% to 65%.

2.3.8. Population Distribution by Economic Sectors

Table 2.4 shows the distribution of the economically active population among the three economic sectors. The share of agricultural employment was still very high in 2008 absorbing 72.3% of the Cambodian labor force, compared to 81% in 1962 and 77.5% in 1998. Agriculture labor is mostly engaged in farming, forestry, and fisheries.

Table 2.4. Structure of domestic product

	1962		1998		2008	
	% of	Workforce	% of	Workforce	% of	Workforce
Primary	49	81	44.5	77.5	32.4	72.3
Secondary	19	4	16.7	4.3	22.4	8.5
Tertiary	32	15	34.8	18.2	38.8	18.2

Source: Migozzi. General Population Census of Cambodia 1999. Analysis of Census Results. Report 3. Labor Force and Employment.

The economically active population employed in the secondary sector remains relatively low at 8.5% in 2008 (599,538 workers) compared to 4% in 1962; this in spite of the rapid growth of industry including construction during the last decade. Secondary sector employment includes about 350,000 garment industry workers in 2008. Informal and self employment accounts for a substantial part of employment in the secondary sector. The tertiary sector share is twice as high, with about 18.2% of the economically active population (1,283,718 workers) compared to 15% in 1962.

2.3.9. Migration

Migration can be internal or external. The main reasons for internal migration are as follows:

- The search for arable land. Most of the farms surrounding the Tonle Sap areas are less than 0.5 ha in extent;
- Seasonal migration which occurs at the end of agricultural work, when farmers migrate to the cities to find seasonal employment, such as tricycle or motor taxi drivers or to forests to do logging.

According to the 2008 population census 3.55 million of Cambodians or 26.5% of total population considered themselves as migrants, a decline from 3.59 million or 26.5% in 1998. The main reason for this decline was reduction in the number of persons with previous residence outside Cambodia. Out of the total migrants, the internal migrants accounted for 97% in 2008. Most migrant workers go from one rural zone to another (51%). Definite resettlement with the family (including marriage) was the main reasons for migration (52.4%), followed by migration in search of better employment (21.5%). Other reasons for migration include sale of farms which have become uneconomic to work on, increasing poverty, sale to land speculators and low investment in rural development and agriculture. Most of the migrants from the rural areas are young.

Rural to urban migration accounts for only 27.5% of the migrants, and only a small proportion of migrants do the reverse migration, i.e. from urban to rural (6.5%). Urban to urban migration made up another 15%. Migration of young female workers from the countryside is increasing, due to the prospect of getting employment in the garment factories in the urban areas. The migrants are able to send back remittances to their families living in the countryside, creating favorable conditions for improvement in agricultural productivity and socio-economic development. However, migration from rural to urban areas has led to the rapidly growing slums and illegal settlements in the urban areas.

2.4. Socio-Economic Status of the Population

2.4.1. Farmer Grouping

According to the World Food Program (WFP) system of classification, Cambodian farmers can be classified into six categories based on their main sources of income, work, and mode of agricultural production. (Helmert et al, 2003):

- **Rice growers** (*Neak Sre*) who live in the rain-fed zones of the plains (2.9 million inhabitants).
- **Riverside and lake edge growers** (*Neak Tonle*) who live along the Mekong and Tonle Sap Rivers and their tributaries, and include 1.3 million inhabitants.
- **Village market sellers** (*Neak Krong/Phsar*) comprising 1.3 million rural people.
- **Day laborers** (*Kasekor Si-Chnuol*) or landless peasants, some of whom may own undeveloped land. They number 1.2 million.
- **Hill dwellers** (montagnards) (*Neak Phnom*) who live in zones of low density (fewer than 8 persons per square kilometer). There are 450,000 such dwellers. They practice

slash-and-burn agriculture in mountainous and plateau zones.

- **Mixed groups** are those who belong to more than one category.

2.4.2. Indebtedness

A serious problem among the rural poor is indebtedness for rice supplies during the year. Members of rural households who are moderately or severely malnourished reported using some of their rice harvest to pay back loans. In addition, farmers also borrow money from usurious lenders (charging interest rates of 50% per annum or higher). While serving as a short-term coping strategy, the practice of obtaining high interest loans for consumption usually carries unacceptable risks.

2.4.3. Vulnerable Groups

For the most part, the following social categories are vulnerable groups: children, women, disabled persons, youth, and the elderly. The protection of vulnerable groups is at the very core of the government's strategy. Group specific programs will be implemented in order to reduce the factors of social exclusion, with particular focus on poor people whose ability to take action is affected by social status (gender), age, physical disabilities, or special circumstances (victims of landmine accidents, floods, or social and political conflicts), so that these groups will have equal access to economic opportunities for employment and social services as the rest of the community.

One of the main issues in the fight against poverty is targeting the groups bypassed in the development process by addressing the specific needs of these groups. Another issue is to ensure the effectiveness and sustainability of the interventions through the implementation of a participatory, decentralized process of piloting, execution, and monitoring/evaluation of programs. These interventions target guaranteeing the speed and transparency necessary for land ownership, as well as ensuring coherence with the various sector programs and local initiatives already operating or in the planning stages.

The design, execution, and monitoring/evaluation of the programs will be based on a sector-wide approach that recognizes and builds upon gender specificities with a view toward improving intervention impact and ensuring equality. Taking into account the different roles of men and women, the disparities between the sexes with respect to control and access to resources, as well as resulting differences at the level of constraints, needs, and priorities, will serve as guiding principles for all components of the strategies adopted

The government will pursue legal and regulatory reforms already undertaken in line with the principles highlighted in the policy program, which recognizes explicitly the rights of

women, notably those linked to land access. In order to translate all these legal programs into facts and make these rights effective, measures will be taken to (i) strengthen women's rights through comprehensive awareness raising and disseminate the legislation in easily understandable terms; (ii) improve the economic and social status of women by establishing facilities to lighten household work, making available to rural women the technologies and equipment necessary for produce processing and preservation (to enable women to devote more time to productive activities) and setting up funds for the economic promotion and support of women's activities; (iii) strengthen the capacity of women to reduce their vulnerability through specific measures within education and health sector programs; (iv) improve access and time spent in school for girls at all levels of education and encourage vocational training for women; and (v) improve the health status of women, girls, and children.

As for disabled persons, government initiatives will focus on: (i) establishing a national program of community-based rehabilitation; (ii) improving their economic and social status and combating the social prejudice that victimizes them; (iii) improving the sanitary conditions and mobility of disabled persons; and (iv) encouraging the education and training of disabled persons.

To improve the living conditions of youth, the government will: (i) enhance vocational training; (ii) work with NGOs to improve the conditions of street children; and (iii) develop programs to handle young drug addicts.

In a more general way, for all the vulnerable groups, the government will focus on encouraging and strengthening formal and informal social safety nets by facilitating access to social insurance agencies and promoting the creation of health groups and other civil and social solidarity facilities.

The government intends that all the above initiatives for vulnerable groups should be strengthened with help from development partners particularly if Cambodia is confronted by external shocks sufficiently strong to throw macroeconomic management off course.

2.5. Population Policy

The liberalization of the economy during 1988-2003 under the first mandate of the government helped Cambodia to reduce poverty substantially. Subsequently even though the economy grew, poverty reduction in Cambodia was less remarkable. While the GDP increased by an average of 6% between 1994 and 2003, the poverty rate of Cambodians declined from 39% in 1993 to 37% in 1997, and to 36% in 1999.. In the meanwhile Cambodian labor force grew by more than 250,000 annually propelled by the high population growth rate of 2.4%.

The high rate of population growth weighs heavily on social services, and makes the task of reducing poverty more difficult. The consequences of high population growth on socio-economic development are recognized and widely documented. The RGC is conscious of the need to stem rapid population growth, create more jobs, reduce poverty, and improve health, and has put forward a population policy framework and a set of family planning programs to address this objective.

In 2003, Prime Minister Hun Sen issued an executive directive to establish a national population program to provide information on and services for family planning, including activities to advocate smaller families. The RGC has put forward a range of population management policies, ranging from attainment of the desired family size, to mother and child health care, including limiting of population growth, and a return to preventive health care.

The population policy of the RGC aims to reduce poverty and reach the Millennium Development Goals. The priorities of the population policy, as stated in the Rectangular Strategy, are as follows:

- Help couples and families to make decisions, freely and knowledgeably, about the number of children they want and about birth control, and to guarantee them access to information, education, services, and all other means to allow them to implement their decisions.
- Control the high fertility rate and make information on family planning widely available.
- Reduce the rate of infant mortality and morbidity, as well as the maternal mortality rate.
- Promote gender equality and strengthen human resources development.
- Limit the harmful effects of demographic pressure on the environment and natural resources.
- Strengthen prevention measures against HIV/AIDS.
- Take into account demographic factors in all plans, programs, and social and economic policies.

The family planning program is proving effective on two fronts: ensuring wider distribution of affordable contraceptives, and successful dissemination of family planning information and increasing awareness among couples to take advantage of the family planning

programs. More radical methods of population control than contraception—abortion and sterilization—have played a major role in slowing down population growth. The government is advocating an expansion of services offered in clinics to include reproductive health care, including post-abortion care and services for adolescents. Providing condoms and contraceptive pills is also an effective safe sex and HIV/AIDS prevention measure.

2.6. Policy on Employment and Social Welfare

As a major initiative in pushing back poverty, employment creation will be placed at the heart of the development strategy. The employment policy centers on (i) measures concerning the management of the work force to help enhance the capacities and opportunities of the poor for employment; (ii) improvement of work force management practices and employability; (iii) strengthening the effectiveness and transparency of the employment market; and (iv) promotion of self-employment in both rural and urban communities.

These measures will be accompanied by the promotion of labor-intensive activities (LIA) in construction, restoration, and upkeep of social and economic infrastructure. The LIA approach is expected to be intensively applied in works programs of the government and the local authorities.

The priorities of the RGC for its third mandate (2003-2008) are:

- Job creation for all Cambodians and in particular for youths entering the job market, through measures that encourage local investment and direct foreign investment in the priority sectors of agriculture, agro processing, industries manufacturing high value added products and tourism.
- Setting up a network for the technical training of disadvantaged people, along with assistance in job searching, in particular for youth and young graduates, commensurate with the needs of the job market.
- Development of job market statistics.

In practical terms, the RGC's priorities are:

- Improving the management of foreign worker employment in order to create jobs for Cambodians.

- Facilitating the transfer of new technologies that will contribute to the development of the country.
- Devising policies and programs for employment and training consistent with the education policy in order to encourage vocational mobility, and setting up vocational and technical training.
- Encouraging the official export of labor to improve people's well-being, build capacity, reduce unemployment, and raise incomes. Labor export is a meaningful strategy for poverty reduction, as the experience of neighboring countries shows.
- Supporting the development of labor-intensive industry in order to create jobs and absorb the influx of labor from rural zones, while taking necessary measures to increase the productivity and diversification of the agriculture sector.

The employment policy will be implemented through:

- Stringent enforcement of the labor law and international conventions on the role of unions in order to guarantee the rights and duties of workers, employees, and employers.
- Improving the working conditions of workers and employees.
- Strengthening enforcement of social security obligations of employers.
- Preparing a feasibility study for the establishment of a fund for old-age insurance, disability allowances, and dependent persons, as well as insurance for occupational accidents in keeping with labor legislation.

2.7. Ethnic Groups in Cambodia

2.7.1. The Khmers

Ninety percent of Cambodians are Khmer, a people belonging to the Austro-Asiatic group that settled in Southeast Asia in the prehistoric period. There are also Chinese-Khmer, Thai-Khmer, and Vietnamese-Khmer, progeny of mixed marriages.

2.7.2. The Chinese

The migration of Chinese to Cambodia started since the first century AD. The Chinese first came to the Sampoeuv Poun Village, Koh Thom District, Kandal Province for trading during the Funan period which preceded the Khmer Empire. In 1296 – 1297, Zhu Daguan wrote: *“The Chinese boat refugees came to here (Cambodia). They did not establish communities to live by themselves. On the contrary, they integrated into the Cambodian society, especially where it was easier for them to have their own interests, such as food, women, housing, furniture and trade”*. The 1860 Treaty signed with China to establish the protectorate regime in Cambodia created opportunity for the new waves of Chinese immigrants to arrive in Cambodia, thus increasing the number of Chinese in the country.

There are five large groups of Chinese in Cambodia coming from Southern China: Cantonese, Hainanese, Hakka, Hokkien and Teochiu (Center for Advanced Studies – 2009). Until 1884, there were active Hainanese and Hokkien communities in Phnom Penh.

The number of Chinese in Cambodia in the 1970s was estimated at 150,000. The Chinese were more involved in trade and dominated economic activities.. However, there are also Chinese and Cambodians of Chinese descent who make their living as farmers in Battambang, Kompong Thom, Takeo and Prey Veng.

2.7.3. The Vietnamese

Vietnamese migration to Cambodia started in the 17th century, with the Nam Tien policy or “southward movement”, to encourage Vietnamese to settle in the delta region of the Mekong in order to farm the fertile land. Moreover, Vietnamese liked to settle along the river banks and surround the Tonle Sap Lake, where fish is abundant. The “Southward Movement” policy came to an end with the establishment of the French protectorate in 1863. However, in the 19 century, the Vietnamese continued to establish settlements in Cambodia and lived as farmers or to establish fishing villages surround the Tonle Sap Lake or along the Mekong River. More recently, a small number of Vietnamese came to Cambodia after 1979. The Vietnamese can be found mostly working as fishermen, construction workers, carpenters, electricians, mechanics and small traders.

2.7.4. The Cham

Cambodia’s historical accounts show that the first migration of the Chams occurred with the southward movement policy of Viet Nam, especially with the occupation of the capital city of Vijaya by the Vietnamese forces. At the end of the 15th century, Cambodia became the main target for the Muslim Cham migrants who arrived en masse following the annexation of ancient Champa to Annam’s Cochinchina in 1471 by King Le Thanh Tong

of Viet Nam. This migration continued until 1830, as the migrants were accused of waging the war against Viet Nam during the reign of the Empress Angmei. The Cham are muslim and belong to the Sh'ite sect.

The Muslim community in Cambodia can be divided into the following main groups:

- The Chvea – who can be found more in and around Kampot and originally migrated from Java. These people do not speak Cham, but speak Khmer and some Malay.
- The Jahed or Imam San Cham, who value the Cham script in which their texts are written as the prominent marker of their orientation. The Jahed stress Cham history as the key feature of their identity and favor adoption of modern Islamic practices and openness to international Malayo-Islamic culture. They mostly live in villages surrounding Udong, in Pursat and Battambang provinces.
- The Cham is the largest Muslim community in Cambodia. The Cham vernacular language is common to Cham with Jahed groups which distinguishes them from Chvea Muslims who cannot speak Cham. As the Cham form the biggest Muslim community in Cambodia, the expression Cham is widely used to represent all Cambodia's Muslim minority. Members of the Cham community speak both Khmer and Cham, but the Cham script is almost defunct.

The members of the Muslim community were one of the prime targets of the Pol Pot regime between 1975 and 1979. After the first massacres in the autumn of 1975, they tried in vain to revolt. The repression was fierce. They were also victims of massacres carried out in the eastern part of the country in 1978, where they were a majority. Their numbers were reduced to 50,000 in 1979. Today, they number about 300,000. The massacre of the Chams fits perfectly the definition of genocide inscribed in the international convention of 1948.

2.7.5. The Laotian

The Laotians migrated to Cambodia following the invasion of Laos by Siam in the 19th century to settle along the Mekong River and three other rivers, Sekong, Sesan and Sre Pork in Stung Treng and Rattanakiri provinces. There is a small community of Laotians living in Preah Vihear province, near the border of Laos. Some Laotians left Champasak and Attapeu provinces of Laos to settle in Rattanakiri province to work in gold and gem mines. However, Laotians can be found in a few villages in Prey Veng and Svay Rieng and are being called “Lao Lung Sat”, which means separated from their country. The number of Laotians living in Stung Treng and Mondulakiri Provinces is estimated at 22,000.

2.7.6. The Thai

Thai migrated to Cambodia during the 19th – 20th centuries to settle in Banteay Meanchey and Koh Kong provinces. Thai living in Banteay Meanchey make their living from farming and also work as construction workers in Thailand. The Thai in Koh Kong (Mangrove Thai) are involved in fishing and farming.

2.7.7. The Burmese

Burmese population settled in Pailin in the late 19th century to work in gem mines. They were also well known as gem traders and experts. In the 1960s some 3,000 Burmese lived in Pailin, but spoke only the shan language.

2.7.8. The Indigenous Hill-Tribe People

There are some 18 indigenous ethnic groups living in the highlands of Cambodia. They are referred to as highland Khmers (Khmer Loeu), highlanders or hill-tribes, due to the fact that they live mostly in the upland forest regions, especially in the North-east, home to the most diverse indigenous population, such as Brao, Jorai, Kachac, Kraol, Kraveth, Kreung, Kuy, Lun, Phnong, Stieng and Tampuan. They belong to different ethnic groups, with different languages and live according to their own traditions. However, all of them live in the highland areas and practice animism.. Frederic Bourdier (CAS, 2009) has classified the indigenous ethnic groups according their languages based on the American classification methodology:

Table 2.5. Ethnic Groups in Cambodia

Ethnic group	Sub-Group	Language	Family	Population	Province
Joray	Cham	Austronesian	Austro-Thai	14,000	Ratanakiri
Rhade	Cham	Austronesian	Austro-Thai	156	Mondulkiri
Kachork	North Bahnaric	Bahnaric	Mon-Khmer	3,165	Ratanakiri, Stung Treng
Tampoun	South Bahnaric	Bahnaric	Mon-Khmer	27,336	Ratanakiri, Mondulkiri, Stung Treng
Broa				7,479	Ratanakiri, Stung Treng
Kreung	West Bahnaric	Bahnaric	Mon-Khmer	18,142	Ratanakiri, Mondulkiri
Kaveth	West Bahnaric	Bahnaric	Mon-Khmer	4,676	Ratanakiri, Stung Treng
Lun				694	Ratanakiri, Stung Treng
Phnong	South Bahnaric	Bahnaric	Mon-Khmer	10,836	Kratie
Stieng	South Bahnaric	Bahnaric	Mon-Khmer	6,768	Kratie, Kompong Cham
Kraol				10,044	Kratie
Meul (Ka Chrouk)	?	Bahnaric	Mon-Khmer	2,208	Kratie
Chorng	Pearic	Pearic	Mon-Khmer	1,091	Pursat, Koh Kong
Samre		Pearic	Mon-Khmer		Pursat, Koh Kong
Por	Pearic	Pearic	Mon-Khmer	888	Pursat, Preah Vihear
Saoch	?	Pearic	Mon-Khmer		Sihanoukville, Kampot
Souy	?		Mon-Khmer	1,811	Kompong Speu
Khmer Khe					Steung Treng
Kouy	Khmer	Katuic	Mon-Khmer	20,387	Preah Vihear, Kompong Thom, Stung Treng

Source: Center for Advanced Studies (2009). Ethnic Groups in Cambodia.

PART II

MACROECONOMIC FRAMEWORK

- Chapter 3. Macroeconomic Performance—Historical
Trends and Key Features of Structural
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- Chapter 4. Banking**
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Chapter 3

Macroeconomic Performance – Historical Trends and Key Features of Structural Adjustment

3.1. Phases of Economic Growth

Since 1989 Cambodia has embarked on a series of reforms to replace central planning with the fundamentals of a market economy. These include the introduction of private ownership of property, rapid price and trade liberalization, current account convertibility, the opening of domestic markets to entry by private businesses, privatization of state-owned companies, demonopolization of industries and services, and the reform of accounting standards, the tax system, the legal system and the financial sector.

Economic development in Cambodia can be divided into three distinct phases:

- The rehabilitation phase, 1989-1998;
- The reconstruction phase, 1999-2003;
- The economic take-off phase, 2004-2008;

The rehabilitation phase, 1989-1998: The rudiments of a market economy were established, with the introduction of private property, privatization of state-owned companies and decollectivization of agriculture, thus paving the way for national reconciliation and the general elections in 1993. However, efforts to implement market reforms were undermined by macroeconomic imbalances caused by the following factors (World Bank, 1992):

- Economic liberalization starting in 1989 acted to hinder revenue mobilization. Privatization of State-Owned Enterprises (SOEs) and enterprise reform combined with price and trade liberalization slashed economic rents formerly captured by the public sector enterprises. This loss of revenue was not made up by fiscal revenues mobilized from the emerging private sector. The contribution made by public enterprises to budget revenues fell from 36% of total expenditure in 1989 to 22% in 1991. The introduction of new taxes made only a small contribution to the budget. Non-tax revenue declined from 5.5% of budget expenditure in 1989 to less than 1% in 1991.

Box 3.1. The “Washington Consensus”

The term “Washington consensus” consists of 10 principles governing the conduct of macroeconomic policy:

- *Fiscal policy discipline to avoid inflationary pressure and flight of capital.*
- *Redirection of public spending from subsidies (“especially indiscriminate subsidies”) toward the broad-based provision of key pro-growth, pro-poor services (primary education, primary health care, and infrastructure investment).*
- *Tax reform broadening the tax base and adopting moderate tax rates.*
- *Positive Interest rates to encourage savings and discourage flight of capital.*
- *Competitive exchange rates.*
- *Trade liberalization and elimination of fees on intermediate products entering into the production of goods for export.*
- *Liberalization of inward foreign direct investment.*
- *Privatization of state enterprises.*
- *Deregulation so as to abolish impediments to market entry or exit, as well as sources of corruption.*
- *Legal security for property rights.*

Source: Williamson, J. (2000) “What Should the Bank Think About the Washington Consensus?” World Bank Research Observer, Vol. 15, No. 2, August, p. 251-264.

However, elimination of customs duties exemptions increased customs revenues from 8.5% of expenditures in 1989 to 37% in 1991;

- On the expenditure side, removal of price control considerably increased the unit cost of the goods and services procured for operations and investments. The government’s policy to protect wages and defense expenditures crowded out public investment and operations and maintenance. Their share in the budget declined from 41% in 1989 to 16% in 1991;
- The elimination of Cambodia’s credit facility under the 1986-1990 trade and payments agreement with the Soviet Union. Commodity aid received under this agreement financed 15% of budgetary expenditures in 1989. Humanitarian assistance from donors amounted to only US\$20-30 million a year in 1991-92.

- Under such circumstances, the government resorted to monetary financing of the budget deficit. Monetary financing covered more than half of the budgetary gap in 1991 and the budget was in arrears for the remaining 20% of expenditures. Wage payments became sporadic. Monetary financing resulted in high inflation, running at average rates of 70% in 1989, 157% in 1990 and 121% in 1991. These developments contributed to the lack of public confidence in national currency and high dollarization.

The formation of the RGC in 1993 led to the end of the economic embargo imposed on Cambodia since 1979 and resulted in the inflows of Foreign Direct Investment (FDI) and Official Development Assistance (ODA) for economic rehabilitation. During 1993-1998, Cambodia was not fully at peace. The RGC of the first mandate could not give full priority to economic development and poverty reduction, as it was required to combat the Khmer Rouge forces scattered across the country. Defense and security spending amounted to 6.3% of GDP in 1994, while social spending represented only 2.1%. However, attention was also given to implementing the first generation of reforms. Inflation was reined in from 121% in 1991 to -0.7% in 1993. A new French-based budget system was introduced and a legal framework established for public enterprises.

With the implementation of the Prime Minister's "win-win" policy, the military and political organization of the Khmer Rouge was dismantled in 1998. The RGC of the first legislature laid out the foundation for peace, security and economic growth in Cambodia. Despite many setbacks, economic growth during 1994-1998 averaged 6.3%. Growth during this period was financed mainly by the overuse of natural resources, Official Development Assistance (ODA) and the FDI inflows into the financial sector. The high performing sectors were forest, rubber, utilities, public administration and banking. Forest value added grew at an annual average rate of 17.2% with wood, paper and publishing increasing by 22.9% a year. Rubber manufacturing grew by 21.9%. During 1994-1998, much of the ODA was used to rehabilitate power generation capacity and water supply. Electricity, gas and water, the subsector of manufacturing, grew at an annual average rate of 14.9%. Public administration grew at the rate of 20.8% and Finance at 38.5%.

The reconstruction phase, 1999-2003: Cambodia successfully implemented the triangular strategy as mandated by the second legislature (1999-2003). Political stability was restored and democratic institutions were rebuilt. This period created unprecedented opportunity for economic reform and social progress. Cambodia regained international recognition, after the factional fighting ended in July 1997, having been given a seat at the UN in December 1998 and having been formally admitted to ASEAN in April 1999. Cambodia has embarked on wide-ranging reforms focusing on macroeconomic management, public financial management and financial sector reforms, and rehabilitation and reconstruction of physical infrastructures, especially the national road network.

The economic reform undertaken by the RGC during 1999-2003, in particular the consolidation of market reforms, reflected the economic orthodoxy of the “**Washington Consensus**,” the prevailing ideology for ensuring sustainable development. This approach to economic development emphasizes macroeconomic reforms and a growth strategy based on exports and on the quality of institutions seen in certain countries of East Asia, especially the imperative of rigorous budgetary discipline, proper functioning of the judicial system, productivity of labor, development of infrastructure, maintenance of a competitive rate of exchange, attractiveness for foreign investors, promotion of exports, and integration into the regional and global economy.

Economic growth during 1999-2003 averaged 8.8%. Although ODA continued to finance growth, FDI particularly investments in garment and tourism, was key to promoting growth. The high performing sectors were rice and cash crop production, utilities, construction, tourism, telecom and transportation and real estate. The decline in value added originating from forestry was offset by improving the production of rice and other cash crops, which grew at an annual average rate of 6.4%. Textile sector was growing by 35.1% a year. Continued rehabilitation of the power and water sector resulted in the electricity, gas and water subsector growing at an annual average rate of 10.2%. Construction became a pillar of growth, increasing at an average annual rate of 20.1%. Recently restored peace contributed to rapid development of tourism; the sector increased at the average rate of 13.6% a year. It coincided with the mobile phone revolution and the transport and telecommunication sector grew at an average annual rate of 12.1%. Real estate was also growing rapidly with growth registering 12.1% at the beginning of the real estate boom.

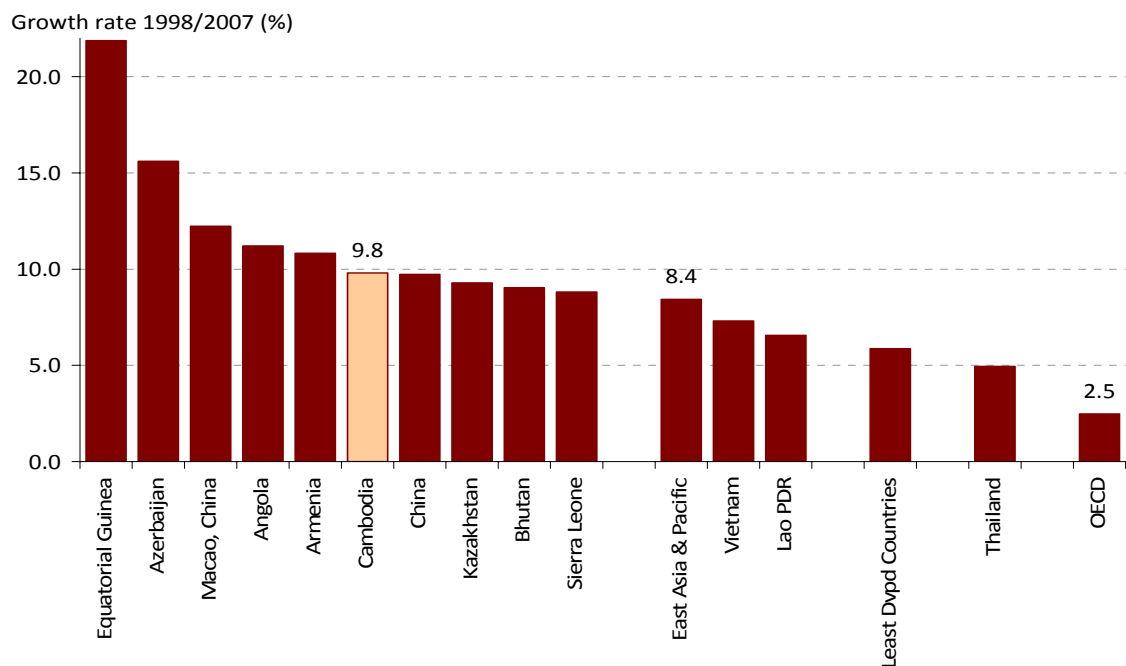
The economic take-off phase, 2004-2008: Considerable efforts have been made by the RGC to implement the second generation reforms as envisaged in the Rectangular Strategy, in particular the implementation of the first phase of the Public Financial Management (PFM) reform program and continued investment in provincial and rural roads. Economic growth during 2004-2008 averaged 10.3%. For the first time Cambodia achieved sustained double-digit growth, financed mainly by the rapidly growing banking sector and FDI inflows. The high performing sectors were rice and cash crop (average annual growth of 9.7%), mining (18.2%), textiles (16.1%), utilities (16.7%), construction (15.5%), tourism (17.4%), telecom and transportation (8.3%), finance (21.6%) and real estate (12.4%).

3.1.1. Structural Transformation of the Economy

Cambodia's sound macroeconomic management is reflected in economic growth averaging 9.5 % during the last decade and 10.3% during 2003 to 2008, with a record high of 13.3 % in 2005.

According to a study by the World Bank, Cambodia was among the 15 fastest growing economies in the world during 1998-2007, positioning slightly ahead of China and exceeding the Asia-Pacific average of 8.4%. Countries that grew faster than Cambodia, such as Equatorial Guinea, Azerbaijan and Angola were mainly driven by the extraction of natural resources.

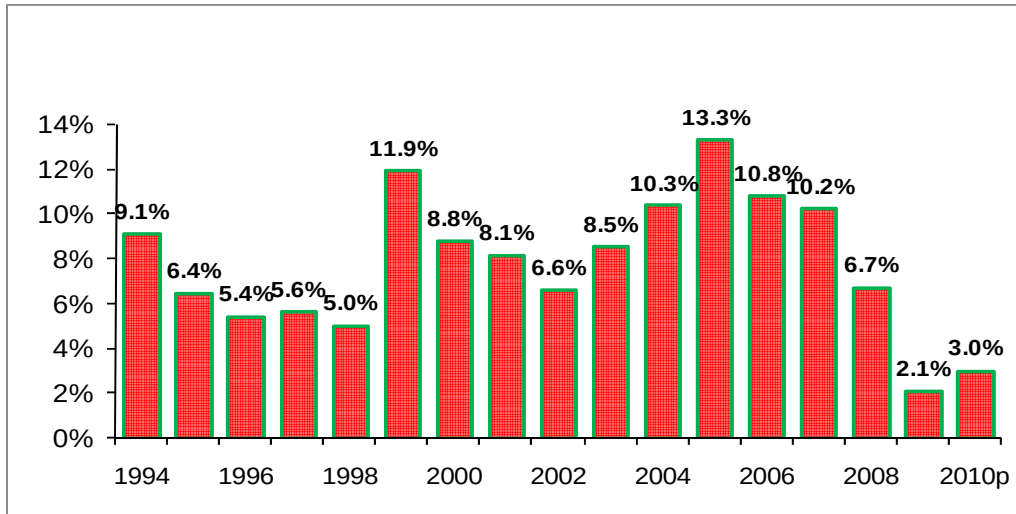
Figure 3.1. Cambodia was among the fastest growing economies



Source: The World Bank

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. This performance is underpinned by the strong support extended to agriculture and the garment sector by the RGC.

Figure 3.2. Economic growth Performance 1994-2008



Source: Ministry of Economy and Finance

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.

During the five years of the government's second mandate, Cambodia exceeded the targeted economic growth of 6-7 %. GDP growth averaged 8.8% during 1999-2003 despite natural disasters such as repeated floods and drought.

Overall, sustained economic growth in the last decade has raised living standards and reduced poverty headcount. Average per capita household consumption rose by 32% in real terms between 1994 and 2004. Calorie intake per capita rose steadily and reached 2,932 calories per day in 2004). In Phnom Penh and other urban centers the rise has been more dramatic. However, poverty reduction is not keeping pace with growth, a sign that Cambodia is increasingly less egalitarian.

The following observations are relevant:

- The main driver of poverty reduction is economic growth. And only growth allows the improvement of other social indicators such as infant mortality and school attendance.
- Yet growth, the necessary condition, is not sufficient for social stability. Poverty reduction must be accompanied by greater equity in income and wealth distribution.

The persistence of childhood malnutrition, despite the economic boom, confirms that the government cannot remain satisfied merely on the basis of the high growth performance.

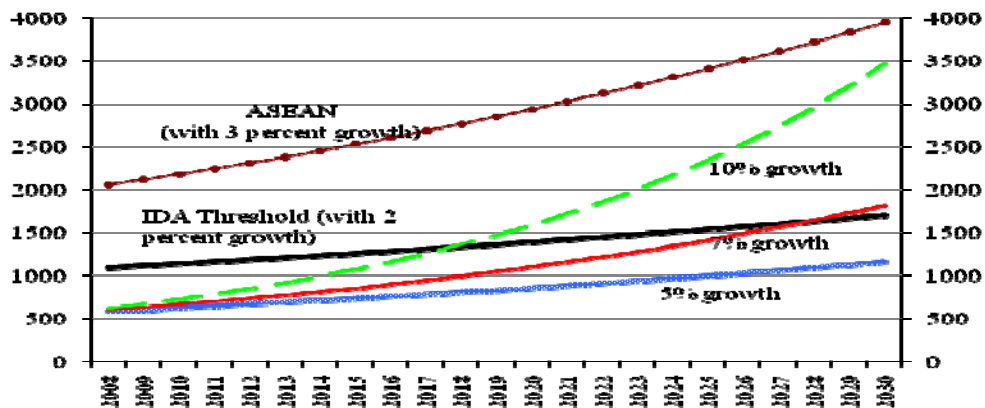
Table 3.1. Cambodia: Macroeconomic indicators, 2001-2008

	94	99	01	02	03	04	05	06	07	08
Real sector										
Real GDP (% growth)	9.1	11.9	8.1	6.6	8.5	10.3	13.3	10.8	10.2	6.7
-Agriculture	9.7	2.2	3.6	-2.5	10.5	-0.9	15.7	5.5	5.0	5.7
-Industry	14.2	21.2	11.2	17.1	12.0	16.6	12.7	18.3	8.4	4.0
-Services	0.6	14.6	11.1	7.7	5.9	13.2	13.1	10.1	10.1	9.0
GDP per capita	248	281	312	331	356	402	468	534	623	739
Domestic saving (without transfers)			8.2	4.3	1.8	3.6	2.0	2.9	3.7	4.4
National savings	19.4	16.6	20.1	21.3	16.2	16.3	17.2	21.7	22.6	12.7
Central government savings	-1.0	1.6	1.0	1.0	0.8	1.7	1.8	1.2	3.2	3.5
Private savings	24.4	20.3	20.3	21.5	18.3	16.9	19.6	21.5	23.2	20.9
Domestic investment	12.1	11.8	12.1	11.9	12.2	11.8	11.1	11.2	11.1	11.5
Public investment	4.7	5.4	7.0	8.3	6.4	5.7	5.2	5.7	6.1	6.3
Donor investments	5.5	3.8	5.6	7.3	5.4	4.5	4.4	4.9	5.3	5.3
Private investments	18.7	16.5	14.2	14.2	12.8	12.9	16.3	17.0	20.4	18.0

Source: Ministry of the Economy and Finance, National Bank of Cambodia, IMF.

- The best way to promote growth for small sized economies is to integrate with the world trading system.
- Since 70% of the inhabitants of Cambodia make their living from agriculture, poverty reduction efforts must focus on this sector. This means increasing the export of agricultural products and implementing reforms through membership in the World Trade Organization (WTO).

Figure 3.3. Projected Per Capita Real GDP



Source: IMF Cambodia

- Cambodia is deficient in economic and social infrastructure. Foreign financial aid must prioritize this sector for their investments.
- The civil administration system plays a leading role in capacity building to manage the development process.

Since the implementation of market reforms began in 1989 Cambodia's Gross Domestic Product (GDP) increased fivefold from US\$1.27 billion in 1989 to US\$10.3 billion in 2008. During this period per capita income also grew fourfold from US\$152 to US\$739. Mainly due to the sustained high growth poverty incidence dropped from 35% in 2004 to an estimated 30% in 2007.

The global crisis is affecting Cambodia's economy, with growth slowed down to 6.7% in 2008 and projected at within a range of 2% and 0% in 2009 (IMF projected at -2 ¾ percent). Three of the four main drivers of growth – garments, tourism and construction – have registered contractions, while signs of bottoming out began in mid-2009. Private investment was also hit. 40,000 jobs in garment factories have been lost.

Growth is projected to pick up to 4¼ percent in 2010, but risks are on the downside. Export-related activity is vulnerable given the narrow base, high concentration of garments destined for the US market, and continued weak prospects for US retail sales. Rising productivity in agriculture could lead growth higher.

Assuming that growth is sustained at 10% per annum, Cambodia's per capita GDP is expected to reach US\$1,000 by 2015, possibly even earlier if oil and gas production comes on stream. However, the resumption of high growth requires more concerted actions aimed at strengthening competitiveness and improving business climate in order to diversify the

production base. The efforts toward full WTO compliance and lowering the cost of doing business are ongoing. However, the number of required laws, amendments and regulations is extensive. The implementation of post-clearance audits and simplified valuation and cargo processing procedures has reduced time required for customs clearance. Reforms should aim at improving basic infrastructure and enhancing labor skills, as well as expanding market access through trade commitments and reducing the cost of doing business, including through streamlining investment approvals and customs procedures.

3.1.2. Agriculture

The agriculture sector is characterized by the coexistence of traditional agriculture, non-mechanized peasant farming, strongly dependent on climate conditions, carried out on small plots of land, along with large scale farms with technology designed to produce exports. The RGC's agricultural policy aims to stimulate agricultural productivity and increase income in the farming sector.

The share of agriculture in GDP declined sharply from 45.8% in 1989 to 29.7% in 2007, while the labor force employed in the agricultural sector dropped from 80% to 60%. The sector grew on average by 4.5% per annum during 1993-2007. After strong growth in 2005 (15.7%) and 2006 (5.5%) agriculture grew by 4.0 % in 2007. Thus, during the last 20 years, the share of agriculture in GDP contracted by 16.1%. This decline was attributable to the drop in the share of rice production and fisheries in the agricultural value-added. Despite the drastic decline in its share in GDP, agriculture continues to dominate the rural economy. Agriculture development is the key to sustainable and equitable growth in Cambodia.

Rice cultivation remains a determining factor in the growth of agricultural sector. Rice is a staple food of the Cambodian people and supplies about 75% of the calories consumed; the rest comes from fish, maize, rootcrops (cassava and sweet potato), fruits, and vegetables. Rubber has become one of the fast growth sectors of the rural economy, especially in the aftermath of the recent commodities boom. Rubber production averaged 50,000 tons a year. Other industrial or cash crops include maize, soybean, mungbean, groundnut, sesame, sugar cane, tobacco and black pepper. Rice production is sensitive to weather conditions. Rice and crop production increased on average by 6.7% a year. Rice production was badly affected by flood and drought in 2000 and 2002. To improve Cambodia's competitiveness as a rice exporting country, the RGC has given priority to investment in irrigation facilities and pumping stations in order to expand the coverage of irrigated areas and to ensure water supply during periods of drought. As a result, Cambodia produced 6 million tons of rice, of which a surplus of 2 million tons in 2007 was exported. Notwithstanding these efforts the share of rice and other crops in agriculture value added declined from 28.9% in 1989 to 15.5% in 2007.

Fisheries production increased at an average rate of 3.2% a year during 1989-2007. However, its share in GDP dropped from 28.9% in 1989 to 15.5% in 2007. Fish production averaged 365,000 tons for inland capture fisheries; 66,000 tons for marine fisheries; and 40,000 tons from freshwater aquaculture. More than 70% of the 365,000 tons of freshwater production is for household consumption. Fish are caught in rice fields or trapped or netted in ponds, floodwaters, streams, and rivers. Subsistence fishing increases during the dry season. Since 2002, half of the commercial fishing lots have been de-licensed and transferred to fisher communities for management. The RGC has put considerable emphasis on the revival of this key sub sector which provides livelihoods for the poor and marginal sections of society.

Livestock grew at an average rate of 2.7 % per annum during 1993-2007. However its share in GDP declined from 7.3% to 4.4% in this period. Livestock remains important for subsistence farmers, who rely heavily on cattle, pigs, and poultry grazing on the farm plots for meat and for their cash income. The use of draught animals has declined as Cambodian farmers are increasingly resorting to tractors and mechanized agricultural equipment for farming.

Commercial logging accelerated during 1994-1998 at an average rate of 17.2% a year. Unsettled internal conditions and continuing sporadic internal conflict led to illegal logging on a large scale and severe depletion of forest resources during these years. Sawmilling was the only processing of wood undertaken at that time and sawn wood was mostly intended for export. However, since 1999, the RGC introduced a logging ban and cancelled 12 concessions of 9 companies covering more than 2 million ha of forest. Logging royalty was also raised from a \$14 per cubic meter to \$54 per cm. As a result, the share of declined from 5.8% of GDP during 1993-1998 to 3.3% during 1999-2007. During 1994-2007, forestry based GDP grew at an average rate of 4.7% per annum.

3.1.3. Industry

Cambodia's industrialization followed the patterns of many developing countries, starting with the development of light industry, such as textiles and garment, as well as the processing of agricultural products, such as rice milling, food processing, and gradually moving to heavier industries such as mining, oil and gas exploration and production and construction. A number of companies have established assembly factories for motorcycles in the country. As per capital income rises, physical infrastructures improves along with the quality of work force, Cambodia is likely to diversify to IT, and assembly and production of electric and electronic equipment in the medium term.

The industrial sector displays a remarkable dynamism benefiting from the country's openness, pro-business and other liberal policies. Sustained and stable growth in the

industrial sector has been attributable to the development of garment exports, informal sector enterprises, as well as small and medium enterprises (SMEs) serving an expanding domestic market for basic consumer goods. The average industrial growth rate was 15% during the last 14 years; which can be broken down as follows: 12.1% in 1994-1998; 18.5% in 1999-2003; and 14% in 2004-2007. Its share of GDP declined from 16.7% in 1989 to 12.6% in 1993, as a result of privatization of SOEs; but increased from 12.6% in 1993 to 25% of GDP in 2007, driven by textiles and garment exports and the expansion of construction activities, which have become the main drivers of economic growth in Cambodia.

Textiles and garment industry, which accounts for nearly half the industrial sector value added, has been the main contributor to industrial growth in recent years. The development of textiles and garment industry is closely linked to the Most Favored Nation (MFN) and the Generalized System of Preferences (GSP) status granted to Cambodia by the United States (US) in 1996 and 1997 respectively. During 1996-1998 garment exports increased at a rate ranging from 70% to 190% annually. This growth slowed down after the US imposed quotas on 12 Cambodian garment products. Nevertheless, textile and garment were the fastest growing sector in Cambodia, increasing at an average annual rate of 37% during 1993-2007 and its share of GDP grew from 1% in 1993 to 12% in 2007. Garment exports rose 107 times from US\$26.7 million in 1995 to US\$2.8 billion in 2007. The number of garment factories increased from 53 to 398 during this period. The number of salaried workers in the industry peaked at 350,000 in 2005. To help garment industry weather the global economic crisis the government has exempted textile companies from the profit tax with a loss of US\$100 million per year to the budget.

The mining industry grew by almost 15% per annum on average during 1994-2008. The main continuations came from oil exploration in the Gulf of Thailand and mineral exploration in some provinces of Cambodia. This includes iron ore exploration in Preah Vihear, and bauxite, copper and gold in the northeast. International mining firms see Cambodia as a new frontier that has yet to be explored. During the last decade, mining accounted for 0.2-0.4% of GDP. This share is expected to increase as more and more companies move from exploration to development and production.

Construction is one of the pillars of economic growth. The emphasis placed by the RGC on the rehabilitation and reconstruction of physical infrastructures during the last 15 years contributed to expansion of construction activities. The annual growth rate of construction averaged 13 % during 1994-2007. A construction boom took place during 2002-2006, with an average annual growth rate of almost 20%. The boom was driven both by construction of many infrastructure projects and by residential construction in Phnom Penh and Siem Reap. Growth slowed to 6.7% in 2007 and was brought almost to a standstill in the second half of 2008 as the global economic crisis set in and foreign investments started drying up.

New township projects and the construction of 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.

3.1.4. Services Sector

The service sector's value added grew at an average rate of 8.6% during 1994-2007. This high growth rate was attributable to the expansion of tourism, transport and communications, banking and real estate. The share of the services sector declined slightly during the last 14 years, from 39.4% in 1994 to 38.5% of GDP during 1994-2008.

The expansion of **tourism and hotel industry** continues, with a growth rate of 14.3%. In 2007, a total of 2 million tourists visited Cambodia. The RGC is emphasizing stronger links between tourism and development of the rural economy, in order to enable the poor to benefit from tourism expansion. For e.g. the government intends to transform the Siem Reap region into a green belt for agricultural production so that strong backward linkages of tourism with local agriculture could be established.

Transportation and communication grew at the average annual rate of 8.5%. **The telecommunications** subsector showed a robust average annual growth of about 50%, especially the mobile phone services. During the last 15 years, the RGC completed the reconstruction and rehabilitation of the national highway network and embarked on the improvement in provincial and rural infrastructure in order to connect the rural communities of Cambodia to the more developed urban areas and bring the rural areas of Cambodia into the mainstream of the economy.

The financial sector expanded at the average annual rate of 24.7%, reflecting the rapid financial deepening and the increase in financial intermediation.

The added value of **real estate** (leasing and real estate services) grew at an annual rate of 8.3%, reflecting the surge in foreign direct investment and residential construction in this activity.

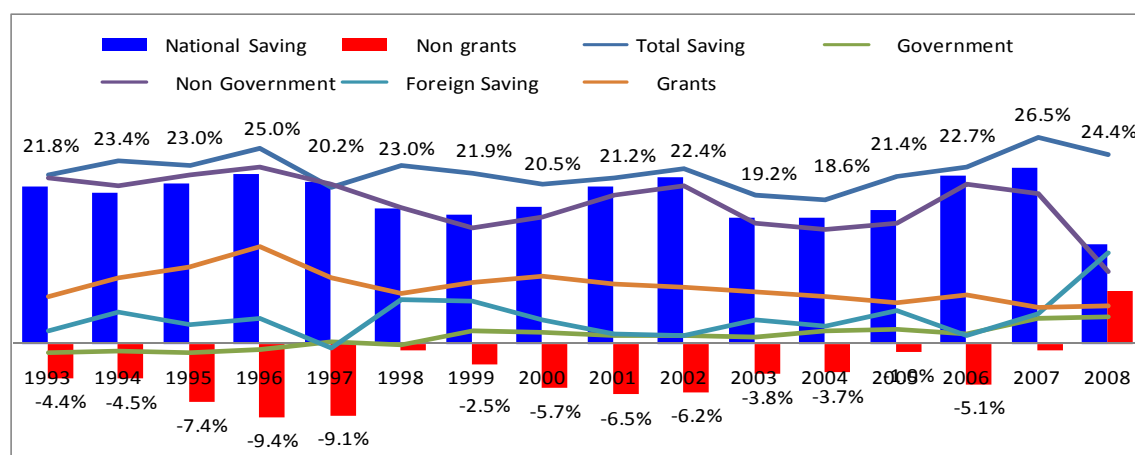
3.2. Savings and Investment Behavior

3.2.1. Savings

Cambodia has a moderate rate of savings varying within the range of 18-26% of GDP during 1993-2008. National savings account for 13-22% of GDP, while foreign savings contributed between 1 to 12%. Savings constitute important sources of domestic and

foreign direct investment. Figure 3.4 below shows the structure of savings during 1993-2008.

Figure 3.4. Structure of savings in 1993-2008 (% of GDP)

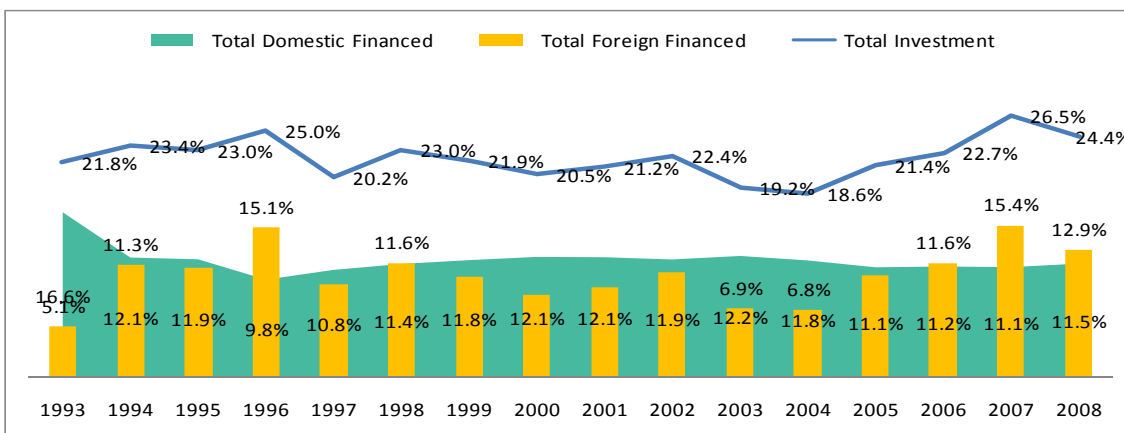


The following features of savings behavior can be observed. First, government savings show an increasing trend from negative (current budget deficit of -1.2% of GDP) in 1993 to a positive savings rate (current budget surplus of 3.5% of GDP) in 2008. Second, savings from households and enterprises account for the bulk of national savings. Third, foreign savings continue to play an important role in Cambodia, increasing from 1.6% of GDP in 1993 to 12% of GDP in 2008, mostly as a result of increased capital inflows to finance current account deficits.

3.2.2. Investment

Figure 3.5 shows the financing of investment by national and foreign savings during 1993-2008. In this period, domestically financed investment accounted for 53% of total investment, while externally financed investment in the form of Foreign Direct Investment (FDI) and Official Development Assistance (ODA) made up the remaining 47%. While the amount of ODA has been broadly stable, FDI inflows has been on the increase, especially during the period preceding the global economic crisis. Broadly, Cambodia's sources of investment financing are: (i) US\$600 million in ODA a year for building social and physical infrastructures to improve environment for economic development, poverty reduction and institutional reforms; (ii) US\$700-800 million in FDI a year for expanding productive capacity of the economy; (iii) US\$1.2 billion in government budget for both current expenditure and capital investments to improve public service delivery. This amount will continue to increase rapidly as a result of the Public Financial Reform Program; and (iv) US\$2.5 billion in bank loans to finance private sector projects.

Figure 3.5. Structure of investment in 1993-2008 (% of GDP)

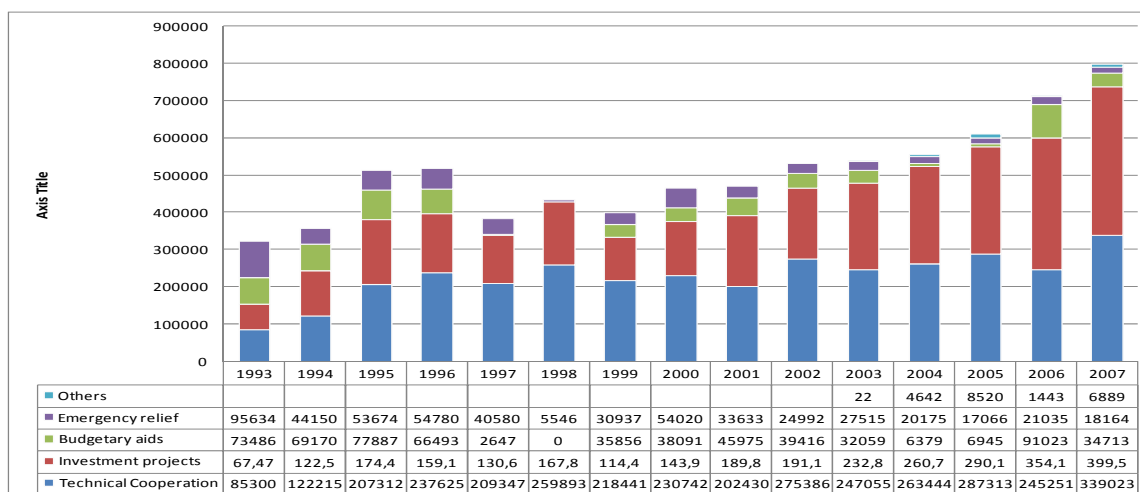


Cambodia has set clear objectives of establishing stock and bond markets in late 2009 as stipulated in the Financial Sector Development Strategy 2006-2015. Progress has been made to improve accounting standards, ensure good corporate governance and prepare the corporate sector to be listed on the stock markets. The RGC invited Korea Exchange (KRX) and foreign securities companies to participate in this important endeavor. Once fully operational, the stock market will become the fifth key source of investment financing for Cambodia.

3.2.2.1. Official Development Assistance

External financing, especially Official Development Assistance (ODA) has played a crucial role in creating the foundation for economic growth in Cambodia. ODA, which includes grants, loans and technical assistance, has grown from US\$500 million in 1993 to US\$700 million in 2008.

Figure 3.6. Types of foreign aid, 1993-2007 (US\$000')



Since 1993, bilateral and multilateral partners pledged \$450 million on the average per year. Between 1993 and 2007, disbursements were at the \$7.6 billion level, or \$507 million a year on average.

Table 3.2: Disbursements by donor: 1993-2007 (US\$ 000')

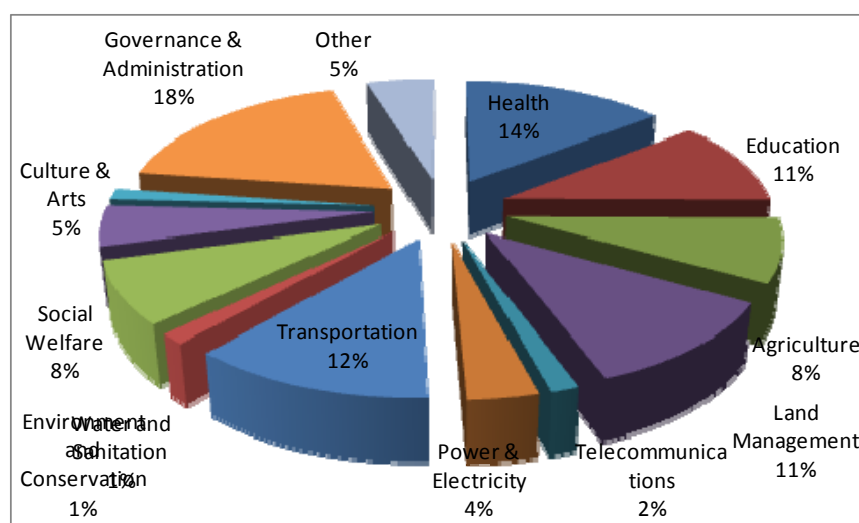
Development Partners	(US\$000')	Percentage
UNITED NATIONS AGENCIES		
Programs Delivered: Total	794,310	
Own Funds Disbursed	642,469	8.4%
INTERNATIONAL FINANCIAL INSTITUTIONS		
IBRD/World Bank	541,418	7.1%
International Monetary	241,523	3.2%
Asian Development Bank Others	745,394	9.8%
OTHERS		
Global Fund	61,767	0.8%
Sub-Total: UN Agencies & IFI's	2,232,571	29.3%
EUROPEAN UNION		
European Commission	467,517	6.1%
Belgium	59,532	0.8%
Denmark	97,382	1.3%
Finland	23,965	0.3%
France	450,404	5.9%
Germany	228,940	3.0%
Netherlands	69,027	0.9%
Spain	7,937	0.1%
Sweden	230,782	3.0%
United Kingdom	178,800	2.3%
Other EU Member States	10	0.0%
Sub-Total: EU	1,814,296	23.8%
MAJOR BILATERAL DONORS		
Australia	323,824	4.3%
Canada	69,323	0.9%
China	303,796	4.0%
Japan	1,491,020	19.6%
New Zealand	17,287	0.2%
Norway	22,395	0.3%
Republic of Korea	119,782	1.6%
Russian Federation	10,297	0.1%
Switzerland	17,454	0.2%
United States of America	514,068	6.8%
Other Bilateral Donors	24,248	0.3%
Sub-Total: Bilateral Donors	2,913,494	38.3%
NGO (core funds)	652,866	8.6%
TOTAL DISBURSEMENTS	7,613,227	100.0%

Source: Council for the Development of Cambodia.

In view of medium to long term debt sustainability, priority is given by the RGC to grants rather than concessional loans. The RGC has generally avoided commercial borrowing.

In total Cambodia received Development Assistance to the amount of US\$7.6 billion during 1993-2007 with the following breakdown: 45% for technical assistance; 40% for investment project; 8% for budget support; and 7% for food aid and emergency relief.

Figure 3.7. Distribution of foreign aid by sector, 1993-2007



Source: CDC

From the above table we can see that UN agencies provided US\$642 million or 8.4% of the development assistance; ADB - US\$745 million or 9.8%; the WB—US\$541 million or 7.1%; the IMF - US\$241 million or 3.2%; members of the European Union—US\$1,8 billion or 23.8%; other bilateral donors—US\$2,9 billion or 38.3%; and NGOs contributed US\$652 million or 8.6%.

Breakdown of foreign assistance by priority sector under the Public Investment Program (PIP) for 1993-2007 period is as follows: 14% for Health; 11% for Education; 8% for Agriculture; 11% for Rural Development and Land Management; 1% for Post and Telecommunications; 4% for Power & Electricity; 12% for Transportation; 1% for Water and Sanitation; 8% for Community and Social Welfare; 5% for Culture & Arts; 1% for Environment and Conservation; 18% for Governance & Administration; and 5% for Other sectors.

3.2.2.2. Foreign Direct Investment

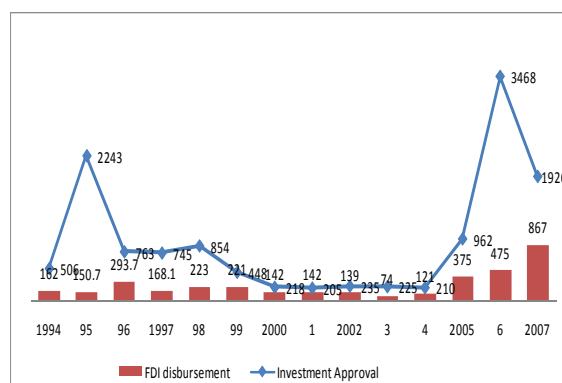
FDI has played increasingly important role in Cambodia's economic development; it amounted to US\$867 million in 2007. During 1994-July 2008, the Council for the Development of Cambodia (CDC) approved private investment totaling US\$21.2 billion. However, only US\$4.2 billion of Foreign Direct Investment (FDI) were disbursed. Cambodia has witnessed increase in both foreign direct and portfolio investments during 2003-2008 reflecting steady improvement in investment climate and the dominant role played by the private sector in promoting social and economic development. Foreign investment funds have contributed significantly to Cambodia's high economic growth.

FDI in the garment sector has created about 350,000 jobs in the country. However, as Todaro and Smith point out FDI involved much more than the simple transfer of capital or the establishment of a local factory in a developing nation. Foreign investors carry with them technologies of production, tastes and styles of living, managerial services, and diverse business practices. All these positive externalities of FDI have benefited Cambodia.

While FDI was within the range of US\$150-250 million during 1994-2004, it has accelerated since 2005 to reach a record level of US\$867 million in 2007. The global economic crisis has slowed down FDI inflows into Cambodia, as a result of both sluggish external demand and the decline in profitable investment opportunities in the country.

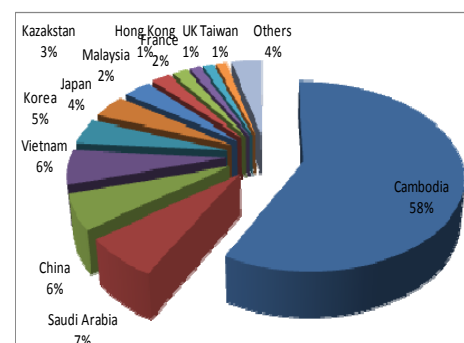
The challenge remains that of instituting an environment conducive to investment through the strengthening of the judicial system and good governance, as well as the capacity of government to provide minimum services for the private sector. Human resources development must be also included in this framework. A good example is the creation, within the Ministry of Economy and Finance (MEF), of its own Economic and Finance

Figure 3.8a. Investment approval and disbursement (in US\$ million)



Source: Council for the Development of Cambodia

Figure 3.8b. Investment approval by country



Institute that is training large numbers of government clerical employees, with the support of several donors and the private sector.

There are two views concerning the investment incentives granted to investors:

- ***The first view*** is that Cambodia does not have any attraction to investors, apart from tax incentives. The general environment, such as political stability, physical security, social order, legal and institutional framework, infrastructure (water, electricity, road), human resources and external markets is less favorable compared to neighboring countries. Moreover, all ASEAN countries have taken bold measures, including providing tax incentives, to attract investment. Hence without providing tax incentives for investment Cambodia will not attract FDI.
- ***The second view*** is that revenue mobilization effort in the Kingdom of Cambodia is still low, accounting for 13% of GDP, compared to the average in the region of 20-25% of GDP. Even though the regional countries have taken the bold measures to attract investment, the Investment Law of the Kingdom of Cambodia is more liberal compared to the countries in the region. Only tax incentives in the absence of a favorable overall environment in terms of political stability, physical security, social order, legal and institutional framework, infrastructure (water, electricity, road), human resources and external markets, cannot attract investments. Government should take steps to improve the overall environment for investment and not forego badly needed tax revenue by allowing investment incentives. Therefore, the government should take revenue-enhancing measures by tightening and rationalizing incentives in order to generate additional resources to strengthen the government institutions, increase investment in infrastructure, human resources, security, social order and marketing research. Moreover, if investors are granted tax exemptions in Cambodia, they will be automatically liable to pay taxes in their own countries. This is tantamount to a reversal of aid, i.e. an outflow of financial resources from Cambodia to shore up tax revenue of more developed countries. As a result, the decision taken at the first step to tighten the tax incentives was made in order to prevent the reversal of foreign aid, whereas Cambodia being a poor country, is obliged to provide budgetary support to developed ones.

The RGC has reviewed the incentive system (Sub-decree No 53 dated 11 June 1999). The next step is to amend the Law on Investment of the Kingdom of Cambodia. The Council for the Development of Cambodia (CDC) is working closely with the Foreign Investment Advisory Services (FIAS)/ International Finance Corporation (IFC) of the World Bank Group to draft the amendment to the Law on Investment.

3.3. Fiscal Sector

The long run objectives of fiscal policy are to ensure a level of spending consistent with macroeconomic stability, to maintain a sustainable fiscal balance with gradual increase in budget allocation for social and economic sectors through rationalizing public expenditure and broadening tax base, preventing leakages, and strengthening customs and tax administration to collect additional revenue.

Table 3.3. Cambodia: Fiscal sector indicators, 2001-2008, (as percentage of the GDP)

	1994	1999	2001	02	03	04	05	06	07	08
Fiscal sector										
Total revenue	8.3	9.9	10.0	10.6	9.8	10.4	10.6	11.4	12.1	13.3
Tax revenue	5.1	7.2	7.2	7.6	6.8	7.7	7.7	8.0	10.2	11.2
Domestic tax	1.2	4.0	4.8	5.0	4.7	5.3	5.5	5.9	7.3	8.4
Tax on foreign trade	4.0	3.2	2.4	2.5	2.1	2.4	2.2	2.2	2.9	2.8
Non-tax revenue	3.2	2.6	2.7	3.0	2.8	2.5	2.2	2.1	1.8	1.9
Capital revenue	0.0	0.1	0.1	0.1	0.2	0.1	0.6	1.3	0.0	0.2
Total expenditure	14.0	13.6	16.4	18.0	16.2	14.2	13.2	14.1	14.7	15.7
Current expenditure	9.3	8.2	9.3	9.7	9.7	8.5	8.0	8.3	8.6	9.0
Wages and salaries	4.1	3.9	3.3	3.5	3.3	3.0	2.8	2.8	3.0	3.4
Civil administration	4.9	4.5	6.2	6.8	7.1	5.9	5.7	6.0	6.2	6.9
Military and security	4.4	3.5	2.7	2.4	2.2	2.0	1.8	1.7	1.8	1.9
Interest payments	0.01	0.17	0.14	0.16	0.18	0.23	0.21	0.17	0.20	0.19
Internal debt	0.01	0.17	0.14	0.16	0.18	0.23	0.21	0.17	0.20	0.19
Capital expenditure	4.7	5.4	7.0	8.3	6.4	5.7	5.2	5.7	6.1	6.3
Primary balance (incl. grants)	-1.0	1.8	1.1	1.1	1.0	1.9	2.0	1.4	3.4	3.7
Aggregate deficit	-1.0	1.6	1.0	1.0	0.8	1.7	1.8	1.2	3.2	3.5
Aggregate deficit (incl. grants)	5.9	-3.8	-6.0	-7.2	-5.4	-3.8	-2.7	-3.3	-2.8	-2.7
Domestic financing	-0.2	-0.3	0.1	-1.0	0.5	-0.5	-1.5	-1.6	-2.2	-3.3
External financing	6.1	3.9	5.7	7.4	4.9	4.3	4.4	4.8	5.2	5.8

Source: Ministry of the Economy and Finance, National Bank of Cambodia.

Over the medium-term, the fiscal policy objectives are to enhance revenue performance and re-orient expenditures to meet pro-poor priority spending. In order to meet these objectives, the RGC adopted the Public Financial Management Reform Program (PFM), a

comprehensive multi-year reform program, in late 2004. The PFM is designed to upgrade public finance in order to provide effective support for growth and poverty reduction through the promotion of good governance. Actions have been taken to streamline the budget process and improve budget management, including the adoption of the new chart of account, new budget nomenclature and the introduction of the Financial Management Information System (FMIS).

Significant progress has been made since 2004 to improve revenue collection, with the RGC working concertedly towards achieving total revenue of 13.3% of GDP for 2008. Current expenditure was restrained to 9% of GDP, resulting in a primary budget surplus of 3.7% of GDP. This led to a decline in the overall deficit to 2¾% of GDP in 2008 from 7¼% in 2002. Fiscal policy continued to remain prudent in 2008 in order to curb inflation.

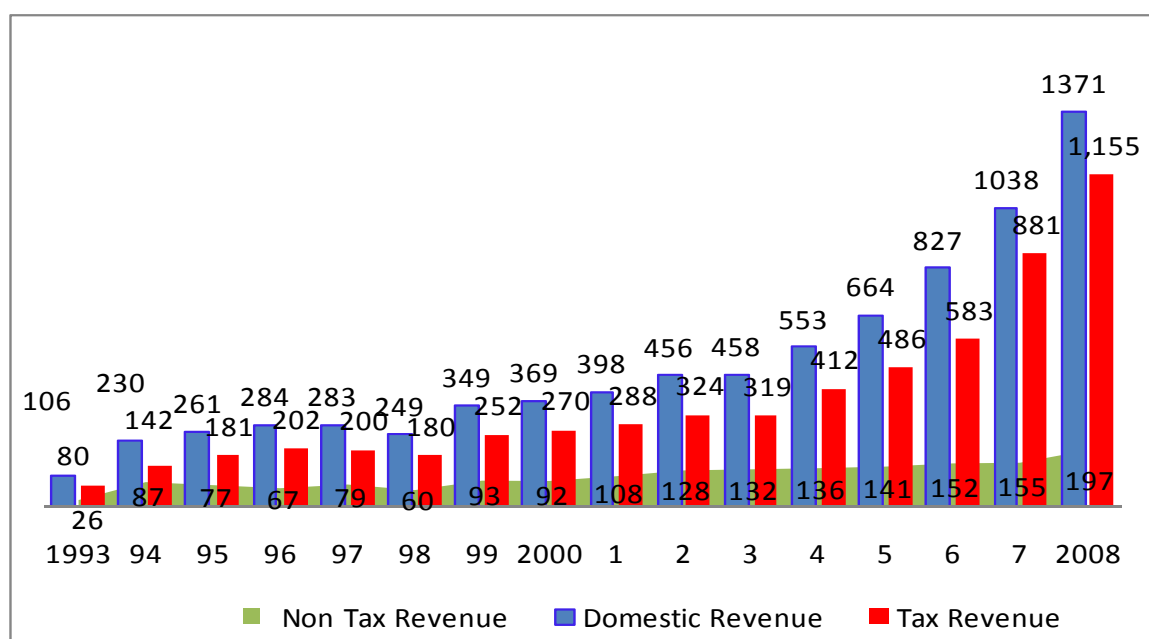
The implementation of major reforms commenced in 2007 including streamlining of budget execution procedures, the introduction of program budgeting, and adoption of a new chart of accounts. These measures follow on significant reforms in 2005 and 2006, in particular: customs and tax revenues collected 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.

3.3.1. Revenue

Domestic revenue increased from US\$106 million or 4.3 % of GDP in 1993 to US\$249 million or 8.0 % of GDP in 1998, and to US\$1,371 million or 13.3 % of GDP in 2008, an increase by 5.3 % of GDP or by more than fivefold over the period 1998-2008. Fiscal consolidation accelerated during 2004-2008, as a result of the vigorous implementation of the Public Financial Management (PFM) Reform Program.

To improve revenue collection, measures have been taken to enforce the Law on Taxation, broaden the tax base to include the informal sector, and strengthen the tax audit. Other measures include reorganizing the tax department, modernizing the customs department, creating a non-tax revenue department, and upgrading the anti-smuggling plan. In addition, the government has made efforts to ensure that all tax revenue collected is immediately deposited into the National Treasury, and to prohibit any tax exemptions beyond the limit allowable under the Law on Investment. The 2005 Prime Minister Order has also helped institute transparent bidding procedures for future government concession contracts.

Figure 3.9. Revenue Collection, 1993-2008, (in million US\$)



Source: MEF

3.3.1.1. Tax Revenue

Tax revenue reached 11.2 % of GDP in 2008, compared to 5.8 % of GDP in 1998, an increase by 5.4 % of GDP. During 2004-2008, tax revenue increased by 3.5 % of GDP. Such performance reflected Cambodia's efforts to improve tax and customs administration, full commitment to zero tolerance of tax evasion, and further tax measures. Tax reform will continue with the view to strengthen tax compliance and expand the self-assessment regime. In this regard, the private sector should also fully comply with its fiscal obligation.

3.3.1.2. Non-Tax Revenue

Non-tax revenue increased from US\$26 million or 1.0 % of GDP in 1993 to US\$60 million or 1.9 % of GDP in 1998 to US\$197 million or 1.9 % of GDP in 2008. The improvements in revenue collection reflected the efforts to recover revenue from Posts and Telecommunications (PTT), the lease of government assets, increased collection of visa fees and tourism income.

Overall, revenue collected by the General Department of Customs and Excises (GDCE) accounts for 55 % of the current revenue (US\$684 million), revenue collected by the General Department of Taxation represents 29 % (US\$363 million), while non-tax revenue accounts for 16 % of the current revenue (US\$197 million).

During the PFM reform period 2004-2008, revenue collected by the Customs and Excise Department (CED) more than doubled from US\$289 million to US\$684 million, revenue collected by the Tax Department almost tripled from US\$124 million to US\$363 million and the non-tax revenue increased by 45% from US\$140 million to US\$197 million.

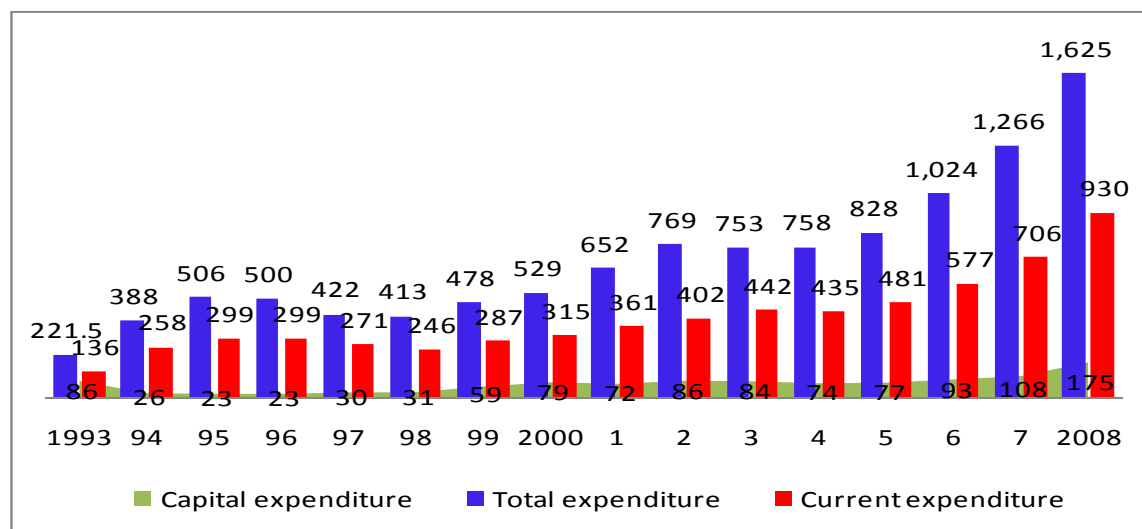
3.3.1.3. Capital Revenue

Capital revenue has been uneven, increasing from US\$3 million in 1995 to US\$9 million in 1998, then soared to US\$92 million in 1996, but dropped to US\$20 million in 2008. Capital revenue is mainly generated from privatization of the state assets.

3.3.2. Expenditure

The improving revenue performance is opening up fiscal space for higher expenditures across the board, but mostly in social sector, agriculture, irrigation, roads, and energy. Total expenditure has more than tripled during the last decade.

Figure 3.10. Expenditures: 1993-2008 (in million US\$)



Source: Ministry of Economy and Finance

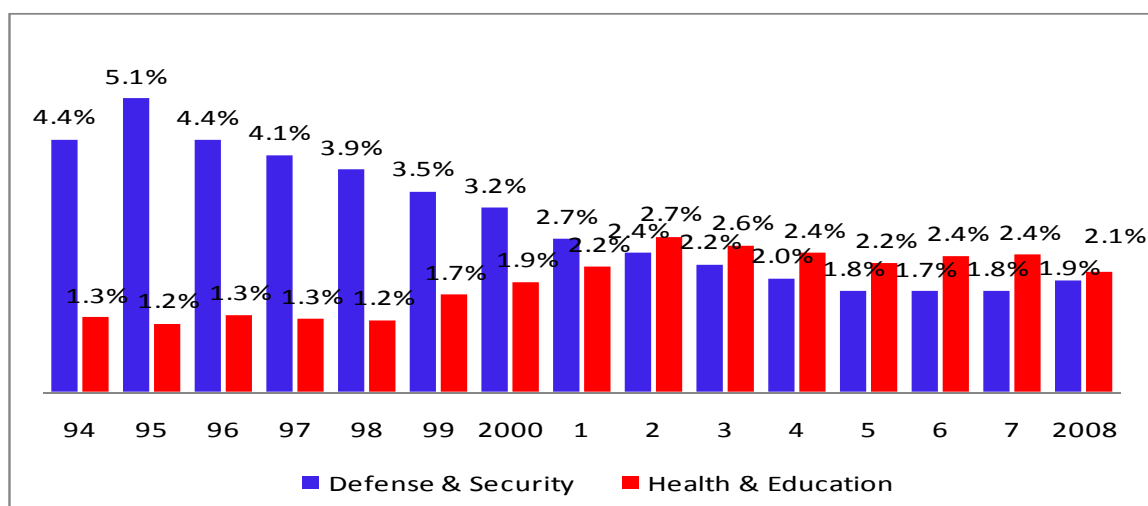
Total expenditure increased from US\$222 million or 8.9% of GDP in 1993 to US\$413 million or 13.3 % of GDP in 1998, then to US\$1.6 billion or 15.6 % of GDP in 2008. During the last decade total expenditure has more than tripled; during the reform period 2004-2008 it more than doubled. The RGC has also benefitted from the IMF's Medium Term Debt Relief Initiative (MDRI) funds (US\$82 million), which has been used to significantly increase spending on rural infrastructure.

3.3.2.1. Current Expenditure

Current expenditure increased from US\$136 million (5.5 % of GDP) in 1993 to US\$246 million (7.9 % of GDP) in 1998, then to US\$930 million (9 % of GDP) in 2008. During the last decade, current expenditure more than tripled; it more than doubled during the reform period 2004-2008.

Total payroll of civil servants and military and security personnel decreased from 6.7% of GDP or 72 % of current expenditure in 1994 to 3.6 % of GDP or 44 % of current expenditure in 2007, but then increased to 4.6 % of GDP accounting for 51 % of current expenditure in 2008. The increase in payroll expenses in 2008 reflected the RGC's commitment to an annual 20% increase in salaries for civil servants and military/ security personnel and the implementation of civil service reform under the Merit-Based Pay Initiative (MBPI) and Priority Mission Group (PMG) scheme. This is considered social spending with a human dimension, crucial for institutional capacity building and should have a positive impact on governance in the medium term.

Figure 3.11. Share of Defense and Social Sector expenditures in Budget



Source: Ministry of Economy and Finance

Military and security spending accounted for 22% of current expenditure in 2008 and civil administration 76%. However, while military and security outlays are current in nature, civil administration spending consists of both current and capital budgetary outlays.

Since 1999 the RGC reduced military and security spending, after the military and political organization of the Khmer Rouge was dismantled to make room for social spending. The proportion of defense and security outlays to GDP gradually declined from 5.1 % in 1995

to 3.5 % in 1999, then to 1.7 % in 2006. However in 2008 defense and security outlays increased to 1.9 % of GDP. During 1994-1998 spending on health and education was about 1.3 % of GDP. Since 2000 the RGC has accorded high priority to increasing spending on economic and social sectors, especially Education, Health, Agriculture and Rural Development. Spending on health and education increased from 1.7 % of GDP in 1999 to 2.7 % in 2002; during 2004-2008 it has stabilized at 2.2-2.4 %. Health and Education ministries have introduced a sector-wide approach (SWAP) by aligning policy, planning, budgeting and monitoring and evaluation processes with sectoral strategies and gradually reorienting priorities in a pro-poor direction.

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 monitoring and evaluation 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 by 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 even though the performance has not been up to regional standards.

3.3.2.2. 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.

Total capital expenditure increased from US\$86 million or 3.5 % of GDP in 1993 to US\$166 million or 5.4 % of GDP in 1998, then to US\$654 million or 6.3 % of GDP in 2008. During the last decade total capital expenditure has more than tripled. The locally financed expenditure increased from US\$26 million in 1993 to US\$31 million in 1998, then to US\$175 million in 2008. The locally financed expenditure has tripled during the last decade and more than doubled since 2004. Capital spending funded by the government is concentrated in three ministries: the Ministry of Public Works and Transport, the Ministry of Water Resources and Meteorology and the Ministry of Rural Development. Externally financed capital expenditure (mainly by the ADB and the World Bank) increased from US\$97 million in 1994 to US\$171 million in 1998, then to US\$478 million in 2008. The externally financed expenditure increased 3.6 times during the last decade and doubled during 2004-2008.

3.3.3. Budget Balance

The current budget turned from a deficit of around 1% of GDP to a surplus of 1.6% of GDP in 1999, and to 3.5 % of GDP in 2008. The increase in the current budget surplus during the PFM reform period allowed the RGC to increase capital spending for socio-economic development. The overall budget deficit was within the range of 4.1-6.7 % of GDP in 1993-1998. It declined from 7.2% of GDP in 2002 to 2.7% of GDP in 2008. 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 monetary financing of the fiscal deficit.

3.3.4. Fiscal Policy in 2009

Fiscal policy was expansionary in 2009. The 2009 budget deficit is projected to widen to 6 $\frac{3}{4}$ of GDP, against the original target of 4 $\frac{1}{4}$ percent (up from 2 $\frac{3}{4}$ percent in 2008). Domestic financing (a drawdown in government deposits) is projected at 1 $\frac{1}{4}$ percent of GDP. Expenditure levels have risen sharply, with large increases in wage and locally-financed capital spending. Revenue collection has been broadly strong. *On the revenue side*, further efforts will be made in 2010 to strengthen tax administration. *On the expenditure side*, containing wage bill growth and maintain budget discipline would be the priority. Moreover, broader efforts will be undertaken to continue public financial management (PFM) reform and accountability, including improving budget integration, establishing single treasury account, more stringent procurement procedures.

3.4. Monetary Sector

3.4.1. Monetary Developments

Monetary policy is aimed at maintaining price stability. The National Bank of Cambodia (NBC) envisages inflation at less than 5 % in the near-term and at about 3 $\frac{1}{2}$ % over the medium-term. After growing by 38.2 % and by 63 % respectively in 2006 and 2007, the banking sector's liquidity (M2) increased moderately by only 4.8 % in 2008.

The key monetary developments during 2008 were:

- Liquidity increased by 4.8 %;
- Net foreign assets of the banking system declined by 3.6 %;
- Net domestic assets of the banking system increased by 163 %;

- Government deposits increased by 54 %;
- Credit to the private sector accelerated by 55 %.

Table 3.4. Cambodia: Monetary sector indicators, 2001-2008

	1994	1999	2001	02	03	04	05	06	07	08
Monetary sector										
Inflation (last quarter; % growth)	17.8	0.0	-0.5	3.0	0.5	5.8	6.8	3.4	9.7	15.8
Inflation (average; % change)	-0.7	4.0	-0.9	-0.1	1.2	3.9	5.8	4.7	5.9	19.7
GDP deflator (% change)	-4.4	2.0	2.6	0.7	1.8	4.8	6.1	4.6	6.5	12.3
Exchange rate	2,570	3,814	3,924	3,921	3,975	4,016	4,092	4,103	4,068	4,060
Liquidity (growth as a %)	35.1	17.2	22.3	28.9	15.3	30.4	16.1	38.2	62.9	4.8
Velocity (GDP/	15.7	9.2	7.0	5.8	5.6	5.0	5.1	4.3	3.1	3.5
Credit to the private sector (% of M2)	52.6	52.9	41.7	36.7	40.2	42.0	43.9	52.3	56.4	83.4

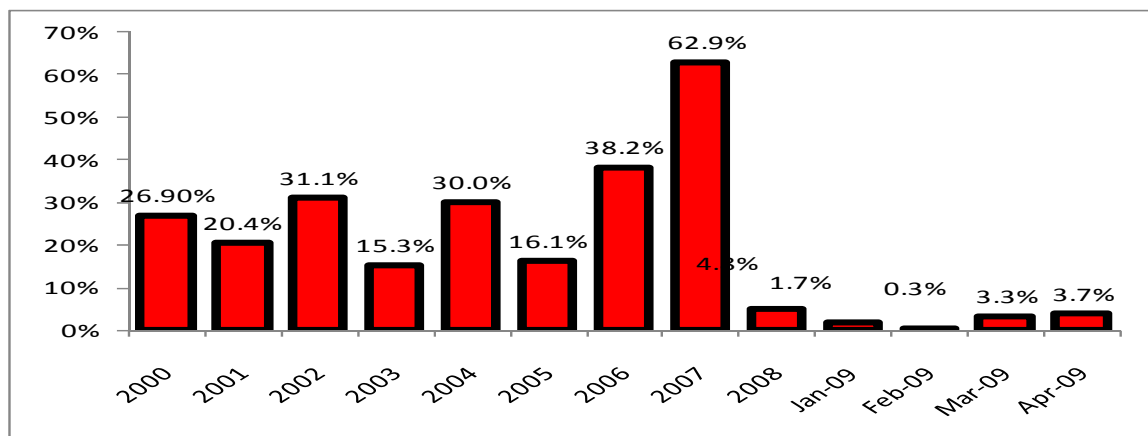
Source: Ministry of the Economy and Finance, National Bank of Cambodia.

3.4.2. Liquidity

The growth of M2 in 2008 was driven by rapid growth in the net domestic assets of the banking system (162.7 %), but offset by a 3.6 % decline in the net foreign assets of the banking system. After a 6% growth from US\$1.7 billion in 2006 to US\$2.8 billion in 2007, liquidity of the banking system or broad money supply increased only by 4.8 % to US\$2.9 billion in 2008 or 28.3 % of GDP, reflecting the tightening of monetary conditions during the global economic crisis. This increase in money supply is designed to accommodate the higher transactions demand associated with economic expansion, at 6.7 % in 2008.

Liquidity is made of primarily by foreign currency deposits, which account for 78% of the liquidity; currency outside bank represents 19% and the remaining 3% is made up by demand, time and saving deposits.

Figure 3.12. Growth of Broad Money: 2000 – 2007



(% change; end of period)

Source: National Bank of Cambodia

Financial deepening started only in 1999, with the restoration of the monetary system. The ratio of financial assets (M2) to GDP– a measure of financial deepening– was estimated in 1999 at 10.8%. Financial deepening accelerated during 1999-2008 with the M2/GDP ratio reaching 32.3%, by end 2008. The ratio declined to 28.5% in April 2009.

The development of the banking sector since 1999 has contributed to the monetization of the economy. This process mobilizes capital from commercial banks and insurance companies in order to allocate it to the investors. The development of the financial market

Figure 3.13a. Structure of Broad Money (in billion riels)

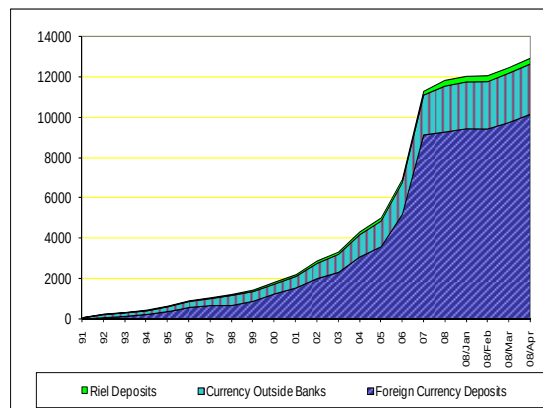
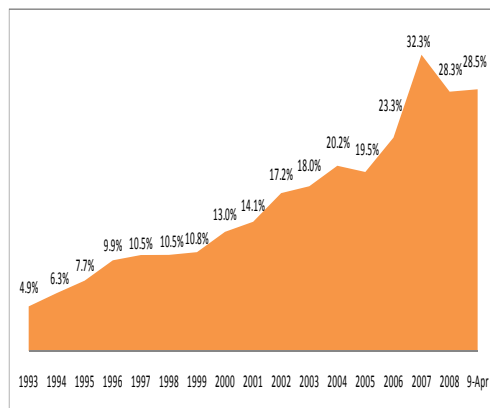


Figure 3.13b. Financial Deepening (M2/GDP)



Source: National Bank of Cambodia

determines the degree of monetization of the economy, which in turn increases the savings and investment level. The strong economic growth that Cambodia has witnessed since 1999 has contributed to the expansion of financial assets in the banking system.

3.4.2.1. Deposits

Both, in absolute and relative terms, the expansion in foreign currency deposits of residents and non-residents has been the major contributory factor to the increase in liquidity. After posting its highest growth rate in 2007, the foreign currency component of broad money slowed, increasing by only 1.5% from US\$2.24 billion in December 2007 to US\$2.28 billion in December 2008 and reached US\$2.44 billion in April 2009. While foreign currency deposits continued to drive the growth in broad money, all of its components – foreign currency savings, time, and current deposits found favor with investors. 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. Deposits with the banking system increased by 45 %from US\$1.3 billion in December 2006 to US\$2.35 billion in December 2008. These deposits comprised foreign currency deposits - US\$2.28 billion; time and saving deposits - US\$45.5 million and demand deposits – US\$25.8 million.

3.4.2.2. Narrow Money

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

Narrow money increased from US\$504 million at end December 2007 to US\$591 million at end December 2008, a rise by 17 %. The increase reflected mainly the expansion in currency outside banks (15.3%) to accommodate the higher transactions demand associated with economic expansion, also reflecting the central bank's policy to purchase US dollars to stabilize the nominal exchange rate and to bolster international reserve position and the a 68% increase in demand deposits.

Overall, the monetary development over the period 2006-2008 shows 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 the government to promote the use of the banking services under the public financial management reform program.

3.4.3. Exchange Rate

Exchange rate policy plays an important role in a small, open economy, especially a dollarized economy. Fighting inflation requires the nominal exchange rate to appreciate relative to the real effective exchange rate. Mildly appreciating currencies will also help to dampen inflation pressures through lowering import costs. Exchange rate policy is crucial for countries like Cambodia and Singapore, which rely heavily on exchange rate policy as an effective monetary policy instrument.

Maintaining an exchange rate and monetary policy stance through sterilization is extremely costly in light of the recent surge in private capital inflows. However, without such sterilization, unrestrained capital inflows will feed rapid currency appreciation, excessive liquidity growth, and asset price bubbles. The widening gap between the domestic and US interest rates will continue to encourage capital inflows. Some economies in the region have introduced capital controls in order to gain control over monetary policy. However, capital controls could erode investor confidence and should be used with utmost care and restraint.

Nurturing more efficient and diversified financial markets would not only help channel capital into productive use, but would also enable a more effective management of capital flows and foreign exchange reserves. Deepening financial systems and implementing market reforms are crucial, if long-term, ways to build financial stability. Measures to develop deeper, more broad-based and transparent financial markets need to be accelerated to allocate financial resources more efficiently and to strengthen the resilience of the domestic financial system to withstand shocks from the ever present threat of herd behavior of international investors.

Cambodia has adopted a managed floating exchange rate regime favoring a gradual accumulation of international reserves by the central bank. Within the context of a dollarized economy, the National Bank of Cambodia (NBC) uses interventions in the foreign exchange market as an indirect instrument of monetary policy. Through interventions in the foreign currency market, (NBC) manages the stability of the exchange rate. The tight monetary policy pursued by the NBC and strict fiscal discipline adhered to by the RGC has resulted in a low inflation environment and a stable rate of exchange.

For stabilizing the exchange rate and offsetting temporary disruptive capital inflows and outflows, the NBC engages in the purchase and sale of foreign currencies, mainly the US dollar. For example, in the case of riel depreciation, the NBC would auction US dollars from its international reserves. However, this intervention is only aimed at relieving a temporary pressure on the riel. It is not the policy for NBC to intervene if the riel depreciation occurs due to structural imbalances. The NBC's purchase of riels has two

effects. First, it reduces the NBC's holding of international reserves. Second, domestic currency in circulation will fall. This decline in the monetary base, would remove the pressure on the riel to depreciate. In the case of dollar depreciation, the NBC would purchase US dollars (sell the national currency) in the foreign exchange market resulting in an expansion of the monetary base and accumulation of international reserves.

The intervention in the foreign exchange market, in which the NBC allows the purchase or sale of national currency to have an effect on the monetary base, is an example of “unsterilized foreign exchange intervention”. In an unsterilized intervention domestic currency is purchased by selling foreign assets leading to a drop in international reserves, a decrease in the money supply, and an appreciation of domestic currency. Domestic currency could also be sold to purchase foreign assets leading to an increase in international reserves, an increase in money supply, and a depreciation of the national currency.

In contrast, in a “sterilized intervention” the central bank does not wish its operations in the foreign exchange market to affect the monetary base. In pursuing this policy it will conduct open market operations to offset the impact of its foreign exchange market operations on the monetary base. For example, in the case of a US\$100 million purchase of

Figure 3.14a. Exchange rate and inflation

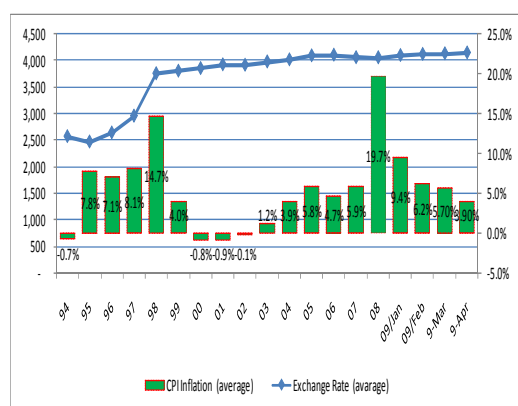
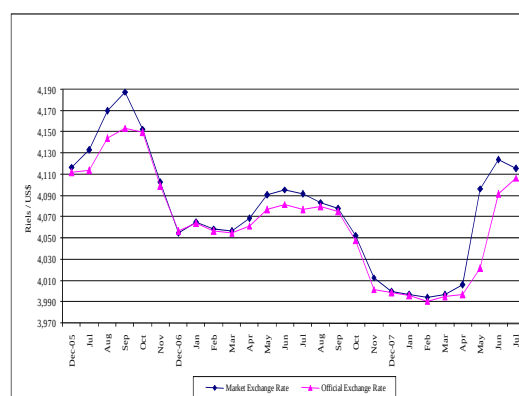
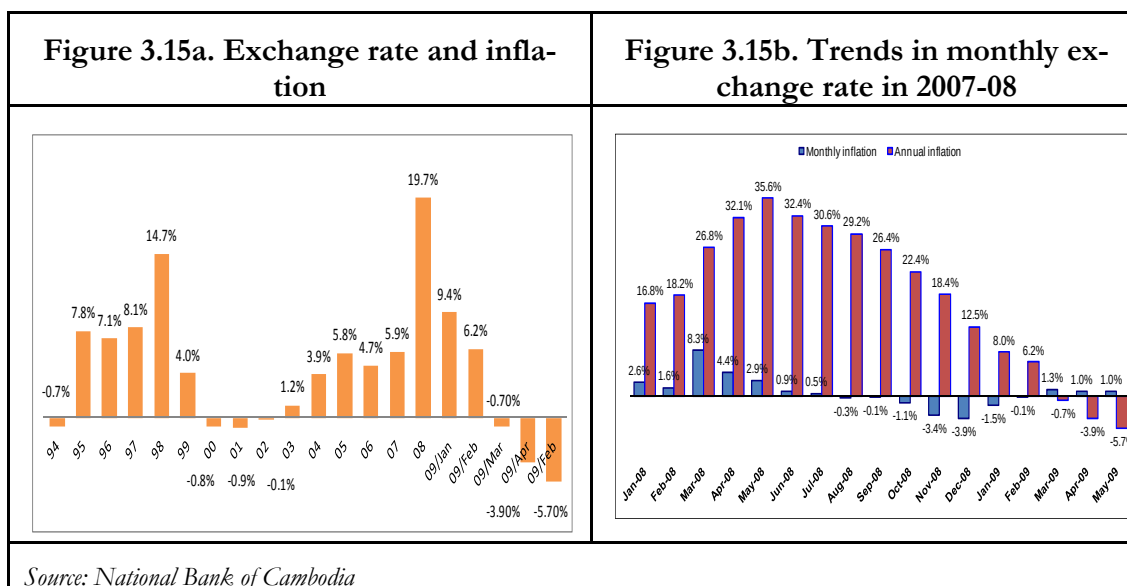


Figure 3.14b. Trends in monthly exchange rate in 2007-08



Source: National Bank of Cambodia

the riel and a corresponding US\$100 million sale of foreign assets in the foreign exchange market, which would decrease the monetary base by US\$100 million, the central bank would conduct an open market purchase of US\$100 million of government bonds. This would increase the monetary base by US\$100 million. The foreign exchange market intervention and the offsetting open market operation leaves the monetary base unchanged. Since there is little scope for open market operations in Cambodia, the foreign exchange



market interventions by NBC by and large have an unsterilized effect on the monetary base.

However, large inflows of capital and rapid depreciation of US dollar over 2007-2008 put pressure on the riel to strongly appreciate. Prudent monetary and fiscal policies helped moderate inflation and maintain a stable exchange rate. For example, in 2007-2008 as a result of higher gold prices, and increased capital inflows and US dollar deposits in the banking sector, the US dollar tended to depreciate. The NBC undertook purchased US dollars in the foreign exchange market. Consequently, Cambodia's international reserves increased from US\$1,079 million at end 2006 to US\$1,616 million in 2007 to US\$2,164 million by the end of 2008.

Allowing the riel to appreciate slowly would make imports less expensive in riel terms, but this does not address the fundamental issue that the inflation is fuelled by US dollar depreciation and the increase in oil and food prices. The winners will include people who earn in riel and purchase imports. The losers would include earners in US dollars including exporters and those who hold US dollars. They would find that except while purchasing goods imported from the US their purchasing power has diminished. Since the majority of Cambodians hold US dollars as their main saving instrument, this measure may not be palatable. However, riel appreciation may encourage economic agents to switch to the riel and speed up de-dollarization.

The NBC intervenes in the domestic foreign exchange market to maintain the stability of the national currency exchange rate. In 2008, the NBC purchased a total amount of USD 261.18 million from money changers in exchange for 1,048.3 billion riels. Moreover, it

auctioned off US\$9.1 million in the market and sold US\$ 89.5 million to the Cambodian Electricity Company (EDC) to absorb back Cambodian riels.

The above intervention was required to stabilize the exchange rate, caused by the impact of government spending and seasonal fluctuations. For example, the average exchange rate for 2008 was recorded at 4,065 riel per US dollar compared to 4,062 riel per dollar for 2007. Nevertheless, there were large fluctuations in the movements of exchange rate during 2008, ranging between 3,978 riel and 4,151 riel. Seasonal fluctuations occurred from mid-May up until late October, as a result of increased demand for riel during the harvest season driving up the value of the riel relative to the US dollar.

The exchange rate of the riel against the US dollar at the end of 2008 was 4,108 riel to 1 US dollar. This meant a depreciation of 2.7% of riel against the US dollar over 2007 end exchange rate. In contrast riel had appreciated by 1.4 % against the US dollar in the previous year. The drop in the value of the riel in 2008 reflected the slowdown in the capital inflows into the country as a result of the global economic crisis.

3.4.4. Inflation

Cambodia is a small, open, dollarized economy. The shallow foreign exchange market and overt dependence on the imports of most consumer and petroleum products make Cambodia vulnerable to external shocks. Fluctuations of the exchange rate and prices in the world market would immediately pass through to the domestic economy.

Cambodia witnessed a period of high inflation during 1995-1998. Inflation accelerated to 14.7% in 1998 as a result of monetary financing of budget deficit. The implementation of the fiscal discipline by rationalizing expenditure, mobilizing revenue and stopping the practice of bank financing of budget deficit, helped Cambodia keep inflation at a low level during 1999-2004. However, inflation started to accelerate in 2005 (5.8%), but slowed to 4.7% in 2006, following the decrease in prices of crude. The strong growth of the money supply in circulation, the high prices of oil, and the rise in the cost of food products, especially rice, contributed to a moderate speed-up of inflation.

Inflation (yearly average) accelerated from 4.7 % in 2006 to 5.9 % 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 % from 1,410 riel to 1,602 riel per kilo for high quality rice, reflecting supply constraints due to rising rice exports to neighboring countries. The pump price of petrol increased dramatically in 2007 and in the first half of 2008. In order to prevent total pass-through of the higher fuel price to the economy, which could have resulted in higher inflation, the government provided fuel subsidies amounting to US\$170 million (by setting low administrative prices for the

calculation of import duties and taxes). The government also maintained electricity tariffs at the same level by directly subsidizing Electricity Company of Cambodia (EDC), the principal power utility. As Cambodia imports the bulk of consumer products from Thailand, Thai Baht appreciation also resulted in higher prices for consumer goods.

Inflation accelerated in the first half of 2008, as a result of the rapid increase in the international food prices and energy prices. During 2008, average yearly inflation was 19.7%. Inflation reached a record high of 25.7% in May 2008, but slowed down gradually to 13.5% in December 2008, as a result of sharp decline in food and petroleum prices following the onset of the global economic crisis in late 2008. The main contributors to the increase in the consumer price index (CPI) in 2008 were the subgroups Food, Beverages & Tobacco and House Furnishings & Household Operations, which posted an increase of 23.2% and 26.1%, respectively. The price of rice increased by 61% between January and August 2008. The weights given to rice and fish in the CPI are heavy since they are the main food articles of the Cambodian people. Inflation measured by the increase in CPI is sensitive to changes in the prices of these critical items in the food basket. The government has recently put more emphasis on the development of the agricultural sector as a long term strategy to manage inflation.

The price of medicine and medical services increased by 10.6%; Housing & Utilities rose 5.8% in 2008. Transportation & Communication, Recreation & Education, and Clothing & Footwear, registered relatively moderate increases not exceeding 1%.

The major factors impacting on inflation include the exchange rate, fiscal policy, seasonal factors, 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;

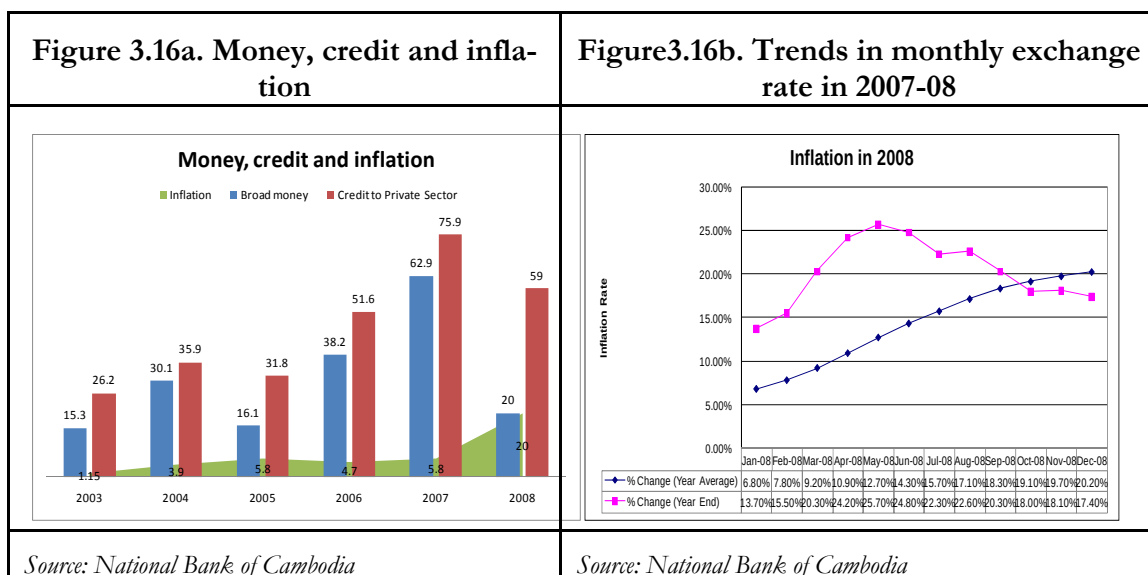
- Domestic prices tend to rise during June-October (lean season) and decline during November-December (harvest season). The seasonal impact could be reduced through more investments in market and storage infrastructure;
- Cambodia is still vulnerable to weather shocks, although the government has made 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.

Inflation has declined sharply in 2009, mainly due to lower food and fuel prices. Headline inflation is expected to be 5% by end-2009. Inflation in 2010 is expected to be low, although upside risk remains, due to expansionary fiscal stance, a sharper depreciation of US dollars and higher oil prices.

3.4.4.1. Increased Capital Flows and Inflation

In recent years, capital flows have played an increasingly important role in the balance of payments. Since 2005 the transactions in the capital and financial account of the balance of payments rose sharply. The financial account increased by 39% 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% 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 %, from US\$475 million in 2006 to US\$867 million in 2007. The increase in investments reflects the confidence of investors in the political and macroeconomic stability of the country. FDI is a non-debt creating instrument of financing because FDI does not add to external debt. Investors acquire equity in a domestic enterprise or create or expand a subsidiary and there are no contractual obligations. The distinctive feature of this type of capital inflow is that it involves not only a transfer of resources, but also the acquisition of partial or full control of a domestic asset by a foreign individual or entity. FDI is an important vehicle for the



transfer of technical and managerial skills from abroad. The benefits of such technological transfers are often seen as more important than the capital flow itself.

In 2007 the overall the balance of payments was in surplus by US\$290 million (3.4% of GDP in 2007 compared with 2.8% 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).

These capital flows have helped to finance large current account deficits associated with higher imports and higher economic growth. It also permitted build up of reserves. At the same time, sudden surges of these sizable inflows have caused some problems of macroeconomic management.

The concerns are:

- Capital flows are temporary and can be quickly reversed;
- Capital flows have induced growth in the money supply and have caused inflation to rise, as the Central Bank the National Bank of Cambodia (NBC) has intervened in the foreign exchange market to mop up foreign exchange in order to stabilize the nominal exchange rate. From mid 2006 to mid 2008, Cambodia's international reserve position increased by US\$1 billion, while it took 12 years to increase international reserves from US\$100 million in 1994 to US\$1 billion in mid 2006.
- The inflationary consequences cannot be avoided since the intervention in the foreign exchange market is not sterilized. For e.g. the RGC cannot issue government bonds or

Treasury Bills to absorb the excess of Cambodian riel injected into the market, while purchasing US dollars.

- If the NBC does not intervene, the capital inflows can cause the riel to appreciate, thus putting Cambodia's competitiveness at risk
- Capital flows have financed a temporary boom in consumption and the real estate sector, which will eventually lead to a cut back in consumption and investment, once the bubble is pricked.

3.4.4.2. Demand-Pull Inflation

Demand-pull inflation is inflation caused by increases in aggregate demand due to increased private and government spending. A surge in the demand for goods and services in general (aggregate demand) is thought to "pull" prices up across the board, especially when aggregate supply is held back by capacity limitations.

There is a strong correlation between the growth in money supply and inflation (graph-----). According to Milton Friedman "inflation is always and everywhere a monetary phenomenon". This is called demand-pull inflation.

The critical issue, however, is to determine how much inflation is caused by the increase in money supply and how much is driven by the costs, i.e. increase in energy and food prices.

The above graph shows the steep rise in liquidity or M2 money supply during the last five years. In response to demand-pull inflation, the NBC has taken the following monetary measures:

- Conduct prudent and tight monetary policy;
- Pursue a policy of managed float, aimed at maintaining a stable exchange rate, strengthening public confidence and sustaining the purchasing power of the riel. To avoid exchange rate volatility and market turbulence, the NBC will strive to maintain appropriate level of local currency in circulation and continue to sell US dollars in the foreign exchange market;
- Increase reserve requirements of commercial banks from 8% to 16% to tighten credit to the private sector (this was subsequently reduced to 12% to increase liquidity of the banking sector during the Global Financial Crisis);

- Allow financially sound banks with excess of liquidity to invest some of their assets abroad;
- Limit government spending, especially increase current budget surplus and reduce overall budget deficit; and increase government deposits in the banking system.
- Tighten regulation of bank's capacity to lend such as by increasing their capitalization requirements. and,
- Promote a policy of gradual de-dollarization.

3.4.4.3. Cost-Push Inflation or “Supply Shock Inflation”

Cost-push inflation is caused by drops in aggregate supply due to increased prices of inputs. The “cost-push” factors include increases in the prices essential commodities such as oil and food, monopoly pricing by enterprises, and wages. Producers who incur higher input costs pass the price increases on to consumers in the form of increased output prices.

Inflation in Cambodia closely tracks oil price increases. Inflation was zero in 2002, rising to 1.15% in 2003 reflecting the comparative stability of international oil prices till 2003. Oil prices started to increase in 2003. Correspondingly inflation rose to 3.9% in 2004. As oil prices accelerated in the second half of 2007, inflation reached 10.8% in December 2007. Rise in food prices also accelerated in early 2008, and helped push inflation further upward.

High inflation due to increases in the prices of essential goods in particular an increase in food prices must be taken seriously, as it imposes disproportionate welfare costs on the poor and the fixed income groups and challenges socio-economic stability. Fiscal policy is a powerful tool to address cost push inflation.

Fiscal policy responses to cost-push inflation in Cambodia include :

- Providing subsidies on petroleum imports by using administrative prices (2001 base price) to calculate tax liabilities (Oil subsidies: \$170 million in 2007 and \$250 million in 2008);
- Providing temporary and short-term subsidies to EDC to maintain electricity tariffs at the same level (Subsidies to power generation around \$30 million);
- Restraining budget deficit; the 2008 Budget will be implemented within the limit of the Budget Law;

- Compensating the affected sections of society, In 2008, base salary has been increased by 20% for government officials, armed forces and retirees; the spouses and children's allowances of the government officials, armed forces, retirees, and disabled officials and soldiers have been increased by 100%, while the teacher allowances were increased by 10%. Living allowances were raised by 20,000 riels per month from August to December 2008 for government officials and armed forces; 1% minimum profit tax for garment factories was suspended for 3 years in order to improve company's cash flows, thus allowing garment factories to increase minimum wage by USD6 from the current wage of USD50 per month;
- The government instructed all ministries and public institutions to save fuel and electricity. In 2008, the use of petrol for administrative purposes was limited to the allocated amount stated in the Budget Law;
- Providing through the Rural Development Bank, special financing in the form of working capital to private rice millers to purchase rice for domestic processing. This scheme originally started in 2005 has cumulatively disbursed 10 million USD till 2008;
- Reintroducing the imports of food products, especially pork which was previously banned due to health concerns.
- Reducing customs tariffs and taxes on imports of agriculture inputs. The revenue loss will be offset by increase in taxes on luxury goods such as cars, phones, televisions, Hi Fi audio equipments, air-conditions, VCR, VCP, alcohol, cosmetics and the other luxury products;
- Introducing temporary VAT exemption on agricultural products to improve food security and encourage processing of agricultural products to supply into domestic market; and,
- Introducing (and then lifting) the ban on exports of paddy and rice for 2 months and instructing the Green Trade Co. and Cambodian Rice Miller Association to sell rice from their stock;

Over the long run agricultural development will be a key aspect of supply side policies to control inflation. Higher food prices should be viewed as providing an incentive for farmers to increase investment in agriculture to boost productivity and exports. The revised Rectangular Strategy approved in 2008 to guide the socioeconomic policy of the fourth mandate of the government has given a high priority to agricultural development recognizing the comparative advantage of Cambodia in agriculture.

3.4.4.4. Built-in Inflation

Built-in inflation is induced by adaptive expectations, often linked to the "price/wage spiral" because it involves workers trying to raise their wages to keep up with higher prices (gross wages have to increase above the CPI rate to net to CPI after-tax if erosion of real income after the wage adjustment is to be avoided) and employers passing higher costs on to consumers as higher prices as part of a vicious circle. Built-in inflation reflects events in the past, and so might be seen as hangover inflation.

The objectives of the Government's introduced policy measures is to return the Cambodia economy to a path of strong and stable growth, accompanied by low and stable inflation. Achieving this objective will require a coherent set of policy responses across a broad front. These will include structural measures designed to improve market efficiency, as well as possible monetary and fiscal policy adjustments. The responsibilities in this effort will have to be shared among all stakeholders. Government policies will have to target stability in inflation which is tolerable to the society rather than avoiding inflation altogether. Broader supply side measures as a basis to sustaining Cambodia economic growth which will restrain inflation include the following:

- Adoption of the policies to foster investment in the oil sector and in energy resources more generally and to ensure that investment regimes are stable and predictable, encourage greater cooperation and synergies between concerned national and international agencies through well-designed partnerships;
- Public awareness campaigns, educational programs and policies to increase conservation and energy efficiency that would help to moderate the growth in energy demand; and,
- Focus on improving agricultural policies, which aim to upgrade infrastructure, distribution, and storage systems, expand irrigation systems, and redirect subsidies toward high-yield products and key agricultural inputs such as fertilizer.

Aggregate demand management should aim at :

1. New fiscal measures on monitoring, controlling and if needed stabilizing key Cambodia's economic sectors that are important to minimize downside risks to growth, such as the real-estate sector and the financial system; and,
2. Tightening expansion of credit to low priority sectors to cool inflation without causing cost push pressures.

3.4.4.5. Additional Measures

Rapidly rising prices are a challenge to economic prosperity and progress. Government policy responses need to be appropriate, structurally coherent and consistent in order to mitigate the impact of fuel and food prices and on the Cambodia's macroeconomic outlook in general. Apart from the measures described above the following measures are under government consideration:

- Continue the policy of nonbank financing of budget deficit;
- Limit increase in current expenditures that may be needed to prime the economy so that the current budget surplus does not fall below 2.5% of GDP;
- Maintaining the overall fiscal deficit at around 2.5% of GDP in 2010 to contain inflationary expectations;
- Increase government deposits in the banking system;
- In the case of revenue shortfalls, propose new saving measures or reduce the current allocations, by cutting down non-priority expenditures;
- Strengthen the enforcement of property tax and unused land tax, including the implementation of the capital gain tax;
- Continue to implement public investment expenditures related to physical infrastructure such as roads, irrigation systems and energy, which aim at reducing economic costs and improving production and productivity along with increasing the expenditure on education and health in the framework of the 2008 Budget Law;
- Propose that all government agencies should identify new savings measures and mobilize revenue collection from all possible sources; and,
- Reduce additional government staff recruitment by 10% for 2009.

Other possible measures include:

- Increase excise duty on liquor and luxury goods;
- Use actual import transaction prices for assessing tax, including for alcohol, cigarettes and petroleum;

- Introduce VAT for electricity and water;
- Further strengthen land transaction tax collection;
- Introduce a property tax initially in major urban areas;
- Increase excise rates, especially on beer and cigarettes;
- Replace current tax incentives with investment allowances, tax credits, and accelerated depreciation.

3.4.5. Money Supply

3.4.5.1. Net Foreign Assets

From the asset side of the balance sheet of the banking system, money supply is composed of net foreign assets and net domestic assets. The vigorous growth in net foreign assets was the main contributor to monetary growth in the 2007 as this item increased by 50% from US\$1.76 billion at the end of December 2006 to US\$2.6 billion in 2007. Net foreign assets peaked in August 2008 at US\$2.74 billion. With the onset of the global economic crisis the net foreign assets of the banking system started to decline as a few commercial banks and depositors repatriated their funds from Cambodia to destinations abroad. Net foreign assets dropped by 5% in December 2008, compared to September 2008. The downward trend was reversed in December 2008 and net foreign assets recovered to US\$2.5 billion. Net foreign assets increased by 9% in April 2009 to US\$2.8 billion, compared to December 2008, with the opening of a Korean commercial bank, Kookmin Bank.

3.4.5.2. Net Domestic Assets

Domestic credit is made up by net claims on government and credit to the private and public sector. In 2007 net domestic assets of the banking sector amounted to US\$142 million, a result of an exceptional increase in domestic credit which significantly outpaced growth in restricted deposits and capital of the banking system. Net domestic credit more than doubled in 2008 to US\$373 million. Rapid growth in domestic private sector credit has been offset in part by the reduction in net claims on government mainly due to the increase in government deposits.

3.4.5.3. Net Claims on Government

As a result of the Public Financial Management (PFM) Reform, government deposits increased more than fivefold from US\$141 million in 2004 to US\$802 million in 2008,

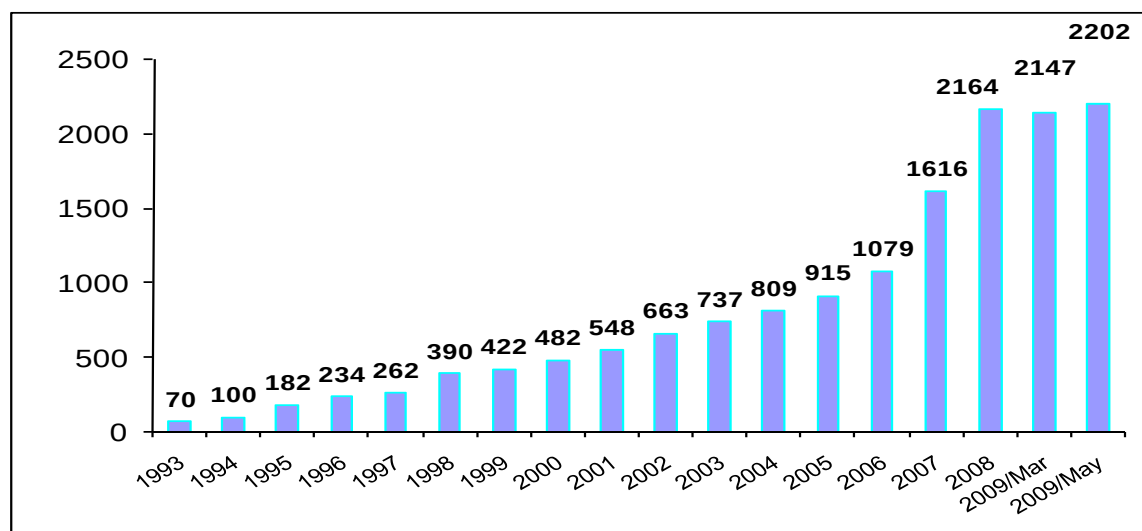
while claims on government have been maintained at the same level around US\$65-90 million. Rapid growth in government deposits resulted in the improvement in the net claims on government from -\$52 million in December 2004 to -\$735 million in December 2008. This amount is a financial resource of the government.

3.4.5.4. Gross International Reserves

In a dollarized economy such as Cambodia, gross international reserves play a crucial role in instilling public confidence in the banking system. Cambodia's gross international reserves doubled from \$1 billion in mid-2006 to \$2 billion in mid-2008. These reserves are held in various forms, including overnight investment, short and medium term deposits, Medium Term Instrument (MTI) and investment grade securities issued by highly rated non-resident institutions. By the end of 2008, investments (excluding gold and SDRs) amounted to USD 2.25 billion, up 27.5% year-on-year from the level recorded at the end of 2007.

Rapid increase in gross international reserves reflects continued good export performance, increase in foreign direct investments and acceleration of capital inflows. This level of international reserves is sufficient to cover 3.9 months of imports of goods.

Figure 3.17. Gross International Reserves, 1993-2009 (in million dollars)



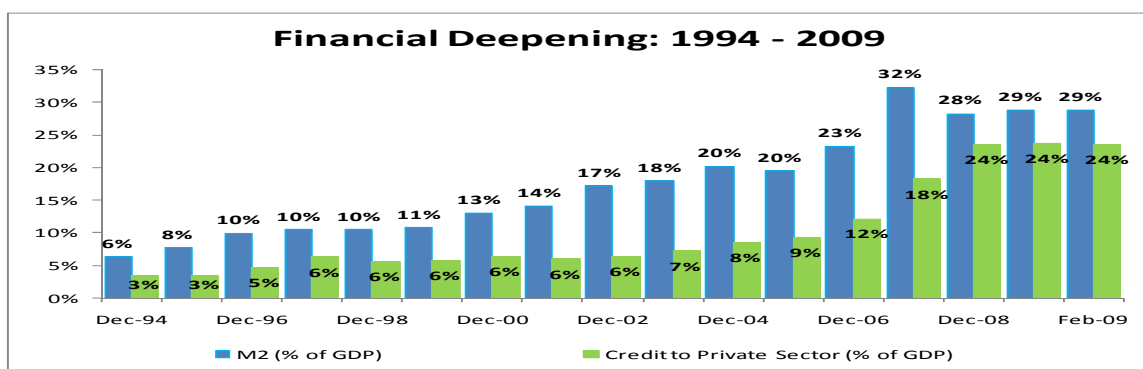
Source: National Bank of Cambodia

Figure 3.17 shows that gross official reserves are expected to be broadly stable, at around US\$2.2 billion (4 months of imports) at end-2009.

3.4.6. Monetary policy

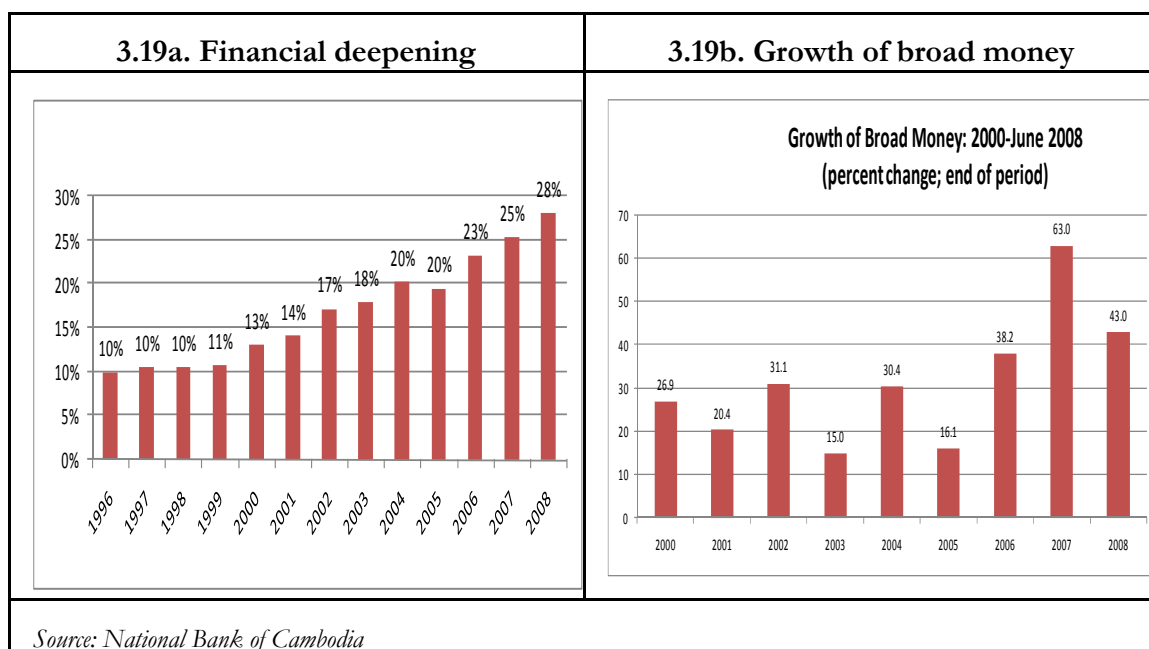
Monetary policy is aimed at maintaining price stability. NBC targets inflation at less than 5 % in the near-term and at about 3 ½ % over the medium-term. During 2006 and 2007, the banking sector's liquidity (M2) continued to expand sharply. The growth rate of M2 in 2006 (38.2 %) was more than double of 2005 (16.1 %), reached 63 % in 2007, but increased only by 4.8% in 2008, as the Global Financial Crisis started in September 2008. A more detailed outline of these developments is given below.

Figure 3.18. Financial Deepening (M2/GDP)



Source: National Bank of Cambodia

This analysis of the structural transformation of the Cambodian banking system is based on the achievements of the last seven years, 2000 to 2006.



The principal functions of NBC are to act as the monetary authority and conduct monetary policy. In this role it has actively intervened in the foreign exchange market to deliver a stable exchange rate and domestic price stability. As a result the value of the riel against the US dollar has been maintained at a stable level during the last three years. (b) act as the sole issuer of the national currency. It has accordingly increased the number of currency denominations and replaced worn out and dirty bank notes; (c) act as the supervisory and regulatory authority of the banking and financial system; (d) oversee the payments system in Cambodia and (f) manage the international reserves of the country.

Dollarization affects the choice of monetary target, the implementation of monetary policy and the structure of prudential supervision. Currency substitution implies that dollar denominated monetary assets are to be reckoned as part of the money supply while targeting the price level.

Heavily dollarized economies require the central bank to use dollar-denominated instruments in monetary management. However, the effectiveness of the instrument will be affected by the degree of substitutability between dollar-denominated government bonds and dollar assets available outside the home country. The higher the degree of substitutability, the lower the effectiveness of the instrument (IMF, 1999). However, this issue is academic for Cambodia at present since neither the government bond market nor the stock market exists in the country.

Within the context of a dollarized economy, the NBC uses interventions in the foreign exchange market as an indirect instrument of monetary policy. Other instruments such as reserve requirements and rediscount rate are notionally available but are not utilized. Targeting the exchange rate is the main instrument of Cambodia's monetary policy.

3.4.6.1. Reserve Requirements

In heavily dollarized economies, foreign currency reserve requirements can play a useful role as automatic liquidity stabilizers (IMF, 1999). Reserve requirements on foreign currency deposits can also be used to tax banks and discourage capital inflows. In general, reserve requirements can be used as a means of sterilizing excess liquidity. For example, a reduction in the reserve requirement decreases the amount of reserves that banks must hold and therefore banks can make more loans. The larger volume of loans adds to money supply and stimulates the economy.

However the indiscriminate use of reserve requirements could have serious consequences for the financial sector. Unremunerated reserve requirements are equivalent to a tax on the financial sector and can lead to financial disintermediation. Raising reserve requirements would increase costs to the commercial banks and may not impact much on the lending

volume or liquidity of the banking system which is generally demand driven. Moreover dollar inflows into the country can still continue, provided that the domestic market interest rates are higher than the overseas rates, the macroeconomic conditions in the country are sound or there are attractive investment opportunities in the country. Reserve requirements within the context of a dollarized economy are therefore used more by the central bank to regulate banks to provide security and stability in the banking system.

3.4.6.2. Discount Lending

The discount window of the NBC provides a safety valve for relieving reserve requirement pressures. By lending funds against acceptable collateral, the central bank provides liquidity to financial institutions, while helping to assure the basic stability of money markets and the banking system. In practice this instrument has not been used to conduct monetary policy in Cambodia.

Monetary policy during 2003-2008 has been successful in achieving relative price stability through a carefully managed growth of money supply particularly restraint on government credit from the banking sector and by maintaining a satisfactory level of net foreign assets. Monetary policy should aim at: (i) a more active management of liquid assets; (ii) better conditions for bank intermediation and private sector financing; and (iii) an exchange rate policy determined by market conditions.

The monetary policy in the mid-term must ensure the stability of monetary aggregates, by such measures as a progressive liquidation of government debt with the non-banking system and active management of liquid assets. The central bank should ensure a healthy financing of the government's cash flow needs through the use of treasury bonds, and avoid recourse to central bank financing. The introduction of treasury bonds will allow the central bank to actively utilize this key instrument of monetary policy to regulate money supply. The further reduction of credit to the public sector will create space for increasing credit to the private sector for productive purposes.

3.4.7. Dollarization

There is a large volume of literature on the issue of dollarization. Dollarization is manifested in many ways in different economies. Economic literature distinguishes between different concepts of dollarization, viz. official dollarization, unofficial dollarization, semi-official dollarization, full dollarization, currency substitution, asset substitution etc.

Ortiz (1983) defined *dollarization* as the degree to which real and financial transactions are performed in US dollars relative to those performed in domestic currency. This definition

of dollarization recognizes the use of US dollar as the medium of exchange in an economy other than the US.

According to Calvo and Vegh (1992), *currency substitution* means the use only of foreign currency and foreign currency deposits as a medium of exchange in the domestic economy. McKinnon (1996) went further to distinguish between *currency substitution* and *asset substitution*, as the two motives for the demand for foreign-currency-denominated assets, thus emphasizing the use of dollars as the medium of exchange (currency substitution) and the store of value (asset substitution).

Studies by the Supreme National Economic Council (SNEC, 2002) and De Zamaroczy and Sa (2002), reviewed the costs and benefits of dollarization. But very few studies have focused on the relationship between dollarization and monetary and fiscal policies. The analysis that follows in this section aims to fill this gap.

Within the Cambodian context, dollarization can be defined as the use of the US dollar in any of the three functions of money in an economy other than US: unit of account, medium of exchange and, in particular, store of value. More generally the term currency substitution refers to the use of a foreign currency other than the domestic currency as a means of exchange in the domestic economy. The term dollarization is used to specifically describe the currency regime in Cambodia where the US dollar is the dominant currency in circulation notwithstanding the availability of the local currency, the riel.

Dollarization occurs in several ways. Partial dollarization occurs when people hold a portion of their financial wealth in foreign assets. This is equivalent to “asset substitution”. In some cases, currency substitution occurs, even if the foreign currency is not considered legal tender. This is called unofficial dollarization. Wages, taxes, and everyday expenses continue to be paid in domestic currency, but high value transactions are often conducted in foreign currency.

Semiofficial dollarization occurs when the economy has a *de facto* dual monetary system. Under this system, foreign currency is legal tender and dominates bank deposits, but plays a secondary role to domestic currency in paying wages and taxes. Semiofficial dollarized economies such as Cambodia maintain a central bank or other monetary authority and have some flexibility to conduct monetary policy.

Official dollarization, also called full dollarization, occurs when foreign currency has exclusive or predominant status as full legal tender. That means not only is foreign currency legal for use in contracts between private parties, but the government also uses it in domestic transactions. Domestic currency may still exist, but its monetary role is minor.

Currency substitution arises when high and variable inflation rates discourage the use of the domestic currency. Asset substitution can also result from the flight from the domestic currency as people turn to foreign currency denominated assets as a store of value. Moreover, in recent years, dollarization has become more prevalent in some countries because of institutional changes, particularly capital account liberalization, have facilitated it. Hence, the increase in foreign currency assets in recent years is a consequence of portfolio decisions under stable macroeconomic conditions and is not necessarily a flight from the domestic currency.

Against the backdrop of continued large flows of foreign assistance and private transfers, high-inflation environment and political uncertainty, the dollarization of the Cambodian economy started in the early 1990s. In the initial stage dollarization emerged in the Cambodian economy largely due to the loss of confidence by the public in the riel, hyperinflation and the rapid loss of purchasing power of the domestic currency. However, dollarization has persisted even with improved macroeconomic performance in the last decades. The increase in broad money has essentially resulted from a buildup in foreign assets, which itself stemmed from a rise in foreign currency deposits.

At present, Cambodia is a highly dollarized economy, with 97.8% of the bank assets held in US dollars. The trends will not be reversed soon. As late as in 2006 the bank deposits in riel increased only by 26%, while the deposits in US dollars increased by 46%. The foreign currency deposits to total deposits ratio has crept up from 84.3% in 1993 to reach 97% in 2006. Thus, only 3 % of bank deposits and 5 % of bank loans were denominated in Cambodian riel.

The Cambodian economy is highly but not fully dollarized. Since the actual amount of dollars and other foreign currencies in Cambodia outside the banking system is unknown it is difficult to determine the correct extent of dollarization in the Cambodian economy (although it is generally assumed that foreign currency makes up about 90% of the total bills in circulation). Vietnamese dong and Thai baht are also widely used in the provinces bordering the two countries. However the US dollar commands the largest share of currencies in use in Cambodia.

3.4.7.1. Dollarization and Monetary Policy

In some ways dollarization has promoted the stability and development of the financial sector but has severely limited the scope of monetary policy in macroeconomic management and as a tool to promote growth. The costs and benefits of dollarization is presented below.

- ***Stability and protection against exchange rate risks*** – in a highly dollarized economy, the bulk of trade-related and large financial transactions are settled in dollars. This has reduced the risk of currency devaluation. The transaction demand for riel is low and the market for it small with little scope for speculative gains. The riel has therefore remained very stable with average annual depreciation against the dollar of approximately 1% for the three year period ended 2008. As a result the pass-through effect of higher import prices on inflation has been limited;
- ***Protection against currency crisis*** – since there is no pressure to defend the exchange rate the risk of balance of payment crises and vulnerability to contagion are greatly reduced. Monetary policy can be used in a normal national currency system to cool demand across the board. This option is not available in a highly dollarized economy; but, in this system price adjustments can still be made in specific goods and factors markets;
- ***Loss of an effective monetary policy*** – another major cost is losing flexibility in monetary policy. The central bank, the NBC, cannot in any significant way influence foreign currency component of broad money and determine the money supply. The money supply depends on the behavior of agents holding both dollar and riel-denominated assets. A fully dollarized economy therefore has no choice but to adopt the monetary policy of the issuing country. This has led to what is called asymmetric shocks (Calvo, 1999);
- ***Losing the central bank as lender of last resort.*** Dollarization does not eliminate the risk of a banking crisis. During a banking crisis, the central bank should function as a lender of last resort to the commercial banks by providing advance or credit lines to solvent but not liquid commercial banks. Dollarization prevents the monetary authorities from providing short-term liquidity to the banking system to address the liquidity crunch. The use of dollars by the commercial banks in their transactions undermines the ability of the central bank in guaranteeing the payment system and the bank deposits. The central bank cannot inject the riel into a system dominated by dollars. One solution is to arrange for lines of credit from foreign banks. However this can be costly even if available. Another alternative is for the central bank to accumulate foreign exchange reserves and along with the treasury, establish a stabilization fund, which can be used to counter bank runs. Thus, the NBC cannot develop strong instruments of monetary policy and its role of lender of last resort for banks facing liquidity problems is greatly constrained. The only policy instrument available for the central bank is the use international reserves to lend to the commercial banks. This may not be sustainable if the crisis extends over a long period.

- ***External shocks***, such as a considerable rise in the world price of oil or the decrease in price of an important export product, can push a country to devalue its currency in a dollarized economy. If the adjustment comes through a lowering of nominal wages and an adjustment of domestic prices the country would run the near-inevitable risk of a serious recession, especially in economies characterized by a rigid labor market.
- ***Dollarization does not eliminate all the sources of banking crises***, although full dollarization protects the banking system from the risk of devaluation, If such a crisis arises, the capacity of the Central Bank to function as a lender of last resort in emergency situations which are long lasting will be severely tested.
- ***However dollarization should not harm excessively the ability of the authorities to provide liquidity to the system on a short-term basis*** or to assist individual banks that find themselves in difficulty. The Central Bank could play this role if it is able to mobilize the necessary reserves in advance or if it is able to obtain lines of credit from international banks.
- ***In the case of widespread loss of confidence***, the authorities will find themselves incapable of guaranteeing the overall system of payments or the totality of bank deposits due to the depletion of reserves. It is the right to create money that enables the Central Bank to guarantee beyond all doubt that debts of the banking system (in national currency) will be honored completely in any eventuality. Once it loses this capacity, its role as lender of last resort, is limited. An entirely dollarized country that has already exhausted its foreign currency reserves will have no option left but to abandon the dollarized regime if faced with a run on deposits.

3.4.7.2. Dollarization and Fiscal Policy

- ***Promoting budget discipline*** – dollarization fosters budgetary discipline. While it will not eliminate budget deficits, these will be financed through fairly transparent methods of foreign financing, higher taxes or more transparent government debt. Thus, dollarization has promoted awareness by policymakers of the need to avoid bank financing of public deficits, which could lead to spiraling inflation. Bank financing of the budget deficit, i.e. the borrowing by the government from the central bank to finance budget deficit would drastically increase the riel-denominated money supply, which will immediately impact the money market, thus affecting the demand and supply of US dollars. Exchange rate fluctuations can occur through this channel. Therefore, dollarization requires the government to ensure budget discipline and to resort to financing budget deficits only through grants or concessional loans, i.e. external borrowing on concessional terms (both provided mainly in US dollars);

- ***Managing exchange rate stability***—dollarization requires that the Finance Ministry to disburse budget spending denominated in riel in a manner that ensure the stability of the exchange rate. As dollarization undermines the ability of the central bank, to use the interest rate to regulate the money supply and the value of the national currency, i.e. the exchange rate, fiscal policy has to play the predominant role in ensuring macroeconomic stability. Excessive supply of riel in the money market will immediately impact the exchange rate. With both current account convertibility and capital account liberalization, however, the fiscal policy should take into account the inflows and outflows of US dollars, through exchange rate adjustments. In short, within the context of dollarization, the only mechanism available to manage the exchange rate is the budget. Sound macroeconomic management in a dollarized economy requires close coordination between the central bank and the Ministry of Finance;
- ***Promoting price stability***—one of the objectives of macroeconomic policy is to ensure price stability and economic growth. There is a strong correlation between the level of inflation and economic growth, as discussed in the second section of this paper. Within the context of dollarized economy, price stability can be achieved through exchange rate stability. As Cambodia imports the bulk of consumer goods for domestic consumption, exchange rate fluctuations can translate immediately into price fluctuations. Careful budget management is necessary to ensure exchange rate stability and hence price stability;
- ***Facilitating international trade and economic integration*** – dollarization lowers transaction costs, which stem partly from the difference between the buying and selling rates for converting domestic currency to foreign currency. By reducing trade transaction costs through avoiding currency conversions it has contributed to the rapid growth of the booming garment industry. Hedging for currency risk against the US dollar has become unnecessary. This would help the integration of domestic market into the rest of the world. In a highly dollarized economy, international reserves will be used more to ensure the integrity of the banking system, and less to ensure exchange rate stability. Dollarization can thus be used to promote institutional change, promote financial accountability and transparency;
- ***Loss of seigniorage*** – the main cost of dollarization is the loss of seigniorage for the government. Seigniorage is the revenue from issuing currency. The seigniorage arises from the difference between the cost of producing and distributing paper money and coins and their purchasing power. Some estimates show that seigniorage losses can be significant for Cambodia. Estimates of this foregone income by the National Bank of Cambodia (NBC) range from US\$20 to US\$90 million.

3.5. External Sector

The main features of the Cambodia's external sector developments during 2001-2008 are summarized in the table below.

Table 3.5. Cambodia: External sector indicators, 2001-2008

	94	99	01	02	03	04	05	06	07	08
External sector										
Domestic ex-ports (% change)	1315	47	15	13	16	29	13	28	11	9
Imports (% change)	55	37	8	11	10	28	20	21	14	23
Imports (garments ex-cluded, % change)	55	28	6	8	8	29	27	21	16	32
Balance of cur-rent transactions (Excl. transfers) US\$ Mns	-347	-444	-349	-359	-450	-440	-591	-526	-730	-1,705
Balance of cur-rent transactions (incl. transfers), US\$ Mns	-112	-188	-45	-47	-137	-122	-256	-77	-332	-1,205
Direct invest-ments (US\$, Mns)	162	221	142	139	74	121	375	483	866	785
Aggregate bal-ance	-113	-49	45	60	33	31	65	193	426	511
Gross reserves (US\$, Mns)	100	422	548	663	737	809	915	1,097	1,616	2,104
(As months of imports)	1.78	2.84	2.79	3.05	3.08	2.67	2.55	2.54	3.29	3.51

Source: MEF

- Exports were growing rapidly during the last decade, but has slowed down in 2007 and 2008, reflecting the vulnerability of export-related activity, given the narrow export base and high concentration of garments destined for the US market;
- Imports were increasing faster than exports, but followed the same patterns. High oil and commodity prices were attributable to the growth in imports;
- The current account deficit widened sharply in 2008, reflecting the hike in oil and commodity prices, but is expected to narrow in 2009;

- Foreign Direct Investment (FDI) accelerated during 2005-2008, but is expected to decline in 2009, as a result of the Global Financial Crisis.
- Gross official reserves have doubled between January 2006 and December 2008, reflecting good export performance and drastic increase in capital flows, including FDI and ODA.

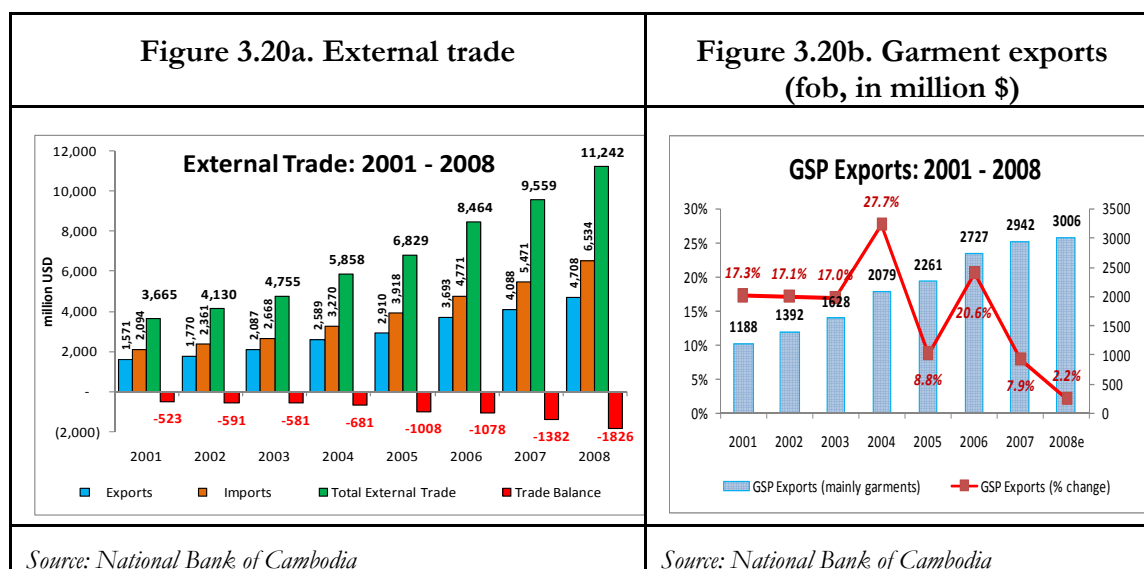
3.5.1. Exports and Imports

Exports increased by 15% from US\$4 billion in 2007 to US\$4.7 billion in 2008. Garment exports grew slightly by 2% to US\$3 billion. The garment sector was hard hit by the global financial crisis which resulted in a lower demand. The decline in garment exports was offset by a 52% increase in non-garment exports, as a result of higher prices of rice, rubber and other agricultural products. The US remained the top export market, accounting for 70 % of Cambodia's total exports, followed by the European Union 21 % and Canada 4 %. Re-exports increased by 19 % from US\$215 million in 2007 to US\$284 million in 2008.

Imports increased by 19% from US\$5.5 billion in 2007 to US\$6.5 billion in 2008. Of this, retained imports increased by 19% to US\$6.3 billion. This growth was attributable to a 43 % increase in petroleum imports, a 16% growth in the imports of other consumer goods, and a 31% increase in imports for re-exports.

3.5.2. Trade Balance

Cambodia's trade deficit increased by 32 % from US\$1.3 billion in 2007 to US\$1.8 billion in 2008, mainly due to the increase in the import value of petroleum products.



3.5.3. Services, Income and Transfers

Services receipts increased by 6% from US\$1.5 billion in 2007 to US\$1.6 billion in 2008. Net services posted a surplus of US\$587 million, a decline by 4%. Transportation and travel services grew by 14 % and 8 % respectively. The number of tourist arrivals increased by 5% to 2.1 million in 2008. Arrivals from South Korean ranked first in terms of nationalities of tourists accounting for 13 % of the total arrivals, followed by Viet Nam (10 %), Japan (8 %), the United States (7 %) and China (6 %). Tourism receipts were estimated at US\$1.5 billion in 2008.

Net income posted a deficit of US\$ 408 million, a 17% increase compared to 2007. The increase in payments related to investment income, dividend and interest payment remittance was the main contributors to this deficit. Net private transfers recorded a surplus of US\$372 million. These are remittances to Cambodia by Cambodians working and living abroad.

3.5.4. Current Account and Capital Transfers

The current account deficit (excluding official transfers) increased by 74 % from US\$732 million or 8.2% of GDP in 2007 to US\$1.27 billion or 12.3 % of GDP in 2008. The increase in the current account deficit was mainly attributable to growing trade deficit, caused by high prices of consumer goods and petroleum products.

The current account deficit (including transfers) is expected to narrow in 2009 to around 5½ percent of GDP, as lower import demand and oil prices more than offset reduced exports and tourism receipts. However, it will widen to 11% of GDP in 2010, owing to sluggish exports, rising imports and oil prices.

Official transfers consisting of grants, food aid, project aid and TA salaries amounted to US\$486 million in 2008, a 1% decline compared to last year. In response to the food crisis, food aid increased by 52% to US\$30 million in 2008. The deficit of the balance on the current account and capital transfers more than doubled to the amount of US\$789 million, compared to 2007.

3.5.5. Financial Account

The financial account primarily consists of official sector loans and non-public sector investment. Net inflows on the financial account increased by 70 % from US\$695 million in 2007 to US\$1,184 million in 2008. The increase in the net inflows on financial account was necessary to finance the growing current account deficit.

Official loans made to the government by other governments and multilateral institutions increased by 18% from US\$199 million in 2007 to US\$235 million in 2005. ADB loan disbursements increased by 183 %, offset by a 55% reduction in the disbursement of World Bank loans. IMF loans are excluded from the official loans and are used to bolster the net foreign assets of the NBC.

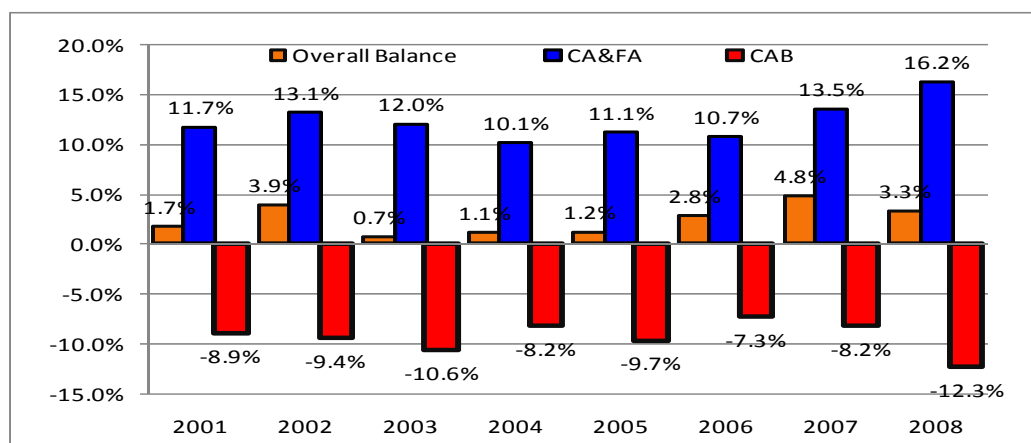
Non-public sector investments grew by 92% from US\$495 million in 2007 to US\$945 million in 2008. Net inflows of foreign direct investment (FDI) decreased by 8% from US\$866 million in 2007 to US\$795 million in 2008. Of this net inflow, direct investment in banks and the non-banking sector amounted to US\$344 million and US\$ 462 million, respectively.

The increase in the financial account was therefore wholly attributable to development in other net investments, which increased by US\$526 million to reach US\$168 million, reflecting increase in net foreign assets of commercial banks (US\$814 million) and unrestricted deposits of banks with the NBC (US\$264 million). Moreover, outflows of other items in the other investment account of US\$ 552 million also contributed to this result.

3.5.6. Overall Balance

The capital and financial account increased by 41 % from US\$1,184.2 million (13.5% of GDP) in 2007 to US\$1,670.2 million (16.2 % of GDP) in 2008. This increase to 16.2 % of GDP was sufficient to finance the current account deficit of 12.3 % of GDP, resulting in an overall balance of payment surplus of US\$395.2 million (3.39% of GDP).

Figure 3.21. Cambodia's Balance of Payments (in % of GDP)



Overall, the increased current account deficit was financed by the official transfers (US\$485.8), concessional loans (US\$234.7 million), net direct investment in banks and non-bank sector (US\$794.7 million) and other net investment (US\$ 168.0 million). Foreign financing of the current account deficit will remain crucial in the years ahead.

3.6. Macroeconomic Developments in 2008 and Outlook

After peaking at an all time record of 13.3 % in 2005, growth of real GDP slowed to 10.8 % in 2006, 10.2 % in 2007 and further to 6.7 % in 2008. Real GDP growth averaged 10.3 % during 2004-2008. This performance is underpinned by the strong support extended to agriculture and the garment sector by the RGC. Tourism and construction have been important drivers of growth. Overall recent economic performance has been characterized by balanced contributions from agriculture, manufacturing, construction and services.

Economic performance in 2008 though somewhat diminished compared with 2004-2007 was still impressive, at the rate of 6.7 %. Important contributions for the strong economic performance in 2008 came from steady growth in agriculture (5.7 %), sustained growth of tourism receipts (9.8 %), the continued growth in garment exports, albeit at much lower pace (2.2 %) and the continued expansion of financial services (19.2 %) and construction activities (5.8 %).

3.6.1. Agriculture

Agriculture posted robust growth of 5.7 % in 2008, lower than the average annual growth of 8 % during 2005-2008. Rice and other crop production increased by 6.6 %, due to considerable investments made by the RGC and the development partners in irrigation facilities. Livestock grew by 3.8 % and Fisheries by 6.5 %. Forestry posted a modest growth of 0.9 %.

3.6.2. Industry

Industry's growth continued to be strong at 4.0 %, buoyed by the expanding **mining sector** (15.8%) and the continued growth of the **garment industry** (2.2 %). The major activities contributing to this growth were the exploration of bauxite, iron ore, copper and gold in the Northeastern and the Eastern provinces of Cambodia. Oz Mineral plans to spend more than \$4 million on exploration of gold deposits in Kratie province.

Construction grew by only 5.8 % in 2008. Construction activities showed signs of slowing down in the second half of 2008. New townships, the construction of the Special Economic Zone and tourism development projects, such as the Koh Puos Development

Project, the Camco City Project, the Boeung Snor Development Project, the Sunway City Project came to a standstill. However, some real estate developers continue their projects, albeit at a slower pace and reduced scale. The slowdown in privately-funded projects was offset by the pick up in public work projects, such as road and bridge construction.

3.6.3. Services Sector

Services grew by 9.0 % in 2008 with robust contributions from all the sub sectors. The expansion of the tourism and hotel industry continued, with a growth rate of 9.8 %. The transport and communication sub sector grew moderately by 7.1 %. 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 19.2 %. The main contributor to the rapid growth was commercial banking services. Real estate services increased by 5 %. Trade services grew moderately by 9.4 %.

3.7. The Global Financial Crisis and Its Impact on Cambodia

3.7.1. The Causes of the Crisis

The financial crisis started in August 2007 as a subprime crisis against the backdrop of global financial imbalances and in the context of unbridled liberalization of world financial markets. The subprime market, which experienced rapid growth during the last few years in the United States, accounted for no more than US\$1,000 billion, compared with stock market capitalization of US\$20,000 billion or the wealth of the American family of US\$60,000 billion.

The following are the factors leading to the subprime crisis:

- ***Excess of liquidity at the global level and financial deepening*** - the ratio money supply/ GDP of the six industrialized areas, United States, Euro zone, Japan, China, United Kingdom and Canada increased from annual average of 20% in 1980-1970 to 30% in 2006-2007 accompanied by rapid increase of the foreign exchange reserves of emerging countries and credit expansion (growth, decrease in real interest rate and financial innovation);
- ***Global decrease in inflation and its volatility,***

- ***General decline in risk premium as a result of reduction in risk aversion.*** The easy availability of liquidity enabled financial market players to invest in high risk assets which carried high returns. By contrast, since August 2007, aversion to risk has drastically increased;
- ***Decline in the long term interest rate*** – the drop in inflation and its volatility, coupled with the reduction in risk premium, led to the reduction in long-term interest rate, despite the contractionary stance (quite late) of the US monetary policy;
- ***Credit expansion in the context of low inflation*** – the drop in interest rate and risk premium created conditions for plentiful and cheap credit. Low inflation scenario has continued, despite the increase in the prices of raw materials (oil, metals and food grains) as a result of the increase in demand in emerging countries. The decline in interest rates and risk premium provided also favorable conditions for high leverage operations – the increase in debt leverage of commercial banks, hedge funds and private equity funds.
- ***Increase in the prices of assets*** – while excess of liquidity did not impact on the prices of goods and services, it had a big impact on the price of assets against the backdrop of limited offer. The increase in the price of assets provided favorable conditions for the expansion in mortgage loans. The increase in the assets price and the accompanying wealth effects led to increase in consumption.
- ***Microeconomic malfunctioning*** – (i) The flight to safety by investors led to bearish stock markets and bullish bond markets; (ii) commercial banks adopted a two-pronged strategy – increase the volume of activities, while relaxing conditions for granting loans and introducing innovation; and (ii) relaxing conditions for granting loans – the volume of subprime loans (granted to high risk borrowers) multiplied seven fold, increasing from \$94 billion in 2001 to \$685 billion in 2006. Loans with variable interest rates also increased dramatically at the expense of the fixed interest loans.
- ***High risk financial practices*** – one of the canons of bank supervision is that the increase in credit volume should go hand in hand with the increase in bank capitalization, thus constraining commercial banks from creating excessive credit. However, financial institutions have adopted the strategy of bypassing this regulation by introducing new vehicles such as off balance sheet financing and securitization.

3.7.2. The Development of the Crisis

Mortgage lenders distributed subprime loans to low income households, who were not eligible for prime rate loans and were known for defaulting previously contracted credits.

The households were not informed that the interest rates were variable or would increase after one or two years. The mortgage lenders then resold the subprime loans to investment banks (in some cases the mortgage lenders and the investment banks were from the same group).

With financial innovation, financial engineers transformed the subprime loans, via securitization, into securities, such as Mortgage-Backed Securities (MBS) or (for non-mortgage loans) into Asset-Backed Securities (ABS), then into Collateralized Debt Obligations (CDOs). The CDO made from ABS or MBS were rated by the rating agencies (Moody or S&P) by differentiating their risk profiles.

Investment banks buy, for their own account or for the account of their clients, billions of CDOs from ABS, which yielded higher returns than the US Treasury Bills. To hedge against the risk, the investment banks bought insurance from specialized insurance companies (credit enhancers) or bought special securities called Credit Default Swap (CDS), issued by other investment banks. CDS have a market in their own right. However, this category of risks in many cases was probably uninsurable. The risk can be insurable, when insurance companies collect small premium from a large pool of policyholders to meet future liabilities to meet only a limited number of claims.

When interest rates started to increase from late 2006, more and more American households found that their monthly debt service payments were escalating. Unable to pay back the mortgage loans, they were evicted from their homes, which were then seized by banks that sought to resell them later on. But when the number of foreclosures exploded, the real estate market collapsed.

Investors who bought CDO via Mutual Funds realized that parts of the mortgages based on which the securities were issued would not be redeemed. Holders of CDOs attempted to get rid of them and the CDO market also collapsed. The credit enhancers who were supposed to guarantee the value of the securities were unable to meet the claims and went bankrupt. The investment banks had to depreciate the value of CDOs that they held on their books.

Each bank knows the volume of “toxic” CDOs it holds but is ignorant how much of these tainted assets other banks hold. As a precaution, banks refuse to lend to other banks; and even if they do they charge a high interest rate. Banks that rely on the inter-bank market for refinancing have therefore become fragile. However the financial institutions are interconnected and the bankruptcy of one financial institution will impact other banks. The bankruptcy of banks, some of them well respected in the market, had a ripple effect on other interconnected financial institutions world wide.

3.7.3. Impact of the Global Economic Crisis

The current global economic crisis has had only indirect impact on the Cambodian economy. Cambodia's commercial banks do not have direct exposure to the subprime loans. Cambodia's banking sector, as a whole remains resilient; the impact is limited to small banks. Although the foreign currency deposits experienced a slight reduction, credit to the private sector continues to grow, drawing on the excess liquidity of the banking sector.

However there are indirect impacts mostly on the real sector of the economy. Cambodia's GDP growth fell from 10.2 % in 2007 to 6.7 % in 2008 and is projected at 2.1 % in 2009. The indirect impact will be felt at the following levels:

3.7.3.1. Indirect Impact on Banks

The current global financial crisis will have only limited indirect impact, if any, on Cambodian banks. The NBC recently authorized financially sound commercial banks with excess liquidity to invest some of their assets abroad. The foreign assets of the banking system are invested abroad only in secure financial instruments under the close supervision of NBC. Therefore, the exposure to the crisis could only be through the channel of the impact on the foreign operations of some of the international commercial banks based in Cambodia. So far there is no information that any of them has been grievously affected by the subprime crisis.

Cambodia's banking system was sound, well capitalized and highly liquid before the crisis. The capital adequacy ratio (net assets or net worth/ weighted assets according to the degree of risks) was 26% in 2007, well above the regulatory minimum of 15%. The liquidity ratio (liquid assets/ total assets) was 50% in 2007. Non-performing loans (NPLs) declined from 9.5% in 2006 to 3.4% in 2007 and further to 2.6% in June 2008.

After the onset of the crisis, the real estate market has slowed down, but there was no sign of hard landing or imprudent lending to the sector by banks. However, Cambodia's slowing economy has weakened banks' balance sheets and stalled new lending. Although Cambodian banks are not exposed to toxic assets abroad, liquidity conditions tightened at the onset of the global financial crisis. In 2008 liquidity dropped by 1.6% in September, 5.4% in October and 2.7% in November; foreign currency deposits dropped by 2.2 5.4% and 3.3% correspondingly. However credit to the private sector continues to grow. It rose by 1.6% in September 2008 and 1.7% in October 2008, but declined by 0.6% in November 2008. But liquidity began improving in early 2009. Foreign currency deposits (FCDs) rose 21% in the first 8 months of 2009, partly due to high deposit interest rates. However, credit growth has fallen sharply, from 55% in 2008 to 4% in August 2009.

The measures to improve the banking system include:

- Limiting commercial bank's exposure to some high risk sectors, especially the real-estate sector, by introducing a 15% ceiling for loans to real estate trading;
- Increasing the minimum capital from 50 billion riels (\$13 million) to 150 billion riels (\$36.5 million) for commercial banks, unless they have as a shareholder of another bank or financial institution with an investment grade rating from a reputable rating agency; and increasing minimum capital to 30 billion riels (\$7.3 million) for specialized banks;
- Reducing reserve requirements for commercial banks from 16% to 12% to increase liquidity of the banking system.

Other measures under consideration include:

- Improving classification of loans in order to strengthen supervision and limit exposure to the risky sectors, especially loans exceeding USD100,000;
- Tightening the valuation of collateral in bank lending;
- Strengthening further the banking system through rigorous implementation of on-site and off-site inspections and supervision;
- Strengthening bank credit information system;
- Strengthening the system for implementing reserve requirements.
- Drafting a Prakas on internal auditing of banks;
- Drafting a Prakas on external auditing of banks;
- Drafting a Prakas on Corporate Governance of Bank and Financial Institutions;
- Drafting a Prakas on Classification of Provisions of Assets held by Banks and Financial Institutions.

The monetary stance is broadly appropriate, further easing – specifically a reduction in the reserve requirement – is neither warranted based on monetary conditions nor desirable from a prudential perspective. Credit growth is expected to rebound in 2010 to 17 percent (y/y), compared to 3 ½ percent in 2009.

Progress continues to be made in improving liquidity management, but the conduct of monetary policy is hampered by the lack of market-based instruments, weak interbank activity, and high level of dollarization, which limits the establishment of operating and intermediate targets. Regulations on issuing securitized instruments and on a repo master agreement is expected to be finalized by end-2009. Issuance of new dollar-based instruments could provide collateral for more riel transactions between banks and ultimately pave the way for trading local currency securities.

However, effective monetary controls would require greater confidence in and use of the riel, as well as more flexible exchange rate arrangement. To this end, exchange market intervention will be limited to smoothing volatility, which would help protect foreign reserves, deepen the foreign exchange market, and facilitate external adjustment.

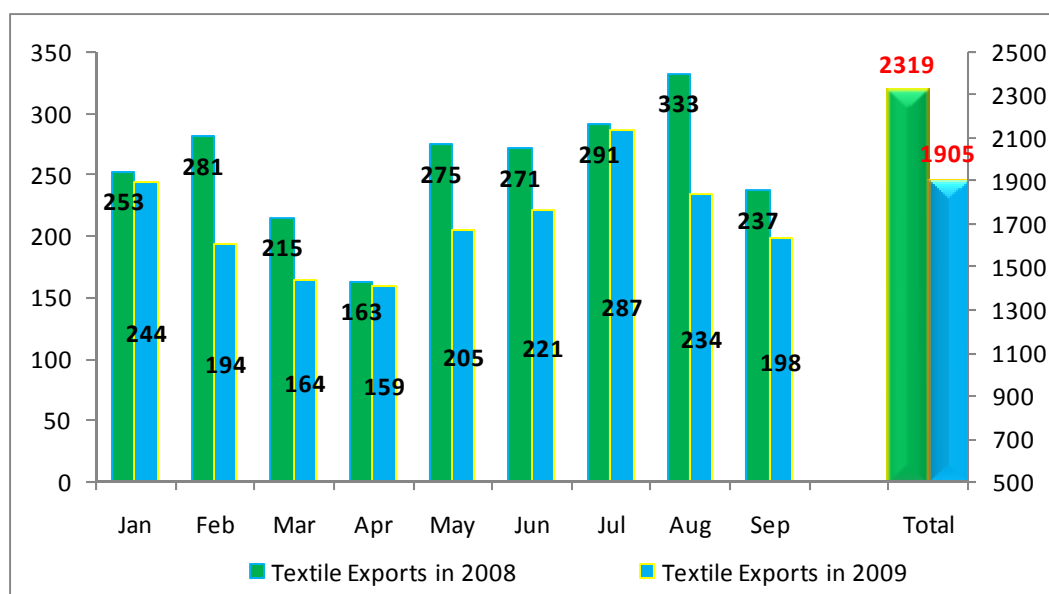
Banks' liquidity has improved, but their balance sheets have weakened. Credit risks have risen, as Nonperforming loans (NPLs) are rising. NPLs rose to 5 ¼ percent at June 2009 from 3 ¾ percent in December 2008. The weakened balance sheets were due to weak risk management, earlier supervisory lapses and excessive credit growth, exacerbated by growth slowdown and property price collapse. Negative interest carry and low demand for credit are squeezing profits, making it difficult for banks to grow out of these problems.

The NBC has taken measured steps to deal with problem banks. Since early 2009, the NBC has conducted a set of prioritized onsite inspections and issued supervisory letters to non-compliant banks and development of corrective action plans to address a range of operational and financial deficiencies. Banks are also being urged to advance compliance with new minimum capital requirements ahead of the end-2010 deadline. Their related party activities are being more scrutinized and internal governance is being strengthened, including through introduction of credit committees and use of more independent directors. Strict enforcement of newly-introduced loan classification, provisioning standards and recognition of loan losses, implementation of corrective action plans and development of a comprehensive bank restructuring framework are critical to strengthening banking system solvency.

3.7.3.2. Indirect Impact on Garment Exports

In a crisis consumers cut back on consumption and build up savings to meet the difficult time ahead. The drop in consumption would affect imports from third countries and would lead to a decline in their GDP in turn. Cambodia exports around 70% of garment products to the US which is in recession. However, it is possible that consumers may shift from luxury goods to cheaper substitutes like Cambodian garments. On the whole, till the US and Europe recover, the prospects of resumption of high growth in garment exports are dim.

Figure 3.22. Textile Exports: 2008 vs. 2009 (in million USD)



Source: Direction General of Customs and Excises, MEF

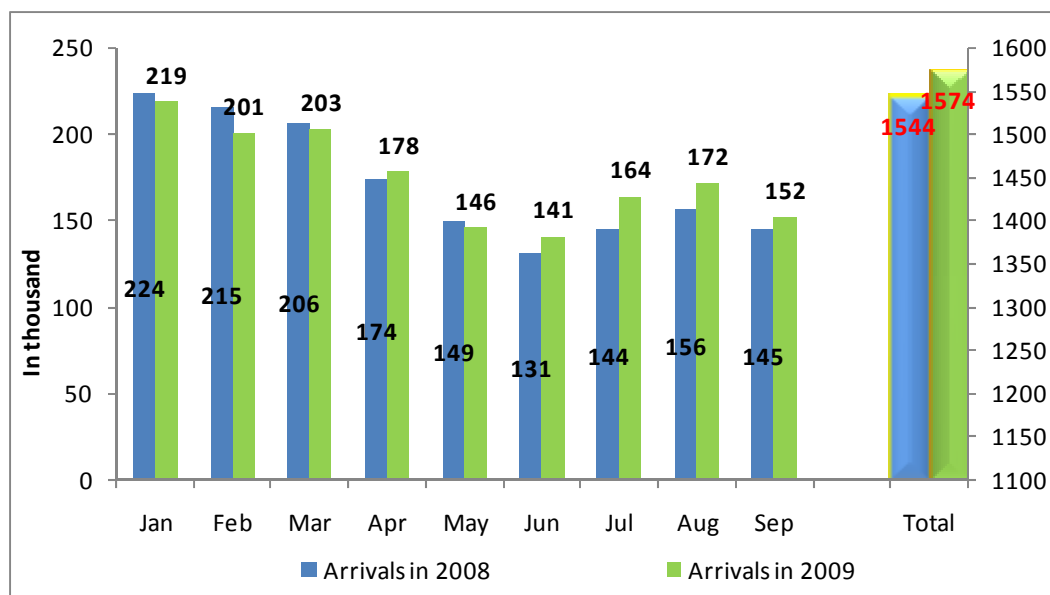
During the first 9 months of 2009, exports of garment under GSP/MFN scheme declined by 17.9% to US\$1.9 billion, mainly due to drastic decline in garment exports to the United State (-26.1%). Garment exports to the European Union dropped only by 5.3%, while exports to Japan increased by 51.6%. Garment workers reduced from 351,340 in January 2008 to 278,398 workers in October 2009, i.e. some 72,942 workers were laid off. At the same time, the number of factories dropped from 293 to 243.

3.7.3.3. Indirect Impact on Tourism

People would prefer to put off their holidays during hard times. Job losses and gloomy outlook would be less favorable for vacations. However tourist arrivals in 2008 increased over 2007 by 5%. This is deceptive since in the fourth quarter of 2008, tourist arrivals declined by about 5% over the same period of 2007. The full impact of tourism downturn has been felt in 2009.

Although the total number of tourist arrivals increased by 2% to 1.57 million during the first 9 months, compared to the same period last year, especially due to the increase in land arrivals from the region, the high end tourism is down significantly, with air arrivals off 12.96% in the first 9 months, reflecting deteriorating financial conditions of high end hotels. Angkor Vat revenues are about 30% lower than 2008.

Figure 3.23. Tourist arrivals in Cambodia: 2008 vs. 2009



Source: Ministry of Tourism

3.7.3.4. Indirect Impact on Construction

The real estate market in Cambodia is stagnant since June 2008. The central bank policy is to limit credit exposure to the real estate market to cool down the market. Moreover, investors are cautious, as real estate crisis is in full swing in the US and Viet Nam. However there is no indication that banks have lent imprudently to the real estate market. Construction activity continues to be slow in 2009, reflecting a decline in foreign investment flows and cautious bank lending.

New township, the construction of the Special Economic Zone and tourism development projects, such as the Koh Puos Development Project, the Camco City Project, the Boeung Snor Development Project, the Sunway City Project were put to standstill. However, some real estate developers continue their projects, albeit at a slower pace and reduced scale. The slowdown in privately-funded projects were partly offset by public work projects, such as road and bridge construction. In 2009, the construction activities estimated to contract by -2.6%.

3.7.4. Outlook for 2009-2010

The global crisis is affecting Cambodia's economy, with growth in 2009 projected at within a range of 0% and -1% (IMF projected at -2¾ percent). Three of the four main drivers of

growth – garments, tourism and construction – have registered contractions, while signs of bottoming out began in mid-2009. Private investment was also hit. 40,000 jobs in garment factories have been lost.

Growth is projected to pick up to 4¼ percent in 2010, but risks are on the downside. Export-related activity is vulnerable given the narrow base, high concentration of garments destined for the US market, and continued weak prospects for US retail sales. Rising productivity in agriculture could lead growth higher.

Moderate growth is expected over the medium term, stabilizing at 8-9% per year.

Two important downside risks threaten Cambodia's economic prospects:

- Uncertainty as to the impact on the economy of the global economic crisis on garment exports and the flu on tourism; and
- The pace of economic recovery in developed countries.

Accelerating economic growth is crucial for the improvement of social indicators and broadening the fiscal base to generate enough revenue to fund the social sectors. Growth will have to be achieved from the diversification of production sources and promoting investment in new manufacturing activities, the agro-industry, and tourism sector development, which have very important multiplier effects on the rest of the economy.

The speeding up of growth of the rural economy will have a direct impact on poverty reduction. The potential of agriculture to create jobs and incomes in the rural areas must be fully explored by increasing investment in irrigation and agricultural extension.

The government is committed to maintaining a stable macroeconomic environment. The medium-term goals of the macroeconomic framework include the following: achieve an annual economic growth rate of 6-7%, maintain a rate of inflation below 5%, limit foreign debt to a level compatible with flows of concessional financing and direct foreign investment, and increase gross exchange reserves to a level equivalent to approximately 3 months of imports.

3.8. 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 % per annum over the next several years, but growth will likely accelerate after oil production commences on a commercial scale expected 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., Viet Nam’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 a 7% growth per annum in non-oil GDP. 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 rural infrastructure increases. The current account deficit in the balance of payments is projected to decline in the medium term. Inflation is targeted to fall to about 3 % 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 will be described in later chapters. 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 structural inequalities and prevent them from taking root. The Rectangular Strategy seeks to rectify the widening rift between the rich and the poor is trend, by emphasizing rural development.

The government has recommitted itself to the enhancement and better implementation of pro-poor growth policies in its fourth mandate. 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 examine the possibility to establish social health insurance and safety nets, particularly for those who are the most vulnerable.

Provide secure land tenure – ownership of land is the basis of wealth, especially in an agricultural society such as Cambodia: emerging patterns of land ownership will be the test to see whether Cambodia follows a path of shared growth in the future, or there would be a growing gap between rich and poor. The policy is to provide secure land tenure through expediting and extending titling to remoter, poorer areas where land disputes are more serious and allow poor landless families 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, such as under the current global economic crisis, 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. The potential loss of market share to more competitive countries could be painful for Cambodia in the post-crisis environment. 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.

Strengthening Cambodia's competitiveness in the post-crisis environment. The resumption of high growth requires more concerted actions aimed at strengthening competitiveness and improving business climate in order to diversify the production base. The efforts toward full WTO compliance and lowering the cost of doing business are ongoing. However, the number of required laws, amendments and regulations is extensive. The implementation of post-clearance audits and simplified valuation and cargo processing procedures has reduced time required for customs clearance. Reforms should aim at improving basic infrastructure and enhancing labor skills, as well as expanding market access through trade commitments and reducing the cost of doing business, including through streamlining investment approvals and customs procedures.

Employment generation will be of high priority. The traditional role of agriculture as the main source of new employment has diminished. At the present, the role of the garment industry as a source of new 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 conditions.



Performance Assessment of Key Sectors

Financial Sector

The government's financial sector reform program is guided by the roadmap for financial sector development 2001-2010 and its update, the Finance Sector Development Plan for 2006-2015. The objective is to develop a reliable financial system based on market mechanisms, allowing for greater mobilization of financial resources and sustainable economic growth. In the medium term Cambodia must adopt a financial system characterized by:

- a competitive, integrated, and efficient banking system, effectively regulated and supervised, permitting the mobilization of savings to finance private sector growth, with a reliable payment system.
- a viable system of microcredit capable of improving access to credit for the poor, in order to increase rural incomes and reduce poverty.
- an insurance sector that will provide businesses and individuals with protection against losses and a pension fund system enabling the funding of long-term non speculative investments in the real estate sector.
- diversification of products and financial and non-banking institutions with a view to creating a balanced financial structure, further strengthen the financial market, and promote competition. This includes leasing, financial market intermediaries, and development financing institutions.
- a money market allowing efficient management of liquidities among banks, companies, and individuals.
- an efficient, transparent financial market with a critical mass of issuers with the ability to mobilize funds for long-term investment, and
- a legal and accounting framework based on the rule of law in commercial and financial transactions, while ensuring transparency, accountability, and predictability.



Chapter 4

Banking

The degree of development of the financial sector is a sound indicator of long-term economic growth. Jalian and Kirpatrick (2005) showed that even for developing countries, improved financial systems speed up the pace of per capita productivity and production growth as they channel the resources of society toward fruitful activities that translate into productivity gains.

Rioja and Valev (2004) point out that the intensification of financial intermediation will undoubtedly have an impact on growth if banks reach a certain level of development measured by private credit/GDP ratio of at least 14%.

There is a strong correlation between a healthy financial sector and economic growth due to the positive effects the former has on private savings and resource allocation. The State has a major role to play in encouraging the development of institutions involved in long-term financing, specialized institutions, and supporting instruments suited to particular types of needs. The measures expected from the State largely involve improving the regulatory and legal framework (competition, prudential rules, tax system, interest rates, credit and recovery law, etc.).

Nevertheless, stringent regulations often hobble development of the banking system in developing countries. Financial repression (Agénor and Montiel, 1999) arises when banks are required to maintain high ratios of mandatory liquidity and reserves. When combined with legal and institutional gaps, such controls are considered as a major cause of underdevelopment in the financial sector. These gaps involve: (i) information on borrowers; (ii) exercise of property rights; and (iii) guarantees and land registry.

4.1. Background

Low public confidence in the banking sector and its limited role in financial intermediation have resulted from the civil war and political upheaval that prevailed over the last three decades. After achieving independence in 1953, Cambodia's economy showed robust growth for a decade until the introduction of a planned economy policy in the 1960s, with the banking and foreign trade sector being nationalized in 1963.

The civil war that broke out on March 18, 1970 effectively annihilated economic recovery of the country. The takeover of power by the Khmer Rouge on April 17, 1975 and the genocide that followed with the goal of setting up a non-monetized agrarian society, led to the total abolition of private property, currency, banks, and markets.

Subsequent to the fall of the Khmer Rouge on April 7, 1979, the People's Republic of Kampuchea reestablished the central bank (NBC). A unique, State-run banking system that fulfilled the role of central bank and the activities of commercial banks was set up based on a socialist model. The economy of Cambodia was put under centralized management.

In 1989, the government undertook far-reaching economic reforms in order to move from a planned economy to a market economy. These reforms focused on reestablishing private property, abolishing price control, ensuring macroeconomic stability, and reducing inflation. This economic liberalization also purported to reduce State controls and open the country up to foreign investment. Furthermore, the government launched a privatization process and took steps to integrate Cambodia's economy into the economy of its regional partners in particular and into the global economy in general. The decision makers felt that such changes would promote economic growth, productivity, and job creation.

In this context, Cambodia undertook reforms of the banking system in order to separate the commercial bank functions from the activities of the NBC and open up the banking sector to foreign competition. With this sweeping structural change, by the late 1980s, Cambodia had a financial system made up of a few commercial banks mainly geared to providing credit to private businesses. These banks were established as joint ventures with the NBC.

4.1.1. Banking Reform Prior to the Asian Financial Crisis

After the 1993 elections, the RGC was formed in the framework of a parliamentary democracy. Alongside the government undertook in-depth economic reforms, referred to as first-generation reforms, with a view to maintaining economic and monetary stability, encouraging economic liberalization, which included a reduction of the State's role in market activities, conducting a prudent policy with regard to public finance, and promoting private enterprise. The RGC gave priority to the creation of a stable environment and a climate of trust, in order to foster the growth of private savings, foreign investments, and official development assistance.

These broad reforms were based on a two-pronged approach: stabilization measures and structural reforms which are also referred to as first- and second-generation reforms. The former focus on short-term macroeconomic outcomes, while the latter have a more structural or institutional character.

Progress was made in the implementation of structural reforms: a two-tier banking system was set up and large denomination bank notes were put into circulation in order to facilitate transactions. Cambodia made a leap forward to reestablish political and economic stability and integrate with the international community. The NBC conducted a flexible foreign exchange policy through the use of market mechanisms, adjusting and aligning the official exchange rate to that of the markets, within a prescribed range.

During the 1990s, the government endeavored to stimulate development through an extensive liberalization of the banking system. The State established a number of semipublic companies with foreign investors, but the commercial banks remained dominated by foreign capital. Starting in 1993, major reforms were set in motion. This was accompanied by a partial liberalization of interest rates and the allocation of credit and creation of a money market, with the intention of encouraging the development of a less administered financial system, one that would be more flexible and competitive.

The reforms did encourage macroeconomic stability, development of trade, and investment flows, along with recovery of growth. Real annual growth reached approximately 7% during 1993-1996. Prudent monetary and fiscal policy resulted in scaling down of inflation from 140% average rate in 1990-92 to 7.7% in 1995-1997. Per capita income grew from about US\$150 in 1991 to US\$281 in 1997.

The number of banks rose and reached 30 by late 1994. This growth was made possible through a relatively relaxed licensing policy with a very low minimum capital requirement. As the number of commercial banks multiplied, this put great pressure on the NBC's regulatory and supervisory capacity, resulting in the latter putting a moratorium on the licensing of new banks in 1994.

In 1996, the NBC strengthened prudential measures by making it mandatory for banks to produce external audit reports and certified financial statements and put in place an onsite system of control. Having so many banks in a limited realm of activities made the banking system vulnerable; all of the banks were operating with a profit margin that was far too low.

4.1.2. Impact of the Financial Crisis on Cambodia's Banking System

Cambodia was hit by the Asian financial crisis that overtook Asia in 1997-1998. Cambodia depended on the region for its export markets, as well as for an abundant source of foreign savings and fiscal revenue generated from foreign trade. However it became vulnerable to a slowdown in regional activity in the aftermath of the crisis. (Okonjo-Iweala et al, 1999).

Structural reforms had also lost steam with the persistence of political uncertainty in the period preceding the crisis. This hindered the mobilization of tax revenues and the proper management of public expenditures. The economy was therefore increasingly vulnerable to external shocks. However, the extensive dollarization of the Cambodian economy did mitigate the impact of the crisis on the monetary and banking sector.

As they were struck by the crisis in their home operations, branches of foreign banks experienced difficulties in maintaining the minimum capital required by law. The lack of opportunity for bank loans and the high-risk environment further penalized these banks. Meanwhile, confidence in the banking sector reached its lowest level, since a number of banks were on the verge of insolvency.

The Asian financial crisis was an eye opener for the reform of the Cambodian banking sector. Much remained to be done to strengthen the prudential regulatory framework and surveillance structures. As a fall out of the crisis, the RGC realized the necessity of having strong institutional capacity, a reliable legal framework, sound administration of public affairs, and a solid foundation for the regulation and supervision of banks—all crucial for the development of a robust financial system.

4.2. Restructuring of the Banking System

In an attempt to fill in the regulatory gaps, the NBC undertook a series of legislative, regulatory, and budgetary measures in order to improve financial transparency and thereby improve financial stability. The legal framework for the banking sector could be summarized as follows:

- Law on the organization and operation of the National Bank of Cambodia, 1996.
- Law on banking and financial institutions, 1999.
- Law on foreign exchange, 1997.
- Law on payment systems, 2005.

The law on banking and financial institutions introduced the principle of the universal or full-service bank. The provisions of this law are in tune with the objective of strengthening transparency and building accountability. To improve the quality of financial statements and obtain greater transparency, the law makes a number of additional conditions mandatory and bolsters the obligation for information disclosure.

Credit institutions are to be incorporated in the form of joint stock companies under commercial law or as non-commercial, mutual, or cooperative companies, under a special legal status (Article 11). The law firmed up the rules applicable to banking licenses and at the same time raised the solvency ratio. The law gives the NBC the power to exercise administrative supervision over the banking system and its related activities, such as the money market, the system of interbank regulations, and financial intermediation. In this context, the NBC is vested with regulatory power for enforcement of this law; in particular, it is empowered to set:

- The minimum capital level and nature of assets allowed for submission.
- The various ratios or prudential coefficients regarding, in particular, liquidity, solvency, distribution of risks, and exposure to foreign exchange risk or market fluctuations.
- Methods for evaluating book balances.
- Conditions under which shares in the capital of the targeted institutions or financial companies can be taken out.
- Criteria for accounts that should be considered as doubtful and the provisioning thereof.
- The chart of accounts for banks and associated accounting norms, norms for consolidation, as well as rules governing the publication of accounting records.
- Organization of interbank services, including such things as setting up clearinghouses for information, risks, or overdue obligations.

It makes it mandatory for banks to have a board of directors. This new governance concept is based on separation between the management arm, the executive function, and the control function, viz. the board of directors. The purpose is to reinforce the control function and introduce greater transparency in bank management.

It also made it mandatory for banks to obtain external audit reports and certified financial statements. Under the law, the authority exercising administrative supervision may ask for any information on the activity and financial situation of the targeted institutions.

When serious threats are sensed regarding the solvency of a credit institution, the administrative authority is empowered to appoint an interim administrator whose main task is to perform an assessment of the concerned institution and determine if it is solvent or

not, while managing its current affairs. If, subsequently even if the institution is considered solvent, but unable within three months, to comply with the prudential norms regarding net own-source assets and liquidity, the license may be revoked and the interim administration turned into a compulsory liquidation.

As for anti-money laundering measures, the law contains provisions making it mandatory for banks to take all possible measures to identify precisely each of their customers and, beyond a certain threshold to be defined by the administrative authority, flag any transactions that may go through them (Article 51). But further measures may be needed to strengthen the legal framework to fight money laundering and funding of terrorism.

4.2.1. Recapitalization and Increased Transparency

The RGC realizes that the existence of a sound financial system is crucial to sustain growth and job creation, as well as to provide the economy with the resources to be more resistant to both internal and external shocks. Bank restructuring is a crucial strategy to strengthen the banking system. Bank restructuring is based on two main pillars: First, steps should be taken to consolidate institutions and restore their financial health, which means putting in place new norms for management and adopting action plans making it possible for them to achieve internationally comparable prudential ratios. Second, focus must be placed on the bank's efficiency, which includes all measures having to do with modernizing the banking apparatus.

The law on banking and financial institutions provides the fundamental framework for banking operations and supervision by the NBC of commercial bank activities including: (i) identification of the banks and scope of application of banking operations; (ii) defining the powers of the NBC in supervising and regulating banks, including the power to impose disciplinary measures and penalties in the case of banks that do not comply with the prudential requirements; (iii) prescribing the obligation of banks to ensure the integrity of their management board; and (iv) detailing the procedures for liquidating commercial banks.

Action to restore health to the banking system was backed up by the effort undertaken by the NBC with regard to capitalization, transparency of financial transactions, and tightening of control over the banking sector. These structural reforms were accompanied by recapitalization of commercial banks requiring a minimum capital of US\$12.5 million. This raises a barrier to entry and limits the number of banks which may be allowed in Cambodia.

The law empowers the NBC to again issue operating licenses to commercial banks. By late 1999, the number of commercial banks had reached 31, including two State banks, 22 private commercial banks and seven branches of foreign banks. But these banks

accumulated many impaired debt accounts and were not providing investment loans for primary and secondary sector activities. Indeed, difficulties in gaining access to credit were among the major challenges encountered by the private sector.

Additionally, private banks differed in their intermediation costs and the quality of credit. Banks that incurred heavy intermediation costs were able to coexist with other more efficient institutions. Due to the risk of bank runs to which they were constantly exposed the weaker small- and medium-sized banks were a threat to the stability of the entire banking system.

Starting in 2000, major reforms were implemented in order to restructure the banking sector, increase financial transaction transparency, and strengthen the financial system. A system of offsite auditing was put in place: Report on Banking Performance and Cambodian Offsite Bank Reporting for Prompt Corrective Action (COBRA). The Department of Bank Supervision under the NBC conducts onsite and offsite inspections every six months based on the Basel 1 Principles and the Banking Disclosure Rules. Either a full or partial audit is done on all banks. Where a full onsite audit takes place, the NBC uses the CAMEL methodology. The NBC has instituted a new chart of accounts and a standardized reporting form in order to improve the quality of the control mechanism.

The NBC has placed commercial banks into three categories based on the CAMEL rating system: (i) reliable banks that are fully capitalized and are not in need of restructuring; (ii) banks that are potentially weak, but under obligation to take corrective measures; and (iii) unreliable banks. Commercial banks that were put in the second category were ordered to prepare a recovery plan for approval by the NBC, including the time line to comply with the minimum capital of US\$13 million.

In keeping with the new law on financial institutions, all banks were under obligation to submit a license renewal application by May 31, 2000. After reviewing their files, the NBC renewed the licenses of 14 commercial banks and four specialized banks.

This review also disclosed that a large number of banks were not viable and were therefore liquidated. The National Bank of Cambodia (NBC) appointed interim administrators to avoid the sale of assets belonging to the institutions. The banking system was restructured by April 2002 and resulted in the liquidation of 15 non-viable banks. Two branches of foreign banks, Crédit Agricole and Standard Chartered Bank, also closed their doors.

For implementing monetary policy efficiently NBC instituted a set of structural measures to reinforce the efficiency and stability of the Cambodian financial system. Computerization of the bank's chart of accounts moved ahead and by late 2003, the NBC set up a

mechanism to fight money laundering. The NBC also adopted the International Accounting Standards (IAS) as the basis for preparation of financial statements by banks.

The NBC undertook the following prudential measures:

- Increase the transparency, governance, and competitiveness of the sector by requiring banks to make loans only to creditworthy customers.
- Speed up implementation of the new information system for conveyance of bank data and undertake surveillance based on risks as an early warning mechanism.
- Improve regulation of transactions conducted by credit institutions by strengthening accounting/bookkeeping regulations, management standards, and conditions for practice of the profession.
- Adopt prudential standards at the international level.
- Improve credit assessments and fine-tune loan approval procedures.

The restructuring was successful in consolidating the banking system. Towards the end of the restructuring process, the banking system was made up of the National Bank of Cambodia, with its 19 provincial branches, 15 universal commercial banks, and six specialized banks.

Prudential standards have been upgraded under the restructuring process. The banking landscape now looks relatively robust. Banks in general are complying with the prudential ratios as well as with standards governing foreign exchange exposure and internal auditing. Recapitalization of the banks has been completed. The microfinance sector has likewise been strengthened.

4.2.2. Strengthening of Bank Supervision

The NBC undertook measures to increase its surveillance capacities in bank auditing through the improvement of onsite and offsite audits of the major public banks and ensuring stringent adherence to the prudential rules. The NBC's supervision capacity was strengthened on two fronts: (i) improvement of prudential regulations; and (ii) strengthening of the NBC's supervisory capacity. The law on the organization and operation of the National Bank of Cambodia (1996) and the law on banking and financial institutions (1999) established a legal framework for bank supervision. A series of circulars was adopted by the NBC in 2000 as a means of bolstering the prudential mechanism,

including circulars on solvency, minimum capital, liquidity, strong exposure to risks, classification of debt accounts and provisions, restriction on loans granted to related parties, and acquisition of fixed assets. The NBC also enacted regulations governing prompt corrective actions, disciplinary measures to be taken against insufficiently capitalized banks, and procedures for offsite and onsite audits.

In February 2002, the NBC took measures to enforce prudential regulations on microfinance institutions. A turnover amount was set, beyond which a microfinance institution must be licensed by the NBC to carry out activities in Cambodia.

4.2.3. Privatization of the Foreign Trade Bank

Restructuring of the banking system picked up momentum with the privatization of the Foreign Trade Bank (FTB), which had been established in the 1980s as a department of the NBC in charge of foreign financial transactions. In order to set up a two-tier banking system, the FTB was separated from the NBC in August 2000. The FTB was to establish its board of directors and capitalize so as to operate as a State bank. In June 2001, the FTB was capitalized to US\$13 million, thereby complying with the prudential requirement for a commercial multiservice bank.

Besides, in order to separate out the commercial functions of the NBC, the Ministry of Economy and Finance acquired 80% of the shares of the FTB in April 2002, thereby becoming the majority shareholder of this bank. In January 2003, the government invited bids to find a strategic partner for privatization of the FTB. The NBC was subsequently privatized, with the government holding only minority shares.

4.3. Current Architecture of Cambodia's Banking System

4.3.1. Key Features of Cambodia's Banking System

Cambodia's financial sector is vibrant, competitive and rapidly expanding. The rapid increase in deposits in the commercial banks and sub sectors (note Table 4.1) attests to growing public confidence in the sector due to the transparency of financial sector policies and the level playing field for investors in the sector. However it is still nascent and lacks many features of a well developed financial infrastructure.

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 have declined. The microfinance loan interest rate has decreased to 36% 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 amount lent by both commercial banks and the microfinance institutions.

Cambodia's banking system comprises: (as of December 2008)

- A central bank (NBC) which is the regulator of the banking sector.
- 24 commercial banks owned by private sector investors, including 21 commercial banks established in Cambodia and three foreign branch banks.
- Six specialized banks, including one State-owned bank.
- Two representative offices of foreign banks, Vietnam Bank for Agriculture and Rural Development and Standard Chartered Bank.
- 18 licensed Micro-Finance Institutions (MFIs).
- 21 NBC provincial branches;
- 26 registered micro-finance NGOs and around 60 unregistered NGOs; and
- 4,320 registered money changers.

The financial system in Cambodia has developed rapidly with active participation from the private sector. Such development possible after the country gained political and economic stability, and after a legal and regulatory framework which was supportive to the functioning and expansion of the financial sector was put in place.

The banks are generally in good condition in 2008, with solvency ratio of 28% compared to 24% in 2007, 13 percentage points higher than the minimum level of 15% required by the Central Bank. The liquidity ratio dropped from 104% in 2007 to 81% in 2008. The non-performing loan ratio was 3.7%, compared to 3.4% and 9.9% in 2007 and 2006, respectively. Aggregated assets in the banking system increased by 26%. Compared to 2007, total loans outstanding provided by banking and financial institutions increased from 6,336 billion riel to 9,832 billion riel (US\$2.41 billion), or by 55%. Over the same period, total deposits of residents and non resident increased from 9,922 billion riel to 10,287 billion riel (US\$2.52 billion), or 3.7%. In the third quarter of 2008, the pace of growth of customer deposits slowed remarkably compared to the previous year, which could be seen as a result of the global economic crisis.

In 2008, microfinance sector grew rapidly. MFIs and rural credit operators provided loans with an outstanding amount of 1,130 billion riel (US\$274 million) to some 852,090 borrowers, an increase by 81% in terms of volume and 36% in terms of creditors compared to the previous year. Meanwhile, deposit-taking MFIs and rural credit operators collected deposits amounting to 22 billion riel (US\$5.4 million) from 155,291 depositors, an increase by 7% and 5%, respectively, compared to the same period of 2007. The solvency ratio for MFIs remained at 20%, higher than the prudential limit of 15%. The ratio of NPLs was 1%. Such indicators show the increase in financial intermediation in the rural areas and the improved confidence of investors in rural finance in Cambodia resulting from economic and political stability.

NBC has also undertaken capacity building measures for a vigorous implementation of its various rules and regulations in cooperation with local and international institutions. The focus of such cooperation is provision of technical support including staff training assistance in reviewing and updating old or existing regulations or issuing new regulations by taking into consideration the experiences and good practices of other countries, especially the core principles of effective banking supervision.

Four local banks, including Canadia Bank Plc., Union Commercial Bank, Singapore Banking Corporation, and Mekong Bank, cooperated in 2008 to introduce the Easy Cash and e-banking service in the market in order to facilitate cash withdrawals and electronic payments. As of end of 2008, there were 313 automatic teller machines functioning throughout the country. This innovation is the outcome of a healthy competitive environment actively encouraged by the NBC.

The Credit Information Sharing System (CIS), which is currently being used by banking institutions to share credit information on defaulters has been undergoing technical improvements. It is expected that these improvements will enable lenders to dispense faster credit to blemish-free customers. NBC has also signed a memorandum of understanding with the IFC to initiate a study on the functioning of the current credit information system and another feasibility study on private credit bureaus in Cambodia.

Cambodia's banking system is characterized by:

- Strong dollarization and high liquidity due to the lack of a national payment system and financial services outside of urban areas.

Table 4.1. Key indicators of the financial sector

	2000	2001	2002	2003	2004	2005	2006	2007
Real GDP (%)	8.8	8.1	6.6	8.5	10.3	13.3	10.8	10.2
Agriculture	35.9	34.3	31.1	32.0	29.4	30.7	30.1	29.7
Industry	21.9	22.3	24.3	25.0	25.6	25.0	26.2	24.9
Service	37.1	38.4	39.3	38.2	39.3	39.1	38.7	38.5
Inflation (yearly average)	(0.8)	(0.9)	(0.1)	1.2	3.9	5.8	4.7	5.8
Interest rate (dollar)								
- on savings deposits	2.3	1.6	1.5	1.3	0.9	0.9	1.0	1.0
- on time deposits	3.7	2.7	2.8	2.6	2.4	2.4	3.3	4.9
- on loans	17.4	15.0	18.6	18.2	17.3	17.3	16.2	16.0
Broad money (%)								
M2	26.9	20.4	31.1	15.3	30.0	16.1	38.2	62.9
Velocity	7.9	7.7	6.4	6.0	5.4	5.4	4.8	3.1
(PIB/M2)	12.6	13.0	15.6	16.5	18.6	18.7	20.8	32.3
Credit to the private sector and deposits								
Loans	6.4	6.0	6.3	7.3	8.6	9.4	12.3	18.3
Deposits	9.5	10.4	12.7	13.3	15.2	14.8	18.2	26.8
Ratio loans/ deposits	67.3	57.6	49.9	55.2	56.5	64.0	67.9	63.9
Ratio loans/ assets						42.9	45.6	46.1
Commercial banks								
Number of loans			86,757	105,347	123,937	145,161	164,931	197,337
Value of loans (in millions dollars)			269.3	360.7	482.7	598.4	882.3	2,480.0
NPL		8.0	15.00	14.00	10.00	8.00	9.80	3.4
Microfinance								
Number of loans		409,963	328,295	265,044	322,056	366,962	471,009	624,089
Value of loans (in millions dollars)		35.9	51.3	32.6	40.8	49.2	92.2	160.4

Source: MEF, NBC

- The lack of a national payment system means that commercial banks have to make local currency transfers through their banking networks or their accounts with the NBC. International transfers are done through correspondent banks abroad or through their accounts with the NBC.
- Banking networks are restricted to urban zones.
- Financial intermediation is rapidly growing, but still in its infancy.
- The lack of an efficient interbank or foreign exchange market and the lack of foreign exchange market instruments.
- Developing legal infrastructure.

Cambodia's banking system occupies a significant place in Cambodia's economy. Reflecting the growing importance of the financial sector in the economy, the weight of financial intermediation in the GDP was increased from 0.3% in 1993 to 1.3% in 2008. In the last decade, the weight of the banking sector accounted for 1.1% of the GDP on average.

4.3.2. National Bank of Cambodia

The National Bank of Cambodia is the administrative authority for banks in the country. Its principal mission is that of defining and implementing monetary policy for maintaining macroeconomic stability and promoting economic growth. It acts as a clearinghouse and information center. Its principal activities include:

- Preparation and implementation of the monetary policy in consultation with the government.
- Preparation and implementation of the foreign exchange and exchange rate management policy.
- Surveillance of money and financial markets.
- Surveillance of payment systems and improvement of the efficiency of interbank settlements.
- Provision of specific services to the National Treasury , and
- Implementation of the interest rate policy.

4.3.2.1. Banking Control and Financial Stability

The National Bank of Cambodia (NBC) is responsible for supervision of the banking sector through its Department of Bank Supervision. In the areas of banking control and financial stability, the NBC carries out the following tasks:

- Issue or withdraw licenses and permits to banking and financial institutions.
- Issue or withdraw licenses and permits necessary to institutions in the foreign exchange and securities markets, as well as dealers in precious stones and metals.
- Ensure compliance of these institutions with banking and financial regulations through off site and onsite auditing missions.

- Draft and implement legislation governing the banking and financial sector.
- Ensure the smooth operation and security of payment systems and systems for the settlement and clearing of financial instruments.
- Handle the printing of notes and minting of coins.

4.3.2.2. Management of Foreign Exchange Reserves

The NBC holds and manages the State's foreign exchange reserves in gold bullion and currency. It may also intervene in the foreign exchange market from time to time. Net foreign assets of the monetary institutions grew from US\$30 million in December 1993 to 1 billion by December 2003, then accelerated to US\$2.7 billion in December 2007, then declined to US\$2.5 billion in December 2008, due to the financial crisis.

Gross foreign reserve assets grew from US\$70 million in December 1993 to US\$2.1 billion in December 2008 because of the good performance of exports and foreign direct investment.

4.3.2.3. Provision of Statistics and Research

The NBC:

- Analyzes the economic and monetary environment of Cambodia.
- Prepares the balance of payments and foreign position of Cambodia.
- Prepares monetary and financial statistics.

4.3.2.4. Provision of Specific Services to the National Treasury

The NBC does the bookkeeping for the central account of the National Treasury under the single accounting system of the Treasury. The NBC is the exclusive depositor of the National Treasury. It records all deposits and all withdrawals and credits National Treasury revenues to the single Treasury account.

The NBC is empowered to provide temporary accommodation for a period not exceeding 3 months to the National Treasury at refinancing rates. The NBC does not provide financing either directly or indirectly to the government, particularly through the purchase of primary securities issued or guaranteed by the government or by public entities.

4.3.3. Universal Commercial Banks and Specialized Banks

Universal commercial banks carry out credit distribution activities to their customers and accept deposits on a market that is increasingly open and competitive. Most of the banks hold capital in excess of US\$13 million, the required minimum, which was increased to US\$36.5 million.

Specialized banks have been established for the purpose of medium and long-term loans based on their own-source funds and on internal or external loan resources. They do not receive deposits from residents. The minimum amount of capital for specialized banks has been set at US\$3.5 million, then increased to US\$7.3 million.

4.3.4. Bank Regulation and Supervision

Chapter XII of the law on banking and financial institutions stipulates that the central bank shall exercise administrative supervision over the banking system and its related activities. In this capacity, it issues licenses, is empowered to regulate enforcement of the above law, which enables it to set prudential parameters including: (i) the minimum capital level; (ii) the various prudential ratios or coefficients regarding liquidity, solvency, division of risks, and exposure to foreign exchange or market risk; and (iii) debts to be considered as impaired and their provisioning.

The consolidation of banks occurred during 2002-2006 aimed at strengthening the financial capacity and efficiency of the banking system. This is in keeping with the requirements of the prudential regulations expressed in three key norms, namely, solvency, liquidity, and separation of risks.

The Central Bank is empowered to require that banking and financial institutions maintain the mandatory level of currency reserves. These currency reserves are kept in the form of special funds or deposits in current accounts opened with the Central Bank.

4.3.4.1. Solvency

The ratio of risk cover or COOKE ratio has been set at 15% since 2005. Own-source funds of each bank must therefore account for 15% of its risk-weighted assets. This standard is crucial to guarantee the security of the banking system by ensuring that borrower defaults will not trigger a chain reaction of bank failures.

Box 4.1. Prudential rules

Minimum capital and net own-source funds of the banks

The minimum amount of capital that commercial banks must hold has been set at 150 billion riels (US\$36.5 million) and 30 billion riels (US\$7.3 million) for specialized banks.

Reserve requirement

Banks are required to maintain a reserve requirement, set at 12% of the minimum capital, with the National Bank of Cambodia (after the 2008 crisis).

Solvency ratio (Basel I)

It is mandatory for banks to comply at all times with a solvency ratio defined as being a minimum ratio between, first, the net worth, i.e. the excess of assets over the total of third-party loan liabilities, allowances for depreciation and justified provisions and second, their assets and signed commitments, assigned a blended weight depending on their degree of risk. The minimum solvency ratio has been set at 15% (since January 2005).

Ratio of large exposure

It is mandatory for banks to limit their loans to a single private person or corporation to a maximum of 10% of their net worth.

Liquidity ratio

Credit institutions must comply at all times with a liquidity ratio, equal to 50% at least (since January 2005) between, first, their net worth and, second, their short-term deposits.

Classification of assets and provisions

Assets are classified into five categories: normal, special mention, sub-standard, doubtful and loss. Sub-standard, doubtful, and loss require provisioning of amounts equal at least to 20%, 50% and 100%, respectively, of their amounts (Article 13 of Prakas of February 25, 2009 on Asset Classification and Provisioning in Banking and Financial Institution).

4.3.4.2. Liquidity

According to the February 17, 2000 Circular of NBC on the classification and provision of debts, banks must make a rating of their full assets, except for debts to the Central Bank. Each bank must rate its debts into four categories to the degree of risk of remaining unpaid (see Box 4.1 and Table 4.2):

4.3.4.3. Separation of risks

Three rules are to be followed, namely:

- ***Limitation of risks with regard to larger customers (Large exposure):*** A bank must limit lending to a person or legal entity to no less than 10% of its net worth

(Article 1 of Circular of November 3, 2006 regarding the limitation of risks towards large customers).

- **Limitation of risks with regard to any one beneficiary.** Must not exceed 25% of the net own-source funds of the bank (Article 2 of the Circular).
- **Limitation of risks incurred on parties related to a targeted institution (Related party loans)** (directors, administrators, shareholders, and statutory auditors): Banks must limit their loans to related parties to no more than 10% of net worth (Article 4 of Circular of October 15, 2001 on loans granted to dependent parties).

Table 4.2. Asset classification and provisioning

<i>Category</i>	<i>Payment</i>	<i>Financial status</i>
Normal	- Punctual -Provision: 1% of gross loan	- Very good financial condition.
Special mention	-30 days < loan past due < 90 days -Provision: 3% of gross loan	-Deteriorating of collateral or adverse trends in the borrower's financial position.
Sub-standard	-90 days < loan past due < 180 days -Provision: 20% of gross loan	-Repayment is not sufficient to service the debt; bank must look to secondary source such as collateral, sale of fixed assets, refinancing or additional capital injection.
Doubtful	-180 days < loan past due -Provision: 50% of gross loan	-Asset is not well secured and collection in full is improbable.
Loss	-360 days < loan past due -Provision: 100% of gross loan	-These are assets that must be written off, with a low recovery value;

Source: National Bank of Cambodia.

Banking and financial institutions must comply with the written instructions the Central Bank may send them, collectively or individually, regarding their statements of financial position, their commitments beyond their statements of financial position, and their operating account regarding the minimum capital, the minimum amount of net own-source funds of a banking or financial institution, prohibitions, restrictions, conditions, and other instructions.

Central Bank circulars provide mechanisms for more stringent internal controls. They require that banks strengthen their methods of risk assessment, apply credit scoring to the different borrowers, monitor their exposure, and assess the matching of their own-source capital with risks.

The prudential rules in force make it possible to take into account real estate and financial collateral in determining the amount of provisioning required to cover bad debts, in keeping with international standards. These standards have become more stringent and the NBC is exercising tighter control over banks. It looks into such matters as “risky loans,” real estate collateral, etc. For e.g. should a real estate bubble occur and burst, the banking system would be exposed to a serious systemic risk. Banking and financial institutions must convey to the NBC any information or data that the latter requests of them to carry out its functions on a periodical basis as prescribed by the regulations. The quality of regulations and bank control has improved, given the progress made in implementing the Basel 1 principles. Some of the most significant improvements include strengthening of credit risk monitoring by the Central Bank and booster training for inspectors.

4.4. Cambodian Banking system – an Analysis of Strengths and Weaknesses

Most commercial banks have established additional branches in other urban centres and are 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% in deposits annually. The Figure 4.2 below shows the rapid increase in bank credit and deposits during 1999-2009.

Underlying cash flows of the proposed project is 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 % 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 banks 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 a sharp 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 at the NBC. 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 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.

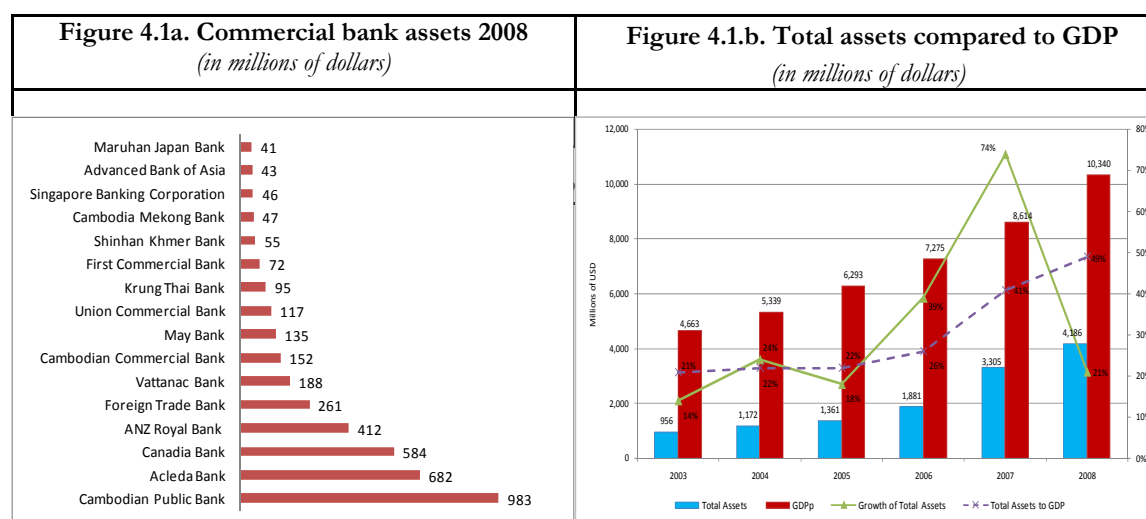
While there is growing support for the establishment of a money market, the volume of bonds and other negotiable short term instruments remains too small to support a sustainable money market in the near future. A capital market focused on the trading of company shares is more feasible as the principal 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.

Overall, Cambodia's banking system is well capitalized and highly liquid. The average solvency ratio of 28% comfortably exceeds the regulatory ratio of 15%. The liquidity ratio (liquid assets/ total assets) was equal 81%. Non-Performing Loans represented only 3.6% of total loans at end-2008. The profitability of the banking system has doubled, but drastically reduced now after the GFC.

4.4.1. Assets

The total assets of commercial banks grew rapidly during 2006-2009. The growth rate was 21-24% in 2003-2005, but accelerated to 39% in 2006 and 74% in 2007, but slowed to 21% in 2008. The total assets of the banking system increased from US\$956 million in 2003 to more than US\$4 billion in 2008. Almost 98% 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 10.6 % during 2005-2008 and improvement in bank supervision and control by the NBC. Transparency in bank management and strict regulations have been crucial in promoting the growing public confidence in the banking system.

4.4.2. 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 71% of assets amounting to US\$2.9 billion. The level of deposit and loan concentration has remained high. 77% of all loans are granted by the largest five banks (Cambodia Public Bank, ACLEDA, Canadia, ANZ Royal, and FTB); 14% of the loans were granted to the services sector (hotels and restaurant). At the end of 2008, the largest three banks accounted for 72% of all deposits of the banking system.

4.4.3. Deposits and Loans

Bank deposits and loans continued to grow in 2008, reflecting public confidence, despite the devastating global credit crunch. There was a phenomenal growth in bank deposits during 2004-2008 reflecting increase in capital flows, foreign direct investment, portfolio investment, and the growth in exports of goods and services (especially a growing tourism sector). Bank deposits grew on average during the last five years by 33%. It grew by 44% in 2006, 77% in 2007, but declined to 4% in 2008.

Domestic credit to the private sector also grew rapidly during 2006-2008. While domestic credit to the private sector was growing on average 50% annually in 2003-2008, it grew at the rate of 48% in 2006, 79% in 2007 and 75% in 2008. Year on year, credit grew 100% in the first quarter of 2008. Such rapid growth poses challenges for the banking sector: (i) the quality of loans might have been degraded; (ii) the rapid expansion of the banking sector has stretched the central bank's capacity to supervise commercial banks; and (iii) increased exposure of banks to the real estate sector could create an asset bubble.

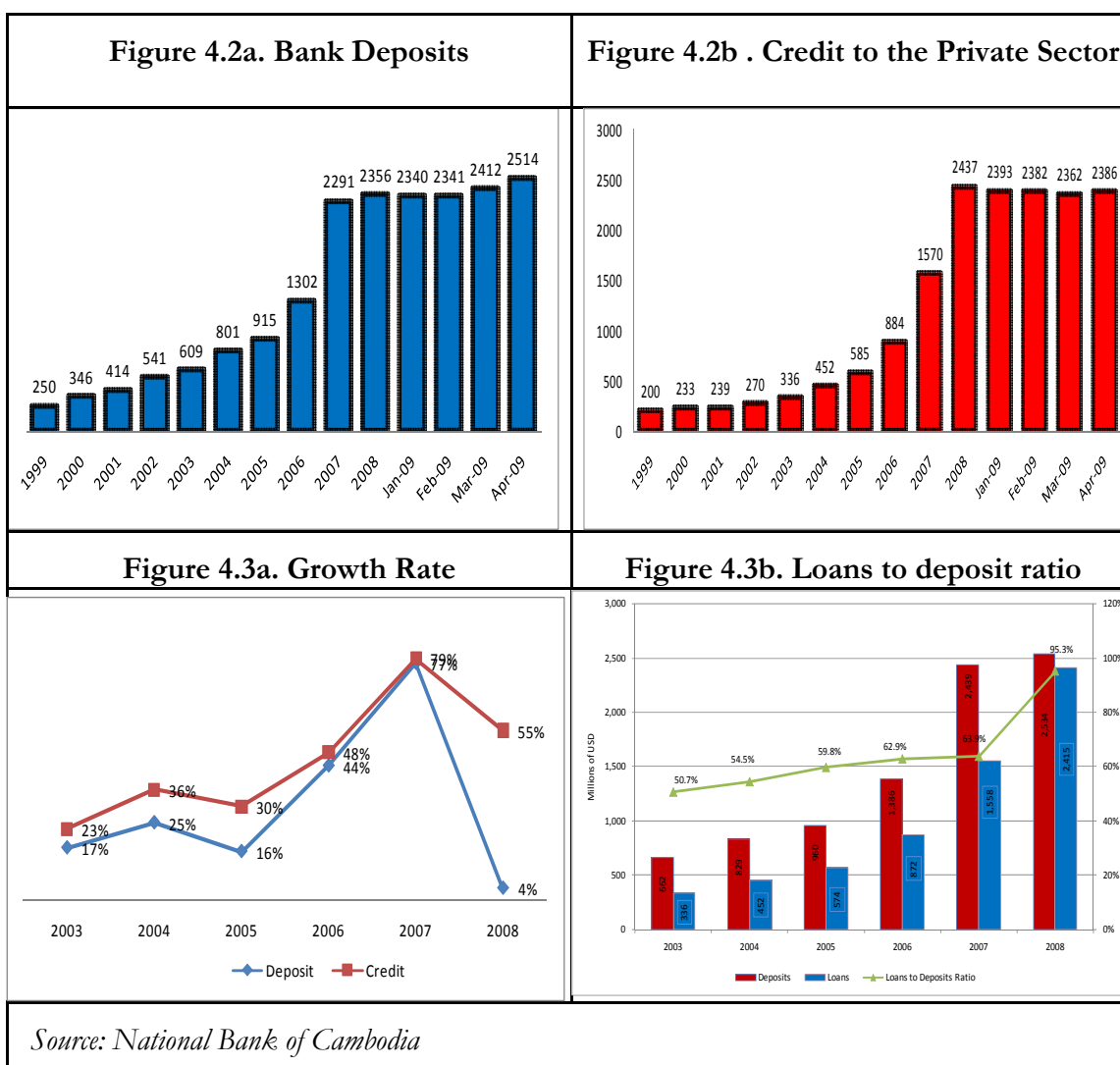
To sustain growth and ensure the soundness of the banking sector, the authorities have taken steps to recapitalize banks, improve prudential regulations and strengthen supervision:

- Increased reserve requirements of commercial banks from 8% to 16% in order to mop up excess liquidity in the economy and tighten lending bank loans to the private sector. This was reduced to 12% in the aftermath of the Global Financial Crisis;
- Limit commercial bank's exposure to some high risk sectors, especially the real-estate trading, by introducing a 15% ceiling on loans to real estate trading;
- Increased the minimum capital for universal commercial banks and specialized banks.

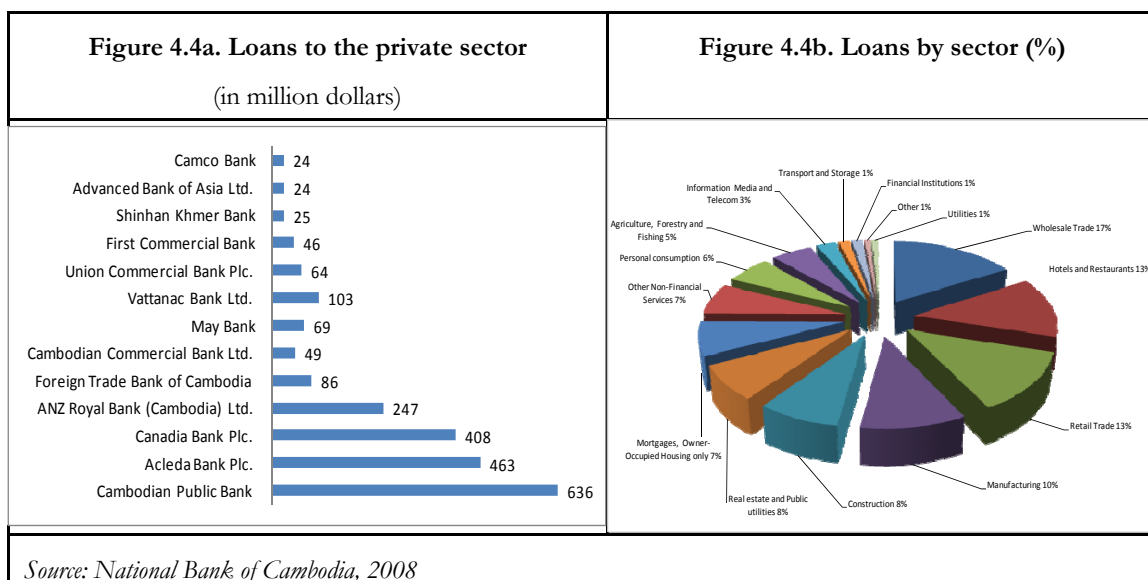
Robust economic growth during the last decade has contributed to the rapid increase in the wealth and improved the balance sheets of households and companies in Cambodia,

resulting in rapid increase in deposits in the banking system. During 1999-2008 the average annual growth of deposits was 30%. Cambodia's bank deposits have increased faster than nominal GDP growth in recent years. For e.g. bank deposits increased from \$250 million in 1999 to \$2.3 billion in 2008, an increase of more than 9 times, mainly due to the increase in dollar-denominated deposits. During this period nominal GDP only doubled. Deposit growth rose sharply to 79% in 2007, but slowed to 4% in 2008 for deposits to reach a record high of US\$2.35 billion in 2008. Deposits rose further to US\$2.5 billion in April 2009. The presence of internationally recognized banks and the increase in confidence in the banking sector also contributed to the increase in bank deposits.

Credit to the private sector plays a crucial role in promoting economic growth and socio-economic development. During 1999-2008, credit to the private sector also increased by annual average 32 %. Credit to the private sector increased by 36% in 2004, 30% in 2005, 48% in 2006, 79% in 2007 and 55% in 2008 to reach a record high of US\$2.4 billion in



2008.



The banking system, however, still provides a narrow range of financial instruments, usually limited to demand, saving, and time deposits. The majority of deposits have been made by individuals but commercial business deposits have been rapidly increasing signifying increased use of banks for commercial transactions.

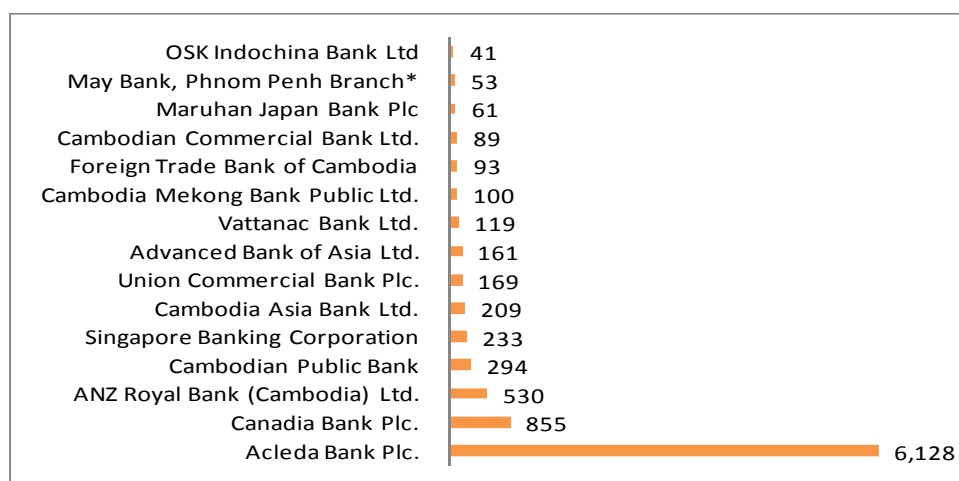
The objective of the credit function is to create value for the banks. It is therefore important for them to ensure appropriate and prudent risk management. Figure 4.4a provides sectoral allocation of bank loan portfolio in the private sector.

The graph 4.4b above provides a breakdown of the loan portfolio to the private sector through banking system. Services (tourist and hotel industry) accounted for 33%, trade – 23%, manufacturing sector – 12%, and real estate – 9%. Construction accounted for 8% and agriculture only 4%. However agriculture had the highest growth in 2008 over 2007 (+114.6%), followed by real estate and public utilities (+101.9 %) and construction (+85.6%).

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 population lives in the rural areas. An encouraging sign in the development of rural banking is that microfinance loans increased by 75% in 2008 to US\$274 million, compared to 2007. Another sign of commercial bank activity expansion is the growth of ATMs, which totaled 338 in 2008.

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 6,128 in 2008, as ACLEDA Bank strengthened its branch network.

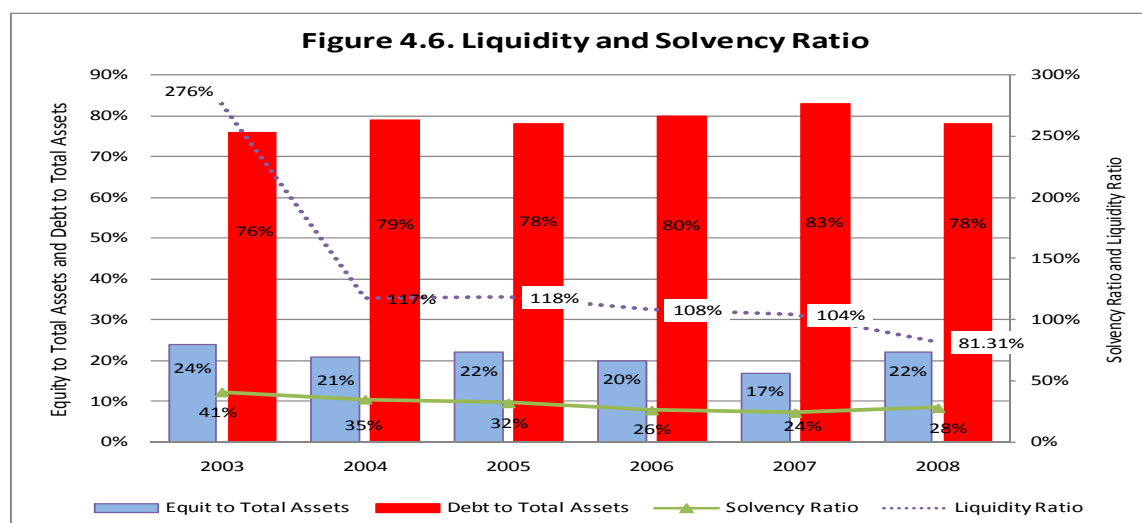
Figure 4.5. Personnel of the Banking Sector, 2008



Source: National Bank of Cambodia. Annual Report 2008. Banking Supervision Department.

4.4.4. Liquidity and Solvency

Two important indicators give a quick snapshot of the banking system: liquidity ratio and solvency ratio. The liquidity ratio is defined as the ratio of commercial bank's net worth to its short-term deposits. In 2008, the liquidity ratio dropped to 81%, due to rapid credit expansion and slow deposit growth, but remains much higher than the supervisory measure of 50%.

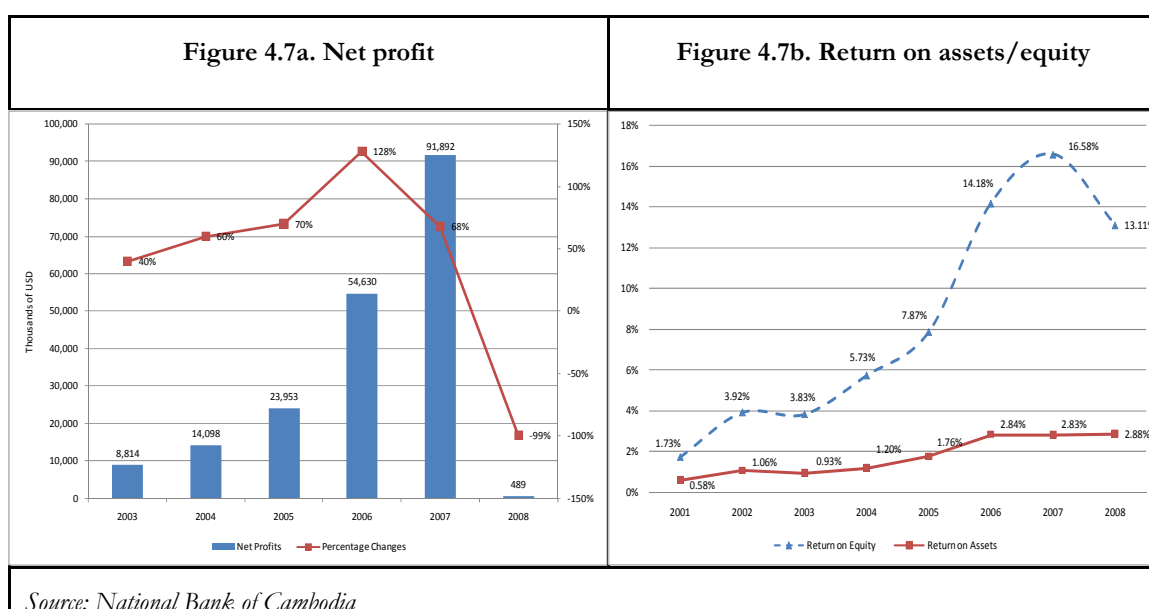


The solvency of the banking system can be assessed from the performance of the banks against the prudential measures. The solvency ratio (or Capital Adequacy Ratio) is the ratio of net worth to commercial banks' assets. It was 28% in 2008, exceeding the regulatory requirement of 15%. The improvement in banks' equity as well as net worth was due to the additional capital of new banks and existing banks pushing up the solvency ratio, as new banks tend to have higher solvency ratio than mature banks.

4.4.5. 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 equity. 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. ROA is measured by dividing net profit by assets.

The main indicator defining ROA and ROE is net profit of commercial banks. Bank restructuring that reduced the number of commercial banks resulted in increasing profitability. Total net profit rose from US\$8 million in 2003 to US\$24 million in 2005. It increased further by 128 % in 2006 over 2005 to US\$54.6 million, peaking at US\$92 million in 2007. In 2008 it dropped to US\$0.5 million. The rapid increase in deposits has provided banks with additional earning opportunities and a means to fund expansion. It is seen in Figure 4.7b that ROE is low in Cambodia, but increasing rapidly. The average return on equity for banks has increased from 1.7% in 2001 to 16.58 % in 2007, even though the level of loans was high. This is notwithstanding high lending costs in Cambodia. The ROE dropped to 13% in 2008, as six new banks have been established in 2008. The new banks usually make loss during the first years of operation. The increase in returns on investment (equity plus



accumulated surplus) is larger for 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.

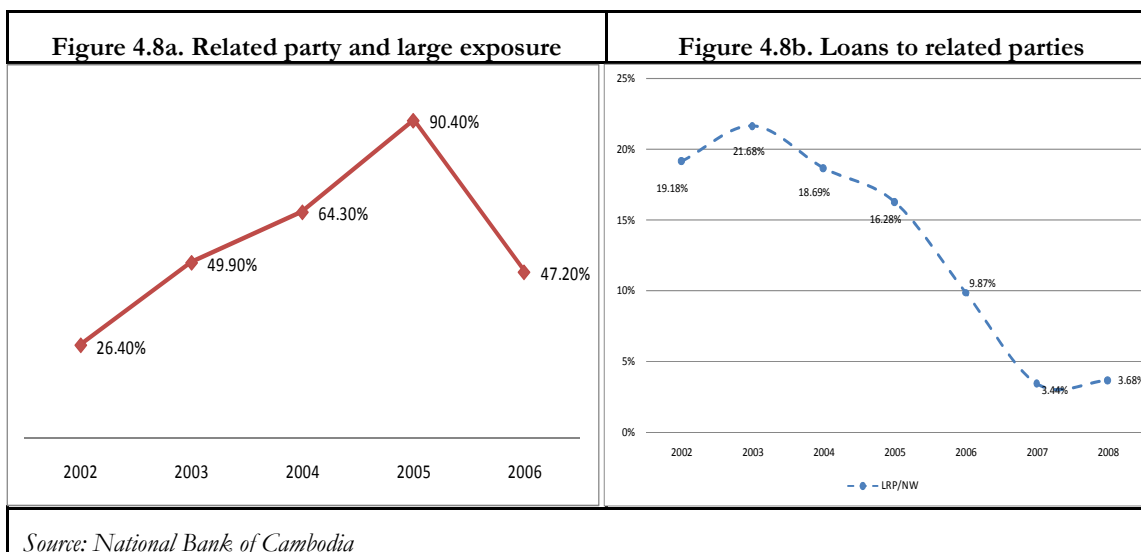
The return on investment after tax is one often used by investors to measure the profitability of their investment. The ROA of banks increased from 0.58% in 2001 to 2.88% in 2008. ROA is rather stable, within 2.8%. This increase was attributable to the increase in interest income and recoveries. The most prominent earning assets are loans (57% of total assets), and the second are deposits with NBC (23%). Banks invest funds with the NBC to earn interest, due to the lack of financial products and an inter-bank market.

4.4.6. Prudential Ratios

4.4.6.1. 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.

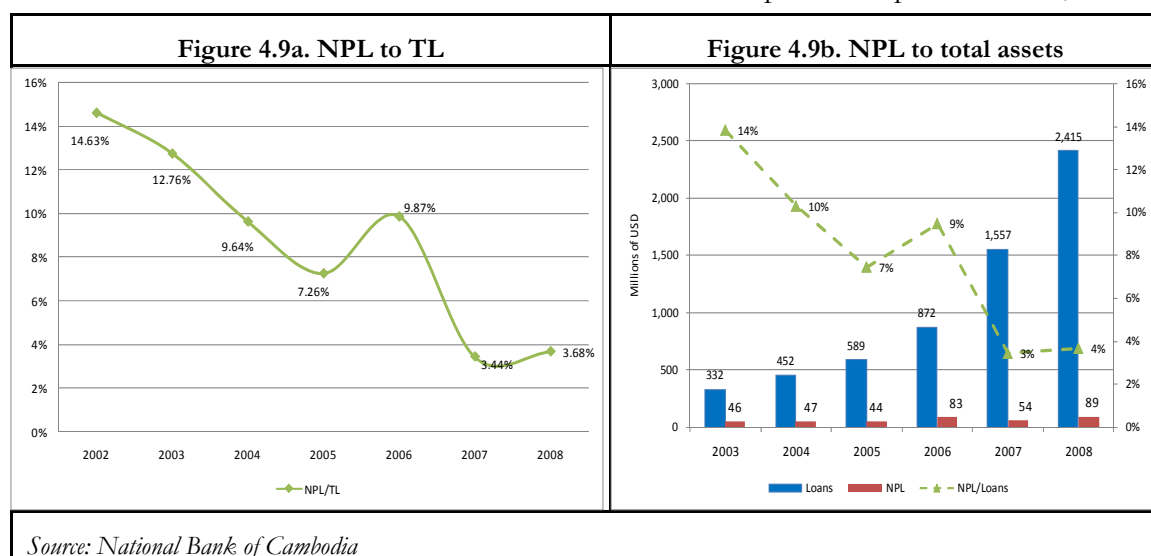
Loans to related parties greatly decreased compared to previous years. Loans to related party decreased from 21.6% in 2003 to 9.8% in 2006, as a result of repayment and change in ownership. It remains at 3.6% of net worth against prudential limit of 10%.



Large exposure increased from 26.4 % in 2002 to 90.4 % in 2005, but decreased to 47.2 % of net worth in 2006, largely due to the change in the calculation method. A few large banks are exposed to lending exceeding the regulatory limit.

4.4.6.2. Non-Performing Loans

The evaluation of the risks for commercial banks should be 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



bursting of the bubble would decimate these assets in the balance sheets of the banks.

The NPL ratio dropped from 14.6% in 2002 to 7.5% in 2005, but increased to 9.8% in 2006, due to the introduction of tighter international accounting standards 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 tighten the assessment of the borrowers in the loan classification system. Provisioning also decreased by 16.5% during 2005-2006, due to the high recovery rate of 18% for NPL. The NPL ratio declined to 3.4% in 2007, then increased to 3.68% in 2008 as the global financial crisis started. The level of the NPL ratio will increase rapidly in 2009.

4.4.7. 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 4,320 exchange bureaus in Phnom Penh and the provinces.

Any form of supervision of these entities 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.

4.5. Microfinance

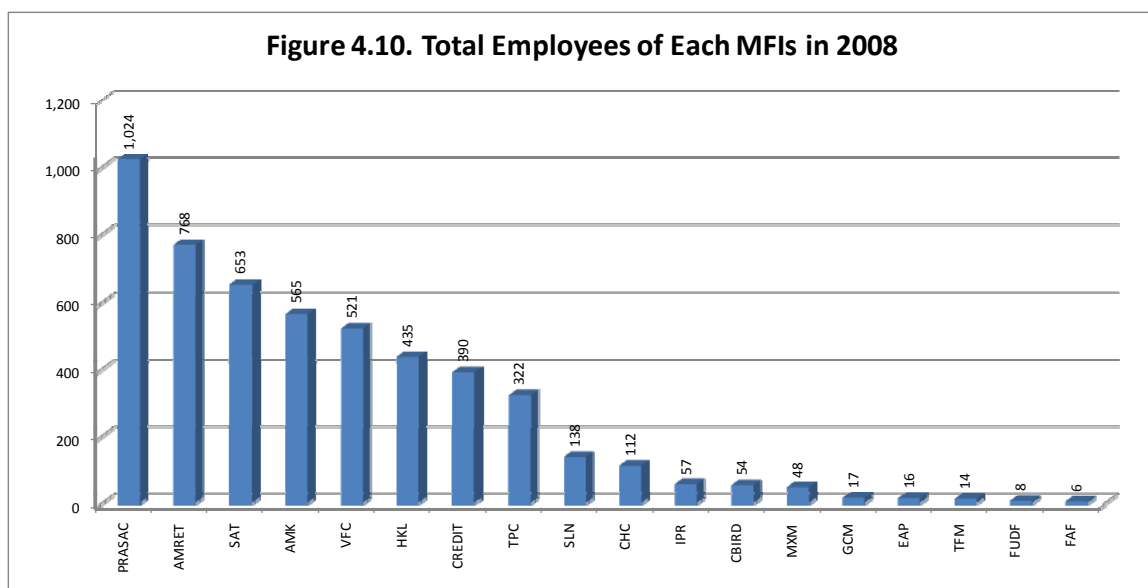
4.5.1. Growth of Microfinance Loans and Deposits

Microfinance is expanding rapidly. In 2007 the volume of micro finance lending rose by about 80% with some institutions expanding lending by 200%. The 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.

There are 18 licensed Microfinance Institutions (MFIs), 26 registered micro-finance NGOs 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 through more lending at existing branches. At the end of 2008, MFIs had a total number of 852,090 loans outstanding, with a total exposure of 1,161.7 billion riels (US\$274 million), a 81% increase over 2007, which shows rapid credit expansion. 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. The expansion in net number of loans is currently around 10% per annum. Microfinance deposits increased by 7% to 26 billion riels in 2008 owed to 155,291 depositors. Therefore, borrowing was the main source of lending. Loan interest rates remained high, 3% per month for loans in riel and 2.4% per month for loans in dollars.

An encouraging feature of MFI development is that not withstanding 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. MFIs' solvency ratio was 20% in 2008, against the requirement of 15%. 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 0.42% in 2008. Cambodian MFIs won 4 out of 20 worldwide awards for Financial Transparency given by the Consultative Group to Assist the Poor which illustrates the high standards of MFI operations in Cambodia. MFIs employ more than 5,000 people in 2008.

Despite these positive developments, MFIs continue to suffer from a lack of funds. The demand is much higher than the supply. It was estimated that demand for micro-finance exceeded supply by about US\$60-70 million. Qualified, reliable employees are also hard to come by. Improvement in infrastructure and cooperation with the appropriate authorities still require attention.

4.5.2. Outlook and Issues

Measures to increase access to credit should also 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.

Since 2000, the NBC has enforced a number of measures that aim to remedy deficiencies in the banking system.

- The first major step forward was setting up a two-tier banking system: the Central Bank as a regulatory authority, with commercial banks as operators. The policy of State disengagement was implemented with privatization of the Foreign Trade Bank in order to create a fair environment for free competition on an equal footing.
- Second, NBC undertook a reform program to implement the law on banking and financial institutions. Non-performing bank loans are being handled diligently and appropriately.
- A third positive development was the improvement to the prescription of norms for own-source funds and risk weighting of loans. Prudential rules included norms for own-source funds, foreign reserves, classification of loans provisioning of losses, operations with related enterprises, consolidation, internal and external audits, and diversification of risks. The necessary means for enforcement of the regulations have been strengthened, with greater clout given to the NBC's supervisory and regulatory arms. Commercial banks are subject to in-depth offsite and onsite inspections on an annual basis.
- Fourth, the payment system was strengthened. The Cambodian payment system is heavily based on cash payments. The reform is intended to enhance the system with the introduction of additional instruments, such as checks, payment orders, credit and debit cards, money orders, automatic transfers from clearinghouses, automatic bank tellers, etc. The growing use of electronic payment and direct debits/ credits will increase the volume of basic deposits and the number of depositors.

Implementation of these reforms is ongoing. Increasing access to credit is hindered by the lack of reliable financial statements published by the companies. Poor transparency and disclosure standards prevent 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.

The integrity of the financial system depends on the soundness of its financial base in terms of own-source funds. The poor performance of the banking system in investment financing could be attributed to the deficit of own-source funds over long term assets and the disequilibrium that arises when long term lending is based on roll over of short term deposits.

In view of the changes in the payments environment that financial institutions are confronted with, modernizing the clearing house system has become a top priority in banking reform. It is crucial that a remote clearing house system characterized by speed and reliability is put in place urgently. The new clearing house mechanism should ensure clearance within two working days following the date of the transaction, regardless of the

place of payment and the paper value to be cleared (check, instrument, or transfer). The major benefits include a drop in the unit cost of processing payment clearances, improvement in bank productivity and profitability, as well as higher quality of the service provided to customers.

The growing dematerialization of paper values (checks, drawings, bill of exchange, and transfer) has prompted development of electronic exchanges and has had a positive effect on the average cost of banking transactions. This process must be speeded up. However, security of bank transactions will have to be ensured when banking processes are mechanized and involve fewer touches. Improving the security of computer systems is a top priority. With the ongoing growth of the volume of bank transactions, the computer has become a vital tool in bank management and bookkeeping. An electricity outage or shutdown of the computer system is a threat for banking operations and can damage its corporate image and compromise the security of transactions. To consolidate internal computer security, an external backup center enabling data backup, has been proposed. However progress has been hindered by the fragmentation of the sector. Consequently, banks that have not yet reached the critical size enabling them to invest sufficiently in training and information technology.



Chapter 5

Insurance Sector

5.1. Insurance Market—An Overview

The insurance industry in Cambodia is of recent origin and 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.

5.1.1. Insurance Industry Regulation

The Insurance industry in Cambodia is governed by the Insurance Law that came into force in June 2000. The Insurance Law is supplemented by the Sub-decree enacted on 22 October 2001, which prescribe the details of insurance contract.

The Law on Insurance and Sub-decree require each insurance company (life and non-life) to have registered capital in Riel at least equivalent to 5,000,000 SDR or US\$ 7 million.

In 2002, the MEF took into account the relatively small size of the insurance industry and the scarcity of capital and accorded it greater flexibility in terms of capital requirement whereby the companies will be given a grace period of up to five years to comply with the capital requirements.

Terms and condition to get insurance license, the company is required to:

- Pay a deposit of 10% of registered capital of US\$7 million into the deposit account of MEF at the National Bank of Cambodia. This is to protect the public from possible risks caused by the bankruptcy of the insurance company;
- Pay a deposit of 50% of registered capital of US\$7 million at any account of commercial bank recognized by the National Bank of Cambodia. This deposit is considered as a solvency margin, which an insurance company is required to maintain;

Supervision of insurance companies is being carried out by the Department of Financial Industry of the MEF. The process includes collection of statistics from insurance

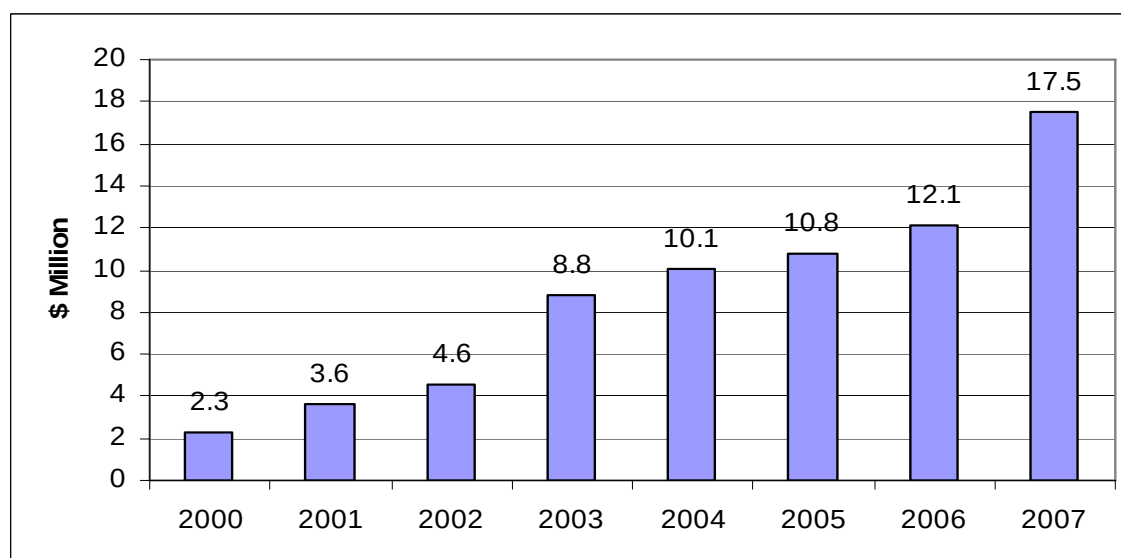
companies, desk analysis of the data submitted, a follow-up on findings, as well as on-site inspections by the regulators.

Under the present system, companies submit complete financial statements, accompanied by an auditor's certificate, once each year. Additional statistical information is collected for interim periods. In support of the audited financial statements, companies also complete a special prescribed form that was developed by a working group of ASEAN insurance supervisors.

5.1.2. Insurance Market in Cambodia

Growth of the industry in terms of value insured has been steady (11 to 42% per annum in the last 7 years). Gross insurance premium increased by more than seven folds from a low level of US\$2.3 million in 2000 to US\$17.5 million in 2007. However, the industry offers a limited range of insurance products. A drastic increase in 2007 of \$5.4 million in premium over 2006 was due to Oil & Gas industry insurance.

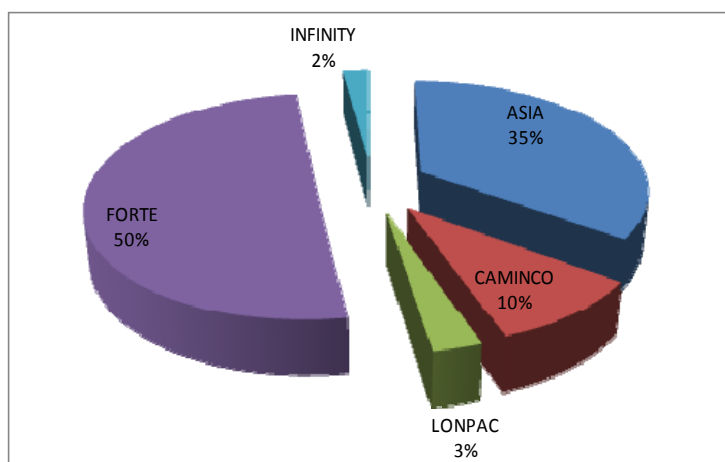
Figure 5.1. Gross insurance premium in Cambodia



Source: MEF

As of December 2007, there are 5 insurance companies operating in Cambodia— Forte, Asia Insurance, Caminco, Infinity Insurance, and Long Pac Insurance - and one reinsurance company – Cambodia Re.

Figure 5.2. Insurance Market Share by Company



Source: MEF

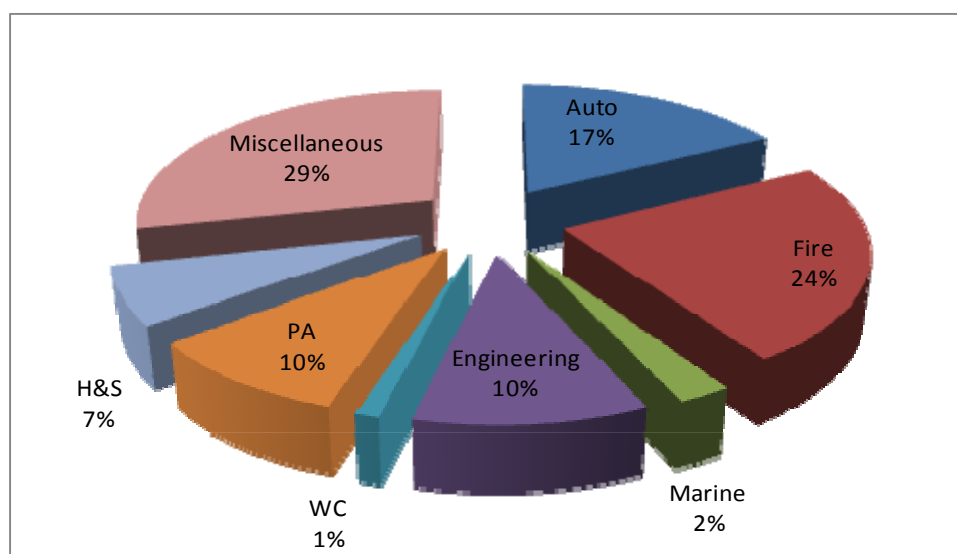
Forte Insurance dominates the market, accounting for 50% of the insurance market share; followed by Asia Insurance, which represents 35% of the market. Other companies are fighting for the pie, such as Caminco (10% of market share); Campu Bank Lonpac (3%) and Infinity (2%). Some 10% of the insurance premium is ceded by the five insurance companies to Cambodia Re.

Table 5.1. Insurance companies by line of business

Line of Business	ASIA	CAMINCO	LONPAC	FORTE	INFINITY	Total
Auto	801,256	1,074,475	112,117	950,955	85,977	3,024,781
Fire	959,899	306,444	185,078	2,641,500	39,309	4,132,231
Marine	171,126	19,947	9,180	223,677	1,683	425,614
Engineering	1,383,762	71,980	35,263	335,744	2,813	1,829,562
WC	171,053	13,295	-	5,424	-	189,772
PA	371,047	135,138	28,537	1,076,925	73,327	1,684,975
H&S	290,629	16,386	5,483	826,713	82,310	1,221,521
Miscellaneous	1,937,933	65,678	143,730	2,740,587	97,363	4,985,291
TOTAL	6,086,705	1,704,695	519,389	8,801,527	382,783	17,493,747

Source: MEF

Figure 5.3. Insurance Lines of Business



Source: MEF

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 surgery-related risks, personal and accident, marine cargo and travelers insurance. Oil and gas insurance has emerged as one of the most active insurance business lines.

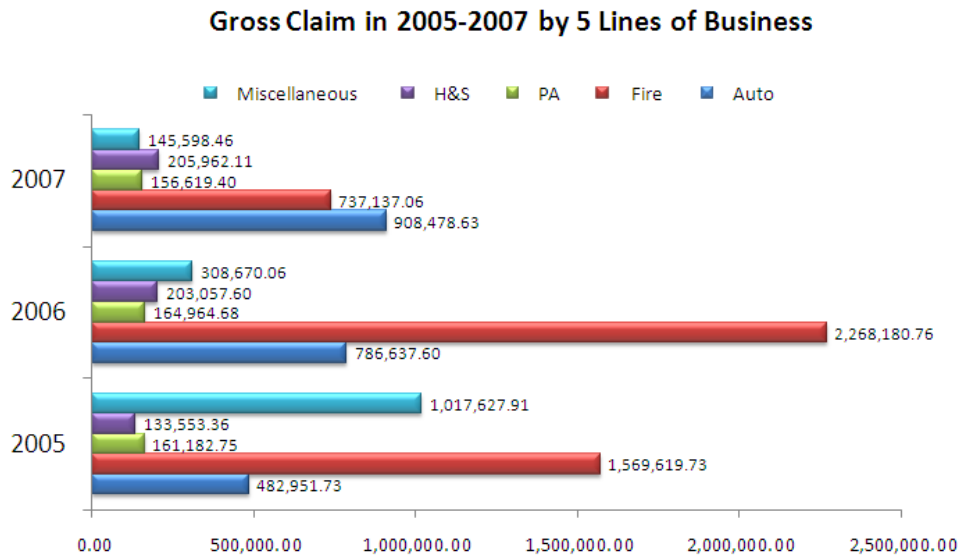
The miscellaneous class of business (burglary, theft, money insurance, liability, travel insurance, fidelity guarantee, general third party liability and employer's liability) accounted for the largest share of business underwritten in 2007 or 20% of the market (US\$4.9 million).

Fire ranked second in terms of market share, representing US\$4.1 million (24% of the market premiums).

It was followed by motor vehicle insurance at US\$3 million or 17% of the market. Personal accident and workmen compensation ranked fourth at US\$1.8 million or 11% of the market share.

Engineering accounted for US\$1.8 million, with health and surgical business and marine cargo following at US\$1.2 million and US\$0.4 million respectively.

Figure 5.4. Gross claims by lines of business



Source: MEF

Fire claims have become more frequent and more important in recent years, especially during the Global Financial Crisis. Other important claims related to miscellaneous and automobile insurance.

5.2. Reform of Insurance Sector

The insurance industry needs to perform a number of specialized 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, and 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 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 regulatory 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 their business 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 facilitated 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, including 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

Chapter 6

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 the financial system which is crucial for stimulating economic growth. The vision for capital market development is to have an efficient and transparent capital market structure with a critical mass of issuers for mobilizing long term investment funds. The market will 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. 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, would be 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 a better record of good management than privately-held companies;

- Companies can acquire other companies for expanding product lines and market share, increase distribution channels, hedge 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 include:

- 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.

6.1. 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.

6.1.1. Phase 1 (2006-2009)

This phase comprises:

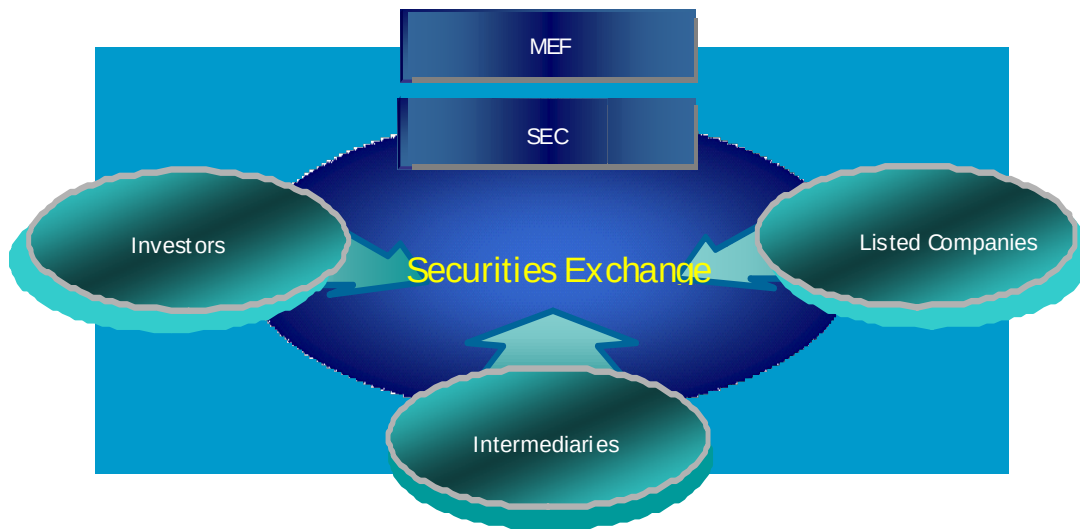
- Enactment of Law on Government Securities. This was accomplished on 10 Jan. 2007. MEF is preparing the sub-decree and Prakas under the law;
- Operation of a government securities market to precede the establishment of a full fledged securities market. This will help gain public investor confidence and get the investors to familiarize themselves with the functioning of the securities market.
- Development of appropriate regulatory framework relating to insolvency, and a progressive corporate governance 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 for establishment of a stock exchange with the Korean Exchange (KRX);
- Training to raise public awareness, investor education and human resource development to support financial market development.

6.1.2. Phase 2 (2009-2012)

The second phase comprises:

- Implementing progressive, graduated corporate governance framework for companies;
- Launch of the Cambodian Securities Exchange (CSE) 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.

Figure 6.1 Capital Market Structure



Source: MEF

6.1.3. Phase 3 (2012-2015)

The last phase comprises:

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

6.2. 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 (SEC) – the only regulatory body regulating and supervising all securities business (it was established in 2009);
- 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.

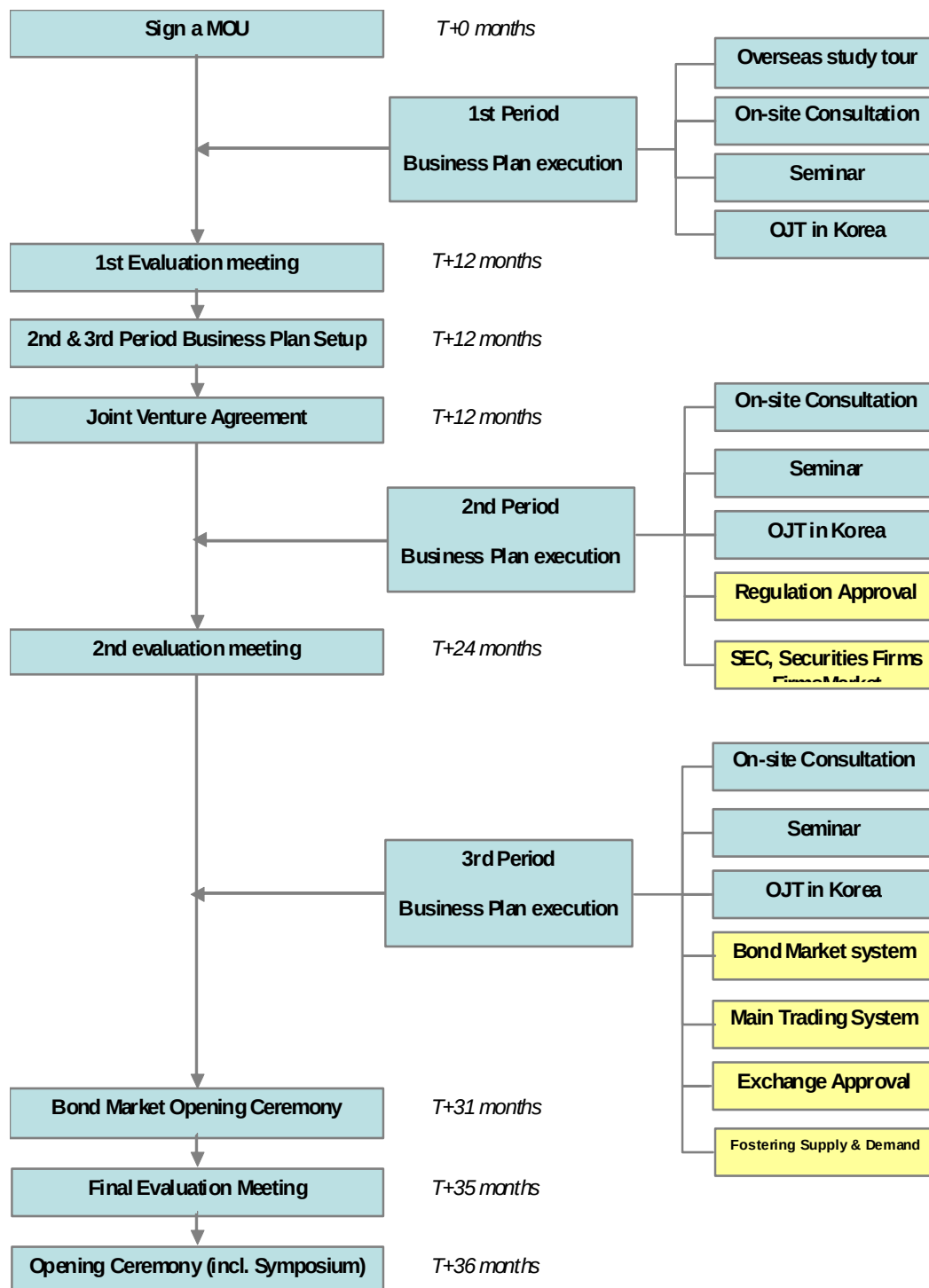
6.2.1. Implementation of the Cambodian Securities Market Project

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 to (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) specify the core tasks to be carried out by each party for the establishment of a securities exchange; and (iii) 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 Korea Exchange (KRX) and the MEF.

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



Source: MEF

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

- formulate and implement laws and regulations for the establishment of SEC, a securities exchange and securities firms;
- formulate and execute laws and regulations for fostering potential listed companies and investors; and
- enforce accounting and auditing standards on corporate businesses.



PART III

THE CHALLENGE OF MODERNIZING AGRICULTURE

- Chapter 7. Agricultural Economy
- Chapter 8. Impediments to Improving the Standard of
Living of Farmers
- Chapter 9. Agricultural Modernization Policies



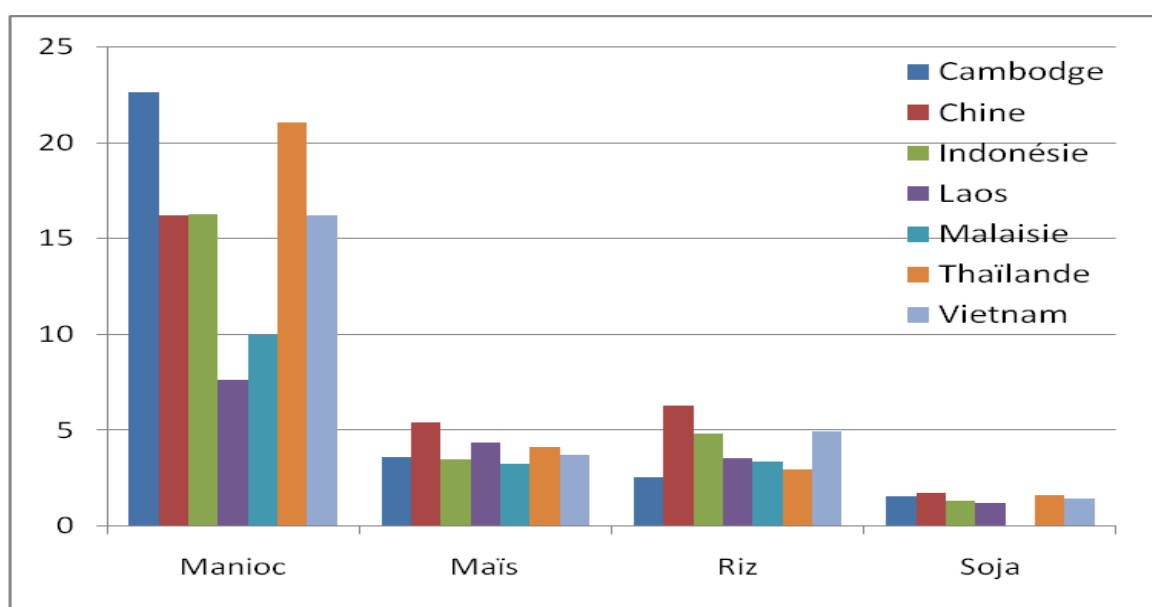
Chapter 7

Agricultural Economy

Agriculture is fundamental to raising rural incomes, especially among the poor in rural communities. It accounted for 29.6% of the GDP in 2005. Given that 85% of the population is rural, 60% of the people make their living from agriculture and that 75% of the heads of disadvantaged families are farmers, development of this sector is crucial for sustained economic growth, poverty reduction, and development of the rural economy.

The chart below compares Cambodia's productivity in the major crops with neighboring countries. Overall there is scope for improving Cambodia's productivity in rice and corn.

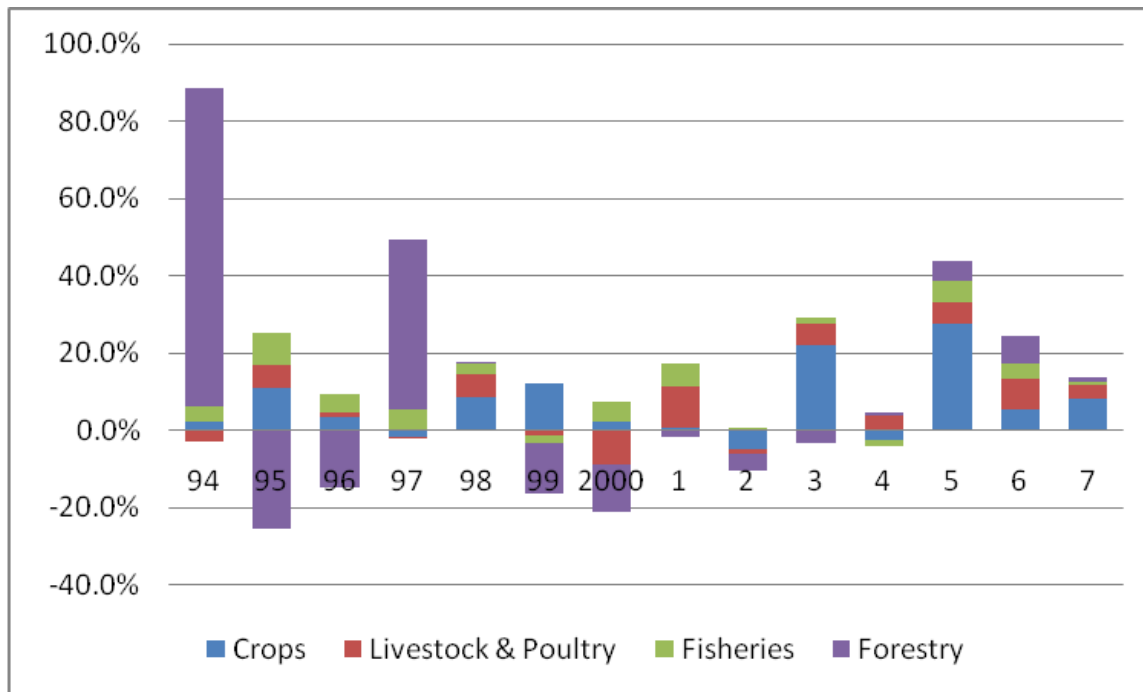
Figure 7.1. Agricultural productivity (T/ha)



Source: Ministry of Agriculture, Forestry and Fisheries (MAFF)

The development of agriculture is central to RGC's strategy to reduce poverty in rural communities, guarantee food security, and promote equitable and sustainable economic growth. While total production from the agriculture, fisheries, and forestry sector increased during 1998-2003, the share of the sector in GDP slumped from 43.7% in 1998 to only 29.6% in 2007, mainly due to the rapid growth of the industrial sector during the same period.

Figure 7.2. Agricultural growth in %



Source: MAFF

Growth in the agricultural sector has been slower than in industry and services. Moreover, economic growth during the last decade has been concentrated in only a few key urban based sectors such as garments, tourism, and construction. Trading, investments, and private sector development have also created more opportunities for urban rather than rural communities. As a consequence a considerable gap between urban centers and rural areas has emerged accompanied by differentiated growth performance between rural communities.

There is a growing inequality between the rich and poor in Cambodia. Between 1994 and 2004, the per capita GDP of the wealthiest quintile of Cambodians had increased by 45%, compared to 8% for the poorest quintile who live mostly in rural areas and practice agriculture. Moreover, the rural poor depend upon access to natural and forest resources to meet their needs. Damage to and privatization of natural resources and land has exacerbated the inequalities.

In order to have an appreciable impact on poverty reduction in the context of strong population growth, the agriculture sector should grow by 5 to 6% each year. Achieving this level of performance in agriculture is challenging. The potential for growth in agriculture through intensification and expansion of cultivated land has been impeded by the

absorptive capacity of the domestic market, the mediocre quality of exported products, and the lack of demand for agriculture products in the region. Agricultural products must also face fierce competition from imported goods and protectionist policies of other producing countries.

Agriculture is dominated by rice growing and animal husbandry, which together account for approximately one third of agricultural production and nearly 27% of the GDP. Fisheries and forestry operations account for only 5% of the GDP, but the prospects for growth are bright. “The only course available to leaders who are truly concerned about improving the status of the greatest number is to help them increase the productivity of their food and commercial crops and raise the prices that farmers receive for them.”

The Socio-economic Development Plan 1996-2000 envisaged the creation of jobs and income through agriculture and sustainable rural development within the framework of a market economy. This plan gave priority to five areas, namely: demining and improvement of farmland; refurbishment and expansion of the irrigation system, and improvement of water management; land use planning; strengthening input supplies; and support services, especially credit, and marketing, along with research and educational outreach.

In 1999, the government announced the launch of a triennial plan intended to promote investment in order to increase agricultural production and the added value of this sector. Priorities included transportation and roads to improve access to markets and agro-food industry to increase added value. Over the last few years, Cambodia has also sought to produce and export high value rice to the profitable markets in Thailand and Viet Nam.

Rice growing in Cambodia continues to be the determining factor in the growth of the agricultural sector, although often afflicted by floods and/or drought. Rice is the most important agricultural commodity for Cambodia and accounts for about a third of agricultural production. Rubber and other crops (such as jute) accounted for 24% of agricultural production, and livestock, 29%, while fisheries and forestry each accounted for less than 10%, and for less than 4% of the GDP. Forestry value added grew sharply during 1993-1998 at an average annual rate of 21.5%. Forestry sector has been in decline since then reflecting the government’s policy of sustainable management of forestry resources.

In 2000 and 2002, there was a sharp drop in the agriculture subsector (0.4% growth on the average from 1999-2002) due to floods and a rain deficit. After a strong upswing during 1994-1998 agricultural production slowed down due to onset of bad weather. Growth of rice production declined (2.5% in 1999-2002 compared to 4.6% in 1999-2003). Livestock and fisheries were affected similarly. After the downturn of 1999 (-1.6% growth), the growth of the fisheries subsector resumed in 2000-2002. The subsector had an average

annual growth rate of 3.1% in 1999-2002. During this period the government implemented a policy of sustainable fisheries resource management.

Cambodia is endowed with 3.8 million ha of arable and permanent agricultural land, 1.5 million ha of permanent pastureland and 12 million ha of forests and woodlands. The area under crops is increasing steadily. During 1998-2008, the area under rice has grown, notwithstanding the fallout from floods and drought. The rubber plantation area is constantly expanding, but accounts for only 2% of the cultivated land in the country.

Table 7.1. Planted areas

(in thousands of ha)

	1966	1980	1990	2000	2003	2004	2005	2006	2007	2008
Paddy	2,510	1,441	1,890	2,318	2,314	2,374	2,443	2,541	2,585	2,616
Corn	117	123	44	71,46	93,36	91,20	90,73	108,83	142,39	163.16
Tapped rubber	46	5	51	-	28,72	-	-	-	-	34
Peanuts	23	6	6	10	14	19	17	13	21	18.18
Sesame	14	3	9	19,22	33,99	64,47	79,25	56,26	47,81	35.87
Soya	8	4	15	33,25	53,06	84,88	118,76	75,05	76,98	74.41
Black pepper	1	0	0	-	-	-	-	-	-	-
Tobacco	17	7	16	9,67	6,4	1,7	8,1	8,7	7,2	9.45

Source: Annual Conference on Agriculture, Forestry and Fisheries

Cambodian agriculture is dominated by small holdings; cultivation on large tracts of land is not a widespread practice. The majority of farmers own the land they farm. But land disputes are quite frequent. Landless farmers comprise 13% to 15% of total number of farmers but this relatively egalitarian situation is rapidly worsening.

7.1. Rice Production

90% of the poor live in the countryside. 80% of the rural poor depend upon rice growing. Rice fields occupy about 20% of the land, prairie 20%, scrubland and forest about 60%. The sugar palm, or thnot, dominates the rice field landscape of the central plain. Rice growing accounted for about 10% of the total real GDP in 2008.

Rice is a basic commodity for Cambodians. It represents some 84% of the annual food production and supplies 68% of total energy requirements. It is mainly grown in the central basin, the Mekong Delta, and the Tonle Sap plain. In the early 1980s, after 20 years of civil war and economic isolation, Cambodia experienced an annual rice deficit of 243,000 tons on average.

Rice growing areas shrank, from about 2.5 million ha towards the late 1960s to 1.8 million ha in 1992-93, due mainly to insecurity and war. During the first half of the 1990s, the revival and expansion of rice production were held back in part because of the enormous number of landmines which, according to estimates, were planted over nearly 30% of the arable land. Since 1995, however, with the return of peace, there has been gradual growth of the rice production area; an exceptional crop was harvested in 1999.

Table 7.2 Key Indicators of Rice

	<i>Unit</i>	<i>2000</i>	<i>2003</i>	<i>2004</i>	<i>2005</i>	<i>2006</i>	<i>2007</i>	<i>2008</i>
Rice areas	M ha	2.318	2.314	2.374	2.443	2,541	2.585	2.616
Harvested areas	M ha	1.903	2.242	2.109	2.414	2.516	2.567	2.613
Average rice yield	T/ha	2.115	2.101	1.977	2.479	2.489	2.621	2.746
Rice production	MT	4.026	4.711	4.170	5.986	6.264	6.727	7.175
Food required/year	MT	1.981	1.937	1.906	2.014	2.054	2.096	1.970
Surplus milled rice	T	0.091	0.686	0.416	1.320	1.434	1.650	2.025
Surplus of paddy	T	0.142	1.073	0.650	2.062	2.240	2.578	3.164

Source: Ministry of Agriculture, Forestry and Fisheries

During 1993-2008 rice production grew rapidly, reaching 7.17 million tons in 2008 from an area of 2.61 million ha. This meant an increase in areas harvested and in yields, and this in spite of irregular precipitation, a shortage of labor and capital, and war damage to institutions and infrastructure.

Rice production reached 7.17 million tons in 2008 and accounted for 80% of all agricultural production and 14% of Cambodia's gross domestic product. This allows Cambodia to have a surplus of 3 million tons of unprocessed rice or 2 million tons of processed rice for exports. In 2008, out of 3 million ha of cultivated land, 78% (2.6 million ha) was allocated for rice growing, 6% to other food crops, 4% to industrial crops, and 6% to fruit and other crops. Out of 2.6 million ha devoted to rice growing, irrigated land accounted for about 430,000 ha (23% of rice fields). Agriculture remains at the heart of Cambodian society, but with decreasing economic importance.

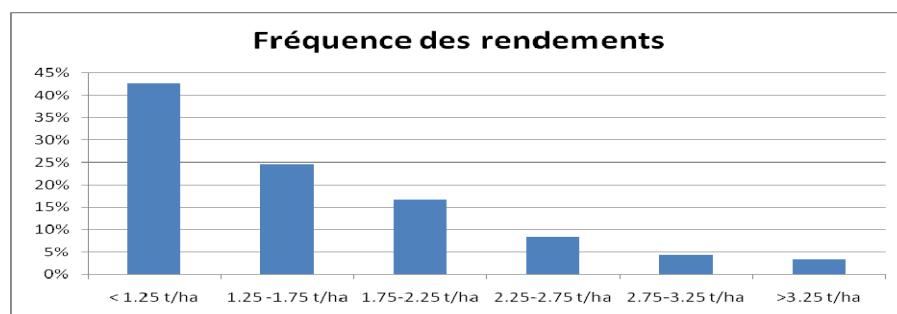
Farms are small because of population pressure. Farm households own on average 1.5 ha and half of them own less than .75 ha of land. This has caused a rural exodus and migration toward urban centers, and has made rural communities more dependent on non-agricultural activities to generate income.

Rice accounts for 25% to 30% of total expenses for poor families. Nevertheless, subsistence agriculture dominates the populous areas, and cash crops in less populous areas. The growth of productivity of subsistence farmers will have a substantial impact on poverty reduction and facilitate the transition to commercial agriculture.

The improvement of paddy yield and expansion of the area cultivated have allowed production to catch up to demographic growth. The total harvest, especially of rice, has consistently increased, creating exportable surpluses in the last few years. Rice productivity rose from 1.79 tons per ha in 1998 to 2.7 tons per ha in 2008. However, it remains lower than that of neighboring countries.

The growth of rice production is essentially due to the introduction of new high-yield varieties and new farming technologies developed and introduced by the Cambodian Agricultural Research and Development Institute (CARDI), and extension services provided by the Ministry of Agriculture, Forestry and Fisheries to propagate them. However, that current yields and growth cycles remain weak (about 2.7 tons of rice per ha) compared to those developed in similar ecosystems in neighboring countries, which reach yield rates of 5 to 8 tons per ha. The rise in productivity is also not uniformly distributed in the farming community; in 65% of the farms the productivity is less than 1.75 tons/ha (Fig 7.3).

Figure 7.3. Frequency of yields



Source: Commune database.

Agriculture including forestry, and fisheries in Cambodia suffers from chronic capital and technology shortages. The rudimentary, neglected transportation and rural road network is being upgraded. Only part of the 283,500 ha of land used for dry-season rice growing is currently under proper irrigation. Rice, along with corn, rubber, legumes, root vegetables, peanuts, soybeans, as well as fruit and vegetables, suffers from exposure to natural disasters, especially frequent flooding and drought. Large crop losses occur every three or four years. The government is giving priority to irrigation development to boost agricultural productivity.

Rainy season rice production accounts for nearly 80% of the total rice crop, the rest coming from the receding water and dry-season rice harvests. During the wet season, farmers plant early, normal, or late maturing rice, depending on location, soil, and general

climatic conditions. Although dry-season rice generally accounts for only 10% of the seeded area, the production is proportionally higher, about 18% to 20%, because of better yields. In any year, the area and production of dry-season rice are dependent on rainfall during the preceding rainy season and flooding of the Mekong River system, which governs the level of water in reservoirs and residual water retained by the soil.

The subsistence nature of farming limits the use of inputs including introduction of improved crop varieties and fertilizer. Moreover, high cost of mechanization has discouraged introduction of modern farming practices. Agricultural support services, especially input supplies, research and extension, marketing and credit, are only in the beginning stages, and mainly dependant on foreign aid.

7.2. Systems of Agricultural Production

From a topographical point of view, the major agricultural areas include the central basin, the adjacent plateau and the mountainous zone, all of which feature different rice-growing systems: (i) the traditional system of agricultural production; (ii) the chamcar farming system; and the industrial-scale system (GRET et al, 2000).

The systems based on rice growing may be distinguished by the flood patterns, management of the water supply, the period and mode of planting, position in the topography, and type of soil. The selection of varieties and crop systems are adapted to the different ecological situations, and farmers try to spread out the risks in an unstable natural environment.

7.2.1. Traditional System of Agricultural Production

The traditional system of rice growing can be classified in different ways. Based on seasonal criterion, four different rice-growing systems are practiced in Cambodia, three during the monsoon season and one during the dry season. These four types are closely linked to weather conditions:

- ***Plain rain-fed rice***: Occupies 58% of the area planted in rice.
- ***Plateau rain-fed rice or chamcar rice***: Rice with a very short growing cycle well adapted to conditions where slash-and-burn agriculture is extensively practiced, and which occupies nearly 2% of the rice cultivation area. Usually such rice is grown with other cash crops.

- **Floating rice:** Practiced in areas of low elevation where the water may reach a depth of 2 to 3 meters and occupies 32% of the area planted in rice.
- **Dry-season rice:** Dry-season rice includes irrigated rice planted during the dry season and dry-season receding-water rice. Rice irrigation is practiced when access to water is obtained from water storage reservoirs or residual river water. Dry-season rice could also be receding-water rice grown in flood zones or along the lake edge where the water level gradually goes down.

Based on the zone criteria, there are four major types of cultivated land growing rice:

- Rain-fed rice growing on red and black soil.
- Irrigated rain-fed rice growing on sandy plains.
- Irrigated rain-fed rice growing on hydromorphic plains.
- Rice growing on zones subject to river/lake overflow.

Table 7.3. Types of rice growing, area, and production in 2007

Type of rice	% of area	Area (ha)	Yield (ha/yr)	Production (t)
Full paddy irrigation	6.06%	174 365	5	230 000
Receding water rice	4.03%	115 917	3	360 000
Rain-fed flooded rice with top-up irrigation	10.35%	297 861	3	810 000
Sub-total irrigated rice	20.43%	588 143		1 400 000
Floating rice	9.77%	281 114	1	210 000
Rain-fed flooded rice	69.80%	2 009 326	2	470 000
Total	< 3 millions ha		> 6 million tonnes	

Source: Boulakia. Presentation to the MEF.

Rain-fed rice on the plains, the main rice crop, is grown during the rainy season from May to December. Three major categories of rice can be identified according to their periods of maturation (early, average, and late). Dry-season rice, grown from November to May, which accounts for 10% of the total seeded area and nearly 18% of the production, benefits from the receding waters but needs top-up irrigation in its final stages. The area seeded during the dry season increased by 17% from 1999-2003 reaching a total area of 283,550 ha by late 2003. This area depends upon annual precipitation and on the Mekong River overflow and thus on irrigation reservoir water levels. Rice production varies considerably according to rainfall, which has been abundant during the last few years.

7.2.1.1. Use of Agricultural Inputs and Post Harvest Technologies

Very little use is made of agricultural inputs such as fertilizer and quality seed by household farms. Continuous cropping does not allow a proper reconstitution of nutritive elements, and this has impoverished the soil. In 2008 the total consumption of mineral fertilizer was estimated at around 40,000 to 50,000 tons, which corresponds to a use rate of 20-25 kg per ha (or less than 10 kg of plant nutrients per ha).

Currently, farmers mainly use their own seed or buy uncertified seed from private merchants. Very little quality seed is available, a mere 2% for all cultivated areas. The figure is even lower for other crops.

Cambodia now produces enough rice for its own consumption and has surplus for export. Self sufficiency in rice was reached ten years ago, and now Cambodia can set aside a surplus of 2 million tons of processed rice annually for export. In the most productive areas, the rice surplus is traded locally and exported. In the poorer, overpopulated provinces, there is still a rice deficit which requires farmers to turn to other income-generating secondary crops or activities for meeting subsistence needs (e.g. handicraft, livestock husbandry, hiring labor out to perform various services).

The growth in rice production is mainly due to the development of rice-growing lands, use of improved traditional varieties, some of which have been multiplied from seed preserved in the genetic materials bank by the Cambodian Agricultural Research and Development Institute (CARDI) as well as to the repair and expansion of irrigation facilities. The government feels that it is important to multiply and distribute improved local varieties and those in great demand on the international market, such as Neang malis.

High-technology mechanical rice mills and huskers are in use during the last few years. There were only about ten of them in 2003; they are feely available in the countryside now. The rate of conversion from paddy to rice using modern technology is 70%. These high-tech huskers play an important role in promoting rice exports through the contract farming system, as exports require high quality rice.

7.2.1.2. Rice Marketing

Rice is mostly privately traded. Farmers have very limited storage capacity and deliver their production as soon as it is harvested to middlemen who resell the marketed portion of the harvests. Rice is abundant after the harvest, in November and December. Farmers often sell a large portion of their production immediately after the harvest to pay off their debts and cover emergency expenses. This means very low prices at harvest time, and reportedly has often encouraged merchants in border provinces to export to neighboring countries.

After a period of low prices due to the offloading of harvests in the market, prices go up early in the year and attract imports.

There are sharp differences in the price of rice between provincial and urban markets due to the cost of haulage between markets, which is an important cause of fragmentation of the marketing system. It is recognized that a trans-border rice trade exists between Cambodia, Thailand, and Viet Nam. Data pertaining to these markets are not available. However Cambodia is widely recognized as a net rice exporter since 1999, which would imply a reduction of rice supplies for the local markets and consequent higher prices of rice for domestic consumers.

7.2.1.3. Food Security

Agriculture must contribute to food security, which is essential for poverty reduction. Food security includes two essential components: first, the availability of food, and second, providing food at a cost that people can afford to buy.

Among the 15 main rice-producing provinces, five are in deficit for their rice requirements. The eight other provinces currently in surplus could also become deficit in rice if production fails to catch up with population growth and demand. There are households suffering from food insecurity in all the provinces. These are typically farmers who work very small plots of land (less than 0.5 ha), who should be targeted in food and farm assistance programs regardless of the overall food security situation in the concerned province.

The costs of transporting food commodities within Cambodia are high. In some cases the best and most accessible rice mills are found across the international border, which has the unintended effect of unifying markets in provinces with international borders to those of the neighboring countries. It is often more profitable to sell surpluses to the other side of the border than to deficit zones in Cambodia. It is also often less costly to import rice from neighboring countries into the rice deficit provinces rather than move rice from the surplus to the deficit provinces in Cambodia.

For the medium- and long term, high priority must be given to improving irrigation systems and their management, to extension services, and to postharvest operations. A vigorous push must be given to the improvement of agricultural productivity as well as to the intensification and diversification of production. Prompt implementation of the quality seed multiplication program and improving and the credit supply for production and marketing are essential for the propagation of the rice intensification program.

Food security zones differ in their livelihood structures: Although rice growing is often the main livelihood of rural households, 26% of these declare other main sources of income. Even within households that are primarily rice growers, the level of income dependency upon rice differs. On the basis of types of plant cover and data from socio-economic surveys, five zones of food economy have been identified in Cambodia: rain-fed plains, bush, forest, river, urban/market, as well as some mixed zones. In defining these zones, the impact of factors such as drought, deforestation, and lack of water resources on food security has been taken into consideration. .

With respect to household access to food, people living on non-irrigated lowlands or bush land are the least well off. In general, they experience a period of food shortage from 1 to 2 months every year, have an above-average level of indebtedness and fewer valuable possessions, and must have recourse to numerous unwelcome expedients to offset the income deficit (such as borrowing money, selling their possessions, emigration, etc.). The overall growth of the economy is unlikely to benefit these people. They make up the main population group suffering from food insecurity during normal years and need food aid as well as an income supplement and jobs. 70% of food aid is in fact allocated to food-insecure communities located in non-irrigated lowlands and bush lands. Infrastructure development such as roads, irrigation canals, rice banks, as well as training activities should be targeted to overcome their chronic food insecurity in the long term.

Farmers living along river banks and lake edges are normally better off in terms of food security than the average. In a normal year, less than 10% of targeted food aid funds go to them. However, the majority of people affected by flooding are to be found in this community of farmers. Their coping strategies include: (a) emigration; (b) artisan fishing; (c) receding water and dry-season rice growing; (d) sugar palm tapping; and (e) petty trade activities. Surveys show that these communities fear that the dry season harvest (as well as other mechanisms of adaptation) will not be enough to compensate for the food deficit, and that they will only incur more debt to make up the difference, and that in spite of recourse to the coping strategies mentioned above.

The less prone farmers are to flood affectation the less likely they will seek recourse to expedients or suffer shocks. The farmers more prone to have recourse to expedients are therefore the ones who have the greatest need for emergency aid, in particular in case of natural disaster. If these families can be helped from falling into the spiral of debt, they will be able to get back on their feet with the next harvest, and will not need long term supplementary food aid.

As far as food security and nutrition are concerned, Cambodia's strength lies in its capacity to produce up to a million surplus tons of rice without recourse to deforestation, since the cultivated area has still not reached its pre-war size. Moreover, raising productivity from 2

to 3 tons per ha or higher will strengthen food security and help increase exports. Agriculture ensures national food self-sufficiency, but many regions still experience an acute food shortage during “bad years” of rainfall.

The orderly and pro poor development of natural resources will help supplement income in marginal farms and add to food security. Land and natural resources play a crucial role in poverty fighting strategy by improving the well-being and reducing the vulnerability of rural communities. The selection of the model for the ownership and access to land and natural resources is a key element of poverty reduction strategy.

7.2.2. The *Chamcar* System of Agricultural Production

The chamcar is a system of agricultural production where rice is grown along with other cash crops such as tobacco, sesame, corn, soybeans, bananas, etc. This system of agricultural production can be divided into two types: (i) production along the edges of lakes and riverbanks; and (ii) production in the plateau areas with red and black soils.

Among the non-rice crops, the most important are corn, mung beans, vegetables, tobacco, sesame, soybeans, and cassava, sweet potato, sugar cane, and peanuts. These crops are grown mainly in densely populated areas such as the provinces of Kandal, Kompong Cham, and Kompong Speu. These provinces habitually experience a rice deficit and farmers respond by growing crops that are more profitable than rice.

Table 7.4. Production of non-rice crops
(in thousands of tons)

	1967	2000	2002	2003	2004	2005	2006	2007	2008
Corn	133	151.88	148.89	314.60	256.66	247.76	365.83	522.70	611.87
Cassava	23	147.76	122.01	330.64	362.05	535.62	2,200.28	2,215.42	3,676.23
Potato	13	28.17	21.25	34.89	53.13	39.14	47.80	38.31	39.62
Mung		15.10	23.92	31.81	45.25	45.04	60.95	54.49	38.60
Peanuts	20	7.49	9.73	18.48	21.54	22.62	18.22	30.50	25.47
Sesame	9	9.85	10.15	21.95	54.95	90.19	34.94	31.94	27.29
Soya	7	28.11	38.80	63.18	110.30	179.09	100.10	117.87	108.45
Tobacco	10	7.66	2.50	7.6	2.4	14.1	15.3	13.6	17.40

Source: Ministry of Agriculture, Forestry and Fisheries. Agricultural Statistics.

Encouraged by higher prices, production of soybeans has increased dramatically over the pre-1967 level. These crops are considered secondary, but are a significant source of income to marginal farmers. The total area devoted to corn, soybeans, mung beans, and cassava has been steadily increasing due to the favorable prices of these crops relative to

Box 7.1. Tobacco and Nurseries

The main activity of British and American Tobacco in Cambodia is the integrated production of cigarettes, from the tobacco plantations to marketing. It employs a regular staff of 485, plus 1,300 seasonal workers on its plantations, as well as at its Kampong Cham work center, drying facility in Takehman, factory and headquarters in Phnom Penh. The company has made a corporate investment of \$25 million.

BAT currently accounts for 50% of the market, or 3 billion cigarettes per year. Cultivated areas: 800 hectares out of a total of 1,500 hectares in Cambodia. Its yields went from 750 to 1,950 kg/hectare and the quantity produced is 2,000 tons per year on average. BAT buys tobacco from the 747 farmers who work under contract with the company. BAT has agreed to buy the tobacco produced, thus ensuring the farmers a 40 % return on their investment. Currently, the tobacco produced is of average quality. Imports, which accounted for 55% of tobacco used, are down to 20%. Exports reach 500 tons per year.

other crops particularly rice. The production of crops such as peanuts, sesame, sugar cane, tobacco, and black pepper is limited by the capacity of processing plants, the size of the domestic market, and the prospects of export demand. A small area of farmland is devoted to the production of vegetables. These crops produced in limited quantities have nonetheless an important impact from the standpoint of their nutritional value for families.

7.2.3. Industrial-Scale Agricultural Production

Industrial-scale agricultural production is predominantly practiced on economic land concessions granted by the government for the production of cash crops, such as rubber, pepper, coffee, and cotton. The Ministry of Agriculture, Forests and Fisheries (MAFF) approved concessions with a total area of 827,286 ha by end 2000. But by late 2002, the MAFF cancelled concessions on an area of 103,680 ha. At present, there are 26 economic concessions with a total area of 723,606 ha. However during 2003-2008 small- and medium-size plantations for industrial-scale agricultural production have become more widespread.

7.2.3.1. Rubber Plantations

Rubber has long been a mainstay of industrial cash crops in Cambodia and a potential source of export income. Rubber was an important source of export revenue in the 1960s. In the late 1960s, plantations covered 65,000 ha, of which 39,000 were tapped, with a yield of 52,000 tons. In 2003, Cambodia succeeded in bringing up the harvested areas to the level of the late 1960s. From 1999 to 2008, new planting was started and about 52,771 ha were replanted.

The government controls production and marketing through State-owned companies. Since rubber crop is labor-intensive, it can contribute to poverty reduction through job creation in rural areas. The area planted with rubber is constantly increasing owing to the development of family-scale plantations. State plantations have also undertaken programs to renew old plantations with high-producing trees.

The development of family-scale rubber growing is one of the objectives of the RGC. This calls for the prior technical training of future small-scale growers and financial support. The project for the development of family-scale rubber growing is being funded by the Agence française de développement (French Development Agency - AFD). The administrative and technical management of family rubber plantations comes under the General Directorate of Rubber Plantations. In 2003, the program called for 410 ha of new family-scale plantations. In addition to its soil cover and the forest climate that it restores to degraded forest lands rubber provides the inhabitants with a long-term source of income. As of 2008 small holder plantations were estimated at more than 41,000 ha.

Restructuring the rubber sector is a challenge for Cambodia. This effort obviously requires major investment, beyond the funding capabilities of own-source funds of the SOEs or allocations from the national budget. The RGC has therefore decided to bring the private sector into the implementation of the sector development plan. This approach is being pilot tested.

Table 7.5. Rubber plantations in 2008

	Tapping	Production	Newly Plan-	Labor
Chup	6,269	9,027	2,773	4,052
Peam Chang	2,001	2,153	284	1,172
Krek	1,363	966	320	1,063
Memot	1,903	1,213	-	1,378
Snuol	1,004	1,065	-	820
Chamkar Andong	1,955	1,341	-	1,556
Boeung Ket	1,300	650	-	908
CRRRI	284	184	-	299
Tapao	1,053	559	-	-
Labansiek	36,500	2,133	-	-
ELC	-	-	8,205	-
Smallholders	13,037	12,385	41,190	-
Total	33,670	31,676	54,227	11,678

Source: 2009 Annual Conference of the Ministry of Agriculture, Forestry and Fisheries

In 2008, rubber plantations cover 107,900 ha, of which 45,469 ha of existing plantations; 54,227 of smallholder plantations and 8,205 of new investments. Some 33,670 are being tapped, yielding 31,676 tons of rubber. Area planted with rubber trees is constantly growing because of the development of the family-scale plantations. State-owned plantations have also undertaken renewal programs, replacing old growth with high-yield trees.

The great majority of rubber plantations are located on the lower plateaus of red basaltic soil in the provinces of Kampong Cham and Kratie. Red basaltic soil provides the best ecological conditions: for growing rubber - deep, homogenous, clayey but permeable soil, with a high fertility potential. Rainfall is abundant in these provinces.

A second area with strong potential is located in Rattanakiri and Mondolkiri provinces. These are located in eastern Cambodia where ecological conditions are suitable. A third zone outside the red earth area is that of sandstone soil zones found in different parts of the country: Kampong Thom, Preah Vihear, and Kampot provinces.

Three types of rubber plantations are found in Cambodia:

- ***State-owned industrial plantations:*** A total of seven State-owned plantations are under the General Directorate of Rubber Plantations in the Ministry of Agriculture, Forestry and Fisheries. The RGC is in the process of piloting a program of privatizing State-owned plantations (State disinvestment), with assistance from the Asia Development Bank. Foreign investors from Asia and Europe and local investors are seeking to obtain land concessions in order to expand new industrial plantations.
- ***Family-scale plantations:*** These are plantations of less than 20 ha mainly developed by well-off farmers, small- and medium-size local investors, and a minority of “poor” farmers (with the support of a development project). The family sector is currently enjoying a very dynamic growth.
- ***Private industrial plantations:*** These are major emerging “actors” with plantations of some 20 ha up to several thousand ha, developed by private Cambodian “non-farmer” investors. Among them are some provincial investors; but the majority are wealthy investors from Phnom Penh. At present, a few private plantations exist in the traditional zone, but a large number of new projects are locating in Rattanakiri and Mondulkiri. The trend for private sector plantations to expand could also mask land speculation. There are also attempts to set up private plantations in the north and west, outside of the recognized rubber-growing zones, but their technical and economic feasibility is still uncertain.

7.3. Forests and Forestry Policy

Most natural resources are public goods because property rights concerning them are not defined. The best example—and also very important for Cambodia—are the forests and fishery resources. A competitive environment that is not regulated can lead to deforestation and to the depletion of fish stocks, since individual fisherman are not concerned with preserving them. Tourism is another industry that depends upon the good management of natural resources.

Forests are a very significant element of national heritage. The FAO estimates that in the late 1990s, forests occupied nearly 60% of the country's total area, or about 10-11 million ha, compared to 75% in the early 1960s. Compared to Thailand and Viet Nam, where the forest cover is now only 20%, the situation in Cambodia is less alarming, but the downsizing of forests is no less a cause of concern. Deforestation is due to commercial operations, logging by the various Cambodian factions during the years of resistance fighting (especially along the Thai border), and uncontrolled tree cutting. However, according to the Forest Administration, forest cover amounted to some 60% (or 11,104,285 ha) in 2008, although the rate of reforestation still remains low.

Given the uniqueness of Cambodian's fauna and biodiversity, in the early 1990s, the RGC introduced protected forest zones in the form of national parks, animal sanctuaries, and catchment basins of protected waters. In 2004, national forest reserves, national parks, and protected zones covered 3.3 million ha. About 110,000 ha of forest have been placed under the management of forest communities.

Cambodia possesses a significant stock of natural resources. Briefly, these resources include: (i) fauna and forest; (ii) fisheries resources; and (iii) beaches. Despite the disappearance of certain species, Cambodia's fauna is relatively rich, thanks in part to the presence of the rain forest. The fauna, which includes certain species of birds, elephants, and turtles, is especially threatened by illegal commercial exploitation.

By law, the forest belongs to the State. Under State Regulations forest cover is divided into permanent reserved domain and protected domain. The reserved domain, under strict conservation or development rules, includes all the reserves for production and protection. The protected domain includes all forest not included in the reserved domain.

The development of forest resources in Cambodia is constrained by poorly regulated commercial development of forestry and rapid urbanization, the effects of which, when combined with poverty, meant destruction of forests. The main issue affecting natural resources management is their sustainable development in a manner consistent with their

economic engagement in the strategic sectors of agriculture, fisheries, and tourism. To address this issue the government has adopted a three-pronged strategy:

- Adopt best international practices in forest management including sufficient reserves to satisfy the needs of domestic consumption, prevent periods of drought and flooding, and provide wetlands that are important to fisheries reserves.
- Institute a system of protected zones to safeguard biodiversity and threatened species.
- Foster trustworthy, transparent community forest development at the local level.

To achieve sustainable forestry management, the RGC has established the following priorities:

- Strengthening the management and protection of the forests;
- Rationalization and classification of the remaining forest to guarantee protection of the environment and preservation of biodiversity, by adopting and applying the subdecree on the classification of forests.
- Strengthening the application of regulations on forests, in particular government's directive No. 01 BB of June 9, 2004, on measures for control of deforestation and encroachment on forests.
- Strengthening protection strategies, such as: protected forests; management of watershed catchment basins; gene pools, protection of wild species; ecotourism; and other protection projects involving the local communities and based on effective management plans.
- Strict enforcement of forest management techniques, including the management and sustainable use of forest resources and concessions.
- Education and awareness-raising campaigns regarding forest resources.
- Enhance forestry contribution to socio-economic development:
 - Highlight the socio-economic necessity of protecting forests and biodiversity.
 - Promote replacement tree planting in the national forests by encouraging private investment and community involvement.

- Optimize use, processing, and marketing of forest products in order to meet local and export demand.
- Promote reforestation and protection of trees.
- Integrate forestry development with poverty reduction strategy:
 - Strengthen legal protection of the rights of communities to manage the forests in order to guarantee food security and promote poverty reduction. These rights are guaranteed by the Forestry Law and other related regulations.
 - Ensure that local communities benefit from the use and management of forestry resources.
- Encourage capacity building and good governance in forestry management:
 - Pursue institutional capacity building at all levels.
 - Institute education, training, and awareness-raising campaigns among the local communities to promote community involvement in the protection and sustainable management of forests.
 - Promote capacity building at all levels of the Forest Administration so that the officials involved are enabled to fulfill their responsibilities in cooperation with the institutions involved.

Government has been paying close attention to forestry management since January 1999. Illegal activities have been reduced; a Forestry Domain Surveillance Department has been created with the full-fledged involvement of the Société Générale de Surveillance (SCS), and the concession system review process has been completed. Based on the results of the SCS review, the RGC took measures to cancel forest concessions. These concessions were reduced from 6.4 million ha in 1999 to 2.4 million ha (eight concessions) in 2004. A new forestry law was enacted in 2002 after a series of national consultations with the stakeholders.

The stringent measures taken by the government against illegal deforestation cover all the enforcement procedures of the law—prevention, detection, and prosecution. In June 2004, the RGC acting on decree No. 01BB for the prevention, suppression, and elimination of deforestation and encroachment, put in place a national committee supported by

subcommittees at the provincial level to enforce this decree. The RGC will continue to zealously combat illegal developments.

The government will continue to raise the technical level of the concession holders and the government agencies involved in the management of forest concessions. The government must also ensure the healthy management of the forest areas withdrawn from the concession system. For this reason, it is committed to redoubling its efforts to improve the operations of the Forestry Domain Surveillance Department.

In terms of legislation, the RGC has developed additional control mechanisms and directives necessary for enforcement of the 2002 Forestry Law. The subdecree on community forestry development promulgated in December 2003 places forestry assets under the direction of local communities within the framework of joint management plans and agreements for the sharing of profits. The subdecree is the outcome of six years of research and consultation with numerous stakeholders and complements other measures such as the subdecree on social land concessions, for better management and greater productivity of natural resources.

The system of forest concessions and individual concessions has been revamped under the 2002 Law to make them more accountable to the forest dwelling communities and more concerned with public interest. The RGC is pursuing implementation of the reform of forestry management, including concluding revised contracts with concession holders still operating and adopting measures to strengthen consultation with local communities and avoid conflicts and negative impact on the environment. The RGC's decision to develop community forestry has empowered rural communities in natural resource management.

The RGC is working in partnership with various donors and non-government organizations to pilot community initiatives in several regions of the country. Nearly 110,000 ha were developed within the framework of community forestry development agreements.

7.4. Fisheries

Fisheries contribute about 10% to the agricultural GDP. Fish is one of Cambodia's major export products. In the late 1960s, commercial production averaged 120,000 tons of freshwater fish, 40,000 tons of sea fish and 5,800 tons from freshwater aquaculture. By 2006 total fisheries production amounted to 516,700 tons, of which the commercial freshwater catch had gone up to around 139,000 tons, sea fish catch to 60,500 tons, aquaculture production to 34,200 tons and community and rice field production to 283,000 tons, certainly a sign of overfishing in Cambodia. It is a revenue-producing activity for nearly 17% of the labor force, or about 1.3 million people.

Table 7.6. Fisheries production (000 ton)

	1999	2002	2003	2004	2005	2006	2007	2008
Fishing lots and Middle Scale	71.0	110.3	94.8	94.5	139.0	139.0	125.0	115.0
Community and Rice Field Production	160.0	250.0	214.0	229.5	166.0	283.0	270.0	250.0
Aquaculture	15.0	18.3	26.4	25.8	21.6	34.2	35.3	40.0
Sea (Marine) Production	38.1	45.9	54.5	32.6	33.9	60.5	63.5	66.0
Total	284.1	424.4	389.7	382.4	360.5	516.7	493.8	471.0

Source: MAFF (2009)

Fish is a dietary staple for Cambodians. Both fresh water and sea fishing are practiced in Cambodia, with fresh water fishing being the more important. Cambodia's fresh water fish resources are abundant due to the annual Mekong River flood and the waters of the Tonle Sap Great Lake. But fishing and agriculture are often in conflict because of competition for space.

Fish supply on average 34% of the animal protein in the diet of Cambodians. In addition to people who work in the fishing industry, the food security of millions of others, in particular in remote rural areas, is heavily dependent on the catch from traditional fishing. Women dominate the subsectors of processing and marketing in fishing. According to modest estimates, women comprise about 50% of the total labor force in fishery.

The Tonle Sap Lake occupies the middle of the central plain. The Tonle Sap River flows from it in a north-south direction. The Mekong River enters Cambodia where the Thailand and Laos borders meet. Its course then takes a long curve to the east of the central basin before reaching Phnom Penh.

In Phnom Penh, the Tonle Sap and the Mekong join. A few hundred meters farther, the Mekong splits into two, thus beginning its delta. One of the tributaries keeps the name Mekong, while the other is called the Tonle Bassac. The confluence and division of the Mekong form an X called "les Quatre-Bras" (the Four Arms). This is where a phenomenon unique in the world takes place—the reversal of the current of a river. Depending on the flood level of the waters, the Tonle Sap either flows out of the Tonle Sap Lake (from November to June) or flows into it (from June to October). The "Water Festival" celebrates the reversal of the current in late October or early November.

The Tonle Sap Lake is a unique natural resource. Besides its hydrological role, it constitutes, along with the inundated forest that borders it, the key source of freshwater fish production. It provides about 60% of the inland volume of fish marketed commercially.

The lake is rich in nutrients and the fish found in it are often much bigger than those that grow in the rivers. However, an ecological threat is hovering over the Tonle Sap. The rate of sedimentation is very high, owing to destruction of the adjacent forests and to the sediment deposited by the Mekong.

One sixth of Cambodia's seacoast of 435 kilometers forms a part of the coastline of the Gulf of Thailand, lending itself to sea fishing.

7.4.1. Freshwater Fisheries

Freshwater fishing during the months of November to May is the major occupation of the communities living along the edges of the Tonle Sap and the banks of the Mekong. As soon as the water level starts to drop, life along all of the watercourses and lakes takes on a frenetic pace. The lake is a lifeline for millions of inhabitants.

The Tonle Sap Lake is the busiest fisheries center in Cambodia; it is estimated that fish production reaches 200,000 tons per year (fresh fish). This quantity seems enormous when considering that the lake has a low water area of 2,700 km² and 10,000 km² at the high water stage. The Tonle Sap is indeed one of the most productive freshwater fisheries and of unparalleled intensity in the world (in relation to its maximum surface), supplying 75% of the annual volume of freshwater fish for the country. At the end of the rainy season, the river goes back to its normal course, and fish are borne downstream. The lake and its fish reserves are also home to about 15 species of large birds threatened with extinction.

The lake's outstanding productivity is due to the particular conditions of its setting. The Great Lake is likely the bottom of an ancient sea gulf; links with the sea were cut off with the gradual buildup of the Mekong Delta. After the mouth of the gulf filled in, the Mekong River pushed its delta out into the sea. This background of the lake is evident not only from the geographical features of the region, but is also backed up by certain facts such as the existence of residual sea fauna, or by the brackishness of the underground water which is found inland for some distance south of Phnom Penh.

These factors partly explain why the Tonle Sap Lake is teeming with fish. Indeed, fish find a very favorable environment for spawning among the inundated trees and underbrush beginning in the month of June. In addition, a profusion of algae and infusoria (microscopic animal life) develops in the flooded forest, turning the waters into a veritable dark-colored bouillon of animal and vegetable matter where fish need only open their mouths to feed.

Literally swimming in food, the fish grow very rapidly. Their rate of growth is remarkable, and they quickly reach the size of sea fish in Europe. A trey kaêk in the Great Lake reaches

a length of 32 cm in two years, while fish in other bodies of freshwater in Cambodia do not grow as rapidly. Each year, millions of fish come to breed in the flooded forests that surround its shores, bringing in their wake myriads of water birds.

This wealth of fish in the Great Lake attracts a great number of fishermen. Man has fit right into this biotope, settling in floating villages where life flows with the rhythm of the waters. A permanent population of fishermen lives in houses perched on tall stilts or secured on bamboo rafts. Hamlets of this type are found everywhere along the shores of the lake. These lake communities spend part of the year on land and part on the water, drawing their means of subsistence from the lake and flooded forest, which is a prime habitat for fish. But during the dry season, the number of fishermen grows considerably, with an estimated throng of 30,000 people involved in fishing.

Of the annual yield of 200,000 tons of freshwater fish from the Tonle Sap Lake about 50,000 tons are consumed as fresh fish. The rest is processed by traditional means into dry or smoked fish, prahoc (fish paste), and tuk-trey (fish sauce). Cambodians prepare fish in different ways. It may be grilled, fried, salted, steamed, or fermented. Among the by-products are fish oil and fish meal, currently used as a fertilizer or food for fowl. After meeting the local demand, some 28,000 tons of fish from Cambodia are exported to neighboring countries.

Fishing methods fall into two categories, small-scale, which is neither labor- nor capital-intensive, and large-scale, which requires costly machinery and a large outlay of capital. Small-scale fishing is done on foot or by boat, with simple tools: fishing line, spear, or nets. Large-scale operators use large dams and nets.

7.4.2. Aquaculture

The capture, processing, and sale of fish are the lake's most important economic activities, followed by catfish and snakehead growing in cages. For families which practice aquaculture, fish is the equivalent of a bank account. They invest in raising fish, which increase in value as they grow and reproduce, like interest in a bank account. When the families need money, they simply sell some of their fish.

Aquaculture is contributing to poverty reduction in Cambodia, strengthening food security, and improving the standard of living. Aquaculture accounts for 8% of the annual production of fish. It plays a crucial role in rural development. It not only enables families to enjoy food of high nutritional value and small farmers to survive after bad harvests, but also provides work and helps increase the income level in local communities.

The RGC in cooperation with the FAO has organized training courses in aquaculture in order to help local communities build ponds, produce fry, and feed fish. CARDI has also provided training in rice paddy fry and fish rearing.

7.4.3 Fisheries Reform

The RGC has introduced far-reaching reforms in fisheries management since 2002 and distributed fishing lots to poor fisherman. As of 2002, the government had distributed 495,000 ha to local communities. The challenge will be the sustainable management of fishing lots. Apart from artisan fishing commercial fishing is undertaken by concessionaires. Fishing rights belong to the State, and are awarded every year to contractors. Some 500,000 ha of fisheries reserves were fenced off for concessionaire operations.

The government will take action to improve the livelihood in fishing communities by promoting local and regional initiatives in the fisheries sector that are eco-friendly. Priority actions have centered on support for communities to improve fisheries management and control illegal fishing. Following the fishing lot reform in 2000, the number of lots went down from about 235 covering a water surface area of nearly a million ha to 164 spread over about 420,000 ha. The decrease in fishing lots also brought about a reduction in conflicts with agricultural communities bordering on or in the proximity of fishing lots.

The second phase of the fisheries sector reform is underway in several provinces. Over 56% of fishing lots have been granted to local communities in order to promote the setting up of community management systems. The royal decree on creation of community fisheries and the subdecree on management of community fisheries were enacted by the government; 360 community fishing lots have already been established in the country with the support of development partners. The fisheries law formalizing community managed fisheries has been submitted to the Council of Ministers and after approval will be forwarded to Parliament.

However, like agriculture, the fisheries sector is confronted by major obstacles that can be summarized as follows: (i) the small, restricted nature of the fishing lots in contrast to the importance of the activities and the increasing scarcity of the resource, which exacerbates conflicts; (ii) the lack of basic infrastructure in fisheries centers (piers, means of preservation, haulage of the produce, etc.); (iii) lack of training and the organizational weakness of stakeholders in the production and distribution chains; and (iv) low added value and productivity. With the goal of overcoming these obstacles, the following objectives of fisheries sector reform have been identified: (i) sustainable management and restoration of fisheries resources; (ii) meeting the national demand in an environmentally sustainable way; (iii) getting maximum value from the resources; and (iv) empowerment of professionals in the sector.

The priorities of the RGC in fishery development stated in the Rectangular Strategy, are as follows:

- Promote community development of the fisheries industry by giving local communities the necessary means to get fish farmers actively, directly, and equitably involved in the planning, implementation, and management of fisheries programs.
- Convert fishing lots whose concession contracts have expired, into fish reserves to increase fisheries resources and protect threatened species.
- Extend community fishing lots, promote aquaculture in response to the growing demand, and reduce pressure on fisheries resources.

In order to reduce poverty of fisheries communities, grassroots support must be provided to them. However, for the initiative to succeed the recipients of such assistance should show the willingness to learn new technologies and methods and proactively engage with the assistance providers.

The involvement of resource users in planning and development is crucial for ensuring that the proposed reforms are accepted and will be implemented. The strengthening of local government and community capacity to administer and manage the reforms is also necessary for the proposed reforms to succeed. Government strategy emphasizes both these aspects of fishery reform.

7.5. Animal Husbandry

Livestock farming is one of Cambodia's primary productions and accounts for 5% of the GDP. The livestock numbers have increased steadily in recent years. The table below summarizes the livestock availability in Cambodia in 2008.

By 1987, cattle numbers (including buffalo) had recovered the level of the late 1960s. Swine herds have been growing steadily in recent years, with the number of pigs reported to be 2.2 million in 2008. The number of fowl is estimated at 16.9 million. Pig farming and raising chickens are generally carried out at the family level. A few private companies have recently started commercial scale operations in livestock business (beef, pork, and poultry).

However, most of the animals—cattle, buffalo, swine, and fowl—are raised by small-scale farmers who practice subsistence agriculture.

Table 7.7. Livestock Resources in Cambodia, 2008

Provinces/cities	Cattle	Buffaloes	Swine	Poultry
Banteay Mean Chey	132,272	21,822	108,630	521,772
Battambang	208,126	6,353	83,911	914,995
Kampong Cham	423,936	83,554	216,807	2,403,460
Kampong Chhnang	205,479	49,409	142,062	584,835
Kampong Speu	402,334	976	110,479	797,335
Kampong Thom	244,443	52,372	105,499	554,628
Kampot	235,009	12,511	131,733	962,657
Kandal	196,075	9,054	115,766	1,004,369
Koh Kong	9,668	10,034	13,419	68,658
Kratie	104,227	45,626	62,501	410,264
Mondulkiri	14,375	12,381	7,387	43,144
Phnom Penh City	11,205	301	15,775	123,562
Preah Vihear	64,383	18,379	38,714	151,036
Prey Veng	280,441	94,685	341,145	2,159,593
Pursat	100,753	103,491	80,830	859,438
Rotanakiri	27,553	17,782	31,117	104,167
Siem Reap	237,400	32,700	125,546	1,717,100
Preah Sihanouk	6,699	5,376	10,820	115,687
Stueng Treng	21,815	31,749	27,181	96,595
Svay Rieng	124,739	130,411	176,795	796,499
Takeo	343,165	4,601	183,199	2,237,280
Otdar Mean Chey	39,806	2,252	70,527	141,144
Kep	16,484	366	9,357	61,822
Pailin	7,400	22	6,441	98,035
Total	3,457,787	746,207	2,215,641	16,928,075

Source: Agricultural statistics, Ministry of Agriculture, Forestry and Fisheries

A relatively large number of people work in animal husbandry. Having saleable animals provides a source of savings which the farming households can use in times of need. The sector faces a number of structural constraints including: (i) technical backwardness such as prevalence of disease and shortage of pasture and watering places (agricultural by-products and cattle feed cannot substitute for pasturage because of their high cost); and (ii) lack of financial support, because of low public investment in the animal husbandry subsector.

The government's strategic objectives for enhancing the contribution of animal husbandry to GDP and poverty reduction include: (i) developing animal husbandry as a key aspect of rural food security; (ii) improving access of the sector to land and natural resources; (iii)

***Box 7.2. Silk production and cloth weaving—Revival of the silk industry
in Cambodia***

Koh Dach—Silk Island—is renowned throughout the country for its production; from every house is heard the sound of busy looms preparing silk cloth. The people on Koh Dach, Kandal province, have been able to benefit from a series of programs funded by the international community and intended to boost the local production of silk yarn and cloth.

The French Agency for Development (Agence française de développement - AFD) has launched a program in support of the silk sector. This program intends to revive a practice that already existed in Cambodia, but focusing on modern silkworm growing techniques and better weaving equipment. At the same time, the AFD is trying to develop better communication between the growing and weaving groups that are concentrated in different regions of Cambodia.

Silkworm growing is currently not very lucrative. On average, it brings in around \$200 per year per household. But successful silkworm breeders can double their profits. Under a pilot project, the worms, from whose cocoons are extracted the delicate silk thread, are also raised in Rattanakiri Province. In 2003, the AFD program involved over 1,800 weavers, while by late 2004, 1,000 breeders had received training. Additional training for breeders was provided in mulberry tree growing, which provides the leaves making up the basic feedstock of the worms.

Source: Cambodia Soir, May 19, 2004.

better management of the environment to maintain land capital, preservation of productive bases, and improvement of production systems; (iv) ensuring growth of productivity; and (v) removing uncertainties constraining animal production. Short- and mid-term initiatives have been identified for facilitating smooth operations in the cattle-meat production chain, breeding of short-cycle species (small ruminants and local fowl), animal feed security, and treatment and processing of animal by-products (hides, horns, etc.).

Development of silk has been identified as having good potential for supplementing rural incomes. Cambodian silk had virtually disappeared as an economic activity during the Khmer Rouge regime but is staging a strong comeback. The box below provides a snapshot of the progress being made in reestablishing the silk industry in Cambodia.

Chapter 8

Impediments to Improving the Standard of Living of Farmers

8.1. Landlessness

In 2004, half of rural households, or well over a million rural families, owned less than 0.5 ha of arable land. Because of the uneconomic size of the landholding, some farmers might have sold their land in order to take jobs in sectors outside of agriculture. In general, a family that owns between a half to three quarters of a ha of average-fertility cropland can earn an annual income of \$300 to \$400, provided that the rice yield is 2 tons a ha and the price of paddy is \$200 a ton.

Arable land accounts for about 20% of the total area of the country. A reduction in the average size of land plots is observed as the number of families increases due to demographic growth. 90% of the plots are less than 0.5 ha and 75% of farms are less than 1.0 ha.

According to a study by Oxfam (2006), landless farmers account for 25% of rural households, while the Socio-economic Survey of Cambodia (SESC-2003-04), which is more representative, identified 25% of the population in the agricultural and non-agricultural sectors as being landless. A survey of farming households suggested that 12% of farmers were landless (Biddulph 2000, Biddulph 2004).

It is obvious that the concentration of land wealth strengthened and accelerated between 1999 and 2004. The SESC-2003-04 found that in 2004, households owning less than 0.5 ha account for only 5.4% of arable land, while those who hold more than 3 ha own 48% of the land. It is estimated that 10% of landowners own 40% of the land.

A growing concentration of land could allow agricultural modernization through the improvement of economies of scale and the use of advanced technologies. However, the secondary and tertiary sectors in Cambodia, despite the robust growth of tourism, textile exports, and construction, have no obvious capacity to absorb the rural exodus of great magnitude, at least in the medium term. Consequently, the growing concentration of land could result in stubborn rural poverty and growing unrest in the urban sector.

A study by Oxfam (2004) of 797 land disputes in 23 provinces and municipalities of Cambodia revealed that 36% of the disputes involved plantations, 32% cultivated land, and 26% construction sites. This study showed that 71% of the cases involved people with no land title, 24% were owners who claimed the land based on registry receipts and only 5% of the owners had property titles.

8.2. Inputs Supply

8.2.1. Water for Agriculture

The key input for the growth of agricultural productivity is water. Good quality seed and chemical fertilizer, skillful management of farms, use of modern equipment and good soil fertility cannot contribute to high yields of rice if proper water management is lacking.

Rice yields have varied considerably in recent years and correlate closely to climatic conditions. In 2008, the average rice yield in Cambodia reached a historic record of 2.7 tons per ha, due mainly to the good level of rainfall and irrigation systems put in place by the government.

According to the Ministry of Water Resources and Meteorology, in 2006, the area of irrigated rice land accounted for 29% of the total rice-growing area, compared with an annual average of 20% during the five preceding years. However, the entirely irrigated rice-growing area during the dry season reached only 11%, or 300,000 ha.

The reason for lack of investment in and under-use of irrigation system capacity is the low financial return from irrigation projects. Nevertheless, irrigation projects do have a high economic and social return if the social benefits for the communities, most importantly their income-generating capacity, are factored in. Government has been emphasizing irrigation development as a strategy to tackle rural backwardness. Investments by the government in irrigation projects have increased by an annual average of 2% during 2003-2006 and reached \$10 million in 2006.

A recent study of irrigation systems showed that water pumping stations are more efficient than large water reservoir systems. With mobile pumping stations, conflicts among the farmers can be avoided. However, energy costs are higher in pumping stations compared with water reservoirs.

8.2.2. Seed, Fertilizer and Pesticides

The use of high-yield seed and the correct application of fertilizer and pesticides could increase yields and consequently profit for farmers. According to AQIP (Agricultural Quality Improvement Project), only 80,000 farmers, or less than 5%, use high-quality seed, because the price is triple of what they pay for ordinary seed

Cambodia is one of the least productive environments in Asia for rice growing because of its infertile soils. From an agronomic point of view, the soils of Cambodia are in general poor in phosphates and potassium (Young, Raab et al, 2000). Fertilizer must be used to increase the yield. According to commune databases, 50% of households use fertilizer but not necessarily in a scientific manner.

Cambodian farmers do not usually use pesticides. But households who do use them generally use them for rice and vegetable growing. It is reported that 27% of farmers used pesticides in 2005.

8.2.3. Energy and Electricity

Only 10% of households have access to electricity. In 2005, electricity rates rose from \$0.09 to \$0.25 per kilowatt-hour in urban areas and from \$0.4 to \$0.8 in rural communities.

Fuel and electricity are important for water control. Reducing the cost of energy will help farmers to increase agricultural production. The energy cost in Cambodia is the highest in the region, except for Singapore.

8.2.4. Equipment for Paddy Processing, Prices, and Market

The lack of granary facilities, the dilapidated state of the roads, and the monopoly of husking factories are the main causes of high costs and low farm gate prices of paddy. In the traditional markets, farmers receive only 70 cents on the dollar from the retail price, compared to 80 to 90 cents obtained by Thai and Vietnamese farmers. (Arulpagason, J. et al, 2003). Liberalization of rice trade and improvement in infrastructure resulted in competition and increase in rice prices.

The harvesting, drying, and husking processes of paddy, impact on the consumer price of rice. If the drying is not thorough, husking will produce broken and defective grains. A poor-quality husking machine also lowers the quality and the price of rice. JICA (2001) estimated the loss due to post-harvest processing at 7% of the total production. The processing of rice is still predominantly carried out in a traditional manner, despite efforts

to mechanize it. This post-harvest loss has declined due to the introduction of high-tech rice milling technology.

8.2.4.1. Rice Markets

There is little modernization of rice marketing. Most farmers still follow the traditional practice of selling their paddy to village merchants, traders, and husking factories at the current market price. Husking factories and merchants buy paddy from farmers as well as village merchants. After husking, they sell the rice to wholesalers, retailers, and private companies for local consumption and for export.

There are many middlemen in this chain, owing mainly to the fragmentation of the market, information asymmetry, and the bad state of infrastructure. These traditional markets are fragmented and function independently without any interaction. Price signals, determined by supply and demand in urban areas, do not reach the farmers. The various middlemen distort the conveyance of consumer price signals to the growers. In the absence of information on prices or a trustworthy mechanism for ascertaining the price of products, farmers have few options about what produce to grow, where to market their produce, and how much to sell it for.

Angkor Kasekam ROUNGREOUNG (AKR) has been able to improve the market mechanism by making direct contact with the growers and offering them higher selling prices. This streamlined system sidesteps the middlemen. The growers receive advance information on the selling price and are cognizant of the costs of transport. Contract farmers can sell their paddy at a higher price in the contractual system compared with the traditional markets dominated by the middlemen.

8.2.4.2. Market System for Cashew nuts, Cassava, Corn, Soybeans, and Rubber

In general, the government avoids direct intervention in the market, in keeping with its overall free market approach. The market for agricultural products other than rice serves to connect farmers to exporters and retail merchants through a chain of village merchants/ middlemen/ wholesalers. Export absorbs about 95% of agricultural produce (except for rice), such as cashew nuts, cassava, corn, and soybeans. Because of the middlemen, the farm gate price is no higher than 70-75% of the export price. This is similar to the farm gate price for rice.

The large differential between the market price and farm gate price is not only due to the cut the middlemen take, but also to high transportation costs and the informal payment made at the border, which amounts to a hidden export tax. In order to increase the farmer's selling price to the level of the market price, the costs of transportation have to be reduced,

informal payments at the border eliminated, and competition introduced between middlemen and the buyers of agricultural products.

8.2.4.3. Growers and Price Information

In the current structure of the rice market, after the harvest, farmers quickly sell their surplus to middlemen in order to raise cash. The latter obtain a good profit margin later by reselling the rice when prices have gone up.

JICA conducted an experiment by setting up the Open Paddy Market (OPM) in Prey Veng in order to maximize the farmer's selling price. The OPM provides warehouse space to buyers and sellers for storing the rice and functions as an auction mart. The warehouse services include weighing, transporting, quality selection, drying, post-harvest storage, distribution of high-quality fertilizer, and mortgage credit. Competition among rice merchants and middlemen was strong enough to raise the farm gate price substantially for farmers who joined the OPM project.

8.2.5. The Non-Agricultural Rural Economy

The capacity of the agricultural sector to absorb the growing economically active population is limited. The number of additional workers entering the agricultural labor market is estimated at 250,000 persons each year. The rural employment situation is exacerbated by the shortage of natural resources on which many rural households and landless farmers depend.

Traditional non-agricultural income-generating activities are forestry products, fishing, fish processing, silk production, weaving, pottery, marble products, and brickmaking. In general, such activities are inefficient and lacking in comparative advantages because of obsolete technology, lack of training, limited access by workers to modern technology, lack of financial resources, limited market outlets, and small scale of production.

8.3. Physical and Social Infrastructure

8.3.1. Education and Occupational Training

The net rate of primary school enrolment in Cambodia was 91.3% in 2005 (gross enrolment is 124%), but only 43% of the students who enroll complete grade 6. The net rate of lower secondary school enrolment is 31.3% (gross enrolment rate is 50%) and for upper secondary school is 11.3% in 2005. Thus, only 19.3% of the students enrolled complete lower secondary education. The dropout rate is large ranging from 11.8% for grade 1 to 25.8% for grade 9. The student-teacher ratio—53 to 1—is considered high in

rural communities for instruction to be effectively delivered. What is more, the opportunity cost for education is high if the parents are poor and illiterate.

Occupational training centers in the formal sector, in particular in rural areas, are insufficient. There are very limited opportunities for productive non-agricultural employment. Unqualified workers who enter the labor force frequently have recourse to traditional agriculture and the natural resources sector for earning a subsistence livelihood. While professional training in the informal sector is widespread, it is difficult to estimate its impact on the labor market. In order to reduce and possibly eliminate the dependence of rural communities on agriculture and natural resources for their subsistence, it is necessary to find a means based on the market system to provide training and productive employment in the non-agricultural rural sector for young people who have just entered the labor market.

8.3.2. Sanitation Services and Health

The fertility rate declined from 4 in 2000 to 3.4 in 2008. The infant mortality rate has also decreased from 95 per 1,000 live birth to 66 in 2005, while the mortality rate for children under 5 years of age has dropped from 124 to 83 per 1,000 live birth. The rate of children vaccinated has grown considerably and only 7.2% of children had received no immunization at all. About 15% of Cambodian children are born with low birth weight. However, nutritional status of children has improved during the last five years. Currently 37% of children are stunted and 7% are wasted, compared with 45% and 15% in 2000.

Access to health care is a major concern. Since most health care personnel and health institutions, especially public institutions, are found in urban areas, the provision of health care services in rural communities is mainly carried out by the private sector and the traditional medicine system. 30% of the rural population has access to private health establishments, another 24% use traditional medicine, and the remaining to the public health system.

8.3.3. Rural Road Infrastructure

The improvement of the road infrastructure in rural zones since 2002 is a major achievement of the government. The Seila Program has also contributed substantially to these efforts. In spite of the improvement, the cost of transportation in Cambodia remains one of the highest in the region, making it an export tax. The reduction of transportation costs through well connected markets and well-maintained rural roads can also reduce the costs of transport.

63% of the road network of Cambodia is laterite or dirt based. The high costs of roads and ports have discouraged Cambodian farmers from competing with their neighbors in Thailand and Viet Nam, where the infrastructure is of better quality. To improve the competitiveness of exported agricultural products in Cambodia, the road infrastructure must be considerably improved.

8.4. Review of Rural Development Policies and Experiences

Improving the standard of living of rural population means:

- i. First, the productivity of family-scale production system and marginal farmers must be improved. This will require the following measures: improving land management, market mechanisms and farm gate prices and ensuring supply of agriculture inputs at reasonable prices.
- ii. Second, opportunities must be created in the rural economy to generate non-agricultural income and absorb the additional number of workers entering the labor market. The goal is to take pressure off agriculture, including through training in non-agricultural activities and in the sustainable use of natural resources. Processing of agricultural products provides a good opportunity for employment and income supplementation since it normally requires only a small investment in equipment, technology and training

8.4.1. Interventions in Agriculture

8.4.1.1. Markets for Organic Produce and Traditional Products

World markets are offering new prospects for the sale of organic products. The Cambodian Center for Study and Development in Agriculture (CEDAC) and the Angkor Kasekam Rungroueung Company (AKR) have redoubled their efforts to promote the production of organic rice, with much success. AKR exports more than 30,000 tons of organic rice per year to Asia and Europe. SRE Khmer, another exporting enterprise has granted technical aid to growers of organic vegetables in Siem Reap, but with little success. Another local company has also managed to produce jams from mangos, pineapple, papaya, and ginger for export to Australia.

8.4.1.2. Connecting Households to Markets

Agricultural exports of Cambodia are excessively directed toward Viet Nam and Thailand, essentially through trans-border trade. The elimination of various middlemen between growers and consumers will enable a higher farmer's selling price for Cambodian exports.

Two approaches have been tested with a view to simplifying the rice marketing system in favor of small-scale growers: the rice bank and the contract farming system.

8.4.1.3. Improving Productivity—Technology Transfer

A survey of rice growers in Kampong Speu, Takeo, and Kampot showed that only 50% of the farmers had access to technical information through agriculture extension services, and of these, only 12% had obtained this information from government services. The majority of growers learned their methods of yield improvement from other growers.

Sub-contracting to NGOs, decentralizing the extension and information services, targeting certain groups of clients and use of the media may be more effective than the centralized departments under the MAFF in the provision of extension services.

8.4.2. Non-Agricultural Interventions

The following opportunities are available for non-agricultural employment outside the natural resources sector:

- Rural tourism, benefiting from the recent improvement of rural infrastructure and security in rural communities.
- Development of small- and medium-size businesses based on the use of local raw materials and local agricultural inputs.
- Public works projects during the dry season.

8.4.2.1. Tourism Development

The government can coordinate, encourage, and give support to rural communities in order to promote village tourism, with a view to attracting international as well as local tourists.

8.4.2.2. Handicraft Production

Handicraft products, such as pottery and woodwork, agro-product processing workshops, equipment maintenance services, metal casting, brick manufacture, small-scale selling and retailing all offer opportunities for non-agricultural jobs. It is necessary to set up centers for occupational training in order to develop technical expertise appropriate for the rural economy. Research institutions that promote the extension of technical expertise in rural zones must be backed up by financial resources and a technical support policy.

Limited access to credit is an obstacle to the growth of the rural economy. The lack of long term financial products with a reasonable interest rate has blocked many promising initiatives.

Reasonable electricity rates could also raise the output of rural industries. The financial and economic viability of electricity projects could be improved by connecting more villages to main transmission lines.

8.4.2.3. Social and Public Works

Large amounts of public funds have been invested each year in the construction of new infrastructure, particularly irrigation systems, schools, roads, and bridges. Labor-intensive technologies could be used for infrastructure construction and create jobs in rural areas. The approach adopted by World Food Program (WFP) projects in its food-for-work initiatives could be adapted to suit field conditions in local communities.

8.4.3. Dynamic, Sustainable Rural Economy Framework

Political stability and the economic integration of Cambodia within ASEAN and the region have opened access for Cambodian agricultural products to regional and world markets. The government and the private sector must work together to profit from these opportunities. Nevertheless, the challenge for Cambodia is that its infrastructure and market mechanisms remain weak.

The government must play an active and strategic role in the development of the rural economy on both the supply side and demand side. As far as demand is concerned, the government must promote the access of Cambodian agricultural products to the world market through the penetration of Cambodian products into new outlets, growth of the markets themselves, and identification of new potential market niches. Intervention on the supply side includes measures aimed at removing obstacles to the expansion of agricultural production, in particular improvement in land management and agriculture inputs supply, and building of rural infrastructure.



Chapter 9

Agriculture Modernization Policy

The vision of the RGC in the area of agricultural and rural development during the next decade is to be the primary catalyst for launching a sustainable transformation of rural economies, by supporting technological, institutional, and policy changes that will, equip rural communities to improve their productivity and real income in a fair and ecologically viable way. “Development with a Human Face” is the central theme of the Government’s policy.

Increased agricultural production and enhancement of its productivity are means of improving the well-being of all Cambodians. Achieving improvement in the well-being of rural households requires a holistic, complex approach, including: (i) a policy and regulatory framework that aims to broaden access to and improve the management of key resources such as land, forest, fisheries, and water; (ii) a coherent strategy regarding agriculture and rural development; and (iii) creating opportunities for employment outside the agricultural sector.

The SEDP 1996-2000 has outlined the directions for rural development. The key initiatives include (i) improving the functioning of markets to be more pro poor; (ii) redirecting resources to improve access of the poor to education, training, research, and extension; (iii) creating a framework conducive to the development of financing systems in rural communities; (iv) ensuring land security; (v) improving the management of forest and fishing resources; (vi) building capacity for the management of water both at the technical level (development of networks) and the management levels (promotion of users associations); and (vii) financing basic infrastructure in rural communities.

In line with these directions the Technical Working Group on Agriculture and Water has drafted an Agriculture and Water Strategy, aiming at poverty reduction, food security, and promotion of economic growth through increased productivity and agricultural diversification, along with improved water resources development and management. This strategy is based on SWOT analysis summarized below:

Strengths Land is available. Water resources are available; Abundant, low-cost labor, is available in rural areas. The Ministry of Agriculture, Forestry and Fisheries (MAFF) and the Ministry of Water Resources and Meteorology (MOWRAM) have a high human resources potential. Policy and strategic frameworks have been developed for the Ministry of Agriculture, Forestry and Fisheries and the Ministry of Water Resources and Meteorology. All stakeholders are committed and recognize the importance of the sector (government, donors, NGOs and farmers). Diverse agriculture ecosystems are available, offering several soil types. Community empowerment and commitment through local authorities as the Commune Councils is under way. Agro-industry activities are being developed.	Weaknesses Institutional capacities, project management, and implementation by the MAFF and MOWRAM are weak. Water resources vary considerably in time and space, and water management technology is underdeveloped. Little investment capacity or interest in investing in the agriculture sector. Technology transfer, know-how, access to technology, and expertise by farmers and extension officers, are weak. Soil fertility is poor in many locations. Socio-cultural deficiency, including lack of solidarity at the community level, vulnerability of farmers to problems afflicting the landless, and the culturally ingrained character of subsistence agriculture. Information asymmetry of the stakeholders. Low productivity of agricultural labor, of land and water (inefficient use of resources). Limited access to markets. Inadequate legal framework for agriculture and water resources.
Opportunities Improve governance, including the commitment made by the government and political stability. Development of the market and integration into the regional and global market; Firm support from development partners for investment in agriculture and water. Science and new technology. Full utilization of natural resources (land and water) that remain under-developed or that are not yet being developed. Investment funds are available, including incentives, private funds and microcredit. Decentralization and deconcentration policy.	Threats The changes taking place in the market, including highly competitive international markets are fraught with uncertainty. High costs of oil and gas. Political circumstances, including demand for government funds for other sectors. Legal circumstances, including failure to enforce the land law, water law, forestry law, etc. Natural disasters. Environmental degradation. Inability to implement governance reforms, legal, and other reforms. Social and political changes, including social conflict for access to water and land; labor migration. Drop off in support from development partners in the agriculture and water sectors.

Source: RGC. Agriculture and Water Strategy, 2006-2010," January 9, 2007, p. 6.

To arrive at a genuine transformation of the agriculture sector, Cambodia must move from subsistence-level agriculture, generally marked by the difficulty of access to markets and poor interaction with the agri-food sector, to agriculture with a greater trade orientation, characterized by better access to markets and strong interactions with agro-industry. This transformation requires increased recourse to the inputs and products market, as well as a greater integration of agriculture with other sectors of the national and international economy. During this transformation process, the sources of growth will be the increasingly intensive use of technology and improvement of management methods and the institutional framework.

The government has identified four major areas of intervention that fit in with its development objectives in the rural sector:

- Poverty reduction and food security.
- Stepping up efforts at equitable economic growth.
- Natural resources management and environmental protection.
- Human and institutional capacity building focused on the poor.

Under this strategy, the RGC plans to center its investment programs essentially on the following areas:

9.1. Choice between Family-scale Farms and Large Plantations

There are two types of farming operations: family-scale farms and large plantations. Seen from the angle of incentive and management, the family farm seems to be the ideal system. Introduction of modern technology is not necessarily limited to the latter. Even on small farms, the use of small tractors can be as profitable as in large plantations. Family farms account for about 60% to 70% of agricultural labor. Family farming remains the dominant form of economic activity in rural Cambodia. It is crucial for maintaining political, social, and economic stability in the country. Family farming is also competitive in organic agricultural products.

Family farms can be more efficient if the family members work hard in order to maximize yields, both to meet their own food needs and to produce a surplus for the markets. Efforts to improve agricultural productivity on the family farm should include connecting these

motivated farmers to produce markets and to the private sector. Family farms could also be efficient under the following conditions: (i) appropriate technology is used, there is access to markets, and local communities have the capacity; (ii) the local trade network is effective; and (iii) infrastructure exists, research is carried on improving the economics of family farms and agricultural extension is available. The family farm model is conducive to the production of traditional products such as rice, corn, sesame, etc., especially for domestic consumption.

The land consolidation now taking place raises the possibility of setting up larger commercial farms. According to Hayami, large-scale, mechanized farms and plantations are advisable for the production of agricultural goods for export, such as rubber, palm oil, tea, and bananas, which requires systematic management, processing, and packing. The advantages of large-scale plantations hinge on the creation of roads, bridges, and ports to move the products to the international markets. However, small-scale family farms could also be organized under a contract farming system in order to create a critical mass to promote the export of agricultural products.

Nevertheless, the creation of large, mechanized farms and plantations in place of small, individual farms risks aggravating the inequitable distribution of assets and income in the society. Adverse developments could include a jump in the proportion of landless farmers, the despoilation of land occupied by poor people and mountain dwellers, and a spurt in the incentive to speculate. Such developments if they materialize could spawn social and political unrest. What is more, the building of new roads incites the wealthy to buy up land in areas that were formerly remote, which tends to exacerbate social tensions.

In promoting the agricultural sector, emphasis will be on the following initiatives: diversification and modernization of agriculture; promotion of agro-industry; strengthening technical and trade services; security of tenure and land administration reform; water resources management reform; upgrading and diversifying rural incomes; reduction of the vulnerability of farming activities; access to markets in the framework of a regionalization of markets; forestry management reform; promotion of rubber plantations; revival of fisheries; creation of conditions for strong, sustainable growth in animal husbandry; institutional capacity building including strengthening of the role of farmer organizations; promotion of integrated rural development and opening up of rural enclaves; development of financing systems in rural communities; support to private sector development and to rural non-agricultural employment; and ensuring the sustainability of donor-funded projects.

9.2. Diversification and Modernization of Agriculture

A number of intensification, expansion, and modernization measures will be necessary:

- Expansion of farmland: Analysis of agricultural ecosystems, improved planning, classification, and inventory of the use of farmland and zoning of arable lands would enable farmers to increase the arable area of the country and invest more in agriculture.
- Diversification of agriculture: The first priority of RGC is to diversify agricultural production to enhance agriculture's contribution to economic growth and poverty reduction- including: (i) channeling public investment and encouraging private investment in the agricultural sector, while improving the quality of Cambodian agricultural products to meet international standards; (ii) developing border areas and remote zones in order to combat the rural exodus; (iii) develop provincial centers already equipped with reliable infrastructure to promote the local economy and provide a means of subsistence to communities in the provinces.
- Improvement of agricultural productivity: Rice productivity can be stepped up by adopting the organic approach in small and family based farms. This would include improving the quality of the seeds, using fertilizer, controlling disease, making effective use of the irrigation system, enhancing postharvest technology, and introducing innovative practices such as the System of Rice Intensification and Integrated Agricultural Crops Management. Extension is of crucial for the success of rice intensification. It is also important to improve the performance of the rice seed company set up by the RGC in cooperation with AusAID, an offshoot of the AQIP project.
- Implementing a strategy for rice production: Emphasis will be put on a two-pronged strategy: the use of high-yield seed for good quality rice production (Thai approach) and high-yield seed of lesser quality rice (Vietnamese approach), taking into account Cambodia's topology.
- Encouragement of plant growing for biofuel production: Biofuels are a partial response to the rise in the cost of carbon-based fuels and shrinking oil reserves. There are three distinct types of biofuels: (i) biofuels extracted from oleaginous (oil-containing) plants such as palm oil; (ii) biofuels obtained from alcohol produced from plants containing sugar (sugar cane); and (iii) biofuels yielded from the anaerobic fermentation of any organic matter (food waste, vegetal or crop waste, etc.): this biogas (methane) can be used directly once it is purified, like natural gas for vehicles.
- Use of new technologies for the modernization of agricultural practices and intensification of plant and animal production.
- Improved inputs supply systems: The increased use of high-yield varieties and other improved varieties will be accompanied by fast-track growth in the use of chemical

fertilizers. Even though farmers are knowledgeable about chemical fertilizers, the main obstacles to their increased use have been an inadequate supply, lack of quality certification and the high purchase price.

- Promotion and extension of access to agricultural equipment and other production factors.
- Training, setting up agricultural councils and strengthening rural institutions: setting up rural institutions committed to speeding up the transfer of new technologies to farmers will be essential.
- Promotion of farmer education: The effectiveness of the extension worker is based on contact and trust. Rural education contributes to the development of channels of communication. If farmers know how to read, contact can be made through written materials, as well as orally. Trust is a must. Most of the time, farmers learn from their neighbors. It is necessary to promote knowledge, information, and technology transfer regarding agricultural practices, water and irrigation management, and the marketing of agricultural products among farmers through seminars and other modes of farmer interaction.

9.3. Promoting Agro-Industry

Agro-industry straddles both the primary and secondary sectors and is mainly concerned with the conversion of agricultural and fisheries products into processed or semi-processed industrial products. Development of agro-industry will increase value added of primary agricultural production enable farmers to get out of subsistence agriculture and encourage their involvement in agricultural marketing. The main areas of agro industry development are:

- Promotion of the processing industry: Cambodia has the potential for processing agricultural products, including tropical fruits, seafood such as fish, shrimp, mollusks, and shellfish.
- The expansion of agro-industrial activities in the private sector for the supply of agricultural inputs and services to rural communities,
- Encourage private sector investment in agro-industrial businesses for the storage, packaging, processing, and marketing of agricultural products.

- Creation of links between private businesses and rural households by means of contract farming and village plantations, and
- Supply of information and forecasts on domestic and foreign market conditions.

9.4. Strengthening Technical and Commercial Services

Extension services ensure the critical liaison between research institutes or experimental farms and rural communities which should benefit from the research outputs. Extension services remain negligible, since only 1% of the farmers have access to them. Future actions should include:

- Strengthening extension services: This would enable farmers to narrow the existing technological gap in production, postharvest services, and processing of agricultural products by using all service models, including technology transfer between growers and a combination of credit grants and extension.
- Technical support to farmer associations: Encouragement must be given to interchange among farmers and their associations to share best practices.
- Building capacity for research by the Cambodian Agricultural Research and Development Institute (CARDI): During the last decade, the government and AusAID have given increased importance to building the capacity of the national agricultural research system through the Cambodian Agricultural Research and Development Institute (CARDI). Priority should be given to further strengthening of CARDI.

9.5. Land Security and Land Administration Reform

The land problem is at the root of numerous social conflicts in many developing countries, including Cambodia. Political tensions and the complexity of issues linked to land could spawn social unrest, thus putting into peril the implementation of the reforms undertaken by the government. Yet, an ever greater number of countries are succeeding in solving the land problem. Approaches may vary from one country to another, but property rights of the poor must be guaranteed, land transactions facilitated, and careful consideration given to land policies so that they are equitable and benefit all.

In Cambodia, with the growth of the population, the development of road infrastructure and the rise in the price of land, the squeeze on available land is becoming ever tighter, exacerbating competition for this natural resource and land conflicts. In order to promote

land development and encourage productive investments, the following measures will be taken:

- Strengthening the legal framework, at the rural community level in such a way as to genuinely encourage conservation and sustainable use of natural resources.
- Strengthening of ownership security: Widening the program of systematic boundary marking of land lots, issuing ownership certificates to communities and individuals, and specifying the limits of rural communities in order to avoid potential conflicts or disputes, by providing land survey departments with sufficient resources to accomplish this mission.
- Strengthening the land conflict settlement mechanism: Because of the limited capacities of the courts, the government has put in place the Authority for the Settlement of Land Disputes, which seeks to settle land disputes before court action is taken.
- Land classification in order to encourage effective use of land resources: About 20% of the land in Cambodia has been classified as the private domain of the State. However, huge tracts of unused agricultural land under government control could be taken out of this category. Moreover, a substantial portion of the public domain of the State has already been released for agricultural purposes.
- Rationalization of economic land concessions: The land law limits the size of land concessions to 10,000 ha. Economic concessions have been granted on the State's own forest domain. These concessions are not bringing in any revenue to the State.
- The granting of land to landless farmers in order to promote socio-economic development through implementation of the subdecree on social land concessions: This measure will address the problem of landless farmers and make productive use of unused lands.
- Promotion of land development and productive investment: The utilization of land resources must promote development at the local level. To ensure sustainable development, productive investment in local infrastructure (construction of roads, dams and irrigation canals, schools and hospitals) must accompany the granting of land to farmers.
- Human resources development: The skills base of those working in land administration must be strengthened in the technical, legal, managerial, and supervisory areas.

- Better management of natural resources: this initiative will be centered on developing innovative land ownership systems for ensuring that rural households will, in the long run, have the necessary incentives for sustainable management of land, water, and other natural resources.

9.6. Water Resources Management Reform

Water is a strategic element in the agricultural modernization program. Improved plant varieties, which consume an increased amount of chemical fertilizers, bring a meaningful rise in yields only when there is sufficient water available at the right time. For this reason, the management of water resources, irrigation, flood management, potable water system, and improvement of sanitary conditions, are all key elements of rural development in Cambodia.

Planning and management of water resources in river catchment is crucial to ensure sustainable use of water and land resources in the interests of the local communities. The river basin is considered to be a unit suited for water management in the context of integrated water resources management. The management of river catchments necessitates coordination and a reliable administration, which means putting in costly infrastructure, such as a system of hydroelectric dams, management of water users, etc. The irrigation strategy based on the river catchment approach can be defined as “the efficient use of land and water resources for agricultural production in catchment areas from the technical, economic, and environmental point of view.” This requires engaging central and local governments, water users, and all stakeholders in river basin water use planning and implementation.

Priorities of the RGC are: (i) structuring and expansion of irrigated areas; (ii) efficient management of water resources through more efficient use of existing systems of irrigation; (iii) development and promotion of more efficient use of water by users in agricultural communities; and (iv) reduction of the vulnerability of communities to natural disasters and to their dependence on climatic conditions.

The government will take the following measures to guarantee an assured and adequate supply of water for farming:

- Designing an integrated approach to development and management of water resources and agriculture, which takes into account all water sources and the relation between water resources, agricultural production, the use and management of land and the environment, and recourse to appropriate water management technologies, particularly suited to agricultural areas with low rainfall. Groundwater use in river catchment areas will be closely regulated. Ecological damage and contamination of rivers and lakes by

chemicals used in agriculture, as well as by other pollutants is a serious concern which is addressed in government's policy on Integrated Use of Water Resources.

- Framing short-, medium- and long-term development plans for the management of river catchments, taking into account changes in the hydrological system, in particular the flow of river water and aquifer levels, in order to guarantee the effective and sustainable use of water resources. This plan will focus especially on the integrated management of the Mekong River, the Tonle Sap River, their tributaries, biodiversity, and ecosystems in order to set up a database on water resources, their demand, and use. As a part of the needed planning an inventory and analysis of agricultural lands and water resources will be undertaken to identify areas of agricultural specialization. This would enable the extension of the irrigated area by gravitational flow systems, in particular in areas afflicted by poverty.
- Expansion of irrigation systems in order to lessen the dependency of agriculture on timely rainfall by constructing dams, main-artery canals, and feeder canals. This initiative will give priority to the rehabilitation and reconstruction of existing irrigation networks in order to meet the urgent water needs of the agricultural sector.
- Enlargement of surface water storage and transmission facilities, such as reservoirs and ponds, canals, and flow systems, consistent with environmental sustainability.
- Promotion of small-scale irrigation: The expansion of small-scale irrigation systems is an important component of the integrated rural development strategy pursued by the RGC. Sustainability of this initiative will be improved if costs are shared with the beneficiaries.
- Strengthening water user associations: In order to ensure efficient allocation and use of irrigation water, the operation and maintenance of the irrigation systems at the local level will be handed over to water user groups and associations living right in the rural communities.
- Mobilization of labor to build rural capital: Roads, irrigation networks, and other components of rural infrastructure are crucial to rural development. Farmers, other concerned stakeholders, as well as the private sector, must be mobilized to participate in all stages of the design, development, and improvement of irrigation systems. In the case of irrigation canal or road construction, the main advantages obtained are increased yields from land close to the canals or easier access to markets for produce grown close to the roads. Land far from canals or roads will bear little or no profit. Yet, incentives must be devised to involve the entire rural community in the project if it is to succeed.

- Improved access to potable water for the inhabitants of rural communities: To realize this objective, new wells must be put in, those with hand pumps repaired, new irrigation reservoirs constructed, and existing reservoirs dredged.

9.7. Increase and Diversification of Rural Income

The development of non-agricultural rural employment is a major strategic intervention for poverty reduction. Major initiatives include:

- Promotion of non-traditional agricultural products for export by way of increasing and diversifying farmer incomes.
- Implementation of a strategy based on development of “niche” export products on the one hand, and increasing supply to the domestic market on the other. To this end, the problems of production and marketing peculiar to each agricultural product—rice, fish, cattle, and rubber—must be identified and addressed.
- A changeover from subsistence agriculture, characterized by rice monoculture, into diversified, marketable agricultural products.
- Processing of agricultural products and facilitating their marketing in domestic and foreign markets.
- Development of up-country tourism to support micro-enterprises or small-scale rural businesses.
- Creation of a competitive market in which rural industries can thrive including improving, access to financial and non-financial services (technical assistance, training, information, marketing, technical support) and capacity building of public and private organizations that support micro-enterprises.

9.8. Reducing the Vulnerability of Agricultural Activities

In Cambodia, the performance of agriculture depends in large part on the timeliness and adequacy of rainfall. In order to reduce the vulnerability of communities faced with frequent natural disasters, the government will take the following measures:

- Prepare a study of the rehabilitation and reconstruction of flood prevention systems, dikes and discharges to minimize the effects of natural disasters.

- Ministry of Water Resources and Meteorology will undertake capacity building to enable the timely dissemination of weather reports and minimize the consequences of floods: create a weather observation system which will make available real time climatic data for forecasts, climatological data for the needs of agro-meteorology, flood forecasting, etc.; revamp existing facilities and put in new hydrological, meteorological, and rainfall recording stations on rivers and at other identified locations; collect and disseminate the data; create a hydrological observatory which will broadcast real time information on the level and flow of water in rivers, and furnish hydrological data used for the design of water resources projects and water resources management.
- Capacity building for quick response to assist communities affected by drought, floods, and other climatic risks, in order to reduce the harmful consequences of natural disasters.
- Strengthening cooperation with the Mekong River Commission and with international flood control programs on minimizing the effects of floods.

9.9. Access to Markets under Trade Regionalization

Access to regional markets is the linchpin of the new direction of agricultural development. To benefit from regional trade Cambodia will have to ensure its competitiveness in the various chains of production and distribution and resolve the various impediments to agricultural development including lack of finance and land conflicts. The greater participation of Cambodia in regional trade will mean:

- Expansion of contract farming for organic agricultural produce, such as organic rice, corn, and tobacco, and the targeting of expanding niche markets.
- Exploration and promotion of new export products such as soybeans, cashew nuts, and silk.
- Elaboration of a strategy to compete with imports in the domestic market. Initiatives include developing a green belt around Siem Reap and Phnom Penh for competing with agricultural products currently being imported from neighboring countries.
- Building the competitiveness of agricultural products: Measures aim to improve the postharvest system and remove obstacles to trade, including indifferent product quality, reduction of postharvest loss, improving the condition of infrastructure and support services, strengthening the delivery system and reduction of avoidable business costs.

- Trade facilitation: Measures include: streamlining and harmonization of import and export documents on the basis of international norms, explore the possibility of using simplified declarations; improvement of customs procedures through methods such as risk evaluation, streamlined procedures for entry, and measures to improve transparency and providing procedures of recourse against customs actions and decisions.
- Strengthening of transportation services, warehousing, and marketing of agricultural products including improvement of the transportation and warehousing infrastructure and establishment of wholesale markets in border zones allowing Cambodian growers to connect with regional and global markets.
- Strengthening of marketing and information services in order to better communicate signals from world markets to farmers, transporters, processors, and financial market officers, and
- Establishment of an Export Products Certification Bureau and a laboratory to test quality and the development of sanitary and phytosanitary standards for agricultural products.

9.10. Forest Management Reform

The RGC has defined the following framework for the management of forest concessions:

- A concession can be operated only if a Strategic Forest Management Plan (SFMP), including an Environment and Social Impact Assessment (ESIA), has been submitted and approved under the provisions of the subdecree on Forestry Concessions Management.
- The documents must be made public and independent experts must be invited to review the SFMP and the ESIA before the government makes its final decision.
- Concession holders who do not submit SFMPs will have their concessions withdrawn.

In keeping with the RGC's commitment, the subdecree on Community Forestry Development was promulgated in December 2003, putting public forestry assets under the direction of local communities with jointly approved management plans and mutual benefits agreements. The government has worked in partnership with several donors and non-government organizations on community forestry development, piloting initiatives in several locations throughout the country. To date, almost 110,000 ha have been developed in the framework of community forestry development agreements.

To promote sustainable forestry management, the RGC has set the following priorities:

- Strengthening forestry management and protection: (i) rationalization and classification of remaining forests in order to guarantee environmental protection and biodiversity preservation by adopting and enforcing the subdecree on classification of forests; (ii) boosting enforcement of forestry regulations, in particular government directive No. 01 BB of June 9, 2004, concerning measures to stamp out deforestation and encroachment on forests; (iii) strengthening of protection strategies, such as: protected forests; management of hydrographic basins (catchment areas); genetic pools and the protection of endangered species; ecotourism; and other protection projects with local community involvement based on management plans proven to be successful; (iv) strict enforcement of forestry management regulations, including the sustainable use of resources and forest concessions; and (v) education and awareness-raising campaigns on forestry issues.
- Rationalization of the use of forests: (i) evaluate the forest cover, including protected zones, in order to identify the forest zones to be kept in the State domain ; (ii) ensure effective protection of biodiversity and critical ecosystems; (iii) identify forest zones lending themselves to local management and zones that could be converted to agricultural land; and (iv) draw up a forestry map showing the boundaries and inventory of forest zones.
- Contribution to socio-economic development: (i) highlight the socio-economic impact of preserving forests and biodiversity; (ii) promote industrial plantations as substitutes for wood from natural forests by encouraging private investment and community involvement; (iii) optimize the mechanisms for use, processing, and marketing of forestry products to meet local and export demand; and (iv) promote tree replanting.
- Contribution to poverty reduction: (i) strengthen legal protection of the rights of communities to manage forests in which they reside in order to guarantee food security and promote poverty reduction. These rights are protected under the Forestry Law and other associated regulations; and (ii) ensure that local communities benefit from the use and management of forestry resources.
- Capacity building and good governance: (i) pursue the strengthening of institutional capacities at all levels; (ii) undertake education, training, and awareness-raising campaigns among local communities in order to encourage community involvement in the protection and sustainable management of forests; (iii) strengthen capacities at all levels of the Forest Administration to enable the people involved to perform their duties in cooperation with the institutions concerned; and (iv) strengthen the collection of forestry revenue.

9.11. Promotion of Rubber

Rubber is traditionally an industrial cash crop grown by concessionaires on government land for export but it is increasingly it is emerging as an attractive alternative for small landholders in areas which are suitable for rubber growing. The government wishes to propagate rubber as an alternative source of livelihood for family-scale plantations. Government-owned plantations have also undertaken programs to replace stands of aging trees with high-producing plants.

The major initiatives in the propagation of rubber are :

- Systematic development of the rubber plantations. This includes (i) mobilizing large investments which cannot be carried either through the own-source funds of the current SOEs nor by allocations from the national budget; (ii) the study of soils suitable for the planting of rubber trees; and (iii) the supply of high yield seeds.
- Scaling up the pilot project for the privatization of State-owned plantations: This initiative aims to strengthen the management of State-owned companies and attract private investment in existing plantations.
- Strengthening the expansion of family-scale rubber plantations: This should be preceded by technical training of potential small scale growers, availability of financial support, dissemination of technologies and information on rubber market trends, and capacity building in plantation management and rubber growing technology.
- Strengthening of the Cambodia Rubber Research Institute: particularly the choice of seeds for high-yield plants and short growing periods and the use of new technology and laboratory enhancement in order to raise the output standards to international levels.
- Promotion of international cooperation in rubber production: this initiative involves strengthening the tripartite cooperation with France and Thailand and other member countries of the International Rubber Research and Development Board and the International Rubber Association in order to improve the quality of Cambodian rubber and promote the modernization of the processing industry.

9.12. Revival of Fisheries

With the goal of reviving fisheries, the RGC is in the process of preparing a master plan to be implemented by 2011 which will serve as a benchmark for the development of the

fisheries sector. The solutions will address the various phases of the fisheries activity cycle including catching, operating, processing and marketing. The master plan will address:

- Community development of the fisheries industry, by empowering the local communities to promote active, direct, and equitable involvement of farmers in the planning, implementing, and management of fishing programs.
- Conversion of fishing lots where concession contracts have expired, into fish reserves to increase the fish stocks and protect threatened species.
- Extension of community fishing lots and promotion of aquaculture in order to meet growing demand and take pressure off fisheries resources in natural habitats.
- Demarcation of fishing lots, identification and safeguarding of protected zones and control of illegal fishing.
- Sustainable management and restoration of fisheries resources: This will include (i) getting maximum value from the resource; (ii) assuring adequate technical qualification of professionals in the sector; and (iii) improvement and modernization of traditional fishing practices.
- Capacity building for research in the Inland Fisheries Research and Development Institute, (established in February 2003) in order to improve the management of fisheries, promote access to state-of-the-art know-how and technology for the general public, communities, and fishermen in particular.
- Rational and responsible use of fisheries resources: Better protection of fishery resources and fostering an institutional environment more suited to the development demands of the sector, and more balanced international cooperation. This initiative aims to ensure the sustainable management of the resource and viability of fisheries, satisfy the national demand for fish products, improve and modernize the conditions under which traditional fishing is carried out, get more value from production, and develop a sustainable system of financing for fishery sector.
- Development of small scale aquaculture to improve the income of farmers.

9.13. Creation of Conditions for Strong, Sustainable Growth in the Animal Husbandry Subsector

Most of the livestock—cattle, swine, and fowl—are grown by small-scale farmers who practice subsistence agriculture. Short- and mid-term actions to support animal husbandry include:

- Development of an integrated system of animal husbandry, consisting of: (i) putting adequate infrastructure in place; (ii) anti-epidemic measures to improve the quality of cattle and disease control; (iii) strengthening the health supervision and inspection departments; (iv) production of animal and fish food and the processing of meat and fish into finished products; (v) increasing the number of veterinary workers in order to reduce the rate of livestock mortality and morbidity; and (vi) treatment and processing of animal by-products.
- Encouragement given to private companies for the start-up of large business outlets for cattle, swine, and fowl products,
- Addressing structural constraints including: (i) technical, notably the persistence of certain animal diseases, lack of pasturage and watering sources (agricultural by-products and livestock feed cannot serve as an alternative to pasturage due to their high cost) and (ii) financial, both in the public and private domains because of the weakness of public investment in the animal husbandry subsector.
- Greater interconnectedness of activities throughout the cattle-meat chain, the breeding of short-cycle species (small ruminants and local fowl), assured supply of animal feed, treatment and processing of animal by-products (hides, horns, etc.).
- Strengthening recovery of the silk industry: Emphasis will be on introducing modern techniques of silkworm growing and weaving equipment with better-performing looms. Small scale silkworm growers will be trained in raising mulberry trees.

9.14. Institutional Capacity Building

Agriculture sector reform strategies are well in place but their implementation is now approaching a critical point. Reforms have addressed introduction of market mechanisms, land titling and security of tenure, liberalization of prices, and adoption of legislation on the creation of joint ventures between the State and foreign investors. The MAFF has been restructured with assistance of development partners. Rice varieties appropriate to Cambodia have been identified and researched and transfer of agricultural know-how to

farmers is being accelerated. Further capacity building of the sector is needed to carry it to higher levels of productivity to match regional standards.

The action program on capacity building will include the following components:

- Streamlining and institutional capacity building, along with consolidation of coordination initiatives among the various ministries in order to guarantee proper implementation of the Strategic Plan for Agricultural Development recently adopted by the government. These measures also aim to (i) build capacity in the decentralized government institutions that serve rural communities and support rural institutions; (ii) build capacity at the grassroots level to allow rural communities to set their priorities and access help commensurate with their needs; (iii) bring institutional support to emerging professional agencies that are promoting agricultural sector development and set up facilities for processing by products at the village level (“one village, one product” concept).
- Review of the role and responsibility of public institutions: The MAFF and other public institutions will concentrate on the supply of public goods and desist from direct intervention in agricultural production, distribution of inputs, and marketing. A functional analysis will be carried out to clarify the role and responsibilities of the public institutions.
- Alignment of financial resources with the agricultural development strategy: Rural and agricultural development is lagging other priority sectors, such as education and public health, as far as improvement of the fiscal policy support and management of the sector are concerned. This will be corrected.
- Reform of SOEs: Many SOEs are not up to their responsibilities in implementing the tasks assigned them. It is crucial to strengthen the governance structure of SOEs to make them competitive with private companies.
- Capacity building among civil servants in agriculture sector: Civil servants will be trained in the analysis and designing of agricultural policy, socio-economic and investment analysis, management of natural resources, marketing of agricultural products, and international trade.
- Institutional strengthening of farmer associations: The globalization of trade will challenge small farmers. Farmer organizations will be institutionally strengthened so that they can assist small-scale farmers in making sound decisions regarding the production and marketing of agricultural products and make them more self-reliant and better equipped to address the interests of the people they are serving.

- Empowerment of farmers: To meet the challenge of globalization and protect their interests, farmers must work together in all aspects of production and the value chain, such as the purchasing of fertilizer, sharing of agricultural equipment, access to agricultural information, processing and marketing of agricultural products.

9.15. Promotion of Integrated Rural Development and Opening Up of Rural Zones

The lack of infrastructure, especially roads, constitutes a major obstacle to the development of rural areas because of the problems of storage and movement of produce that this entails. Consequently, it is necessary to invest in adequate infrastructure to improve the well-being of the rural population through both public and private initiatives. However for infrastructure to yield the intended benefits it is necessary to adopt the integrated rural development approach. The components of integrated rural development are health care, road construction, other infrastructure, extension services, credit, inputs, and marketing. The government has given priority to the following initiatives in promoting integrated rural development:

- Road improvements in rural communities: The construction of rural roads will help increase agricultural production, either through expanding the area of arable land or by intensifying the use of existing land, which will allow farmers to take advantage of new market outlets, and consolidate the links between agricultural and non-agricultural activities within rural areas, and between rural and urban zones.
- Construction of rural social and economic infrastructure that will contribute to the viability of rural economies. This includes rural electrification and supply of complementary social services, which would attract the qualified human resources necessary for the development of rural economies and enable the rural communities to have better access to education, health care services, and water.
- Continuation of food-for-work programs: These programs are of crucial importance both to promote the rehabilitation and upkeep of rural roads, including laterite and packed-earth roads, and to ensure at least part-time employment to farmers and improve food security for the rural people. These programs have the additional advantage of setting up a socially meaningful mechanism to channel resources to the poorest of the poor in the society.
- Capacity building of the government in agricultural extension: Extension services function within the framework of an integrated rural development system. To be successful, the government must free up the resources necessary to meet the recurrent

expenses of extension officers so that they have the mobility and means necessary to meet the needs of the farmers.

- Coordination of integrated development projects: The institutions and executing ministries must be better structured to ensure the success of integrated rural development project implementation.
- Public awareness raising with respect to malnutrition, iron deficiency, children's diet, and iodized salt, through workshops, training programs and other promotional initiatives. Much remains to be done in this area: local production of iodized salt covers only 20% of the needs of the country, only 35% of children aged 6 to 59 months receive vitamin A supplements, and the number of mothers who have access to iron supplements remains very low at 2%.

9.16. Development of Financing Systems in rural communities

Strengthening rural banks and micro-finance institutions is crucial for implementing the government's rural development strategy. The RGC's main institutional arm for channeling credit to rural sector is the Rural Development Bank funded by the State budget. However as part of the implementation of the Financial Sector Strategy, the government is encouraging the private sector financial institutions, particularly the MFIs to expand their activities in rural areas. The main initiatives in the area of rural finance are:

- Setting up and strengthening efficient private financial networks, able to mobilize domestic savings and provide credit using innovative techniques to communities and groups in rural areas. This will facilitate land intermediation and increase investment in agriculture.
- Extension of MFI coverage to farmers for increasing production and facilitate processing of agricultural products.
- Refinance MFI loans of farmers at interest rates lower than the prevailing informal market rates.
- Support of small- and medium-size enterprises: KfW is offering grants channeled through the Ministry of Economy and Finance of approximately \$8 million for the SME development program. The RDB has granted a loan under this initiative to a commercial bank partner with the view of retroceding it to end borrowers for the implementation of pilot water supply projects in Takeo province.

- Incentive for the Rural Development Bank to provide within the limits of its available funds, the medium and long term financing of micro-businesses at preferential rates.
- Encouraging banks to invest in water and electricity supply in rural areas and in local agri-food activities.

9.17. Development of the Private Sector and Non-Agricultural Rural Employment

The private sector is the main beneficiary of agricultural development and must therefore participate in it comprehensively. But returns to private investment in agriculture are uncertain due to several reasons, notably the lack of public and institutional infrastructure, weaknesses in the legal and regulatory apparatus, and the high cost of electricity. To encourage private investment in agriculture the following initiatives are underway:

- Improvement of the business climate in order to attract private sector investments in agriculture.
- Development of technologies and their swift adoption into the agricultural production and processing systems.
- Promotion of “one village, one product” initiative to stimulate creativity and restore the confidence of rural communities. This policy hinges on: (i) encouraging methods of production suited to a village environment and market needs; (ii) facilitating identification of market outlets, financing, and appropriate technology transfers; (iii) supporting human resources development and management training; and (iv) facilitating the creation of agricultural communities to promote price stability of agricultural production.
- Taking steps to reduce production cost, especially transportation and electricity costs; and
- Strengthening support to essential services, such as improving access to markets and research and information, and organizing farmer co-ops.

9.18. Sustainability of Donor-Funded Projects

Donor programs in the sector have helped to improve sector performance but in order to obtain maximum benefits from the assistance they should be aligned more closely with the

government's priorities and strategies in the sector. A quick review of donor programs in agriculture shows the following:

- The PRASAC program funded by the European Union: This program involves large investment in priority sectors (village water, irrigation, extension, and credit) in 6 provinces. The risk in this project centers on the sustainability of the initiatives undertaken, including an underestimation of maintenance and management costs for the infrastructure funded (for e.g. the irrigation component). Another sustainability problem concerns the capacity of the ministries to continue these initiatives once the projects are completed.
- Agriculture Productivity Improvement Project (APIP), funded by the World Bank and IFAD. The purpose of this project is to develop government capacity for planning, developing, and implementing agricultural and rural programs. The focus of this project is funding the training of management staff and officers in the construction or rehabilitation of buildings, supplying equipment and giving support to revive lending activities. This program is encountering implementation difficulties because of administrative red tape, an inability to coordinate the various components, and the lack of enthusiasm in certain implementing departments. The lack of liaison between the central level and the provinces is a major impediment for activity implementation and monitoring.
- The AQIP project, funded by the Australian cooperation agency AusAID, aims to improve food security and income for farmers. It has six components: viz. production of rice seed, postharvest technology, fruit and vegetable marketing, rehabilitation of irrigation systems (by funding the rehabilitation of small networks as well as setting up user associations for their management and maintenance), and training (through training of trainers for the "Farmers' Field School"), and project management. The lessons learned from the project have contributed to improving the design of village level development projects.
- The Integrated Pest Management (IPM) Program, set up with support from the FAO, has developed an original approach to the training of producers through the Farmers' Field School approach. The approach comprises observation by the producers in the field, setting up trial projects, and subsequent information exchanges on the outcomes and means of control. This system is based on a bottom up approach and is not burdened by a national policy on extension or a cumbersome list of predefined objectives. The IPM approach with its network of stakeholders sharing common concerns, and trained in solving technical problems at the field level and techniques of group leadership, offers valuable lessons for designing agricultural extension programs.

- The Seila program is the first large-scale program (6 provinces) first set up in 1996 to promote local development and local institutions. At the outset, this program was experimental in nature for the implementation of decentralization and deconcentration, and has set the benchmark for the authorities and a number of development partners in terms of designing rural development policies and programs.



PART IV

THE CHALLENGE OF INDUSTRIALIZATION

- Chapter 10. Industrial sector—An Overview
- Chapter 11. Private Sector Development
- Chapter 12. Industrial Policies



Chapter 10

Industrial sector- an overview

After achieving independence in 1953, Cambodia pursued a mixed economy model in which both State property and private property were recognized and allowed to coexist. Agriculture, light industry, and commercial services were left to the private sector, while heavy industry and finance were controlled by the public sector. Large SOEs were created in the 1960s. At that time, Cambodia pursued an import substitution policy in light industry and agricultural product processing industries, which enjoyed strong protection, government subsidies, and were often allowed to function as monopolies.

10.1. State-Owned Enterprise

The government of the People's Republic of Kampuchea (PRK), formed in 1979, inherited from the Khmer Rouge regime an economy where private property had been destroyed with much of the production apparatus in ruins. Industrial enterprises were State property. In the early 1980s, the centralized management system was gradually made more flexible, the production structure evolved with a market orientation, and the private sector officially recognized in 1985 began to play an increasingly important role in the economy. With private sector's revival by early 1989, nearly 90% of medium and large-size industrial enterprises had begun to produce again. However, State-Owned Enterprises (SOEs) formed the core of the Cambodian industry.

In late 1989, the authorities of the People's Republic of Kampuchea instituted a new regime of financial autonomy for SOEs, which were required to be financially self-sufficient. This meant that they would no longer receive subsidies for operations and no capital loans. However, they would keep all of their net profit and would pay to the State only half the amount of the loan amortization due from them. They would have to borrow from banks at market rates for their working capital and investment needs. In theory, they would function like commercial businesses in a market economy. Further, they would be subject to the same taxes as private businesses.

From 1989 onwards, the government launched a program of State disengagement in industry, encouraging privatization in all sectors. The goal of this policy was to supply businesses with the capital necessary to get them back into shape, modernize, and expand, and allow them to acquire modern management methods and technologies. Moreover, the leasing out and transfer of businesses was a source of budget revenue.

Table 10.1. State-Owned Enterprises in 2008 (in million riels)

No.	Name of enterprise	Assets	Own capital	Total staff	Financial year 2006		
					Total revenue	Total expenditure	Profit
1.	Agricultural Input Company	21,948	21,278	49	2,827	2,773	54
2.	Sihanoukville Autono-	473,187	467,094	1,032	97,015	87,181	9,834
3.	Phnom Penh Autono-	108,473	105,017	465	18,469	12,772	5,697
4.	Kampuchea Shipping Agency & Brokers	24,387	22,574	148	9,090	4,630	4,460
5.	Green Trade Company	45,272	41,850	194	7,152	7,184	(32)
6.	Cambodian National Insurance Company	31,933	29,470	60	4,547	4,045	502
7.	Printery	29,367	29,154	145	11,046	10,130	916
8.	Telecom Cambodia	228,633	185,937	617	81,982	55,947	26,035
9.	Royal Cambodian Railways Company	3,951,329	3,948,159	1,609	7,830	9,294	(1,464)
10.	Engineering and Public Works Lab	1,717	1,283	24	422	502	(80)
11.	Phnom Penh Water Supply Authority	555,218	434,609	568	78,512	58,650	19,862
12.	Electricity of Cambodia	589,404	348,297	2,180	613,600	601,259	12,341
13.	Rural Development Bank	65,057	30,416	49	4,043	2,708	1,335
	Grand Total	6,635,566	6,145,020	19,149	1,129,930	1,008,764	121,166

Source: Ministry of Economy and Finance.

At present there are several types of SOEs. According to the Law on the General Status of SOEs, promulgated by Preah Reach Kram of June 17, 1996, SOEs are classified into three categories: State-owned companies (with 100% public capital), public institutions with an economic purpose, and semipublic companies (Joint Venture) in which the State or businesses with public capital hold separately, severally, or jointly with other public

institutions more than half of the social capital or voting rights.

A public institution with an economic purpose is a legally constituted public body with financial autonomy, and which carries out exclusively or principally an activity of providing goods and services for sale. The State-owned company is a company whose capital is held solely by the State. The conditions for the creation of a State-owned company are set out by Anukret, upon joint proposal of the MEF and the line ministry or line authority.

In 2003, there were 24 SOEs, 5 public institutions and 9 semipublic companies under the supervision of 9 line ministries and one municipality: Agriculture, 14; Telecommunications, 7; Public Works and Transport, 6; Finance, 4; Industry, 1; Commerce, 1; Education, 2; Health, 1; and the Office of the Council of Ministers, 1. At the municipal level, there is only one State-owned enterprise, the Water Authority of Phnom Penh. In 2008, with the privatization of rubber plantations the number of SOEs was reduced to 13 (Table 10.1). SOEs function in strategic sectors such as electricity, water, river and maritime ports, insurance, reinsurance, rubber plantations, hospitals, telecommunications and trade in agricultural products.

10.2. Structure of Industry

Economic performance in Cambodia was quite impressive during 1998-2008. The Industrial sector has been the main engine of growth; industrial GDP rose by an annual average of 16%. The sector consists mainly of the manufacturing sub-sector (78.5%) and the construction sub-sector (18.8%).

Table 10.2. Structure of Cambodian industry (in billion riel)

	2003	2004	2005	2006	2007	2008	%
Mining	58	74	97	115	135	165	2%
Manufacturing	3,374	4,027	4,585	5,541	6,074	6,441	69%
-Food, beverage, tobacco	488	505	608	664	757	924	10%
-Textile	2,294	2,847	3,158	3,869	4,234	4,315	46%
-Wood, paper, publishing	105	119	148	171	203	239	3%
-Rubber manufacturing	111	122	126	181	148	153	2%
-Other manufacturing	377	433	545	657	732	811	9%
Electricity, gas, water	93	110	124	164	195	212	2%
Construction	1,106	1,288	1,631	1,995	2,338	2,572	27%
Industry	4,6311	5,498	6,436	7,816	8,741	9,389	100%

The textiles and garment sub-sector led this spurt, displaying a remarkable dynamism. Cambodia's garment industry has displayed dramatic growth following the US granting the Most Favoured Nation (MFN) status in 1996 and the Generalized System of Preferences (GSP) in 1997. Employment in garments and textiles has been a major stabilising force for the population and the economy in recent years, as the sector has absorbed a large number of skilled and semi-skilled labour, especially poor female workers who would have otherwise been unemployed or underemployed.

Table 10.3. Investment by sector (in Million USD)

	2003	2004	2005	2006	2007	2008	%
Mining	2.2	0.9	63.7	57.1	101.5	92.6	7%
Manufacturing	121.9	145.5	337.8	391.1	624.2	601.3	46%
-Food, beverage, tobacco	28.0	19.0	21.9	36.7	51.6	52.4	4%
-Textile	66.5	95.6	112.3	163.8	250.1	247.1	19%
-Wood, paper, publishing	7.5	6.8	7.3	9.4	12.4	13.7	1%
-Rubber manufacturing	3.3	7.6	13.2	14.4	22.9	21.5	2%
-Other manufacturing	16.7	16.5	183.2	166.7	287.2	266.7	21%
Electricity, gas, water	55.4	70.7	86.6	107.4	150.8	169.9	13%
Construction	176.3	172.5	192.7	277.6	380.3	434.8	33%
Industry	355.8	389.5	680.9	833.2	1,256.9	1,298	100%

Source: MEF

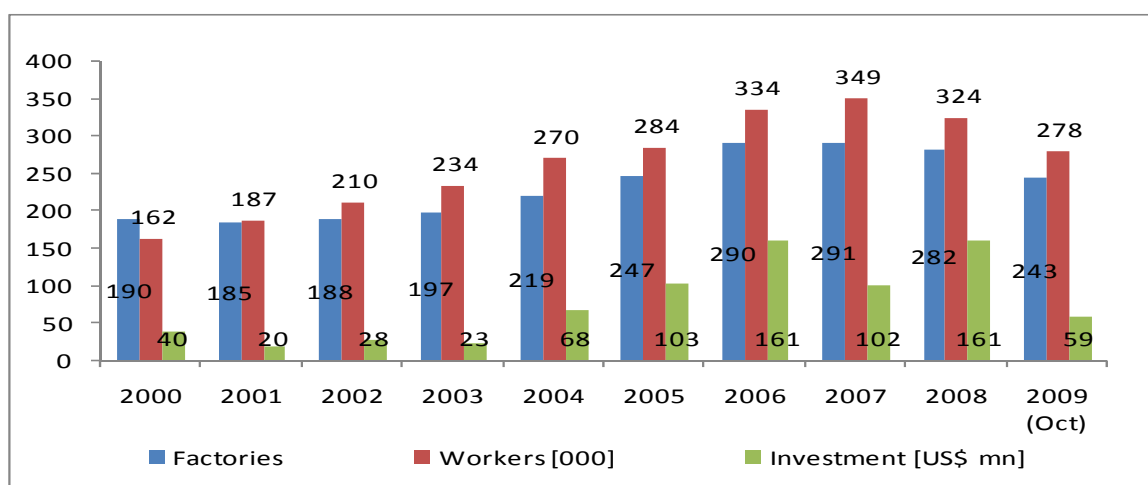
Industry continues to show remarkable buoyancy, which is mainly the outcome of the economic liberalization policy being pursued by government. The average rate of growth of 12.5% in 1994-98 continued until 1997, with a slight fall in 1998 (-2.5%) owing to internal events in Cambodia and to the regional financial crisis. The growth of industry was strong between **1999-2002 (20.2%)**. The sector share of the GNP rose from 11.6% in 1993 to 17% for 1998 and 26.2% for 2006, but dropped to 22.4% in 2008. The main industries in Cambodia are: mining; food, beverage and tobacco; garment; wood, paper and publishing; rubber manufacturing; electricity, gas and water; and construction. The main industry in Cambodia is textile, which accounts for 46% of industrial output (US\$2.3 billion in 2008), followed by construction (27% of the output); food, beverage and tobacco (10%); wood, paper and publishing (3%); electricity, gas and water (2%) and mining (2%). This section provides detailed analysis of the main industries only.

10.3. Garment and Textiles

The garment branch—nearly half of the industrial sector—has been the most robust subsector in industry, with an annual average growth of 58.5% during 1994-1998. This growth slowed in 1999-2002 to an annual average of 35.4%, with the introduction of quotas in the American market. Cambodia responded favorably to foreign demands with respect to the protection of social rights of workers in this sector. The implementation of labor standards allowed Cambodia to maintain the growth of garment exports, with an annual average growth of 45% during the decade between 1994 and 2004. However growth in the industry has decelerated to an average annual growth of 12% during 2005-2008. The subsector's contribution to GDP rose from 1% in 1993 to 13% for 2006, but declined to 10.3% in 2008.

Although Cambodia's soil and climatic conditions are suitable for cotton production, there is virtually no textile manufacturing in Cambodia. The local cotton and textile industry can deliver cotton at 20% of the price of imported cotton. However, this would require more investment and higher risks involved.

Figure 10.1. Textile industry trends, 1995-2003



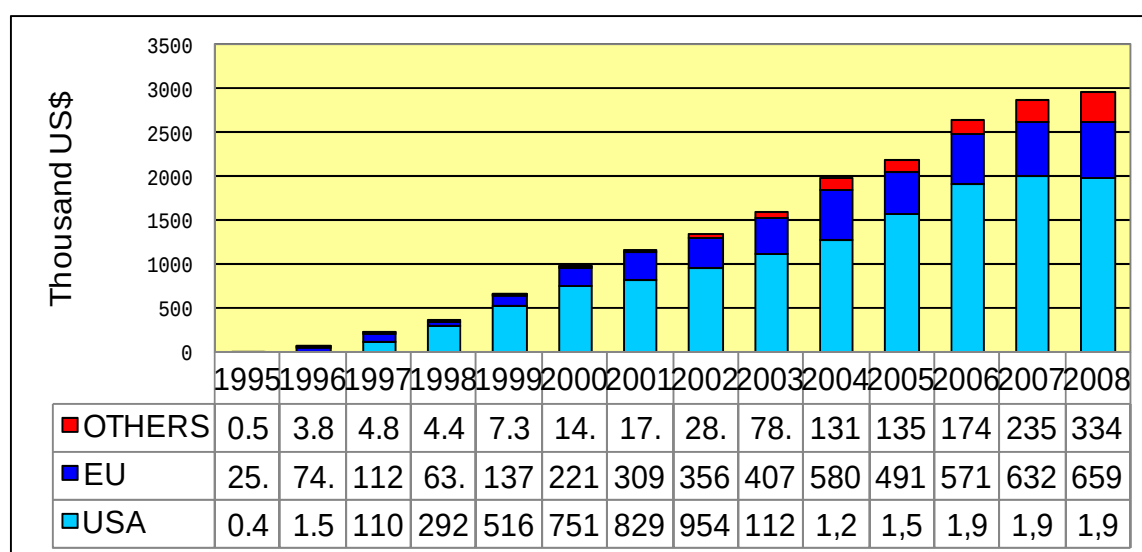
Source: MOC

Cambodia has instead specialized in Cut-Make-Trim (CMT). Garment factories perform only cutting, sewing, finishing and packaging, while fabrics are imported from overseas. While the majority of factories have left their overseas partners to negotiate with buyers, some 25% of the garment factories have involved in full garment production, which includes purchasing the fabric, CMT, packaging and shipping the orders to their buyers. A number of factories are sub-contractors, covering only CMT. Over 60% of the cost of

production in the garment sector consists of imported material and other inputs. Therefore, the garment sector has not created other activities through backward linkages and Cambodia's garment industry is characterized by the lack of vertical integration. Nevertheless, there has been considerable scope for an accessory and service industry supporting garments.

The garment sector is a labor-intensive industry employing workers, mostly female, who come from the countryside. The sector has provided employment to over 350,000 factory workers in September 2008, assuming a ratio of four dependents for each worker, income for more one million Cambodians. Garment is a large contributor of foreign exchange.

Figure 10.2. Textile and garment exports, (US dollars, in millions)



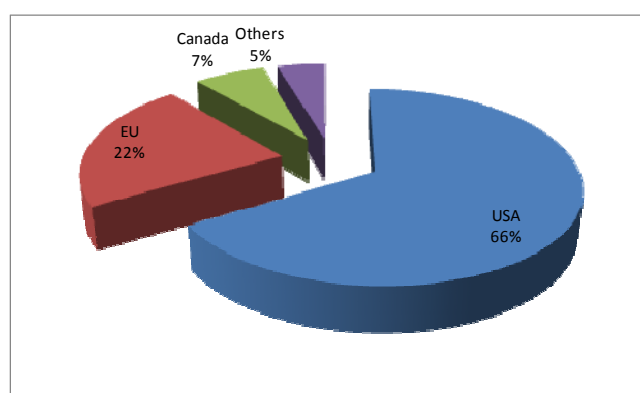
Source: Ministry of Commerce

As of October 2009 there are over 243 garment factories that employ over 278,000 workers in Cambodia. Currently, slightly over 8 percent (15 companies) of the companies operating in Cambodia command over 50 percent of total garment exports. The garment industry in Cambodia is represented predominately by foreign rather than local investors. Specifically, the largest investments in the industry come from Hong Kong, Taiwan, China, Singapore, South Korea and the U.S. Thus it is difficult to determine how many corporate entities are actually represented in Cambodia, it does not appear that the garment sector is characterized by barriers to entry, monopoly or other anti-competitive conditions.

The garment industry has been a key driver of Cambodia's integration into the world economy. The garment industry depends on exports and therefore is exposed to external shocks. Of Cambodia's total export volume of \$4.43 billion in 2008, 65 percent or \$2.89

billion was represented by the garment industry. The track record of growth has been tremendous. The garment exports grew from \$20 million in 1995 to \$2.89 billion in 2008. In 2008, some 66% of garment products are exported to the United States, 22% to the European Union, 7% to Canada and the remaining 5% to Japan and other ASEAN countries.

Figure 10.3. Share of garment export markets



Source: Ministry of Commerce

The Cambodian garment industry had gone through three challenges:

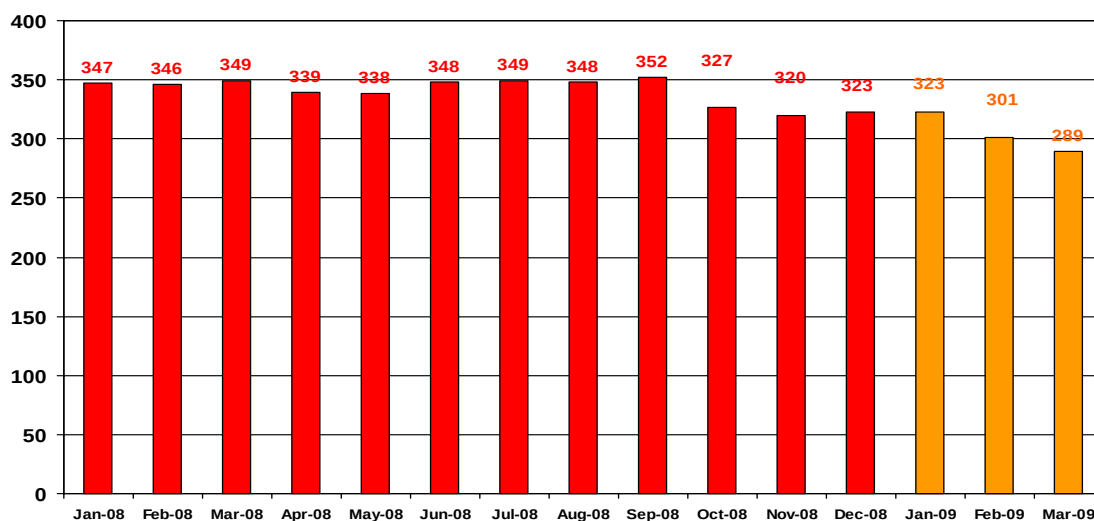
Firstly, the introduction of quotas in the American market in 1999. The U.S.-Cambodia Bilateral Textile Agreement of 1999 offered Cambodia a quota in market segments, which could be increased by up to 14% per year based on adherence to a set of labor standards. The pursuit of a policy of protecting the rights of workers and adherence to labor standards allowed the Cambodian textile and garment sector to be evolved as a modern sector characterized by good working conditions. Thus, the garment sector has pioneered the practice of corporate social responsibility and has embedded these principles in the Labor Law. The Ministry of Commerce is responsible for providing certificates of origin to authenticate country of origin and to manage quota allocation, to verify fulfillment of quotas both on the Cambodian side and in the export destination, to verify compliance with duty exemptions, and to manage quality. The International Labor Organization (ILO) is tasked to verify compliance with labor standards. Unions exist to organize and express the needs of labor, and the voice of the Garment Manufacturer's Association of Cambodia (GMAC) has clearly influenced policies that support the needs of the sector, through the Government-Private Sector Forum. Additional quotas (over 6%) are granted if inspections conducted by the ILO conclude that there was an improvement in working conditions.

Secondly, the removal of textile quotas in the US on January 1, 2005 under the WTO Agreement on Textiles and Clothing (ATC) means that the Cambodian textile industry had to compete openly with more competitive countries such as China and India. Therefore the

benefits of the U.S. protected market were effectively phased out. After 2005, Cambodia has accessed the US market on a most-favored nation basis, along with other WTO members, unrestricted by quotas. However, the US moved to introduce safeguard provisions against Chinese imports to protect domestic market. Moreover, the RGC took measures to reduce administrative costs, streamline export and import procedures, curb informal payments and improve the investment climate to ensure the survival of the Cambodian textile and garment industry. Important trade facilitation reforms have been implemented to improve competitiveness and build investor confidence by reducing production and marketing costs. After the removal of textile quotas in 2005, large supply orders are on the increase. In response to the placement of large orders, about 30 textile companies have begun to expand though some uneconomic facilities closed. The fear of a free-fall of Cambodian production and textile exports has turned out to be ill-founded.

Thirdly, the Global Financial Crisis has posed a challenge to the garment industry in Cambodia. Garment industry will face bigger challenge in the post-crisis environment, as production costs for the Cambodian garment-textile industry are higher than those of some of its competitors such as China and Viet Nam. China's garment sector is much larger and also vertically integrated. Cambodia has responded to move into niche Japanese and ASEAN markets. Cambodia will need therefore to focus on cost competitiveness by accelerating further trade facilitation reforms and increasing value-added. But the enterprises in Cambodia pay less tax since the Cambodian fiscal administration is weaker than that in China and Viet Nam.

Figure 10.4. Workforce of the garment sector (000')



Source: Ministry of Commerce

10.4. Construction

Construction has been one of the pillars of the Cambodian economy, accounting for 27% of the industrial sector and 33% of the investment in the sector. During the last decade, the sector was growing at an average annual growth of 17%. Construction activities fluctuate strongly with economic cycle, as evidenced by the poor showing in 1997-98 (an average annual decline of 9%), which was the result of wait-and-see attitude of investors in view of the prevailing uncertainty in the domestic situation of Cambodia and the Asian financial crisis.

Construction investment began picking up again in 1999 and 2000 (27.4% and 36.8% respectively) but the growth slackened in 2001 (-1.8%) before reviving in 2002 (27.1%). During the period of 2002-2008 construction activities increased at an annual average growth rate of 15%, while investment in the construction sector totaled \$1.8 billion. Construction contributes about 6% of GDP.

10.5. Agro-Industry: Food and Beverage

The agro-industrial sector consists of a large number of small and micro-enterprises. The distribution of the manufacturing sector is sharply skewed toward the food and beverage industry in terms of number of firms. Of over 30,000 agribusiness firms, 91% are small, employing less than five employees and having a capital outlay of less than \$1,000. Food, beverage and tobacco sub-sector accounts for 10% of industrial production and only 4% of investment.

In spite of its apparent comparative advantage in agro-industry, driven by extremely low labor costs and abundant agricultural land, value added in agro-industry is very low. The vast majority of the private sector by number consists of firms in the food sector, the vast majority of the poor derive some income from off-farm enterprise.

Rural food and beverage enterprises are mostly informal, serve local markets or middlemen, and are not specialized. In Batambang, which includes a large number of rice millers, 70% of output is sold directly to consumers and the balance to small local businesses. Exchange relationships are still at an early stage of formalization. Competitive wholesale marketing and distribution is absolutely essential to this.

Commercial funding is almost absent for the agro-industrial sector- only 3% of working capital is met from commercial sources – yet capital use is inefficient. The Government's core strategy for agro-industry development is focused on the size of landholdings. The policy grants concessional enterprises on a long-term basis, and to encourage the participation of local small landholders through contract growing for processing factories in

the area. The vast majority of the private sector operates on the basis of personal exchange with individuals or traders. The benefits of formalization – secure property rights, access to capital and access to markets – simply do not accrue to the private sector.

10.6. Other Industry and Industrial Diversification

10.6.1. Electricity, Gas and Water

Improving access to efficient and affordable water and electricity services can have major impacts on the living standards of individual households. Efficient infrastructure is also essential to sustain broader economic growth and industrial competitiveness, thus creating jobs and expanding a country's tax base.

Electricity, gas and water account only for 2% of industrial production and 13% of investment. During the last decade this sub-sector was growing at an average annual rate of 12.6%. However, high costs appear to be the major issue faced by the private sector and households. Where electricity is available, firms and individual consumers face very high energy costs.

Given the fiscal constraints facing the Cambodian government, private provision of services is an important tool to achieve service delivery goals. There is strong recognition of the benefits of private provision of infrastructure in Cambodia, where significant experience with the Public Private Partnership (PPP), can be found across all sectors. The PPP will be discussed extensively in the next chapter.

10.6.2. Mining Industry

Cambodia is a net importer of oil and this situation is not expected to change in the near future. The country has just begun to survey mineral resources and some deposits of mineral have been found. There are good potentials for oil and gas, bauxite, gold, copper and other minerals. Limestone used by the cement industry occurs in Kampot province. However, at this stage the mining industry, except for oil and gas exploration, remains small. However, during the last decade the mining industry was expanding at an average annual growth rate of 20%. Investment in the mining industry increased drastically during the 2005-2008 period, averaging US\$79 million per year.

10.6.3. Industrial Diversification

WTO accession has not resulted in substantially improved market access for Cambodian producers. Therefore, the opportunities afforded by WTO will not result in growth of productive employment unless business environment constraints are removed and market-

supporting institutions built. In this regard, reform measures must be implemented to diversify Cambodia's industrial structure, including:

- **Relaxing licensing requirements:** This measure is designed to remove state sanctioned exclusive trading arrangements and local monopolies. This would improve the provision of agricultural inputs including raw materials, semi-and finished products, which are crucial for agri-business industry.
- **Reducing inspection Requirements:** Although quality assurance is an important part of consumer protection, the policy for assuring quality can be a disincentive to full competition. The current legislation prohibits the commercialization of any product that has not been inspected. However, the regulatory cost is high and it is not possible for a government to inspect all commercial activity. In this regard, quality control regulation can be used to suppress specific businesses and to limit competition. Moreover, the inspection requirements could create an atmosphere of intimidation and discretionary authority.



Chapter 11

Private Sector Development

The main motivator of industrial development, wealth creation and accumulation is the private sector. While much progress has been made in reviving the private sector after the Khmer Rouge regime it is yet to exhibit the dynamism of private initiative which has been the hallmark of the outstanding economic performance of the Southeast Asian countries in recent years. There are constraints and roadblocks which prevent it from playing an even greater role in development policy performance.

Manufacturing activities are by and large located in the private sector. The average annual growth of manufacturing industry's value added was 15.4% per year during 1994-2008. This is at variance with the behavior of the index of production for the formal manufacturing sector which shrank during this period. An explanation could be that in this period, the contribution of manufacturing to GDP came from the informal manufacturing sector

The size of the enterprise provides a basis for analyzing Cambodia's corporate sector. Three large groups of enterprises can be distinguished from this perspective: large businesses, small- and medium-sized businesses, and micro-businesses of the informal sector. The first three groups viz, large, medium and small businesses comprise the modern sector and engage in commercial scale activities. The broad definitions and distinguishing characteristics of each group are as follows:

Modern sector (SME Development Framework, 2005, p. 13):

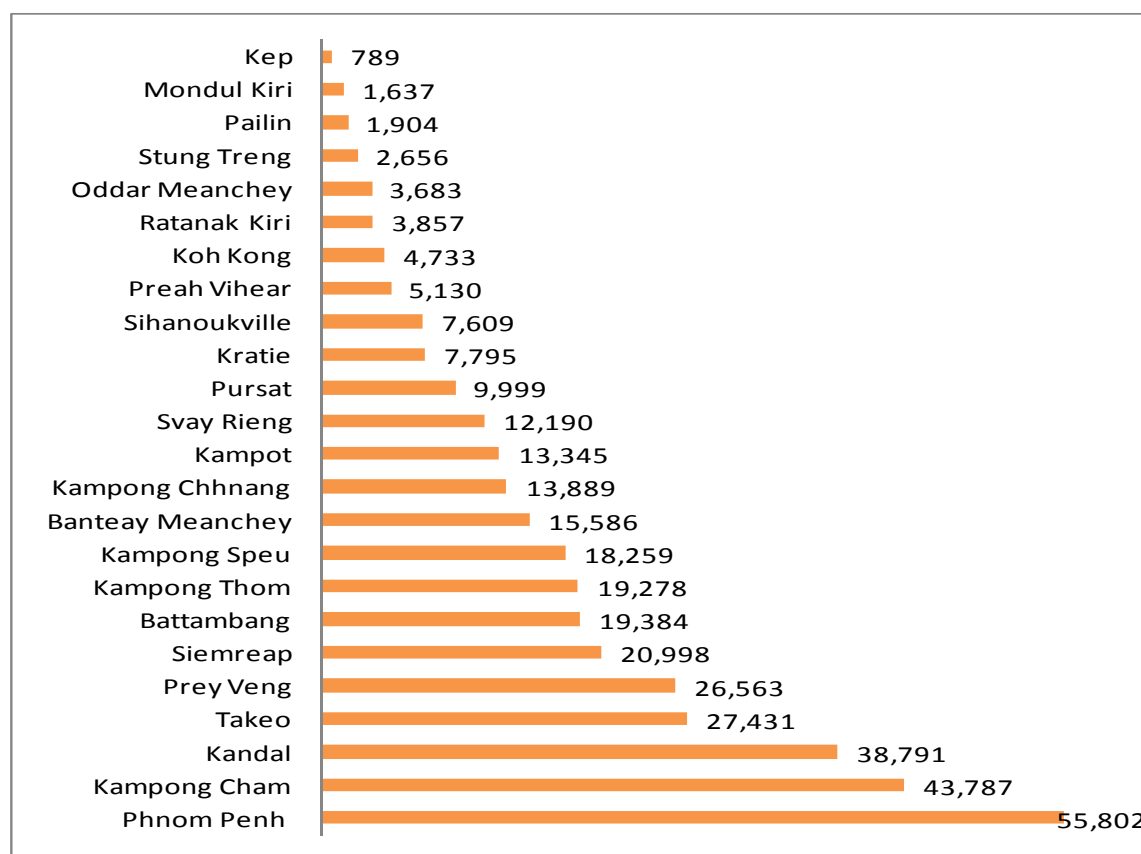
- ***Big businesses:*** The company could be privately owned or State-owned. Privately owned big businesses are often a branch or partner of a foreign company. Big business is generally defined as having more than 100 permanent employees or having more than US\$500,000 in capital invested, excluding land.
- ***Medium-size enterprises:*** In general these are funded by family capital and organized in a modern way. They generally employ from 51 to 100 workers with an annual turnover between US\$250,000-US\$500,000. They can be physically located, since they occupy fixed sites, are registered with the appropriate authorities, keep regular accounts, and often try to keep their identity distinct from that of the principal owners or promoters.
- ***Small-size modern enterprises:*** These enterprises are defined as those employing between 11-50 workers, with assets of between US\$50,000-US\$250,000.

Informal sector:

- These businesses usually produce traditional products including cottage industry and handicrafts. They include *micro-enterprises* which can be further categorized based on criteria such as the amount of accumulated capital, added value, potential for growth into a modern business, or the career path or profile of the entrepreneurs. Micro-enterprises are those businesses, which employ less than 10 employees, with less than US\$50,000 in assets, excluding land.

In general, each group of business faces characteristic development constraints not necessarily shared by the other groups.

Table 11.1. Number of Establishments Ranked by Province in 2009



Source: National Institute of Statistics, 2009

According to the recent Establishment Survey conducted by the National Institute of Statistics, Cambodia has 375,095 establishments and the number of establishments per 1,000 persons is 28.0 establishments. Thus, Cambodia has relatively fewer establishments

for its population size (Indonesia 22.7 millions and 102.3 and Laos 209 thousands and 37.4 respectively). These establishments are by and large small and informal.

Meanwhile, the smallest province was Kep with 789 establishments or 0.2% to the national total perhaps reflecting the fact that its area is the narrowest in all provinces, followed by Mondul Kiri (1,637 or 0.4%), Pailin (1,904 or 0.5%), Stung Treng (2,656 or 0.7%), and Oddar Meanchey (3,683 or 1.0%). These five provinces are located in the northern or eastern part of the country except Kep. Although Kep was the smallest, there are three large-scale industries: hotel, salt producing, and fish sauces. In Pailin, there were five large-scale industries: casino, guesthouse, restaurant, quarrying, and selling construction materials. In addition, electricity supply is an outstanding industry. However, casinos, guesthouses, and restaurants are decreasing.

The biggest province in terms of the number of establishments was Phnom Penh with 55,802 establishments or 14.9% to the total number of Cambodia, followed by Kampong Cham (43,787 or 11.7%), Kandal (38,791 or 10.3%), Takeo (27,431 or 7.3%), and Prey Veng (26,563 or 7.1%). These five provinces are located in the southern part of the country and are plain areas, occupying more than 50% of the total number of Cambodia.

Phnom Penh has been developing as the capital city, and especially, the tertiary industry has achieved remarkable development. Furthermore, the construction of high-rise buildings is in progress, and a special economic zone has been partially completed. In Kampong Cham, there are six large-scale industries: rubber, starchy food, animal feed, footwear, timber, and wearing apparel manufacturing. In Takeo, there are five large-scale industries: rice milling, pure drinking water, wearing apparel, brick producing, and water supply. In addition, construction material center is an outstanding industry. In Prey Veng, wearing apparel is a large-scale industry.

11.1. Modern Sector

Businesses in the modern sector (large, medium and small size) dominate the secondary sector and financial services. These businesses are expected to meet international norms and standards. The modern sector is essentially active in tourism, finance and in the port and maritime sector. The contribution of SMEs to the economy remains weak in Cambodia, accounting for barely 8% of the GNP. These businesses are diverse in origin and include companies financed with foreign capital. Privatized businesses also belong to this category of businesses.

11.1.1. Characteristics of the Cambodian Private Sector

On average, Cambodia's private sector is dominated by small firms. Of the 63,500 modern establishment identified by the International Financial Corporation (IFC) in 2008, 67% employ only the owner, 22% have between one and four employees, and 1.5% have more than 20 employees (WB, 2009. p. 1). Cambodia's private sector has many features of an informal sector: poor tax compliance, poor accounting practices and limited use of the banking sector.

The Ministry of Industry, Mine and Energy (MIME) considers that micro-enterprises are businesses with fewer than 10 employees, small enterprises have 11 to 50 employees, medium enterprises have 51 to 100 employees, and large enterprises have over 100 employees.

Table 11.1. Firm distribution

	% in terms of number of firms				% GDP
	Small	Medium	Large	Total	
Manufacturing	4.3	1.7	2.7	8.8	28.2
Trade	23.3	4.5	1.0	28.8	14.5
Tourism	18.4	5.8	0.4	24.5	7.0
Other	25.2	9.7	2.9	37.8	50.3
Total	71.2	21.8	7.0	100.0	100.0

Source: The World Bank and the International Finance Corporation. A Better Investment Climate to Sustain Growth in Cambodia. Draft for Discussion. 9 February 2009. Classification based on sampling for ICS 2007. p. 2.

We can see from the above table that only 7% of Cambodian firms can be considered as large, while 21.8% are medium. The predominant majority of Cambodia's private sector firms (71.2%) are small. Some 28.8% and 24.5% of the firms are in the trade and tourism sector respectively. Only 8.8% of the firms are in manufacturing and 30% of manufacturing firms, mainly garment factories, are considered as large.

Among listed business, almost half (48.2%) are in commerce, followed by services (45.4%), manufacturing and construction (5.4%) and natural resources (1%). Of those businesses in the commerce sector, only 1% of firms are in wholesale businesses, while 64% are in retail, and 35% operate convenience stores and grocery businesses. In the services sector, the second largest industry, food services (restaurants, bars, food stalls etc.) comprises 48% of enterprises, maintenance is 22%, professional services 5%, and others 25%. In the

manufacturing and construction sector, manufacturing (excluding food processing), represents 57% of enterprises, food processing 15, and construction 28% (IFC & Asia Foundation, 2009, page 6).

Of the 63,507 listed firms, 45% are located in Phnom Penh. Far behind Phnom Penh, the most economically active provinces of Battambang, Kandal and Siem Reap contain the next largest percentage of firms with 105, 7% and 5%, respectively. Provinces which have the fewest businesses listed are Kep, Stung Treng and Preah Vihear.

Micro-enterprises represent 97% of all businesses included in the listing. Only 2% of businesses are small enterprises, and less than 1% of the total are medium and large enterprises. Most of the provinces did not contain medium or large enterprises. Siem Reap, Phnom Penh, Kep, and Sihanoukville have a higher rate of small enterprises with, 4%, 3%, and 3%, respectively, while Koh Kong, Kratie, Prey Veng, Pursat, Stung Treng, Svay Rieng, Takeo, and Pailin each have less than 1% of the nationwide total of small enterprises.

Phnom Penh employs 55% of workers, followed by Kandal, Siem Reap and Battambang, with 18%, 8% and 5%, respectively. These provinces contain the most firms (67%) and employ the largest number of workers (86%).

Cambodian businesses are relatively new. Only 15% have been in operation for over 10 years. The majority (64%) have been in existence for less than 5 years, while 31% are less than 2 years. Starting in 2003, the number of firms began to grow remarkably fast due to increase in FDI and strong economic growth.

As most businesses in Cambodia are small and staffed and managed by family, more than 99% of businesses target the domestic market. Only about 1% of all firms listed target both domestic and international markets.

The WB and IFC's Investment Climate Assessment 2009 also pointed out that: (i) Cambodian firms are increasingly connected to global markets; (ii) Modern ITC technologies have gained ground significantly in recent years; (iii) the quality of labor is also gradually increasing; and (iv) Cambodian firms also have a high proportion of women in their labor force. Labor productivity is above that of Bangladesh and below Laos, Sri Lanka and Vietnam. However, the gaps in terms of wage is smaller, posing some issues for the country's competitiveness.

At present the principal industrial subsectors are textiles and garments, manufactured metal products, food products, and chemicals catering mainly to the domestic market except the textiles and garments industry which is export oriented and is an attractive destination for private entrepreneurs and capital including foreign investors. The private sector has organized associations according to product specialization in order to safeguard its interests

and promote dialogue with stakeholders including the government and labor. The Garment Manufacturers' Association of Cambodia (GMAC) is an example which has succeeded in successfully negotiating several arrangements and agreements with the government and labor.

11.1.2. Issues in Accelerating Growth of the Modern Sector

Improving the legal and regulatory framework is crucial for the development of the private sector, and promotion of growth. Private sector development is also constrained by infrastructure deficiencies (roads, ports, access to raw materials), weak legislation, cumbersome access to financing, corruption, limited information, lack of qualified human resources, and the high cost of public utilities such as electricity, water, and telecommunications. Private investment in the agricultural sector is limited by uncertainties related to land titling and land tenure.

The benefits from fiscal incentives for private sector investment are not clear but there is certainly a revenue loss from these incentives. In 2003, the RGC passed an amendment to the Investment Law, to rationalize the fiscal incentives for investment. The measures included:

- Introduction of a profit tax at a rate of 20%;
- Elimination of tax exemption on reinvested profits and the introduction into the Tax Law of a new provision limiting the exemption of reinvested profits to a maximum amount regardless of whether they were new projects or expansion of existing projects, and regardless of the source of financing;
- Introduction of a new formula allowing exemption from income tax for businesses for a maximum period of 3 years after startup of activities, followed by another 3-year period;
- Elimination of the right to tax-free repatriation of profits and other income by approved businesses.

The adoption and proper implementation of an appropriate strategy for private sector development should open Cambodia up to better prospects for growth and reduction of poverty. Cambodia would then benefit more from globalization and regional integration taking full advantage of its outstanding macroeconomic performance, favorable geographic location in East Asia and preferential market access to the markets of Europe and America. The foundations of such a strategy include:

- Strengthening of the long-term prospects of development;
- Improvement of the effectiveness of State intervention;
- Capacity building of the private sector.

The long term prospects for private sector development to a considerable extent would depend on how nimble private entrepreneurs are in adjusting to the ongoing integration of Cambodia into ASEAN and the WTO. This process opens up new opportunities and also presents some real threats. There are two areas in which Cambodia scores over its competitors – low wages and adherence to international labor standards. The United States and many European countries, are no longer willing to buy products from “sweatshops” in which minimum working conditions are not guaranteed. Cambodia has accepted this market access requirement and has put in place a tripartite system of production management in which the business owners, labor and the government under the supervision of ILO, cooperate and jointly ensure that the international labor standards are met in production. The government must publicize this arrangement as a comparative advantage for Cambodia in trade negotiations and discussions.

Excessive government intervention in business adds to business costs and is effectively a tax on investment and growth. In Cambodia the cost of starting up a business is US\$615, which is high for a developing country. However this cost is rarely incurred in practice since most new businesses are in the informal sector. Apart from this requirement, several rules and regulations apply. According to a World Bank report, excessive rules and regulations reduce access to employment for young people and women. What is more, it is “often associated with a greater ineffectiveness of public institutions (inordinate delays, inflated costs), with greater unemployment, corruption, and lower productivity and investment.”

The report proposes a series of reforms that are “simple to implement”: deregulation; cutting out or dropping the minimum wage; adapting work periods to those of high activity thus avoiding payment of overtime; simplification of dismissal procedures; less intervention by the courts in trade matters; transparency of information on credit; simplification of judicial procedures for debt collection; strengthening of legal protection for creditors; reform of the bankruptcy laws; and making reform into a continuous process. The implications of some of these recommendations for compliance with ILO labor standards and for meeting corporate governance standards should be taken into account before implementing them.

11.1.3. Improving State Intervention Efficiency

The following areas are of priority in the reform of state intervention in business:

- Legal and judiciary framework.;
- Financing;
- Streamlining of procedures;
- Liberalization of trade and pricing, and the promotion of competition;
- Public administration reform;
- Fiscal policy and public resources management.

11.1.3.1. Establishing a Legal and Judiciary System for Fostering Private Initiative

Private investment and markets can only develop in an environment where the rules of the game are clear, stable, and complied with, and where competition is effectively arbitrated. The legal framework for business must guarantee ownership rights and place economic activities on a secure foundation. Moreover, consistency in the rules of the game for the different operators, and their effective enforcement, are prerequisites for the establishment of a private sector led and market driven economy. These rules must be guaranteed by a functioning, equitable, predictable judicial system that is independent from the legislative and executive branches.

The relationship between the legal environment and the economy must be considered both in its traditional aspects, and in the specific context of globalization. On the domestic level, the judicial environment influences the propensity of economic operators to formalize their businesses and transactions. In international relations, the legal environment influences overall how investors measure the country risk. Even though they do not systematically desert countries deemed risky, investors will seek out prospects for high short-term profit in countries where the risk appears high. Added to these general aspects are the peculiarities incidental to economies in the process of restructuring. The effective functioning of the market economy depends on the legal environment that will ensure its dynamics and respect for the rules of the game. In this sense, the legal environment in restructuring economies must meet one specific priority: facilitate the reallocation of assets, which is the corollary of economic restructuring and change.

A recent survey of businesses has highlighted the burden of several constraints in the effective functioning of the legal system and dispensation of justice, viz.

- Administrative red tape, incessant control, the lethargy of procedures, and badly written or imprecise rules;
- Complexity of regulations (legal, fiscal, and social);
- Slowness of judiciary procedures, the lack of benchmark jurisprudence, and the quality of some legislation that is subject to different interpretations;
- Sluggishness and unpredictability of the judiciary system. The courts are often short of resources, which slows down the proceedings.

Much remains to be done to improve the performance of the judicial system in Cambodia. Investors complain about the shortage of judges, the incompetence of some of them, and corruption, which gives rise to unpredictable and even aberrant judgments. There is also the lack of confidence in debt recovery processes.

The government is committed to put in place a comprehensive judicial framework conducive to investment, which squares with Cambodia's commitment to facilitate business, subsequent to its accession to the WTO. The proposed reforms will address the following objectives:

- Strengthen protection of corporate rights in relation to the State;
- Adapt legislation to corporate needs;
- Assure the effective enforcement of corporate law;
- Make laws governing loans and recoverability more favorable to growth;
- Support the promotion of commercial law.

Alongside, the government will encourage arbitration procedures to resolve conflicts and improve the training of judges and their assistants. In sum, the legal and judiciary systems are undergoing reforms that are anticipated to contribute to the improvement of the business environment. However, it is important to consolidate them and ensure that there are no gaps.

To oversee and orchestrate the reform the RGC set up, in June 2002, the Council for Legal and Judicial Reform (CLJR), co-chaired by the Deputy Prime Minister and Minister in charge of the Office of the Council of Ministers and the President of the Supreme Court. In December 2002, a project management department was formed to draw up the Strategy for Legal and Judicial Reform. The CLJR's main tasks include improving the quality of judicial decisions and ensuring their effective enforcement, and the needed institutional support, for e.g. by promoting computerization. The expected outcomes are:

- Training and instruction of magistrates and court clerks;
- Improvement of the functioning of the judicial apparatus;
- Better access to the person under the jurisdiction of the court.

The actions currently being taken by the CLJR include: (i) support to the institutional framework; (ii) support for the streamlining of legislation governing corporations; and (iii) support for ongoing reforms and the promotion of business law. Areas in which the reforms and capacities of the legal and judiciary system are being buttressed involve: (i) resolution of judicial infrastructure issues and capital costs thereof; (ii) development of alternative modes for conflict resolution; and (iii) the system to make bank guarantees work. To enable the proper management of the reforms taking place in the justice sector, the government has undertaken to boost the staff resources of this sector and provide training, particularly in the better handling of economic issues.

11.1.3.2. Streamlining of Procedures

Complex and opaque administrative procedures are a serious impediment to private investment. To reach the level of desired growth (6-7% per annum), the rate of private investment must be increased considerably. Despite the efforts of government, the level of private investment in Cambodia remains insufficient.. Since foreign direct investment not only brings in additional capital, but also technology transfers, poor performance in this area is a set back for development. The business climate is particularly important for foreign investors, inasmuch as they are free to choose among a large number of countries. Red tape and lack of transparency also tend to breed favoritism and corruption. The absence of legal and regulatory transparency sometimes tends to benefit private interests at the expense of public welfare.

In order to improve the business climate, the government introduced in 2004 the one-stop service office at the Council for Development of Cambodia and amended the law on investment in 2003 to rationalize the incentive system. To this end, the RCG has decentralized investment approvals to the provinces and established one-stop business

registration centres to streamline procedures. In spite of these important steps, there is still much more to be done to streamline procedures for investment, trade, and taxation in Cambodia and to ensure transparency. Problems with delays, supplementary costs, and confusion of investors, are typical of countries that use investment codes founded on fiscal incentives and Cambodia is no exception.

Procedures for registering and licensing are also deemed to be clumsy, complicated, and costly, with many different stages, each with its own licensing requirements and supporting documents. Gaining access to land and developing industrial sites are also complicated involving long and costly delays. To create a more favorable business environment, it is crucial that procedures for clearance, incorporating, and licensing be simplified. This will be addressed in the reform relating to streamlining of procedures.

11.1.3.3. Implementation of Labor Legislation

Even though the Labor Code was adopted more than a decade ago on March 13, 1997, its implementation is still a work in progress. Although there has been some progress in implementation during the last few years, the enforcement of the legislation has given rise to considerable uncertainty in the business environment. The government has launched several important measures relating to labor legislation to clarify the situation in consultation with employers and labor unions.

The goal of these measures was to:

- Help improve the competitiveness of businesses through increased productivity of the work force;
- Increase labor flexibility in terms of both manpower hiring and downsizing;
- Ward off social conflicts within businesses by establishing dialogue in the enterprise between the government, employers, and labor unions.

11.1.3.4. Pursuing Public Administration Reform

The administrative reform process results from the necessity of adapting the role of the State to changes in the environment and improving the efficiency of public intervention. The redistribution of roles between the State and private sector require administrative personnel possessing skills, open-mindedness, and the information necessary to suitably assume their responsibilities in the scheme of designing the development strategy and implementing it. Since 1999 the RGC has undertaken several reforms to improve the quality of public service. The main weaknesses in public administration are: weak

management capacity for development, lengthy procedures, and a high rate of absenteeism. This situation may be partly explained by a lack of motivation on the part of public officers, and the inadequate means made available to them to carry out their responsibilities including a poor salary.

The crux of central administration reform is the creation of a government more focused on supporting the private sector development strategy. Government role is to ensure that the private sector is able to function freely within clearly defined parameters and mechanisms of transparency, accountability, auditing, merit, and sanctions. The objective of government regulation is to increase efficiency and performance, and to control supplementary costs. Among these costs, those due to corruption are the most harmful as they result in inefficient resource allocation.

An important lacuna in public administration is the weak empowerment of local governments. To complete the architecture of decentralization, it is necessary to fill the void that existed between the strong but distant central government and the local authorities that, although closer to the people, were without resources. The solution lay in turning the region into a local, intermediary authority. At the current stage of implementing this reform, serious constraints result from the weak management capacity at the regional level and the low level of local financial resources. Indeed, management of taxation should focus on the harmonization of tax measures at the central and local levels, to avoid undue burden on private business.

11.1.3.5 Improving the Quality of Financial Intermediation

There is a strong positive correlation between a healthy financial sector and economic growth performance. A vibrant financial sector supports domestic resource mobilization from the private sector and helps to improve efficiency in resource allocation by selecting viable projects for financing. The State has an important part to play in promoting the development of institutions involved in long-term financing including specialized institutions, and introducing and propagating instruments suited to particular types of needs in the financial market (insurance, risk capital, financial lease, etc.). Measures required from the State focus mainly on improving the regulatory and legal framework (competition, prudential rules, taxation, interest rates, credit entitlement and rules on loan recovery, etc.).

Difficulties of access to credit for SMEs and new businesses remain a crucial problem. Although in principle direct intervention by the State in the management of banks is undesirable it needs to intervene to correct market failures. Typically financial markets fail to allocate adequate resources to the SME sector since these businesses are perceived by the lenders to carry high risks. If government does not intervene to correct this market failure the SME sector will languish. Possible interventions include state owned banks

dedicated to SME lending but privately managed, promoting competition in the financial sector, allowing higher interest rates for SME loans to offset risk, and the tying in of loans to SMEs to technical support subsidized by public funds.

In Cambodia, the difficulties in accessing credit are the most serious impediment encountered by the private sector. In general SMEs do not have a strong asset base. Since lending by the financial institutions is collateral based, most SMEs find it difficult to prepare the documentation needed by banks for extending a loan. Businesses also complain about the slow speed of processing of loan applications. The poor quality of applications submitted, the absence of financial statements or sufficient references (in particular for new businesses), and uncertainty about or the reputation of sectors deemed “risky” are also behind many rejections of loan applications by SMEs. .

The majority of businesses have favored the following:

- The setting up of funds or special mechanisms of loan guarantee or collateral, or specialized mutual aid funds;
- The development of financial products or the establishment of specific lines of credit, adapted to the production cycle and to the realities of their activity sector (credit management by a specialized agency);
- In general more flexible access to credit.

Lack of venture capital remains the major problem of the fledgling business. All measures (in the legal or regulatory apparatus) that might contribute to the emergence of risk capital ought to be examined. Since difficulty with financing is mainly a problem for small-scale projects, preferential access to such funds should be established for them.

The cost of financing has also been cited as a major obstacle to private sector development. Large businesses also cite this as an impediment to their growth even though these may have easier access to credit than the SMEs.

11.2. Informal Sector

The fast growth of the informal sector in Cambodia in recent years is attributable to the rapid urbanization and the rural exodus following economic liberalization in the 1980s and 1990s. Many young Cambodians could not find work in the formal sector and thus became involved in the informal sector and are contributing to its growth. For most of these enterprises their traditional approach to management and preference to avoid complex

regulations, taxation, and State controls which they have to adhere to should they move to the formal sector, motivates them to continue in the informal sector even if there is scope and opportunity to graduate to the formal sector. Some important characteristics of informal sector operations are described below:

- i. Only about a third of entrepreneurs in the informal sector are literate. This explains in part why they shun complex government and management regulations that govern modern businesses.
- ii. Most activities of the private sector are rural and informal and employ 70% of the labor force. The modern private sector employs only 15% of the labor force. Informal businesses play a predominant role in the primary and tertiary sectors, that is, in agriculture, trade, and transportation. A major portion of retail trade and a large share of imported consumer goods are transacted by informal businesses.
- iii. If agriculture is not included, the informal sector is dominated by small or micro-businesses providing trade and other services. Those involved in providing services to the large import trade are taking efforts to modernize, and are gradually turning their attention to manufacturing activities. Female heads of informal businesses have been particularly successful in import operations and some of them are motivated to start new ventures in manufacturing. Informal businesses are also found in the secondary sector, notably in handicraft manufacturing and construction.
- iv. Informal sector entrepreneurs trying to enter the formal sector face considerable difficulty in moving out of their ambiguous relationship with the State, notably with regard to tax payment and labor regulations.
- v. The informal sector plays a prominent role in terms of contribution to GDP and employment but is characterized by low productivity and undercapitalization.

11.2.1. Promoting Cottage Industry

Cottage industries provide an important source of income for the poor in rural and semi-urban communities but have failed to exhibit dynamism due to: (i) weakness of the basic institutional framework and infrastructure; (ii) gaps in resources for operating and self-financing, as well as in the availability of industrial sites equipped for craftsmen; (iii) often cumbersome access to markets for craftsmen, particularly public markets; (iv) poor access to credit, due notably to bank reluctance and to the absence of financing structures adapted to the needs of the sector; and (v) irregular access to quality inputs.

Cottage industry development is a key component of the government's rural development strategy. Development initiatives for cottage industry address the following objectives:

- In the area of financing, successfully put in place decentralized funding structures that are technically and financially sound, such as MFIs, so as to win the confidence and support of craftsmen
- In the area of marketing and outlets, improve the quality of handicraft products in order to make them internationally competitive, so that they can benefit from the expansion of the tourism sector. For craftsmen, this will involve getting exposed to a modern sales and export techniques.
- Provide onsite training services in modern but simple technology for production, marketing, management, communication, and supervision. ,.

To achieve these objectives the government will engage the following strategies:

- In the area of financing, build up the managerial capacities of the decentralized financing structures through officer training and post-training monitoring, and adapt their financing system to the realities of the sector.
- In the area of marketing and promoting handicraft products, improve product quality, create a ramified distribution channel out of the villages in which cottage industries are located, and establish decentralized distribution centers. This will also involve promoting these products on the domestic and international market by participating in fairs, exhibitions, cultural events, festivals, etc.
- As regards training and acquisition of proficiency, raise donor awareness regarding the necessity of providing training for craftsmen and supervisory staff in a sustainable manner, as well as repairing and upgrading the training centers.

11.3. Constraints to Investment and Productivity

Cambodia's achievements in economic development during the last decade are remarkable, driven by the vibrant private sector, with the public sector providing enabling support. As a result a vibrant modern private sector have thrived. The evidence of such modern business sector includes: the number of firms registering is increasing every year (from 720 in 2003 to 2,890 in 2007); an increasing proportion of firms using email and websites; and rapid growth in technology-based sectors such as telecoms and banking. Some more capital intensive industries, such as Aluminum cans, are emerging.

The Cambodian private sector is characterized as an optimistic, modernizing private sector; but with very little diversification and continued large informal sector. Most of the companies are small and medium enterprises, operating in a very informal economy: poor tax compliance, limited use of banking system.

Overall productivity at the firm level remains low, less than offset by lower wages; some good performance, e.g. in garment – but large gaps between mean and top-performer in all sectors. In garment, much closer to competition – with somewhat higher-than-average wages. Garment is more productive and higher efficient. Some Cambodian firms are becoming more connected to the global market – but exports still only in garments and agricultural products. A majority of firms is becoming more modern (use of technology; training). Average wage is around \$100 per month, but mark-up (value-added minus wage) is much higher in wholesale trade and transport.

The 2009 WB Investment Climate Assessment identified the following problems as constraints to productivity and investment:

- ***Access to finance is limited and uneven.*** Only 10% of firms use banks to finance investment. However, only 1 in 10 firms sees access to finance as a severe constraint;
- ***Skills are emerging as a significant concern.*** The level of skills is poor, and poorly adapted to a new demand from the private sector. Addressing this problem will take time and required a multi-pronged approach. Wages remain competitive, but are increasing rapidly. Labor regulations are not viewed as a constraint. The incidence of labor disputes, strikes, and civil unrest has increased considerably.
- ***Progress in improving customs, infrastructure, and the quality of the logistics industry is necessary to attract new industries.*** Some elements of logistics have improved (e.g. customs) – but transparency and efficiency still low. And high costs of freight transport. Progress in trade facilitation has been significant. The time to clear a shipment (between the port and the factory) has decreased for exports to 4.3 days and for imports to 5.1 days. This reflect the implementation of the 12-point action plan on trade facilitation adopted in 2004. However, progress should be accelerated in the efficiency of ports. The supply of trade-related services is weak and logistics services remain under-developed.
- ***In the area of infrastructure, limited access to electricity, high cost, and unreliability is becoming an issue.*** There is also a need to provide an adequate distribution system and improvements in the regulatory environment in order to keep price low and improve the quality of services.
- ***Despite progress, starting a business remains difficult.*** creation a business has a

median cost of US\$240 at the Ministry of Commerce, US\$300 each for tax and VAT registration, and US\$630 for labor registration.

- ***Trust in the judicial system remains very limited.*** Concerns related to crimes and safety has improved significantly; firms report very few disputes with the government. Disputes mainly concern contractual issues.
- ***Governance issues remains the most severe constraint.***



Chapter 12

Industrial Policies

12.1. Future Challenges and Opportunities

The export oriented garments and textiles sector has been mainly responsible for the high industrial growth of Cambodia in the last decade. Cambodia has been seriously affected by the decline in garment exports due to the global economic slowdown in late 2008. Cambodia has also been losing ground in the US its major destination for garment exports. Cambodia faces several constraints in dealing with the abolition of garments quotas including: (1) declining competitiveness; (2) high concentration on a few markets; and (3) heavy reliance on imported inputs/materials. The current trends in the Cambodian garment industry show a slowdown in market growth, which could cause damage to the industry if measures are not taken to address this backward trend.

Cambodia suffers from poor infrastructure and high cost of utilities. Attention should also be paid to labour costs in Cambodia which have been rising steadily without a matching increase in productivity. Electricity prices, transportation and port handling costs in Cambodia, are high when compared to other countries in Asia. While the still cheap labor cost will be an attraction for foreign investments, this alone will not be sufficient to attract foreign investors as large-scale producers such as India or China also enjoy a similar advantage.

It is crucial that Cambodia maintains its competitive advantage as a low-cost production centre by addressing the high costs of transportation, utilities and handling of containers at the ports. Mechanisms to link wage increases to productivity improvement should also be focused upon. Within the garment industry, expansion of both product range and markets is essential if the industry is to survive and grow. Attention should be given to the further expansion of garment products outside of the quota system.

To reduce transport costs, attention has been given to improve the road network across the country. Large investments have been made in the improvement of national, provincial and rural road infrastructure. The government has also conducted a study on the operational cost structures, especially import-export and container handling costs. Concrete actions should be followed up in order to reduce operational costs at the international port.

There are several downside risks facing Cambodia. Reflecting the deteriorating global economic environment, the growth momentum of Cambodia's exports has weakened. Moreover, prospects for Cambodia will depend significantly on developments in the domestic political environment and the state of the world economy, about which there is currently considerable uncertainty. Foreign direct investment and continuing donor support will be crucial to the achievement of GDP growth targets of 6-7 % per year in the medium term. Attraction of FDI will require relaxing several constraints that weaken Cambodia's competitiveness. Cambodia will be in competition with other countries to win the approval of foreign investors.

Several potential sources of growth have been identified, including diversification of production and improvement in agricultural sector. Large areas of land remain underutilized. Cambodia has a potential to increase rice yields, improve food security and expand rice exports. Agro-processing and fish farming can also become promising sources of growth.

In the short to medium term, the civil service and legal and judicial system must be improved in order to facilitate the implementation of governance reforms and to enhance the environment for private investment, reduce trade facilitation costs and generally foster private sector development and trade-driven growth. It will also be important to improve road infrastructure to facilitate market access and reduce transportation costs, as well as enhance port management and power and utility services to reduce production costs.

12.2. Diversification of Industrial Development

Diversification within the garment industry as well as the development of new industries will be crucial steps in Cambodia's industrialization strategy. The development of new industries should however, be strategic, sustainable and evaluated in terms of their benefit to Cambodian people. The development of high quality products will require investments in technology, training, and quality control.

It is important to promote the development of ancillary industries in order to reduce Cambodia's dependence on imported inputs. Supporting industries that produce garment accessories and the initial processing of imported grey fabric could be indigenized to save imports and deepen the technology chain.

Although there is an apparent abundance of labour in Cambodia, workers are not skilled in operating the sophisticated machines used in industry. Far too little has been spent on training of staff with skills that are transferable across the industry. Better skilled staff will also be more contented and productive.

Moreover, the RGC needs to urgently diversify toward other industries to reduce its dependence on the garments and textile trade. The RGC is conscious of the need to diversify the Cambodian economy and emphasizes that apart from assisting in the adjustment and further development of the garment industry, it will give priority to the development of other labour-intensive enterprises, such as toys, footwear and assembly of electrical and electronics appliances for domestic and industrial uses. This provides the framework for diversifying Cambodian industrial structure. Provision of low-cost water and power supply, and competent and cost effective financial, information and telecommunications services is a high priority to support industrial diversification.

The RGC's industrial sector strategy may be summarized as follows:

First, continue to develop labour-intensive industry, such as garments, toys and footwear industries;

Second, promote the development of agribusiness by strengthening legal framework for longer-term land management; provide tax incentives to establish facilities to process agricultural products, such as cotton, jute, sugar, palm oil, cashew nuts, rubber, cassava and fruits;

Third, develop industries based on the utilization of locally available natural resources, such as fish and meat processing, cement , and tiles including bricks.

Fourth, promote SMEs, micro-enterprises, and handicraft;

Fifth, promote industries that produce appliances and electronics products for domestic and industrial uses and improve product quality; it is necessary to establish a system of quality control of all manufactured products, particularly exports to meet international standards and enforce the intellectual property laws.

Sixth, establish industrial and export processing zones by developing infrastructure, improving service quality and encouraging investments. These zones can be established on the outskirts of Phnom Penh, Sihanoukville, Banteay Meanchey, and Koh Kong; in these zones the RGC will build road networks, develop power and water supply, ensure waste management and environmental protection, provide education and vocational training, upgrade health services, establish warehouses and streamline customs procedures and other formalities to ensure an environment conducive to business profitability and growth;

Seventh, encourage the development of import substitution in paper, chemical industries, such as the production of fertilizers and acid, as well as daily consumption goods such as soap, paint, electrical appliance, water pumps, agricultural inputs, etc.; and

Finally, promote culture and nature based tourism development in Cambodia.

Growth in these areas will help absorb Cambodia's rapidly growing labour force. In order for the poor to take advantage of these opportunities, work force will need appropriate skills and also mobility to move to the high growth sectors and areas.

The RGC's industrial policy has two goals, viz, supporting the development of export-oriented industries, and the development of import-substituting production of selected consumer goods. These goals are to be achieved by promoting: (1) labour-intensive industries, (2) natural resource-based industries, (3) SMEs, (4) agro-industries, (5) technology transfer and upgrading the quality of industrial products, (6) establishment of industrial zones, and (7) the development of import-substituting production of selected consumer goods. In line with this approach, the government intends to promote private sector development through selected and carefully designed industrial policies. These can be summarized as follows:

- Encouraging expansion of the SME sector, especially through provision of medium and long term finance;
- Improving the performance of SOEs through corporatization and privatization;
- Stemming the flow of illegally imported products;
- Reducing barriers to export such as export taxes and inefficient provision of trade facilitation services;
- Reducing barriers to importation of essential inputs;
- Providing infant-industry protection in carefully selected instances;
- Enhancing the linkage between SMEs and large industries;
- Promoting a national productivity centre that will assist SMEs to increase productivity and reduce production costs;

- Establishing a National Institute of Standards to ensure that product quality matches regional and international standards;
- Establishing a National Laboratory with the technical capacity to undertake physical, chemical, microbiological, and mechanical testing that will establish the quality and other specifications of these products;
- Establishing an industrial property rights bureau that would protect new products, designs and technologies from illegal copying;
- Promoting vocational training domestically and overseas; and
- Upgrading the legal framework in the areas of factory law, industrial zone law, patent and industrial design law, weights and measures, and industrial safety.

The promotion of labour-intensive manufacturing will continue to focus on the textiles and garments industry, where the abundant supply of labour underpins cost competitiveness. However, the government recognizes that retaining and increasing market share in an increasingly competitive international environment requires the upgrading of product quality, as well as improving productivity through world class technology and management. The development of better industrial relations within the established legal framework is also needed; and ways of increasing the spill over effect of garment manufacturing need to be investigated. Currently, most of the garment sector operates on cut, manufacture and tailor basis, with fabric and accessories (zippers, buttons, thread) being imported, and the purchase of local inputs limited to transportation and freight clearing services, utility-type services to run factories, and construction to build factories.

In order to diversify the manufacturing export base, the Government will encourage toy production, whether under license or through 100% foreign direct investment. Such manufacturing is considered to be well suited to the country's relatively large endowment of low skilled labour. A second area that will be promoted is assembly of electronic products, where all parts and components are initially fully imported.

The promotion of locally available natural resource-based industry will focus on identifying and exploiting opportunities in processing of natural resources, including non-metallic mineral resources, timber, and fisheries. The development of animal and fish breeding may permit their supply as a raw material for reprocessing factories. However, the better prospects in this area are in the processing of non-metallic resources for manufacture of construction materials.

Cambodia's Power Sector Strategy (2001-2005) sets out the priorities and outlines a major investment program to lower tariffs and bring reliable electricity supplies to considerably more Cambodians. The planned investment program includes: (1) the development of a generation and transmission grid to link large electricity generation units between Phnom Penh and the provincial capitals; (2) provincial towns electrification plan to rehabilitate supplies; and (3) the development and implementation of a rural electrification plan. Rehabilitation and expansion of Phnom Penh's electricity supply system is being continued. Generation capacity is also being expanded with an interconnection from Viet Nam and Thailand, and over the next five years from a new coal-fired power plant in Sihanoukville. These improvements will allow a more reliable and better security of electricity supply to the outer regions of Phnom Penh.

The Program to establish a National Generation and Transmission Grid commenced in 2000. The first stage of this program is the construction of transmission line between Viet Nam and Phnom Penh through Takeo Province. The second stage is the construction of a transmission line from Kampot province to Takeo province. The third stage is the transmission line from Sihanoukville to Kampot province which will allow generating units to be established in Sihanoukville to provide supplies to provincial cities between Sihanoukville and Phnom Penh and also increase the capacity available to Phnom Penh. Establishing generation in Sihanoukville which is expected to be a gas power plant, the need to transport fuel on the Mekong would be avoided reducing the danger of oil spills and environmental damage. The portion of transmission line from Phnom Penh to border of Viet Nam through Takeo was established first to import electricity from Viet Nam in 2003. The 220 kv Interconnection from Viet Nam will supply power to communities in the South and increase capacity available to Phnom Penh.

A Five-Year Rural Electrification Program including renewable energy will also be implemented. The total cost of the first part of the power transmission and rural electrification project is estimated at US\$89 million. Another 115 KV interconnection transmission line has been established to connect from Thailand to Banteay Meanchey, Battambang and Siem Reap provinces to support the provincial and rural electricity program. The plans also include developing hydropower project in Kamchay and thereafter Stung Atay, Se San and Russey Chrum.

Consideration of hydro-power stations in Cambodia will require carefully balancing the objectives of growth, environmental protection and social equity. Efforts should be made to avoid the mistakes of neighbouring countries, where the development of hydro-power has led to environmental, social and economic problems. If rural electrification could serve the cause of rural employment creation at least the objectives of growth and social equity would be addressed.

In regard to small-scale industry and handicraft production, the Government intends to give priority to the promotion of traditional art and crafts for the tourist market in both rural and urban areas. Another area with potential for expansion is small-scale tobacco production which can contribute to increasing the supply of raw materials to the large manufacturers. However, in order to succeed it will be necessary for these enterprises to ensure sustained product quality. In addition, because they do not have access to credit other than from high-cost moneylenders they will need to be provided with reasonably priced micro-finance credit facilities.

The core strategy for agro-industry development is to grant concessions of land plots to both domestic and foreign companies on a long-term basis, and to encourage the participation of local small landholders through contract growing for supplying processing factories in the area. The development of agro-industry initiatives will require close co-ordination between the ministries of Industry, Mines and Energy, MAFF and local authorities, as well as technical assistance for the full assessment of development potential. Strengthening the economic linkage between agriculture and industry within the context of sound environmental management is essential to the creation of sustainable incomes and employment.

12.3. Industrial Corridor Development

Industrial development should begin straightaway in regions with adequate infrastructure and supportive facilities. On this basis, the RGC has formulated a plan for the promotion of three poles of development: Phnom Penh, Siem Reap and Sihanoukville.

The government launched a concept of “growth corridors”, aimed at developing the areas along the road network linking different parts of the country and turn them into agricultural, industrial, trade and investment development zones. The growth corridors will get priority while allocating resources for physical infrastructure, such as telecommunications, water supply and electricity, as well as in the development of other ancillary facilities and social and legal infrastructure.

12.3.1. Development Image of Growth Corridor

The Growth Corridor Area is composed of three distinctive sub-areas, with different characteristics. The following table describes the present and future scenarios of economic development in the Growth Corridor Area.

Table 12.1. Matrix of Economic Development Directions

Sub-Area	(2002 status) Short-term	(Up to 2008) Long Term	Med to (Up to 2015)
Greater Capital Area	-Garment and footwear (Labour intensive industries); -Supply of agriculture products to urban consumption.	-Development of agro-processing industry; -Airport based industry (high value added, labour intensive industry), electric appliance/transportation machinery assembly.	-Enlargement of agro-processing industry; -Development of import substitution industries; -Electric appliance/transportation machinery assembly and production; -Development of IT industry; -Logistics center.
Shihanouk-ville Area	-Garment and footwear (labour intensive industries); -Beverage production; -Marine products processing; -Improvement of port facility; -Beach resort for domestic visitors.	-Development of agro-fishery processing industry; -Port based industry (Garment; light manufacturing); -Enlargement of beverage; -Port-oriented industry (ship repair; boat building); -Coastal tourism for domestic visitors.	-Development of agro-fishery processing industry; - Development of import substitution industries; -Electric furnace semi-assembly/production -Enlargement of used machinery reuse and recycling; -Export of beverage Products; -Coastal tourism for local and international visitors.
Other Areas	-Cottage and handicraft industry; -Vegetable and fruit production; -Cattle farming; -Fishery.	-Enlargement of suburban agriculture for import substitution; -Modernization of cottage Industry; -Promotion of village tourism; -Agro-fishery processing.	-Further improvement of agro-fishery processing for export.

Source: JICA

12.3.1.1. Sustaining and Enhancing Competitiveness of Garment Industry

12.3.1.1.1. Short- Term Strategy

The total employment of the garment industry was around 350,000 in the Growth Corridor Area. As most (75%) of Cambodian garment exports go to the U.S. market, diversification of export destinations will need to be pursued as an export strategy. Diversification from knitted fabrics to woven fabrics should be helpful in catering to demands from different export destinations. Technology improvement and quality control will add to the competitiveness of the industry. Liberalization of imports of material fabrics and auxiliaries and export of the finished goods is imperative, and the development of human resources will also be necessary to succeed in this endeavour.

12.3.1.1.2. Medium- Term Strategy

The medium-term target of the garment industry is to achieve a substantial structural transformation. It will be necessary to boost the value-added of products to make them competitive in the medium-price market. For this purpose, development of industries for the manufacturing of ancillary materials, such as ribbon, button and collar stay and other accessories of garments, will be important. Support for business incubation with Cambodian initiatives will be essential to widen the Cambodian garment industry base and start anew a process of industrial accumulation. It is imperative to move away from the present contract-based manufacturing to direct access to export markets, for which the strengthening the marketing capability will be necessary. Much will depend on the increasing role of domestic enterprises in garment production and related peripheral industries for this industry to continue to enjoy its status as the premier industry of Cambodia.

12.3.1.2. Recycling of Used Machinery; Automobile, Electric and Electronic Appliances

A large quantity of used machinery; particularly automobiles, electric appliances and computers, is disposed of or discarded in Japan and in other developed countries. Used machinery would have a substantial value if usable units are selected, repaired, refurbished and sold. Parts could also be disassembled and sold. Recycled machinery or parts could be marketed in Cambodia or exported to neighbouring nations. Cambodia can host such functions and serve as a gateway to the Indochina market in refurbished goods and supply of parts. Free Trade Zones will provide an excellent site for displaying and sales of such goods. In pursuing this policy care should be taken to ensure that environmental safeguards and safety standards are met.

12.3.1.3. Promotion of Agro-industry

The agro-industry straddles the primary and secondary industry, development of agro-industry will increase the value added from both agriculture and industry since the processed products are more valuable than unprocessed raw materials. The potential areas of agro-industry are seafood, such as fish, shrimp, squid and seashell, and fruits and vegetables.

12.3.1.4 Promotion of Assembly Industry

Assembling is a labor intensive industry, requiring inexpensive but trained labor force. Without much of industrial accumulation in Cambodia, it may not be possible to manufacture sophisticated goods from the scratch. An alternative method is what is called

knockdown or semi-knockdown production. Possibilities include electric appliances, transportation machinery assembly, wire harness for automobile, etc.

12.3.1.5. Import Substitution -Recapturing of Domestic Market

12.3.1.5.1. Mineral and Agro-based Products

Cambodia imports various commodities including products whose raw materials are locally available. Agro-based commodities, such as processed food, account for 3% of the total import, and mineral products including cement account for 4%. With ample local resources in agro-fishery, at least a part of the imported processed food could be locally manufactured to replace imports. Processed meat, fish, canned or dried fruits and vegetable oil are other commodities in this category. A comprehensive assessment of the endowment of the resources needs to be made to ensure that unnecessary imports do not take place. Recapturing of the domestic market by made-in-Cambodia products will contribute to the betterment of trade imbalance and nurture a base for future exports.

12.3.1.5.2. Construction Materials

Construction contributes about 5% of the GDP. It could contribute more; only a small fraction of construction materials are manufactured locally, such as simple bricks. As the expansion of urban areas and industrial estates continue, the demand for construction materials will increase. In order to translate this into domestic income and employment capabilities need to be boosted for the production of construction materials including secondary products, such as concrete pipes, slabs and panels, and galvanized iron steel sheets and more sophisticated bricks and tiles. Construction materials are bulky and heavy, and are suitable for import substitution.

12.3.1.6. Promotion of Footwear Industry

The footwear manufacturing, or shoe making, is already established in Cambodia with exports of US\$ 8 million annually. This industry is labor intensive and is suitable for development in the capital short Cambodia. Liberalized regime for imports of inputs and exports accompanied by improvement of the technology and quality control will provide the much needed impetus for the growth of this industry. For sustainability the industry should explore opportunities for boosting production of more sophisticated and higher value-added of products. This would require the effort of both the public and private sectors.

12.3.1.7. Upgrading of Small and Micro Industry

Small and micro (handicraft) enterprises are indigenous to Cambodia, providing substantial employment. Although the contribution of these enterprises to GDP is not yet high, the advantages of in terms their close linkages with the domestic economy through capital ownership and employment and potential for quick response to changing market conditions, provide powerful arguments for an industrial policy that supports their development. Small and Micro Enterprise technologies are often conventional or traditional, where ample room for improvement exists. Managerial skills are often not sufficient, requiring support for upgrading.

Lessons learned from the experience of different models of support to these enterprises and private sector development emphasize: (i) stimulation of entrepreneurial initiative; (ii) organization and facilitation of access to counselling services; (iii) establishment of a comprehensive, coordinated support system; (iv) creation of an environment conducive to the development of enterprises; and (v) coordination of direct international support to the enterprise. The strategy for Small and Micro Enterprise development must take these priorities into account.

As far as financing is concerned, ongoing experience in the promotion of SMEs and micro enterprises must be consolidated. The conditions often imposed with regard to margins of own-source funds, providing an unreasonable level of collateral and excessive quality control and scrutiny of loan applications must be reviewed and made more client-friendly and appropriate for prevailing field conditions. The proximity approach is another way of developing micro-finance institutions.

12.3.1.8. Necessity of Industrial Estates with Competitive Infrastructure

While its neighbours Thailand and Viet Nam, have been active in the last decade in providing industrial estates with competitive infrastructures, Cambodia has little to offer to potential investors to locate their production facilities in the country. Utility costs are high, particularly electricity. Transportation costs are substantially higher than most of the neighbouring nations, particularly in Phnom Penh. Efforts should focus on providing industrial estates with high quality and efficient infrastructure.

Table 12.2 Comparison of Cost for FDI in Asian Nations

Country		Cambodia		Thailand	China	Viet Nam		
City		Phnom Penh	Shihanouk-Ville	BKK	Shenzhen	Shanghai	Hanoi	HCM N
Monthly Salary (\$/month)	Worker (incl. of fringe benefit)	60-70	60-70	140	40-110	190-280	75-115	95-140
	Engineer /supervisor	100-500	100-300	300	120-250	280-460	190-310	155-290
	Manager	500-2,500	n.a.	620	340-720	430-910	470-540	470-620
	Minimum wage by law	45	45	3.71/day	69.35	59.2	41.6	41.6
Land/office price	Factory lot sale in IE (\$/m ²)	20-40 (outside IE)	n.a.	30-70	14 (50 years)	25 (50 years)	80 (30 years)	100 (40-50 years)
	Factory lot lease in IE (\$/m ² /month)	0.1-0.2	n.a.	unknown	0.24	unavailable	0.22	0.23
	Office floor (\$/m ² /month)	10-20	10-20	10	12-14.5	30	22	16
	Apartment (\$/month)	1,000-2,000	800-1,500	1,350-1,460	360-970	2,150-4000	1,700	1,800
	Electricity (\$/kWh)	0.21	0.21	0.04	0.09-0.12	0.07	0.07	0.07
	Water (\$/m ³)	0.20	0.25	0.21-0.36	0.23-0.29	0.15	0.23	0.23
	Telephone (3 min. in Japan)	4.8	4.8	2.3	2.9	2.9	6.9	6.9
Transport (40 ft container to Yokohama port Japan)		1,800	1,600	1,450	1,250	700	1,500	1,500

Source: Data for Cambodia by Study Team's factory interview survey, all other data from JETRO.

12.3.2. The Development of Special Economic Zones

The Special Economic Zones (SEZs) are intended to attract industries (such as toys or other assembly industries) that, due to wage growth, are no longer viable in Thailand, Malaysia, Taiwan or Japan. SEZs have played an important historical role in Thailand, Taiwan, China, Hong Kong and Malaysia, but some of the earlier successes in SEZs (including Thailand's) were clearly related to the tariff and policy environment that

prevailed in the three previous decades, particularly high import tariffs. SEZs and special production zones could be enclaved from the domestic economy to produce entirely for export, and therefore have no need for an import tariff regime. The principle gain from SEZs is employment.

The key attractions to a zone are a concentration of the necessary infrastructure and trade facilitation practices that are favored by exporters, and sometimes tax incentives - all of which is costly. Beyond this, many governments also subsidize investment into the zone through tax incentives.

Realizing that the SEZs will be crucial to economic diversification, the RCG adopted in December 2005 a sub-decree on the Establishment and Management of Special Economic Zones (to include export processing zones and free trade zones). The Royal Government has since approved a total of 21 Special Economic Zones (SEZs) located along the border with Thailand and Vietnam (Koh Kong, Poipet, Savet, Phnom Den), at Sihanoukville and Phnom Penh. Of the 21, 6 have commenced operations.

The SEZs offer the following advantages: (i) a 'One-Stop Service' for imports and exports, with government officials stationed on-site providing administrative services. Applications to establish factories within the SEZs are dealt with on-site as well as all administrative clearances, permits, authorisations; fiscal incentives, including income tax, customs, and VAT benefits; location adjacent to road networks; state-of-the-art factory buildings, plentiful water supplies, water treatment plants, vocational training, banking services, postal services and telecommunications; power plants to generate their own electricity.

The Phnom Penh-Sihanoukville Growth Corridor, which consists of Phnom Penh, Sihanoukville and five provinces located along Route 4, with a population of 4.8 million people and a total area of 31,000 sq. km. The rationale of establishing the growth corridor is to effectively respond to the challenge of diversifying the Cambodian economy and to promote demand-driven development, such as food processing and export promotion.

A key policy decision was to establish a Special Export Zone (SEZ) to attract FDI to Sihanoukville. However this alone is not sufficient; a sound legal and institutional framework should be established to encourage inflow of FDI into the SEZ. Moreover, improvement of the port facilities is also an important element to project Sihanoukville as an efficient international gateway.

Table 12.3. Type of industries/services to be attracted to SEZ

Zone Category	Category of prospective industry	Specific types of industry
Free Zone (FZ)	Non-traditional, export oriented and labour intensive industry	Garment/fabrics (high to medium notch), sportswear
		Wooden, stuffed and plastic toys
		Machinery components
		Automobile parts and components such as Wire har-
		Ceramic products – Ceramic tiles, roof tiles etc.
		Rubber products – surgical and medical rubber gloves,
		Paper products – packing and cushioning materials,
		Others (jewellery, etc.)
Promotion Zone (PZ)	High value-added, recycle oriented and labour intensive industry	Used car/motor cycles and used tire – for resemble, retreat and recycle
	International Wholesaler	Temporal duty – free storage of goods for transhipment
	Export – oriented (traditional) and labour-intensive type	Garment – outerwear, shirts, pants, infant wear and
		Footwear – leather shoes and chemical shoes
	Export – oriented, partly import-substitute and domestic resource based industry	Process agricultural products – processed vegetables, fruits and nuts
	Export-oriented, partly import-substitute and labour intensive industry	Electric appliance assemble – washing machine, refrig-
		Machinery assemble – small pumps, generators and
		Metal processing – galvanized iron sheet, steel cutlery, building materials

Source: JICA

The improvement of connecting roads, particularly National Route No. 48, is essential for strengthening the linkage with Thailand and giving impetus for future coastal zone development. The SEZ could then be used to induce FDI enterprises to enter into supply arrangements with local enterprises such as for locally available fruits and seafood. The SEZ framework established firmly for Sihanoukville will serve as the basis to further accommodate FDI in a variety of goods production

In the long run, the spread of urbanization will induce demand for local products, which should be supplied mainly by Cambodian manufactures and service providers. The capacity of secondary sector should develop alongside urbanization if Cambodia is to benefit from growing urbanization. Rapid industrialization will have environmental costs. Right policies for the management of natural resources should be instituted now so that environment is not irreparably damaged as industrial development gathers steam.

The SEZ in Sihanoukville will be a strategic zone for Cambodia to serve as a prototype for diversification of exports and creating forward and backward linkages between the SEZ and the rest of the economy. The emphasis in Sihanoukville SEZ development will be on fostering industries and services not existing in Cambodia presently. Faster and more efficient export processing will also be put in place in the SEZs.

Another aspect of industrial policy is the development of industrial promotion zones. In these zones the emphasis will be on developing traditional industries using domestic resources and serving domestic markets rather than exports, attracting FDI and development of new technologies. The table below summarizes the main features of the SEZs and the industrial promotion zones.

12.3.3. Public Private Partnership

Recognizing the benefits of private provision of infrastructure, the RCG has developed a legal framework for Public Private Partnership (PPP) in infrastructure, across all sectors - in urban electricity generation and rural electricity generation and distribution; provision of rural water supplies; international, mobile, fixed line and internet telecommunication services; highways and airports; and municipal waste collection and disposal services.

Table 12.4 summarizes the main PPP contracts to date in Cambodia, grouping them by sector; indicating the public entities (ministries, departments and regulatory agencies) that are officially responsible for administration and approvals for each sector and those that were actually involved with each PPP contract; describing the form of PPP contract deployed in each case; and where known, the capital value of the project.

Table 12.4. Public Private Partnership

Sector Project	Public Entities	Form of PPI contract
<i>Municipal Services</i>		
Waste management	APSARA Authority	Concession for Angkor Wat garbage collection with a private sector firm
	PP Municipality	Concession for Phnom Penh garbage collection with a Cintri Company
	various agencies	
<i>Water</i>		
Rural	MIME, MRD, MOWRAM, MPWT MPWT, PGs	Ten rural systems privately negotiated MIME Six rural systems directly negotiated with MRD- MIME-PGs
<i>Transport</i>		
Roads	MPWT	National Route 4 negotiated with CoM
	Provinces	Rural concessions negotiated with provincial governors
Ports	MPWT	Oil terminal and dry ports negotiated with CoM
Airports	CoM, SSCA	Concession with Vinci subsidiary SCA for development of Pochentong Airport, Phnom Penh (PNH) negotiated with CoM
	CoM, SSCA, MPWT	Concession with Vinci subsidiary SCA extended to include Siem Reap International Airport, based on international exclusivity clause in PNH concession
	SSCA	Air navigation services negotiated with CoM
<i>Electricity</i>		
	MIME, CoM, EdC, EAC	
Urban	MIME	Power Purchase Agreements for IPPs negotiated with MIME in cooperation with CoM in the presence of EdC as offtaker
Rural	MIME, EDC EAC (regulator)	Battambang and Siem Riep negotiated with MIME-EdC Licensing of (existing) small rural electricity providers >50kW
<i>Telecoms</i>		
	MPTC	
Inter-national gateway	MPTC	Joint venture agreement with RTI
2nd fixed line network	MPTC	Joint venture agreement with Indosat for Camintel
mobile services	MPTC	Joint venture agreements with 4 operators: Mobitel, Samart, Camtel, Shiniwatra negotiated with MPTC/CoM
VOIP	CoM, MPTC	One Licence for Voice-Over-Internet Protocol (VOIP) granted to BCC, negotiated with CoM
Internet	MPTC	Licences to Internet Service Providers

Source: WB

PART V

SERVICES AND INFRASTRUCTURE

- Chapter 13. Tourism
- Chapter 14. Telecommunications
- Chapter 15. Transport Infrastructure
- Chapter 16. Energy Sector



Chapter 13

Tourism

13.1. Background

Cambodia is a country with a rich diversity of cultural and natural resources. During the last decade the tourism industry has been growing to become one of the main pillars of economic growth. The rapid development of the tourism sector was attributed to the following factors: (i) attainment of peace and stability since the late 1990s; (ii) tourism attractions, especially Angkor Wat, which was listed as a World Heritage site in 1992; (iii) an increase in international and domestic travel; and (iv) the RCG's policies on tourism development, such as the open sky policy, visas on arrival and visa exemption for Cambodian living abroad (CDRI, 2007, p. 31).

Tourism comprises a major part of Cambodia's services industry. The push for the development of services came from the rapid expansion of tourism and hotel industry during 1994-1998. Tourism has had two set backs since then- first in 1997-98 when it was affected by the Asian Financial Crisis and the unsettled conditions prevailing in the country at that time; the second in 2003 following the SARS pandemics, the anti-Thai riots and the political uncertainty in the aftermath of the 2003 elections.

However, the RCG has made serious strides to implement policies that aim to: (i) promote marketing and tourist products, with a focus on Phnom Penh, Siem Reap and Sihanoukville; (ii) develop products, with an immediate aim of upgrading standards in hotels, restaurants, tourism sites, services and infrastructure; (iii) improve access point through upgrading physical infrastructures, such as airport, and linking Cambodia to tourism international gateways in South-East Asia such as Bangkok, Kuala Lumpur and Singapore; (iv) improving the quality of Cambodia's work force through training; and (v) strengthening tourism sector coordination and management through institutional development of government ministries and agencies.

Since then the tourism sector has had a steady growth with the number of tourist arrivals reaching more than 2 million mark in 2008.

13.2. Tourist Attraction and Activities

Cambodia has the following tourist attraction related to natural environment, history and culture:

- ***Historical, archeological and cultural feature*** – The Angkor complex of Angkor Vat, Angkor Thom and other temples and the Barays constitute the most important and internationally known attraction of Cambodia. Angkor Vat and Preah Vihear temples were inscribed on the List of World Heritage;
- ***Other important temples and archeological site*** – Other temples such as Preah Vihear, Banteay Chhmar, Phnom Penh, Angkor Borei, Sambor Prey Kuk are also considered as significant tourist sites;
- ***Museums and Monuments*** – The National Museum in Phnom Penh and the Angkor National Museum provide comprehensive introduction to Khmer history and culture;
- ***Royal Palace and Historic Buildings*** – The Royal Palace and French colonial buildings in Phnom Penh and in the provinces have become important tourist attraction;
- ***Floating Villages*** – Floating villages, especially on the Tonle Sap Lake have attracted many tourists to come and visit Cambodia;
- ***Traditional Crafts and Contemporary Arts*** – Cambodian arts and handicrafts are very much appreciated and unique: Cambodian silk, silverwork, wood carvings, gemstones, jewelry and ceramics;
- ***Natural Features*** – Seven natural parks and ten wildlife sanctuaries were designated as protected areas; scenic hill mountain landscapes, waterfalls and lakes have become tourist attraction sites. Ratanakiri and Mondulakiri provinces are designed as the destination of ecotourism to diversify the tourism project.
- ***Beaches, Marine Areas and Mekong River*** – excellent beaches are found along the coast at Kep, Ream and Sihanoukville. Offshore islands offer some excellent protected beaches and swimming areas.

13.3. Cultural Tourism

Cultural tourism is one of the major pillars of economic growth performance in Cambodia. Angkor Vat, of worldwide renown, is a legacy left by the architectural genius King Suryavarman II (1113-1150) which has turned out to be a major source of foreign exchange

earnings for the country in modern times. During the reign of King Suryavarman II, Khmer engineering reached the pinnacle of technical excellence and artistic merit. Built as successive layers of stone slabs on an artificial mound, the Angkor Vat temple symbolizes the summit on which gods and monarchs lived in bliss and is the masterpiece of Khmer architecture.

Angkor, the main point of tourist attraction in the country, was the capital of the Khmer empire between the 9th and 15th centuries. In addition to the temples of the Angkor complex, there are about 40 more edifices of various styles and periods in the area surrounding Angkor. These temples are located in an exceptional natural space, featuring rivers, forests, and rice fields. Further, Angkor is also a living site on which dwell several communities which have kept popular traditions alive and possess a rich heritage which has been passed on from generation to generation through folklore.

UNESCO declared the Angkor Vat temple as a World Heritage Site in 1992 and put it on the List of World Heritage in Danger. The World Heritage Committee waived some of its usual requirements before approving the inclusion stating that the decision was “in response to an exceptional situation.” Preservation of the site has become an issue of worldwide concern.

At the Bayon, in the shadow of towers featuring gigantic sculpted faces with perpetual smiles, scenes of the life of yesteryear play out. On several levels, the world of the gods surmounts that of the kings, while below is found the world of the common people—from servants preparing food to bystanders watching a cockfight. At some distance from the more popular Angkor temples is Banteay Srei, a work of art in pink sandstone, whose sculptures of apsaras and young warriors are of incomparable beauty. Also remarkable are Preah Palilay enshrouded in trees, the beauty of the sunset over the Srah Srang pond, and Ta Prom, with trees and lianas growing in and over the stone structures, bearing witness to the condition in which the temples were found before restoration work started.

Ten years after the campaign to safeguard Angkor got underway, the most serious problems of this emblematic site of Khmer culture have been resolved, thanks to the efforts of the international community, which has invested over US\$50 million, the commitment of the RGC and the coordination work led by UNESCO. The accomplishments of these ten years are considerable: a hundred or so restoration and development projects were completed, more than 25,000 landmines neutralized—3,000 of which were planted on the archeological sites—and 80,000 bombs and explosive devices were destroyed. A heritage police unit has been created, a careful inventory of cultural artifacts has been made and awareness-raising campaigns have been conducted to help prevent trafficking in stolen cultural property and looting of artifacts within the protected area.

In addition to archeological and architectural safeguarding operations still being carried out by teams from France, Japan, Germany, Italy, India, and China, the time has come to act in favor of development, by widening the process with projects that directly benefit the local communities. To improve links between the site and the other provinces in the country, the government has made a long-term commitment for the construction of a new airport well away from the archeological sites, increased river traffic between Phnom Penh and Battambang, and rehabilitation of the access road to Thailand in tandem with development of the provincial road system. It is hoped that this will contribute to lengthening the average tourist stay by encouraging visitors to travel more extensively in the cultural belt and discover its many points of interest.

One of the challenges of tourism development is the management of the massive visitor flows: more than 300,000 in 2003 and growing by 30% a year. The RGC recognizes the necessity of developing ethical, sustainable tourism in the Siem Reap-Angkor area as an instrument for poverty reduction. The government is involving the local communities living in the zone around the Tonle Sap Lake while promoting the policy of showcasing the rich diversity of Cambodia's cultural resources, both tangible and intangible so that they can earn a decent living.

13.4. Tourism as the Pole of Growth

Growth in tourism has considerable impacts on the economy by creating jobs, generating income, training the work force, attracting FDI and improving the livelihoods of the Cambodian people. Tourism has become an important source of economic growth. Tourism is bringing a substantial boost to the GDP of the country. It is next only to fisheries among the subsectors that provide foreign currency inflows to the national economy. In 2008, gross receipts from tourism rose to some US\$1.3 billion. The key objective is to safeguard and get best value from the tourism potential.

13.4.1. Tourist Arrivals

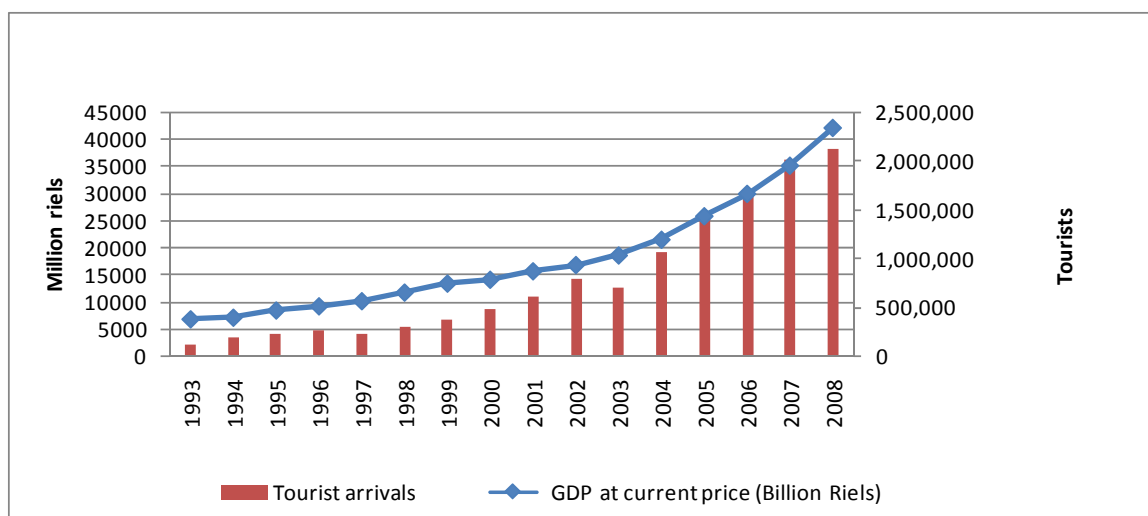
In 2008, the number of domestic tourists was 6.73 million, compared with 4.25 million in 2004, 1.82 million in 2003 and 0.26 million in 1993.

The number of foreign tourists to Cambodia tends to fluctuate depending on the international and domestic situation, but it has been steadily increasing since 1995. International tourists reached 2.12 million in 2008, up from 0.12 million in 1993. If compared with 2000, it is grown by more than four folds.

The tourism industry is dominated by cultural tourism, which accounts for 58% of the total tourist arrivals in 2007, followed by business tourism (27%), gambling (9%), coastal tourism

(5%) and eco-tourism (2%). Eco-tourism has been growing rapidly, but infrastructures are still under-developed.

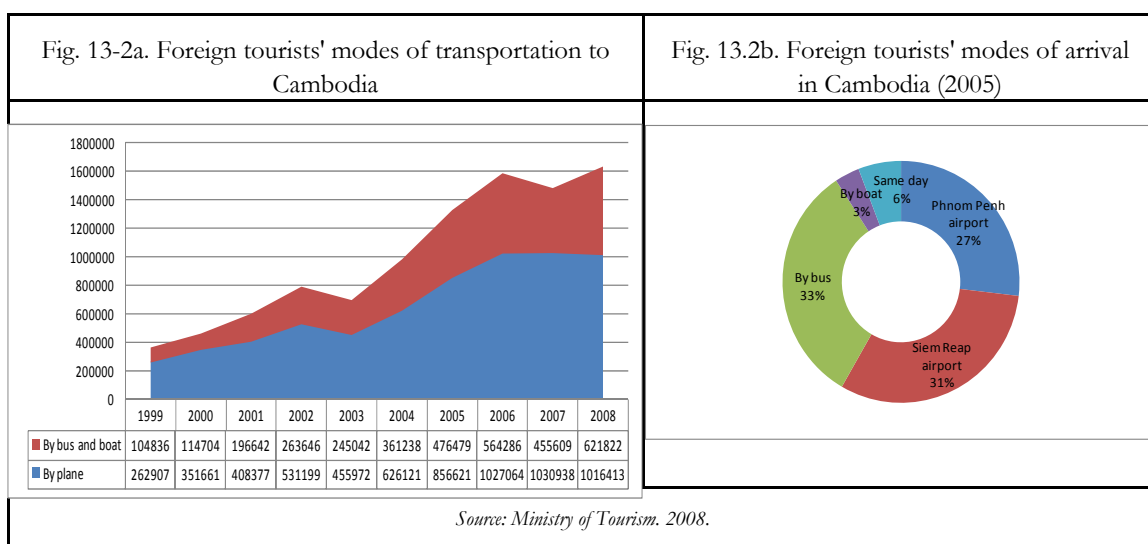
Figure 13.1. Number of tourist arrivals and GDP



Source: Ministry of Tourism.

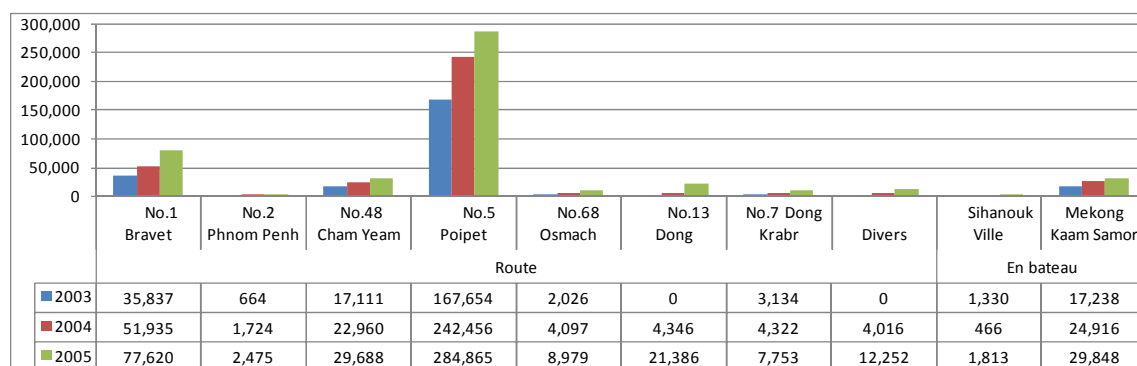
The majority of tourists arriving by land or water enter the country from Thailand using National Road No. 5, followed by tourists from Viet Nam using National Road No. 1. The Mekong River is the next most popular transport mode followed by National Road No. 48 used by tourists from Thailand.

Tourists use all available modes of transport viz. air, land and water. There has been a large increase in the percentage of tourists using large buses, owing to the development of



national roads during the past few years. More than two-thirds of tourists arrived by air (in Phnom Penh and Siem Reap), while the remaining one third arrived by bus (from Ho Chi Minh City and Bangkok) and by boat.

Figure 13.3. Foreign tourist arrivals by border checkpoints



Source: MOT.

There was a shift in Cambodia's tourist arrivals from Europe and North America in the 1990s to the increasing number of tourists from Asia, especially from Korea, Japan, China and Vietnam in the 2000s. Korean tourists comprise the largest share of tourists classified by nationality. There has been a rapid increase in Korean tourists during recent years due to the commencement of direct flights from Korea. Therefore the Global Financial Crisis that has hit Korea very hard has had considerable impacts on the tourist industry in Cambodia. Following the GFC there was a shift from high-end tourists to middle and low end tourists, which resulted in the decline in tourist expenditures.

13.4.2. Hotel and restaurant

Up to the end of 2008, Cambodia had 1,323 lodging establishments, more than doubled compared to 2000, of which 398 are hotels and 925 were guesthouses. The total number of rooms available were 20,678 hotels rooms and 12,180 guesthouse rooms, representing increases of 47% and 27% respectively compared with the same period of 2000. They are divided into three main points of tourist destinations, which are Phnom Penh, Siem Reap and Sihanoukville. Phnom Penh had 133 hotels with 6,782 rooms, Siem Reap had 112 hotels with 8,263 rooms, and Sihanoukville had 46 hotels with 1,782 rooms. There are additional 107 hotels and 319 guesthouses offering about 8,082 available rooms in other provinces such as Battambang, Banteay Meanchey, Kampot/Kep, Prey Veng, Kampong Cham, Rattanakiri, Koh Kong, Kratie and other provinces. Thus, there are close to 32,858 accommodation rooms in the country.

Phnom Penh is well provided with restaurants, the second is Siem Reap and the third is

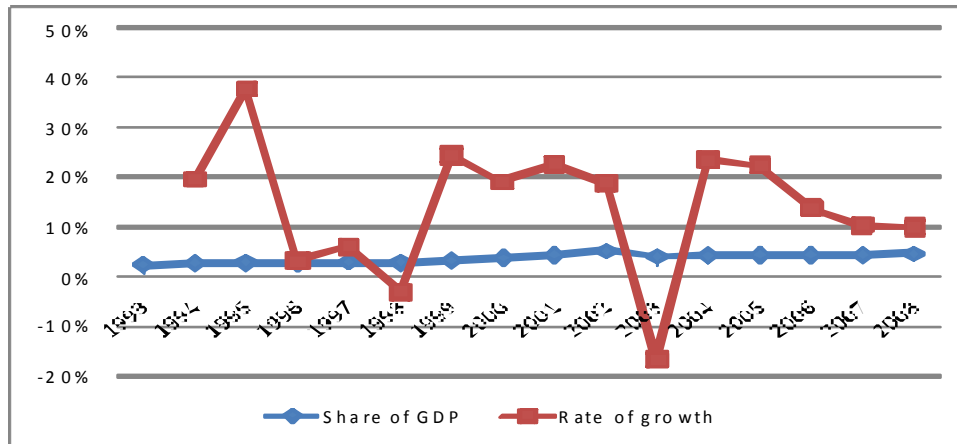
Sihanoukville. In 2008, there were totally 934 restaurants in which 284 in Phnom Penh, 113 in Siem Reap and 78 in Sihanoukville. A variety of cuisine is available in the restaurants including Khmer, French, Chinese, Japanese, Korean, Indian, Thai etc.

Table 13.1. Accommodations and Room in Cambodia

<i>Province</i>	<i>Hotel</i>		<i>Guesthouse</i>	
	2008		2008	
	Number	Room number	Number	Room number
Phnom Penh	133	6,782	280	3.605
Siem Reap	112	8.263	216	2.796
Sihanoukville	46	1.782	110	1.548
Kratie	7	269	22	245
Kampot	2	88	26	348
Preah Vihear	-	0	10	127
Banteay Mean Chey	13	517	28	525
Ratanakiri	8	251	11	86
Oddar Meanchey	4	215	14	180
Kandal	-	0	31	256
Takeo	-	0	13	236
Koh Kong	7	207	14	202
Kampong Chhnang	5	122	8	99
Battambang	22	1.035	18	385
Kampong Thom	4	147	10	209
Pursat	4	99	14	167
Kepville	6	122	11	150
Kampong Cham	5	208	30	248
Svay Rieng	1	60	9	97
Prey Veng	8	175	2	20
Kampong Speu	-	0	11	88
Mondulkiri	2	87	18	258
Stung Treng	5	174	10	160
Pailin	4	75	9	145
TOTAL	398	20,678	925	12.180

Source: MOT

Figure 13.4. Share of hotel and restaurant in GDP



Source: MEF

During the last decade, the hotel and restaurant sub-sector grew by an average annual rate of 15%. However, this sector is vulnerable to external shocks, as evidenced by the steep decline during the Asian Financial Crisis (1997-98), the SARS epidemics (2003) and the political turmoil in Thailand and the Global Financial Crisis (2008-2009). Overall, the share of hotel and restaurant subsector increased from 2.3% of GDP in 1993 to 4.5% of GDP in 2008.

13.4.3. Employment

Table 13.2. Direct tourism jobs

Sectors	Number of direct jobs	Percentage
Accommodation	16,117	29%
Food and beverage	8,287	15%
Shopping	4,212	8%
Transportation	10,417	19%
Guides	2,235	4%
Airport staff	5,274	10%
Travel agencies	2,660	5%
Tourism related civil servants	4,763	9%
Others	1,000	2%
Total	54,965	100%

Source: Mekong Private Sector Development Program MPDF/IFC (2007)

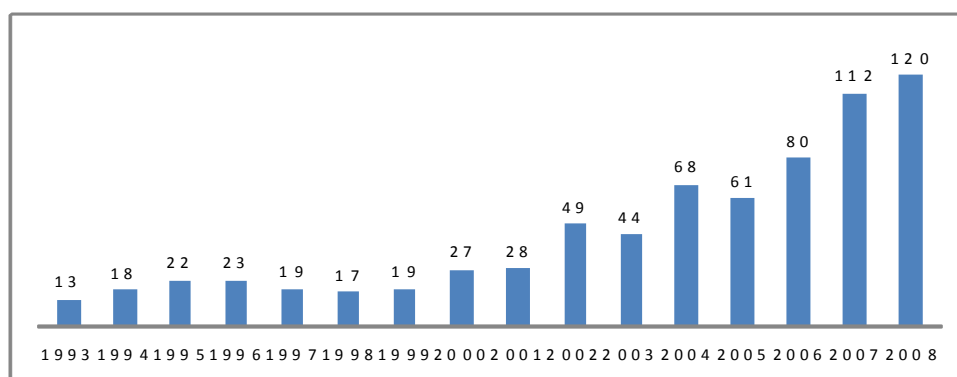
The sector generated about 566,444 of both direct and indirect jobs, representing 8.3% of total employment in 2004, and is expected to employ 1,108,000 people or 15.8% in 2007, in both direct and indirect activities (WTTC, 2007). The direct jobs are those related to accommodation, food and beverage, shopping, transportation, guides, airport staff, travel agencies and some proportion of civil servants.

According to the MPDF/IFC survey, hotel was ranked first in terms of job creation, accounting for 29% of the workforce in the tourism industry, followed by transportation (19%), food and beverage (15%), airport staff (10%), commerce (8%), travel agencies (5%) and guides (4%). CDRI survey reported that construction work created the largest indirect jobs in the tourism sector, accounting for 38% of both direct and indirect tourism employment.

13.4.4. Investment in Hotel and Restaurant

Investment in the hotel and restaurant sector was the main drive behind the development of major tourist destinations in Cambodia, especially in Siem Reap. Investments in hotel and restaurant industry increased from US\$13 million in 1993 to US\$120 million in 2008, an average annual increase of 56%, with a total investment of US\$720 million. A large proportion of this investment has been made by Cambodian investors.

Figure 13.5. Investment in hotel and restaurant (in million USD)



Source: MEF

13.4.5. Tourism expenditure

According to the Ministry of Tourism, each foreign tourist spends on average US\$95 in Cambodia per day. For a length of 6.5 days, on average a tourist spends US\$617.5 per trip in Cambodia. Multiplying by 2.15 million of tourists visiting Cambodia in 2008, this brings

the contribution of the tourism industry to the Cambodian economy to US\$1.3 billion or 12.8% of GDP.

13.5. Tourism Policy

The strategy for development of the sector, covered in the Cambodia National Tourism Development Plan, 2001-2005, prepared in 2001, aims at strengthening what has already been successfully implemented viz. getting Cambodians involved in operation of the sector. The main thrusts of this plan include the enactment of a tourist code, showcasing new sites, developing and diversifying products and markets, including the promotion of up-scale tourism and charters. This strategy will be coupled with the promotion and support of holiday resorts and the development of trades linked to leisure activities.

In order to develop entrepreneurs, stakeholders and cultural officers in the tourism sector, the government will establish a favorable legal and fiscal environment for the tourism industry and will grant professional status to it. This will allow the formation of industry associations supervised by the Ministry of Tourism. The Ministry's institutional capacity to lead the development of tourism will be strengthened and support provided for cultural institutions to professionalize their activities.

Tourism has contributed much to poverty reduction in recent years. The government recognizes its potential to fight poverty even more forcefully in the future provided the central and the local governments work in tandem to promote the industry.

Tourism policy is founded on the following overarching principles:

- **Demarginalization:** Seek to fit the sustainable development of tourism into poverty elimination programs and, conversely, incorporate measures for poverty elimination into the overall strategy for sustainable development of tourism.
- **Integration:** Adopt an approach that will dovetail with other sectors and avoid excessive dependency on tourism resources for all interconnected sectors.
- **Equitable distribution:** Seek to square the tourism development strategy with a more equitable distribution of wealth and services.
- **Local initiative:** Concentrate initiatives at the local level or on the concerned destination under a national support policy.
- **Keep benefits within the country:** Limit the drain on the local economy and create relations within it by concentrating on the supply chain supporting tourism.

Map 13.1. Tourism Map of Cambodia



Source: MOT

- **Commitment:** Draw up a long-term plan of action and resource allocation for tourism.
- **Follow-up:** Formulate indicators and simple systems in order to evaluate the impact of tourism on poverty.

Cambodia is yet to fully tap the tourism potential of its coastal resources. The following initiatives will be undertaken to realize this potential in a practical way:

- Successful pilot projects will be brought into the national strategy for ecotourism development;
- The impact of coastal tourism on the environment will be reduced through strengthening of public-private partnerships;

Pilot projects will involve environmental management systems in tourist facilities on the coast, ecotourism in coastal zones, and coral reef management. The overall thrust is the

preservation of coastal ecosystems by strengthening the institutional resources of national government and local administrations, promoting public-private partnerships, as well as reducing poverty through overall economic development of the coastal areas.

The government is committed to (i) implement a bold policy for the development of tourist sites and their accessibility by road; (ii) encourage private sector involvement in tourism operations and investment through targeted coaching (financing, taxation, real estate, etc.); (iii) initiate a policy of air transport conducive to the development of the sector (for e.g. open skies); (iv) undertake an aggressive promotion of tourism destinations in leading inbound tourism markets; (v) conduct a campaign to combat insecurity and guarantee a healthier and safer environment for tourists; (vi) linking tourism to agricultural development.

Chapter 14

Telecommunications

Information and communications technology (ICT) refers both to the technologies of information and to telecommunications equipment and services. These two technological sectors, which were clearly separate at their inception, have converged considerably in recent years.

The telecommunications landscape in Cambodia in the last decade has seen major structural changes: liberalization of markets and arrival of new inputs. The ongoing development of networks and telecommunications services is of crucial importance for Cambodia's economy. At the micro level, telecommunications has become a full-fledged factor of production. At the macroeconomic level, the telecommunications and computer sector has become an essential engine of economic growth. The added value of the telecommunications sector has more than quadrupled, rising from US\$15.6 million, or 0.56% of the GDP in 1994, to US\$65.5 million, or 0.9% of the GDP in 2006. This structural change has created a series of issues for policy management. The lowering of tariffs and the development of new technologies (ADSL, VOIP) are two such issues.

In response to technological developments, particularly the growing convergence between telecommunications, information technologies and the media, and recognizing the vast development potential of the telecom industry, especially the Internet, the RGC drew up the Communications Law, which will be enacted soon by the National Assembly. The Communications Law addresses the following objectives:

- Develop the policy with regard to communications development and regulation and
- Establish a common regulatory framework for electronic communications networks and services.

14.1. Laws and Institutional Regulatory Framework

Till the early 1990s, the telecommunications industry was viewed as a national monopoly. The management of telecommunications, which basically meant the national telephone lines, both domestic and border telephone links, and data transmission and the postal

service, was handled exclusively by the Ministry of Post and Telecommunications (MPTC) created in 1993.

The liberalization of the telecommunications sector, underway since the 1990s, intends to open the market to the private sector and competition and attract investments into the sector. Starting in 1992, the RGC signed a number of joint venture agreements with foreign telecom companies, granting them operating concessions.

The MPTC is in charge of the overall postal and communications sector, and more generally responsible for formulation and the implementation of development strategies and policies for ICT in Cambodia. This includes functioning as a regulator for the sector until an autonomous national regulatory authority is established in future.

The rapid pace of technological developments and innovation in communications services sector requires a regulatory response equally nimble. Cambodia is currently preparing the legal and regulatory processes to manage the communications sector. The new regulatory framework will deal with regulating competition in the networks and electronic communications services markets; radio frequency spectrum, and the minimum bundle of lines to be rented and the standard features and the norms associated with them.

In the Communications Law “Electronic communications network” refers to: (a) transmission systems that allow the sending of various signals by means of electrical, magnetic, or electro-magnetic energy; and (b) includes (i) the equipment used in this system, and (ii) the equipment used for the sending of signals. “Electronic communications service” means a service consisting of the transmission of signals over electronic communications networks. Electronic communications services include telephony, telex, telegram, fax, electronic e mail, voice mail, the Internet, video, data transmission, storage, conversion code and protocol, data processing, radio, the transmission and assignment of the spectrum.

In accordance with the principle of separating the functions of regulation, policy, and operation of electronic communications, the following division of work was drawn up between the MPTC, the proposed Cambodian Communications Authority, and the operators of communications networks and services.

14.1.1. The Ministry of Post and Telecommunications

The MPTC is in charge of developing and implementing policies, strategies, and plans relating to electronic communications. The Ministry of Post and Telecommunications has the following responsibilities:

- Preparing the policy and strategic plan for development of the communications sector;
- Drawing up the policy and action plan to integrate information and communications technologies into a regulatory framework;
- Formulating the regulatory policy on networks and communications services;
- Completing a regulatory directive relating to competition in the provision of communications services;
- Elaborating the policy governing the granting of licenses.

At the present time, the MPTC is also handling management of concessions through a system of licensing in order to allow free entry into the market and stimulate competition. The management of electronic frequencies including radio frequencies and radio electronic spectra, since they are national resources, is also temporarily being handled by the MPTC. This role will be given to the Regulatory Authority once it is set up.

14.1.2. Cambodian Communications Authority

A national regulatory authority, the Cambodian Communications Authority (CCA), will be set up in order to ensure regulation of communications services and construction and operation of communication networks. In principle, the CCA must be legally distinct and functionally independent from all organizations providing networks, equipment, and electronic communications services. The CCA must exercise its power in an impartial and transparent manner.

Enterprises providing networks and electric communications services must submit all information, including financial information, which is required by the CCA in order to ensure compliance with the provisions of the Communications Law.

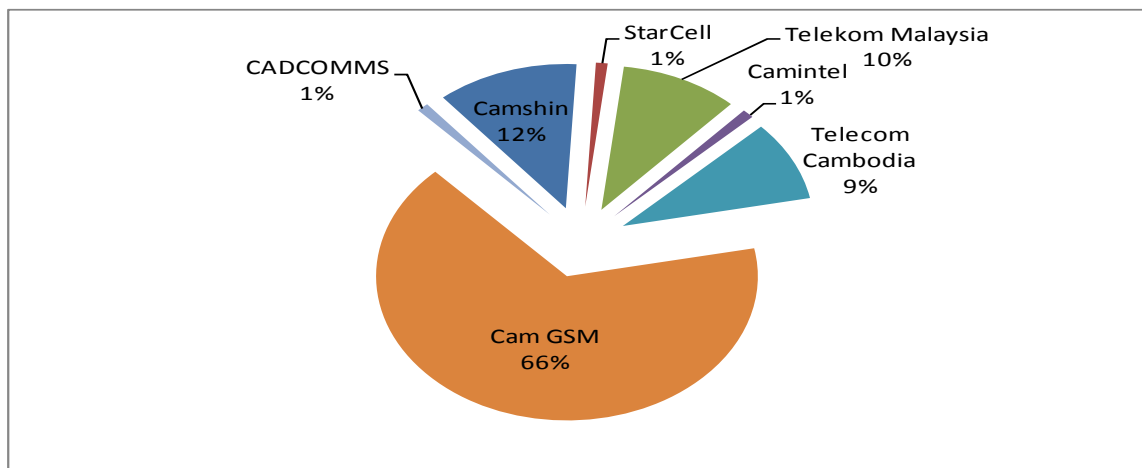
As a regulator, the CCA is responsible for the following tasks:

- Encouraging efficient investment in communications infrastructure and services.
- Ensuring that competition is fair and that the market functions efficiently.
- Ensuring the protection of consumers of communications services.

- Ensuring the consistent enforcement of regulatory provisions in the communications sector including:
 - A. Preparation and implementation of a regulatory framework for infrastructure interconnection and utilization.
 - B. Procedures and conditions relating to rate setting for communications services.
 - C. Preparation of standards for telecommunications.
 - D. Management for the assignment of all national resources for numbering, as well as management of the national plan for numbering and electronic addressing.
 - E. Management of radio frequencies for electronic communications service users.
 - F. Resolution of conflicts between businesses providing networks or electronic communications services and between such businesses and consumers.
- Granting licenses for the provision of communications networks and services.

14.2. Key Features of Market Developments

Figure 14.1. Telecommunications sector in Cambodia



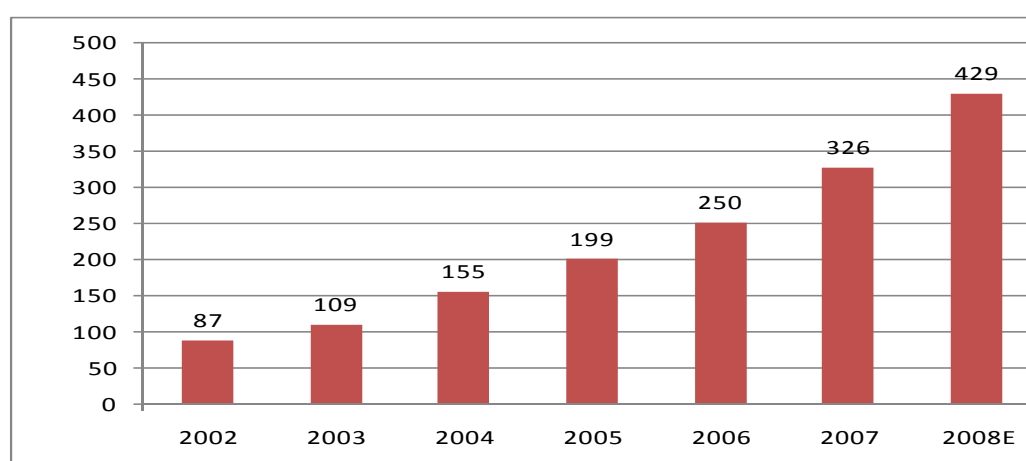
Source: Telecom Cambodia

The telecommunications sector is typically subject to rapid changes in technology and market practices. Competition pushes stakeholders to invest in new technologies in order to offer ever improving services based on the blending of high-speed networks, audiovisual media, and electronic devices, so that consumers can receive faster, better quality data transfer.

The telecommunications market in Cambodia is dominated by CamGSM (Mobitel), which has 66% of the market, followed by Camshin – 12%; Telekom Malaysia – 10%; Telecom Cambodia (TC) – 10%; Camintel – 1%; Starcell—1% and CADCOMMS (QB) - 1%.

The mobile telephony sector is the dominant component of the Cambodian telecommunications industry, accounting for 97% of the number of telephony service subscribers in Cambodia. Fixed-line telephony accounts for only 3% of the market.

Figure 14.2. Telecom company turnover
(in million dollars)



Source: Telecom Cambodia

Turnover from the telecommunications market in Cambodia stood at US\$429 million in 2008. The growth in turnover has remained very robust, holding a high level of 31% per year on average for the last six years. Voice telephony via the Internet (VoIP) is an additional threat for the market share of well-established actors in the telephony market. In the future, turnover figures for communications services by Internet are expected to increase sharply due to deepening market penetration by the service providers.

Table 14.1. Turnover of telecom companies
(in dollars)

Companies	2002	2003	2004	2005	2006
Telecom Cambodia	19,192,116	18,277,549	13,664,440	16,557,393	25,229,590
Cam GSM	52,076,710	70,500,424	97,634,746	126,209,924	163,715,189
Camshin	15,968,672	18,40,061	20,507,798	29,115,825	39,098,035
Telecom Malaysia	10,341,311	11,368,991	14,563,910	21,983,022	30,997,539
Camintel	3,161,476	3,025,326	3,077,864	3,434,725	3,752,593
RTI (007 Gateway)	5,490,509	5,789,346	18,774,973	18,354,502	12,419,447
Total	87,038,678	109,087,148	154,559,291	199,097,998	249,982,803

Source: MEF

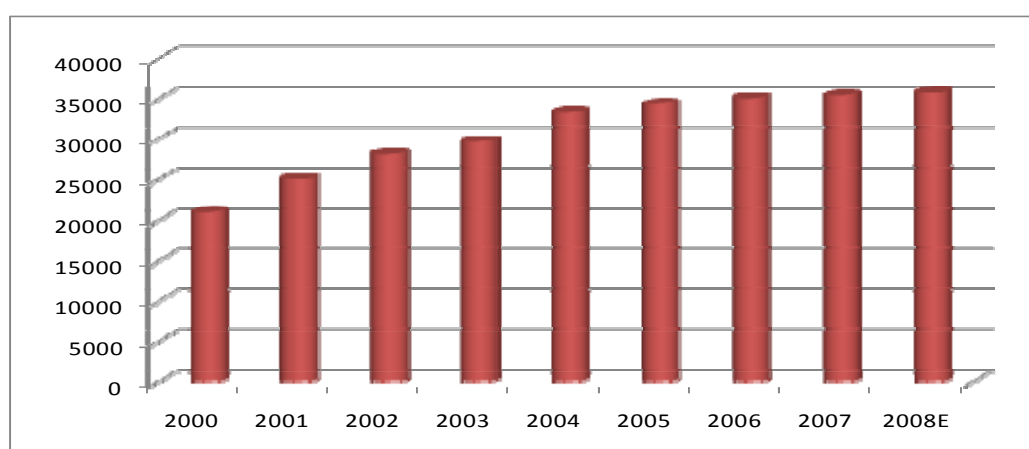
The telecommunications sector is booming in Cambodia. The liberalization underway since the early 1990s is potentially opening up a vast field for competition, notably in mobile telephony. But this strong position of telecommunications in Cambodia overall must not conceal the challenges confronting the sector. Despite the reforms and the introduction of competition the telephone costs remain too high to allow free communications especially in remote areas.

14.2.1. Fixed-Phone Operators

During the 1990s, fixed-line telephony saw a dazzling growth of between 20-54% per year. The erstwhile lucrative landline telephony market has fallen victim to severe competition from mobile telephony, producing only weak growth in the number of subscribers. Competition should push the suppliers of both landline and mobile communications to invest in new technologies in order to reduce costs and better position themselves in an environment where all service providers are expected to provide all services.

Despite growing competition, the growth of the number of subscribers to landline telephony slowed to 15% in 2000. Between 2000 and 2006, the number of subscriptions to fixed-phone services grew on the average by only 7.6% per year; in 2007 it rose by only 1%. This is due to the development of VOIP telephony. The corporate market accounts for 68% of the market for landline phones.

Figure 14.3. The Number of Subscriptions in Fixed Telephony Service



Source: Telecom Cambodia

In 2008 Cambodia had 35,415 landlines or 2.4 landline telephones per 100 inhabitants (compared to 12.9 landlines per 100 inhabitants in Thailand). Telecom Cambodia (TC) accounts for 49% of the subscribers, Camintel – 38% and Camshin – 13%.

Telecom Cambodia is a public operator in landline telecommunications, fixed data transmission services and rented line services. The business earned a profit of US\$3 million in 2006, for a turnover of US\$25 million. Telecom Cambodia is a state-owned enterprise.

Telecom Cambodia also operates an “international telecommunications gateway—001,” which was set up under a joint venture between the RCG and Telstra and handed over to the government in October 2000. In addition, a fiber optics cable has been installed with assistance from the Federal Republic of Germany, connecting Phnom Penh to the Thai border. Another fiber optics cable will be laid with financing from the Japanese Bank for International Cooperation (JBIC), connecting Phnom Penh to Sihanoukville and to Kampong Cham. A GMS telecom project, financed by Chinese loans, provides fiber optics connection of Cambodian provinces surrounding the Tonle Sap Lake.

In the future, fiber optics cables will play an important role in data transmission. Telecom Cambodia is aiming for 45,000 subscribers to fixed-phone telephony by 2010, which, in the light of past results, seems realistic.

14.2.2. Mobile Phone Service Operators

The Ministry of Posts & Telecommunications (MPTC) has granted 11 network licenses to date (March 2009), eight of which have commenced operations with three more preparing to enter the market. Those already operating are: Hello GSM (TMIC), Mfone (Camshin), QB (Cadcomms), Star-Cell (Applifone), Excel, CamGSM, Metfone (Viettel), and Smart Mobile (Latelz). Despite, the world downturn, the growth of Cambodia's telecommunication sector remains significantly positive due to heavy investment in infrastructure. But in an unsettled, price-sensitive mobile market will saturate the local market and that local costs, while a benefit to consumers would drive down profitability.

Table 14.2. Mobile Market

Operator	Prefix
Mobitel (Royal Group)	012, 092, 017
Hello (Telekom Malaysia)	015, 016, 081
M-Fone (Camshin)	011, 099, 085
qb (Cadcomms)	013
Star-Cell (Applifone)	098
Excell (GT-Tell-Cambodia)	018
MetFone (Viettel)	097
Smart Mobile (Latelz)	010, 093

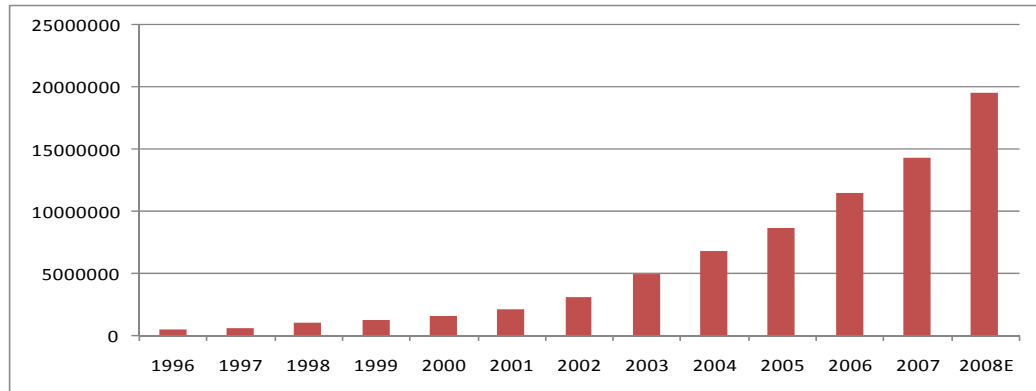
Source: MPTC

The mobile telephony market in Cambodia is dominated by CamGSM, which holds 59% of the market, followed by Camshin – 24% ; Telekom Malaysia – 15%, and Camintel – 2%. Cambodia has experienced a rapid surge in the number of portable telephones, in excess of 1.21 million of users, or 83.7 portable telephones per 100 persons (compared to 30.6 portable telephones in Thailand). The number of mobile phones has grown by 49% per year on average in the last 12 years. Thus, the slow growth in fixed telephony coverage is offset by the exponential growth of cellular subscribers. The number of mobile phone users in Cambodia increased by nearly 15 per cent in 2008 reaching 3 million users by the end of 2009.

The explosive growth of mobile communications is matched by the sharp growth of turnover (32% in 2007). The turnover was US\$429 million in 2008. Nevertheless, the cost

of international roaming remains very high. Third-generation (3G) services are in the process of being deployed.

Figure 14.4. Mobile phone usage



Source: MPTC

CamGSM (Mobitel), created as a joint venture in 1996 by a Swedish company, Millicom International, and a Cambodian company, the Royal Group of Companies, is playing a dominant role in the mobile communications market in Cambodia. It was awarded a 25-year concession. By late 2006, CamGSM had about 859,000 subscribers, and held 69% of the market. The development of telecommunications requires huge investments. Mobitel had invested more than US\$200 million for the construction of networks and service provision. CamGSM's turnover has been spiraling by an annual average of 33% in the last four years, compared with 26% for the three other telecom companies (Camshin, Malaysia Telekom, and Camintel).

In November 2000, a "Second International Gateway" was launched subsequent to the granting of a concession to Royal Telecom International (RTI) in June 1997. Millicom International and the Royal Group of Companies invested US\$15 million in this business. The RTI will transfer 51% of the gross income to the government. This gateway is linked to 220 countries by two satellites and an undersea fiber optics cable network.

Camshin which is in second position with a market share of 18 per cent.

Telekom Malaysia International Cambodia (TMIC) is close behind with a 15 per cent share. TMIC launched its new brand identity 'Hello' in November 2007. The company has seen the number of its subscribers almost double during the past 12 months and is now Cambodia's third largest operator. TMIC is investing \$150 million in Cambodia to upgrade network capacity and add 500 new Base Transceiver Stations (BTS) for coverage in rural and provincial sites.

To meet the needs of its growing number of subscribers, Hello has announced the launch of the new prefix number 081. Customers using the new prefix will still receive the same benefits as existing customers using the provider's 015 and 016. In February 2009, the company launched an unlimited international roaming package. This is Cambodia's first unlimited roaming package and will cut the cost of going online through a mobile when travelling outside Cambodia. The Daily Unlimited Data Roaming Plan is aimed at the small segment of business and government travellers who travel throughout the region and wish to use the internet overseas.

Smart Mobile became service provider number eight in March 2009. Smart Mobile has a Russian parent company, Latelz, which is 100 per cent owned by Timeturns Holdings – a Cyprus based company created by shareholders for managing and operating GSM/UMTS operators around the world. With Cambodia's telecommunications sector growing so quickly, Smart Mobile is confident it can capture a significant share of the market and is investing heavily in infrastructure.

Smart Mobile has designed a new high-tech, community-minded Smart Store in the heart of Phnom Penh that is open to anyone. It's the Smart Mobile goal to make quality mobile technology accessible to customers across Cambodia. At the cutting edge Smart Store on Monivong Blvd, Phnom Penh, consumers will be able to learn about Cambodia's newest mobile service provider and its offering, to subscribe to Smart Mobile, to add services out of Smart Mobile's service portfolio and to receive support. Inside are free internet and gaming kiosks and a large video screen set up for multi-media presentations- including seminars on 'Smart living' or game contests.

Sotelco, the Cambodian subsidiary of Russia's VimpelCom has signed a contract to build a GSM network in Cambodia with China's Huawei Technologies. As part of this new framework agreement, Huawei will deploy a nationwide GSM mobile phone network for Sotelco over the next five years. Sotelco selected Huawei for this key rollout project because of its expertise and proven track record in delivering quality mobile phone networks. VimpelCom has pledged around \$200 million to be spent on its Cambodian network in the first three to four years following its commercial launch.

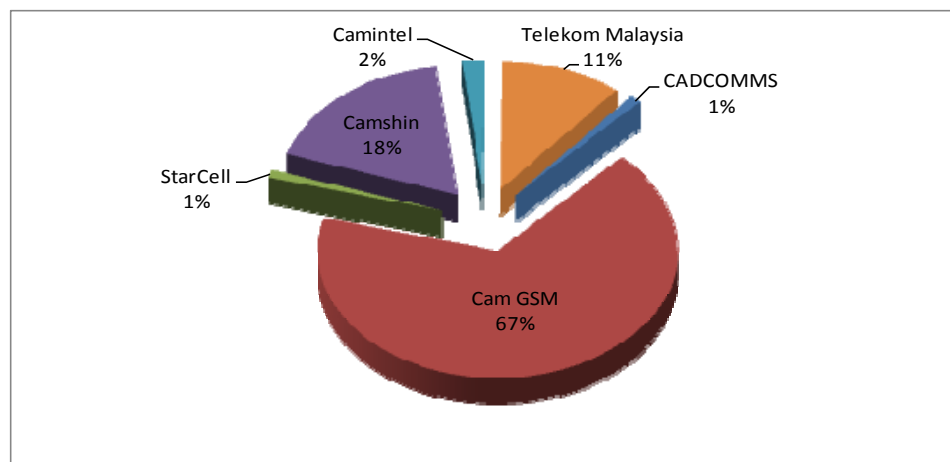
Viettel – Vietnam's Ministry of Defence-run telecoms unit – officially launched its Metfone service in Cambodia in February 2009. The company immediately gained more than 500,000 subscribers in the Kingdom by distributing free SIM cards, and is launching a major drive to tap Cambodia's rural market and bring schools online. Viettel provides the Ministry of Education, Youth and Sports with US\$5 million to help install free broadband internet transmission lines in 1,000 of the country's schools. The project will be implemented over the next five years. Viettel has installed 1,000 transmitter stations countrywide and 5,000 km of fiber optics cable, covering all 24 Cambodian provinces and cities. The company plans to install additional transmitter stations and cable in order to

extend its coverage to Cambodia's islands.

Applifone, known under the brand name Star-Cell, is a private GSM mobile operator in Cambodia. The company was established in 2006 and commercially launched in 2007. In order to increase its coverage to all 24 provinces, Star-Cell recently teamed up with Ericsson to introduce solar-powered base stations to Cambodia. The satellite transmission feature provides affordable mobile-network coverage in remote areas where other transmission solutions are unavailable. Ericsson's solar-powered site with satellite transmission will enable Applifone to expand cost-effectively into rural areas, connect people for the first time, and offer affordable services that improve quality of life. Star-Cell has extended its services to most areas of Cambodia.

In the area of mobile communications, the market continues to grow. The turnover continues to grow at an estimate rate of 32% in 2008. On average, the market of mobile telephony increases of 31% in the last five years. The segment generated \$298 million in 2007. Nevertheless, the price of international roaming remains high. Currently, there are two more incumbents for the mobile services provider. There are StarCell (098) and CADCOMMS (013), which offers third generation (3.5G) mobile services. The emergence of Internet telephony and new packages offered by different operators has begun to drastically reduce the price of communications in mobile telephones.

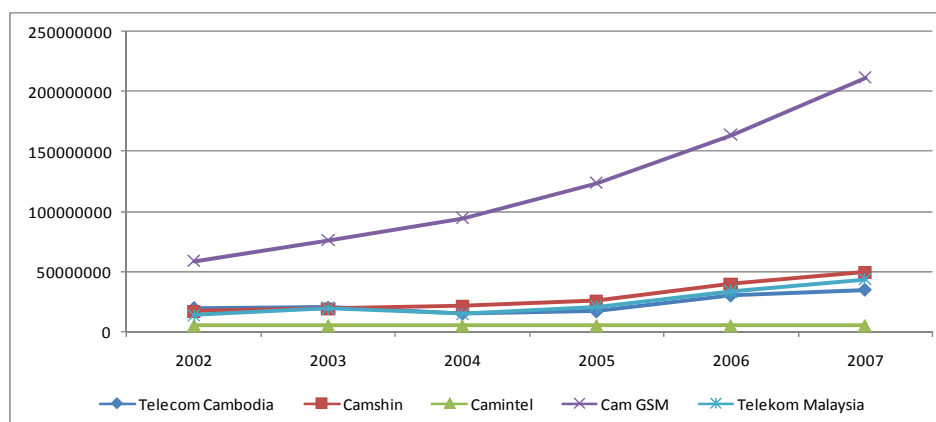
Figure 14.5. Market shares of mobile service providers



Source: Telecom Cambodia

Competition on pricing and quality of service is increasingly crucial in the mobile telephony market. The emergence of Internet telephony and of new packages offered by various operators has begun to reduce drastically the price of communication by mobile phone.

Figure 14.6. Growth of the mobile telephony sector

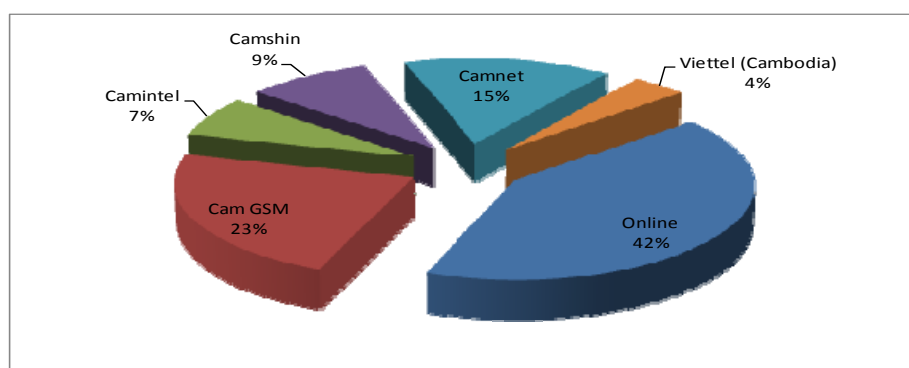


Source: Telecom Cambodia

14.2.3. Internet services

The Internet represents the convergence of two sectors, each of which has evolved in order to come closer to the other: electronic data processing and telecommunications sector. Innovations propelled by competition and technological progress are accelerating the convergence. With the arrival of the Internet and VOIP on the telecom market, the number of Internet Service Providers (ISP) is increasing steadily.

Figure 14.7. Market shares of Internet service Providers

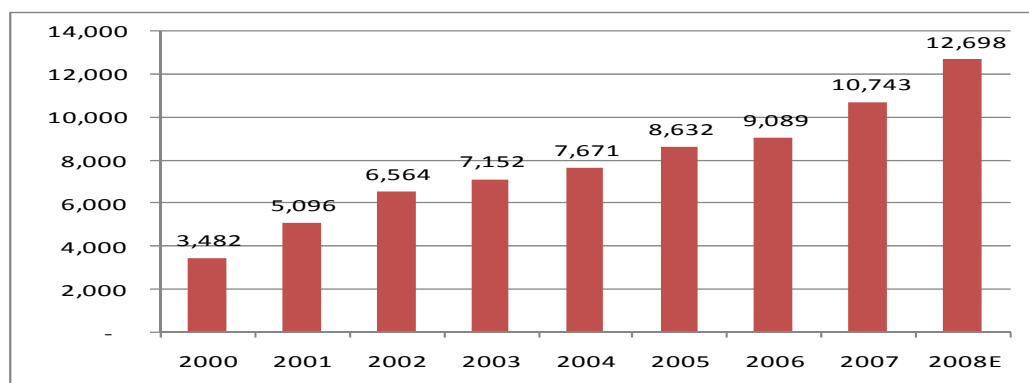


Source: Telecom Cambodia

As the number of Internet service providers on the market increased, the costs to the user have fallen, while transmission speeds have increased. The Internet service operators are Camnet (TC), Online, ISP CamGSM, Camintel, Camshin Internet, and Telekom Malaysia.

IP is becoming the standard means of information exchange for both domestic and international transactions.

Figure 14.8. Internet Users



Source: Telecom Cambodia

The number of access points to the Internet at the end of 2008 was 12,698. The growth has remained very strong, mainly because of the development of high-speed data transfer technology and the emergence of telephony on the Internet. Improvement in call quality on Internet telephony now offers highly attractive rates for consumers.

Cambodia currently relies heavily on bandwidth from Vietnam and Thailand, and that reliance come with a hefty price tag. While wholesale prices within Vietnam are around \$400 for every two megabytes per second of bandwidth, ISPs in Cambodia must pay between \$1,300 and \$1,400. Respite is on the way, with local firm Telcotech winning a bid in 2007 to link Cambodia via a submarine cable to the Asia-America Gateway, which allow Cambodia to bypass neighboring countries and connect directly to the World Wide Web.

Greater competition in the domestic market is needed to get the rates further down, improve quality, and diversify the offer. In addition to lowering rates, the vitality of the Internet depends upon having many and varied stakeholders, especially service providers.

Regulation of the Internet is intended to further sustain competition for the benefit of the consumer through ensuring fair and healthy competition in the market. For the RGC, it is essential to:

(i) Promote the establishment of high-speed networks that allow the introduction of innovative services.

High-speed networks require considerable investment both for the creation of new communications infrastructure and for the adapting of existing networks. With the fast-paced increase of the capacity of long-distance fiber optics networks, the essence of the problem is that of deploying high-speed networks in the local medium and high-speed radio loop. This will allow all operators to provide services based on xDSL technology.

Broadband requires a higher speed infrastructure and has major economic and social implications, given the upgrading of Internet capacity in terms of content, applications, speed, and services. These measures are intended to accelerate the deployment of broadband services on networks, which include cable networks, wireless, fiber optics, and access by satellite, as well as the Universal Mobile Telecommunications System (UMTS), one of the third-generation (3G) mobile telecommunications technologies.

Currently, the most available networks are ADSL and cable modem. In the future, however, fiber optics networks will play a paramount role in electronic communications, with the increase in data transfer at the individual and corporate level. As computers and these various networks become an integral part of daily and professional life, data security will also become more important. Safe information networks and systems are crucial for e-commerce.

(ii) Adapting regulations to changes in service and technologies

Current regulations were designed to open up the telecommunications sector to competition with the main goals of innovation in telecommunications services and price reduction. The regulations must now be adapted to changes taking place in the information technology sector, and particularly to the increasing importance of Internet-based services. Such adaptation of the regulatory framework must be guided by the following principles:

- The regulatory framework must promote the deployment of innovative technologies and services.
- Regulation must be technologically neutral: competing or substitutable services must be subject to similar regulations, regardless of their technological medium.
- It must provide users and investors with a sound, stable legal framework.
- Regulation must be limited to what is strictly necessary and make room for greater self-regulation.

(iii) Internet of the future

The “great convergence” that is putting under one umbrella computer science, telecommunications, and audiovisual technology in a broad sense, is now underway. This merging of audiovisual technology and the Internet is already well advanced with the digitization of the entire audio-visual value chain, but a further step will be taken with the introduction of digital terrestrial television, which will bring about a real equivalence between the existing audiovisual networks and those of telecommunications.

The unifying element, between these various worlds will be the “Internet of the future,” with capacities in terms of usage and services much greater than today’s standards and performance. However the Internet of the future will have to demonstrate its capacity to integrate audio-visual flux, link information with use, manage mobility or roaming, and provide a secure environment for user transactions. The Internet will also have to preserve what has made it so successful—its global village communitarian character—and also its extremely fruitful combination of technological innovations and use innovations.

14.3. Technological Progress and Its Impact on Electronic Communications Revenue

The emergence of Internet telephony and the improvement of call quality made possible by this technology have brought about a reduction in the revenue of landline operators and mobile services, which compete with them. The government must seek other sources of revenue to compensate for the loss of telecommunications revenue due to the fall in prices. Procedures must therefore be introduced for the auctioning of licenses and radio frequencies assigned to network operators and electronic communications services. In Morocco, for example, the auctioning of electronic communications licenses is bringing several million dollars into the State’s coffers.

Operators must obtain licenses for the construction of communications networks and provision of communications services. The objective of issuing licenses should also allow the MPTC and the CCA to:

- Promote the development of electronic communications networks and the provision of electronic communications services.
- Enforce regulations in order to guarantee the proper functioning of the electronic communications industry.
- Put in place a framework guaranteeing fair competition among the stakeholders.
- Ensure greater consumer protection.

14.4. Strategies and Policies for Telecommunications Development

The promotion of the information society is a determining factor in achieving a modern society with sustainable economic growth. The Rectangular Strategy underscores the crucial role of information and communications technologies (ICT) for economic revival and poverty reduction. Cambodia has made considerable progress in the development of the telecommunications sector in order to stimulate investment and innovation, with a broader choice, better quality, and lower prices for the consumer, and to expand communications coverage to all parts of the country.

Cambodia has the potential to establish itself as a technological hub, making the most of its geographical location, the quality of its infrastructure, and its competitive wages compared to the other countries of the region. The two objectives of the government's strategy in the telecom sector are to establish an integrated telecommunications network and promote the development of services at the lowest possible user rates. This strategy must also guarantee faster and less expensive access to the Internet, for individuals as well as businesses.

The government's strategy in the telecommunications sector addresses the following major objectives:

- Encouraging investment in the principal infrastructure components of information and communications technology, especially in high-capacity fiber optics networks.
- Promotion of competition in the network markets and in electronic communications services.
- Opening up the market to free competition between public and private operators based on commitments made by Cambodia to the WTO.
- Setting up, in the next five years, fiber optics networks (i) linking Penh to Kampong Cham, Takeo, Kampot, and Sihanoukville; (ii) linking Kampong Cham to Kampong Thom, Siem Reap, and Sisophon; (iii) linking Kampong Cham to Kratie and Stung Treng; and (iv) linking Monduliri to Pailin, Preah Vihear, and Oddor Meanchey.
- Construction of communications networks in Phnom Penh, Sihanoukville, and Siem Reap.

- Finalizing national norms and standards in the operations of electronic communications networks and services, information and communications technology and the Internet.
- Dissemination of new media and their integration into daily life through an on-line administration (e-Government) and on-line education (e-Learning).
- Designing an action plan to widen effective access to the Internet and expansion of access to this medium to the greatest possible number of people, while ensuring mass broadband availability throughout Cambodia, as well as security of the networks and information.
- Developing a regulatory framework accompanied by the full enforcement of existing policies concerning telecommunications, viz. the new regulatory framework for networks and electronic communications services (as provided for under the draft Communications Law) including (i) subdecree on the Obligations of Universal Services; (ii) subdecree on Management of the Internet; (iii) policy concerning the Internet; and (iv) subdecree on Management of Radio Frequencies.

14.4.1. Interconnection, Access and Shared Use of Infrastructure

Article 22 of the Communications Law provides that the goals of interconnection, access, and shared use are as follows:

- Guarantee interconnection between different networks: a subscriber to one company must be able to communicate with everyone in the service domain, including subscribers of other operators, and should have access to any service.
- Allow competition between telecommunications operators on the national level.
- Encourage investment in electronic communications.

Interconnection is an agreement in private law between the interested parties: it covers reciprocal services between the network operators and the service providers and is covered in a business agreement between the stakeholders. This applies to network access contracts (the Agreement on Interconnection) contemplated under Article 26-1 of the Communications Law.

With respect to the Internet, this interconnection is expected to be achieved at the level of the GIX (Global Internet eXchange), or exchange nodes for Internet traffic. These are

switches allowing operators to exchange their traffic. For example, the creation of a GIX in Phnom Penh allows two subscribers linked to different operators and communicating by visiophony not to have their traffic go through other countries. The service quality of real time applications is therefore improved.

In addition, the local exchange enables a reduction in unnecessary data transmission: it thus increases the overall efficiency of the networks. However, it does entail installation and processing costs for the operators. This local exchange is a good example of two benefits that can be had from such an operation:

- Improvement in the quality of service, due to the elimination of needless transfers of data in and out of the center.
- Drop in costs for Internet access providers, bringing lower retail rates for consumers.

Article 23 provides that telecommunications operators must:

- Ensure the interconnection of their communications networks with those of other operators.
- Guarantee the shared use of infrastructure that they set up with other operators.
- Allow other operators to have access to communications services.

The law seeks to promote equal access to public infrastructure for all stakeholders, in non-discriminatory and reasonable conditions. The goal is allowing access to infrastructure, not just to active networks. This will promote competition by the networks, which sustainably promotes innovation and lower prices to customers.

Article 54 (1) of the law grants to the CCA the power to settle disputes relating to the sharing of these networks and infrastructure. In order to ensure competition and avoid moral hazard, the license for network provision and the license for the provision of communications services must be issued to separate entities. An operator who obtains a license for the provision of an electronic communications networks may not obtain another license for the provision of communications services, and vice versa.

14.4.2. Management of Rare Resources: Numbering and Frequencies

Article 34 (1) of the Communications Law states that the national plan for numbering will be devised by the CCA in order to “guarantee equal and transparent access for users of the various networks and telecommunications services.” In the context of the full opening up of competition in the telecommunications sector, numbering constitutes an essential element, particularly to enable local loop subscribers to choose their long-distance operator. The CCA is empowered to define the conditions and procedures for the assignment of one-digit prefixes (prefixes referred to as “E”) and to four digits (prefixes of the 16XY format) for call-to-call selection of the long-distance carrier.

The Authority grants radio frequencies and radio electric spectra to operators. The Authority must also prepare a national plan for radio frequencies, taking into account the need for national security, maritime and aviation security, and communications services.

14.4.3. Universal Service

Universal service is one possible form of public service. Universal telecommunications service (UTS) includes:

- Access to quality basic telephonic service.
- Emergency access to communications services.
- Access to communications services in rural and remote areas.

The idea of “universal service” has been introduced in order to encourage the construction and development of communications networks throughout the country. The Authority will appoint one or more operators in charge of universal service from among the operators under conditions that are non-discriminatory and transparent.

It is expected that the financing of the net costs of universal service will be covered through the creation of a universal telecommunications service fund, mobilized from contributions from all telecommunications operators. The CCA will be empowered to determine the amount of the contribution of each operator. This will be determined on a pro-rata basis of the turnover of the telecommunications services from which future earnings from the provision of universal service will be deducted.



Chapter 15

Transport Infrastructure

The RGC has made considerable progress during the last 15 years in rehabilitating Cambodia's core transport infrastructure which was practically destroyed during the civil strife. The ability to transport merchandise over long distances at a reasonable cost is indispensable for export competitiveness .

Public investment in infrastructure has significant externalities and a high social return. However depending only on the private sector to fund infrastructure investments is not an effective approach and will result in under investment in transport development. Private sector is guided by private returns which may not be attractive in transport sector compared with alternatives. Besides, indivisibilities in infrastructure necessitate large scale investments which private sector may be unable or unwilling to mobilize

However, it is possible for the government to increase the volume and efficiency of investments in basic services through recourse to the private sector, privatization, or subcontracting. Besides, in the provision of public services such as transportation and electricity, the State must exercise the role of a regulator to ensure that consumers are protected.

The following summarizes the key elements of infrastructure in Cambodia and their shortcomings:

- The Sihanoukville port, characterized by high cost of services.
- A road network, perceived as excessively costly to use (especially unofficial costs).
- A railway system, dilapidated and poorly performing.
- Electricity, but at a prohibitive cost.

Since 1992, the Cambodian government launched a program of transport development, which envisaged investments to restore, and to a lesser extent, expand the infrastructure capacity, focusing on the following main objectives:

- Reduction of transport costs.
- Strengthening management of the sector.
- Involvement of the private sector in carrying out construction and providing services in the sector.
- Restructuring public transport agencies (such as Royal Cambodian Railways).

The program made good headway in achieving many of these objectives but the objectives are far from having been completely achieved. In spite of major accomplishments in the road sector shortfalls are noted at the planning level, programming of actions, allocation and mobilization of sufficient financial resources, notably for road maintenance, management of construction quality, and reduction of the costs of road transport. These shortcomings are basically due to a lack of coordination—aggravated by the absence of a national vision—between the ministries involved, such as the Ministry of Economy and Finance, Ministry of Public Works and Transport, and the Ministry of Rural Development.

The shortfalls in meeting the objectives may be attributed to the following key factors:

- Lack of reliable data. For e.g. in the road subsector lack of reliable data is a source of many errors in the design or programming of work that does not always respond to the most pressing needs, whether for investing in new roads or road upgrading.
- Needs are beyond the resources available for e.g. in the road fund.

The government transportation strategy envisages the following objectives:

- Improve maintenance of the existing road network.
- Harmonious and coherent development of the network under a master plan.
- Modernization of the land transport administration.

The strategy includes: (i) measures of institutional reinforcement and modernization of structures to increase the efficiency of the sector, build capacity for planning, programming, designing, and managing the institutions; (ii) infrastructure maintenance and reconstruction investments, including the railway; (iii) strengthening the involvement of the private sector in sector management and investment; and (iv) finalization of the rural transportation strategy.

15.1. Present State of Roads in Cambodia

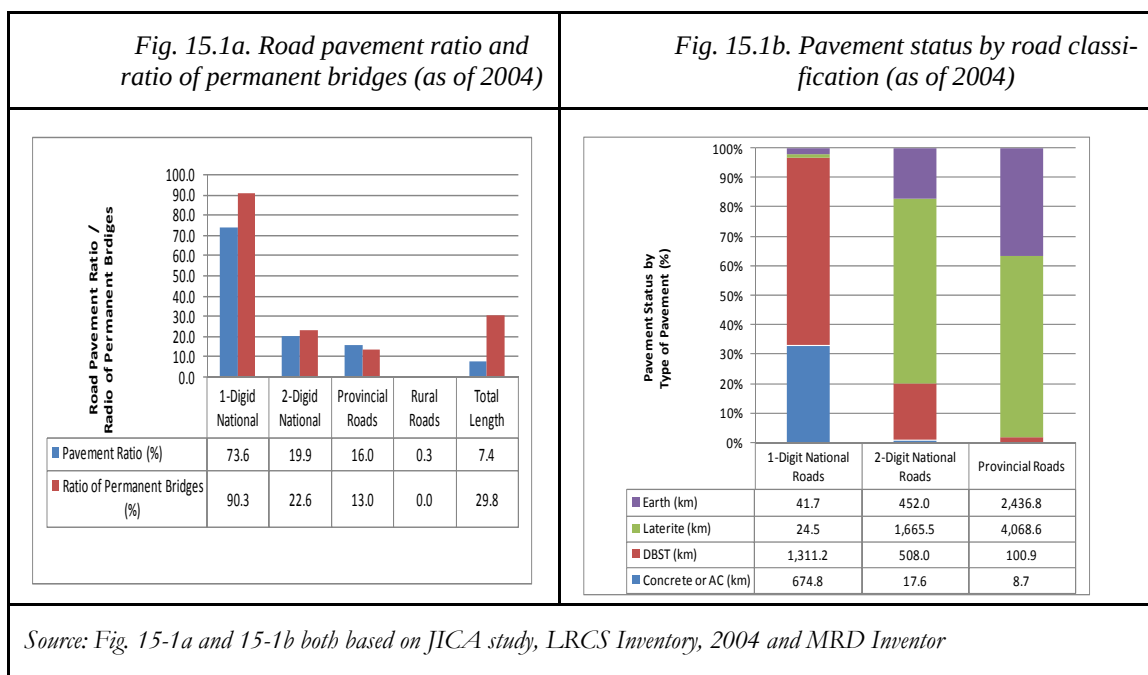
Roads play a crucial economic and social role in Cambodia but they are seriously deficient. In the Cambodian transport system, the road subsector constitutes the most important link, being used for over 90% of personal travel and haulage of goods.

Table 15.1 Road network length (as of 2006)

Road Classification	Length (rate)	No. of Bridges (Length)	Management Authority
1-digit national roads	2,097.280.km (5.31%)	589 (17,643m)	MPWT
2-digit national roads	2,704.737km (6.85%)	698 (15,710m)	
Provincial roads	6,692.440km (16.95%)	904 (16,309m)	
Rural roads	28,000 km (70.89%)	N/A	MRD
Total length	39,494.457 km (100.0%)	2,121 (51,917m)	

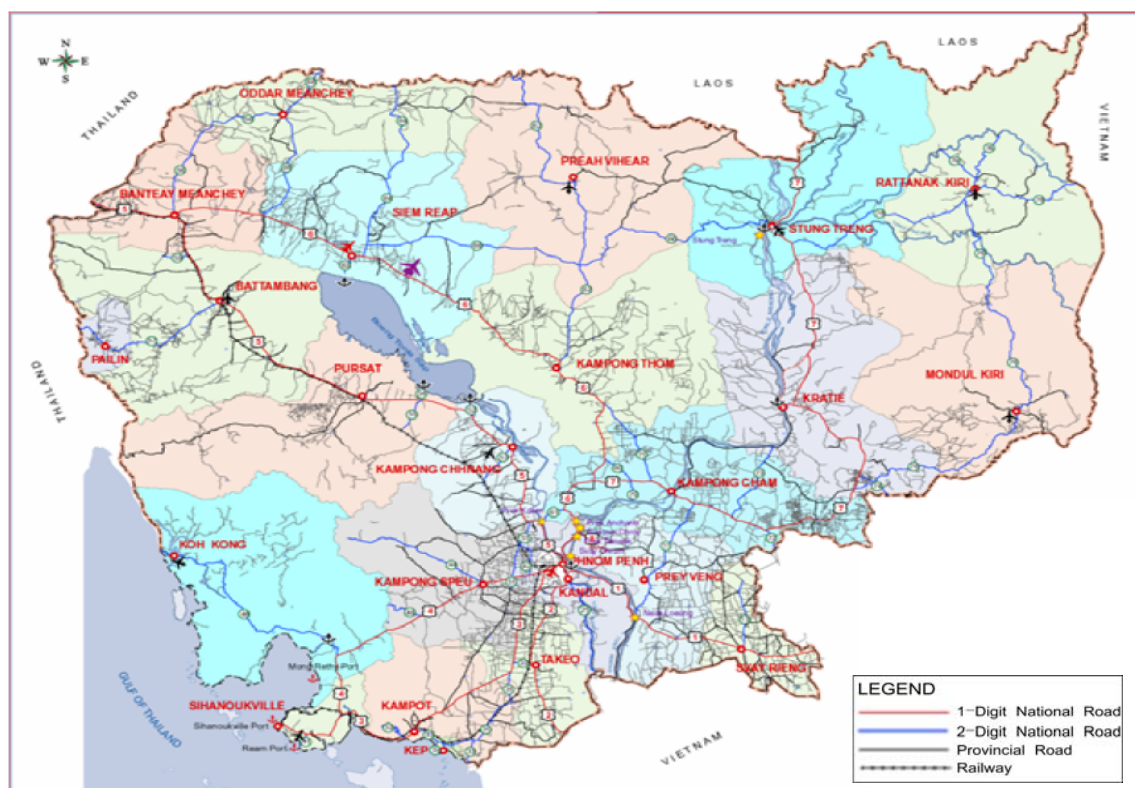
Source: LRCS Inventory, 2006 and MRD Inventory 2006

The road network in Cambodia is composed of arterial roads managed by the Ministry of Public Works and Transport (MPWT) and rural roads managed by the Ministry of Rural Development (MRD). The division of responsibilities in road management is shown in the table below.



The national road network is shown in the figure below.

Map 15.1. National Road Network in Cambodia



Source: Cambodia Investment Guidebook, Dec. 2006, CDC

Pavement and Bridge status of national roads is shown in the table below.

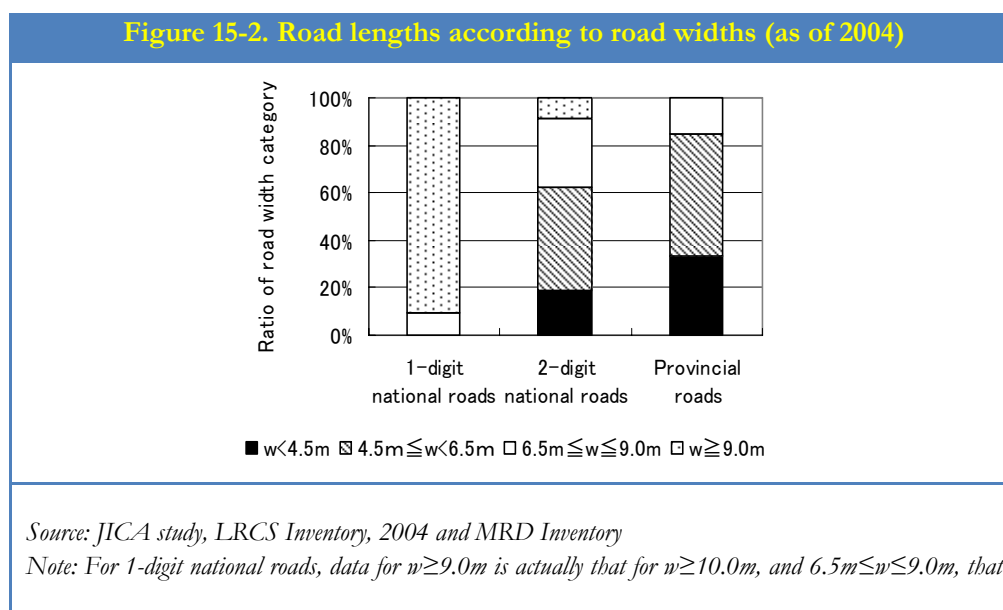
Table 15.2 Pavement status of 1-digit national roads (unit: km)

No	AC	DBST	DBST (fair)	Laterite	Earth	Total	Remarks
NR.1	79.1	87.1	0.0	0.0	0.0	166.2	Includes 56 km Section (On-going)
NR.2	57.8	14.3	47.9	0.0	0.0	120.0	Includes 51.7 km Section (Completed)
NR.3	12.8	54.3	135.2	0.0	0.0	202.3	Includes 32.8 km Section (Completed)
NR.4	214.2	0.0	0.0	0.0	0.0	214.2	
NR.5	59.8	346.7	0.0	0.0	0.0	406.5	Includes 47.3 km Section
NR.6	190.0	223.4	0.0	0.0	0.0	415.5	Includes 98.2 km Section
NR.7	61.1	402.4	0.0	0.0	0.0	463.5	Includes 192.8 km (On-going ; New alignment shorter than exist-
NR.8	0.0	0.0	0.0	22.4	41.7	109.08	New 1-digit national road (On-going)
Total	674.8	1128.2	183.0	24.5	41.7	2,097.28	
	32.9%	55.0%	8.9%	1.2%	2.0%	100%	

Source: As-built Drawings, Design Drawings and Tender Drawings Collected by JICA Study Team

Note: All 1-digit national roads have at least two lanes, while only 37.8% of 2-digit national roads and 15% of provincial roads have two or more lanes.

The Table below shows the quality of the road network in terms of availability of number of lanes.



15.1.1. International Roads

A portion of national roads No. 1 and No. 5 forms a part of Asian Highway 1; similarly national roads No. 4, 6 and 7 a part of Asian Highway 11; national roads No. 48, 3 and 33 a part of Asian Highway 123; and national roads No. 66 and 78 a part of the arterial highway of the Greater Mekong Sub-region (GMS).

Roads in Cambodia differ little compared to roads in neighboring countries in terms of total road length over area, but the inadequacy of Cambodia's road development is reflected in the low share of paved roads in total road length in Cambodia.

These regional links are shown in the table below.

Table 15.3. International roads in Cambodia

Name of international road			Transit Cities	Length (km)	International Road Classification					Missing Links	Remarks
GMS roads	Asian Highway	ASEAN Highway			Primary	Class I	Class II	Class III	Below Class III		
Central Subcorridor	AH1	AH1	Poipet-Sisophon - Phnom Penh - Svay Rieng - Bavet (NR1, NR5)	572.4	-	-	11.2	561.2*	-	-	*103km upgraded to Class II (Japan [56km] and ADB [47km])
Inter-Corridor Link	AH1 1	AH11	Sihanouk Ville - Phnom Penh - Kampong Cham - Stung Treng - Trapengkreal (NR4, NR6, NR7)	755.0	-	-	364	391.0**	-	-	**Includes 193km on-going Road Rehabilitation of NR.7 (China Fund)
Southern Coastal Subcorridor	-	AH123	Cham Yeam - Koh Kong - Viel Rinh - Sre Ambel - Kampot - Lork (NR48, NR3, NR33)	163.3	-	-	2.4	8.7	152.2	-	NR.48 funded by Thailand NR 33 funded by ADB
Northern Subcorridor	-	-	Siem Reap - Preah Vihear - Stung Treng - Rattanak Kiri - O Yadav Border (NR66, NR78)	464.9	-	-	-	-	464.9	-	NR.78 funded by Viet Nam.
Total Length (km)				1,955.6	-	-	377.6	960.9	617.1	-	

Source: JICA Study & MPWT Updated

International road classifications are as follows (ASEAN STANDARD):

- [Primary] Roads used exclusively by automobiles / AC or concrete pavement
- [Class I] Highways with 4 or more lanes / AC or concrete pavement
- [Class II] Roads with 2 or more lanes / AC or concrete pavement
- [Class III] Narrow 2-lane roads / DBST pavement

Fig. 15.3a. International comparison of road den-

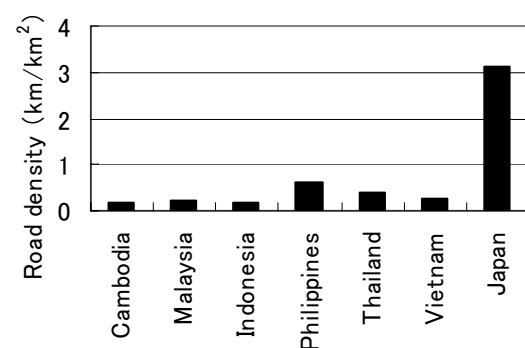
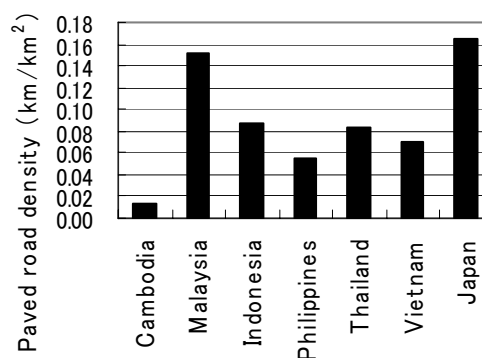


Fig. 15.3b. International comparison of paved road density



Source: Figs. 1-4 and 1-5 both prepared based on JICA study

Table 15.4. Population by Road Density

Road			
1-digit NR		2,097.28 km	
2-digit NR		2,704.37 km	
Prov. Road		6,692.44 km	
	Rural Road (L1)	28,000.00 km	
	NR and PR (L2)	11,494.09 km	
	Total length (L3)	39,494.09 km	
Land areas (A)		181,035 sqkm	
Population, P (x1000)			
	(in 2005)	PxA	(PxA) ^{0.5}
Total population	13,800.00 mill.	2498283000	49982.83
Rural	11,592.00 mill.		
Urban	2,208.00 mill.		
Road density and Road density index			
Road density, RD=L/A (km/sqkm)	0.218	(all roads)	
	0.063	(National & Provincial roads)	
	0.155	(Rural roads)	
Road density Index, RDI RDI=L/(PxA) ^{0.5}	0.790	(all roads)	
	0.230	(National & Provincial roads)	
	0.560	(Rural roads)	
Total population/Total road length		350.00 Person/km	
Rural population/Rural road length		414.00 Person/km	

Source: World Bank

Figure 15-3 describes the total population compared to the total road length and rural population to the rural road length. In general, the poor make up one of the most mobile social groups in Cambodia even though efficient and reliable means of transport are lacking. However, even with impaired mobility the poor must explore all avenues for

survival wherever they exist. The poor are often clustered and found in remote locations. Infrastructure such as roads, railways, and other means of conveyance are essential for opening up the areas left behind in development and integrating them into the national economy. Transportation can have a major positive impact on poverty reduction in that it allows poor to access existing or potential resources in locations different from where they live. Some urban stress is likely fallout as some poor may move to urban areas rather than to non urban environments. This will have to be managed.

Once urban-rural connectivity is established the comparative advantage of urban areas in terms of transport availability will vanish and more investments will tend to locate in areas which have been opened up through transport development. This is a desirable outcome since it will help create livelihoods for the poor in the areas where they are already resident and lessen the urban stress that would be created if rural-urban migration were to occur.

At present urban transport facilities are also not adequate. Residents living in the suburbs find it difficult to undertake travel at any time of the day or night. The government is seized of this problem and is in dialogue with the local governments and the private sector to find a solution.

15.2. Road Infrastructure Issues

The lack of infrastructure including roads is an obvious obstacle to the rapid expansion of a vibrant private sector. In 1998, the inventory of damage revealed that 28% of paved roads and 82% of unpaved roads were in bad condition.

The infrastructure bottlenecks must be cleared in an urgent manner. It is in this context that at the opening of every new highway, Prime Minister Samdech Hun Sen unfailingly repeats the expression “there is a way...” meaning that a path, inspiring hope that the future is becoming brighter. This is a way of metaphorically linking the destiny of the country with the development of its road network.

The government’s road transport policy seeks to achieve several desirable outcomes. The goal is to establish an efficient transport network which is low cost and competitive, is able to sustain economic growth, reduce poverty, maximize trade, develop tourism, and facilitates Cambodia’s integration into the regional and global economies. The medium-term priorities of the RGC in road transport are:

- Rehabilitation and repair of the main national and provincial highways and tertiary roads, in order to improve access and connectivity countrywide.

- Improve the efficient use of existing infrastructure and institutions, as well as operational performance.
- Construct connecting roads to neighboring countries to promote regional integration of markets and tourism.
- Increase resource mobilization from the road transport sector, in order to cover at least maintenance and operating costs.
- Strengthen institutional capacity in planning and management.
- Frame a sustainable program of road maintenance, and
- Encourage private sector financing of road infrastructure development.

Much road upgrading and resurfacing took place between 1991 and 2004 alongside new projects for the extension of paved national highways. New highway construction and road upgrading projects were taken up during 2002-2008, including rehabilitation of a 60-km stretch of National Road 1 between Phnom Penh and Neak Loeung, 154 km of National Roads 5 and 6 (Poipet-Sisophon-Siem Reap), and 198 km of National Road 7 between Kratie and the Laotian border, with a bridge crossing the Sekong River at Stung Treng.

There are major shortcomings in road transport provision. As regards national roads which receive the best attention in resource allocation from the budget, the spatial coverage of the network is inadequate. The continued partial or total cut off of certain areas, notably in the border regions, is a reason for concern. The overall condition of the national road network is bad due to insufficient upkeep and poor-quality construction work.

Outside of mining-related transport, roads handle most of the trade and travel traffic. Private transport operators have contributed to the development of road traffic; their contribution has been much less in the other modes of surface transport (rail and river travel). However road transportation system for goods and people is characterized by its informal nature and the unsophisticated organization. The type of vehicle used often does not meet the needs of users, especially for perishable goods. Further, there is no coordination between shippers and haulers, which results in a mismatch between demand and capacity.

15.3. Road Development Funding

Since the early 1990s, foreign aid has been the major source of funding for upgrading the road network. The program includes urgent repair work and one-off rehabilitation of 4,800 km of the road network and maintenance of the upgraded roads. The priority will be the main national roads (NR 1-7) and the provincial roads linking Cambodia with neighboring countries, and those linking the provinces among themselves.

Japan is at the top of the list of donors involved in the road sector. The major projects with Japanese assistance include the Chroy Changvar Bridge in Phnom Penh, the Kizuna Bridge at Kompong Cham, and the current project at Neak Loeng. Japan has released nearly US\$242 million for these work sites. ADB is next in the list of donors with assistance of US\$162 million followed by the World Bank (US\$32 million), South Korea (US\$21 million) and France (EUR3 million). The RGC has spent nearly US\$100 million from the budget on the maintenance and repair of the road network

Table 15.5. Expenditures for road infrastructure,
2001-2004 (in millions of dollars)

	2001	2002	2003	2004
Public works and transport	13.72	21.69	19.04	18.00
Current expenditure	1.99	3.14	9.83	10.00
Capital expenditure	11.73	18.55	9.21	8.00
Rural development	5.95	12.16	16.96	35.24
Current expenditure a	0.55	1.38	1.50	1.00
Capital expenditure	5.40	10.78	15.46	34.24
Donors	59.71	76.43	121.56	111.55
Grand total	79.38	110.28	157.56	164.79

Source: Ministry of Economy and Finances

15.3.1. Road Development Projects

For transport planning purposes, Cambodia is divided into three economic regions: a tourist region (the provinces of Siem Reap, Oddar Meanchey, Preah Vihear, and Kompong Thom); an agro-industrial and ecotourism region (region to the east of the Mekong, including the provinces of Stung Treng, Rattanakiri, Mondolkiri, and Kratie); and an

industrial region that covers the coastal region of the country's southwest. The geographical situation of the country offers a strategic possibility for positioning Cambodia as a regional transport hub within the Greater Mekong Sub-region (GMS). The government is therefore giving high priority to the development of transborder road links. The primary national highways were conceived as regional pan-ASEAN motorways to promote cross-border transport, trade, and tourism. The other national and provincial secondary roads were conceived not only to serve as connecting roads to the regional pan-ASEAN motorways or other primary national highways, but also to strengthen links between the different economic centers of the country.

Within the GMS cooperation program, the following road projects will be undertaken:

- i. Rebuilding of National Road 6 will continue, in order to link up Siem Reap and the temples of Angkor to Phnom Penh and Poipet (on the Thai-Cambodian border).
- ii. Improvement of NR 1 and NR 5 was the first stage of the road project linking Ho Chi Minh City-Phnom Penh-Bangkok (central corridor of the GMS) through Cambodia. NR 48, NR 3 and NR 31 (southern coastal corridor) will now be rehabilitated so as to link Sihanoukville to the Bangkok port and other international ports in the region.
- iii. NR 7 will be rehabilitated with support from the People's Republic of China, to connect the south of Laos to Kratie, Phnom Penh and Sihanoukville via NR 4 and by the construction of the bridge over the Mekong River at Kompong Cham with aid from Japan.
- iv. NR 8 will be upgraded in order to link Sihanoukville, at the heart of the industrial and trade zone of the country, to Bangkok international port and other main international ports in the region, which will facilitate the transport of goods. This artery has an excellent potential for the expansion of regional trade.
- v. Under arrangements for economic cooperation between Cambodia and Thailand, several secondary and provincial roads connecting with the Thai-Cambodian border (NR 56, 57, 58, 59, 68, 69, 64, etc.) will be rehabilitated. The rehabilitation of National Roads 78, 76a, 78b, 76, and 72, as well as provincial roads (PR 303a and 303b) in the provinces of Rattanakiri and Mondulakiri will facilitate transport of goods and traffic at the borders.

Table 15.6. Externally Funded Road Projects

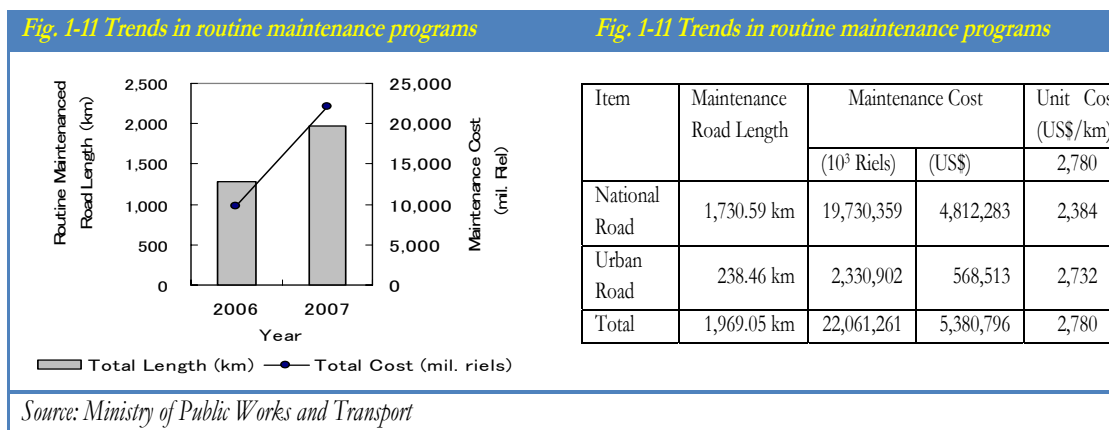
<i>Project Type</i>	<i>Scope</i>	<i>Source</i>	<i>Start Year</i>	<i>Compl. Year</i>	<i>Project cost (\$million)</i>
Road Rehabilitation	NR 5	Thailand	1992	1993	6.4
Emergency Repair	NR 5	UNDP	1992	1993	0.4
Bridge Reconstruction	NRs 5, 6	AusAid	1992	1996	9.0
Road Rehabilitation ^a	NRs 1, 2, 3, 5, 6, 11	ADB	1993	1997	67.7
Road Rehabilitation	Various	Sida	1993	1997	5.0
Road Reconstruction	NR 4	USAID	1994	1996	30.6
Road Reconstruction	NRs 6, 7	Japan	1994	1999	109.0
Ferry Rehabilitation	NRs 1, 6, 7	Danida	1995	1999	2.5
Airport Improvement	Siam Reap	ADB	1997	2003	15.0
Bridge Construction	NR 7	Japan	1998	2001	53.2
Road Improvement	NR 1	ADB	1999	2003	50.5
Emergency Flood Repair ^a	NRs 1, 2, 5, 6, 7, 11, 21, 41	ADB	2000	2002	65.0
Road Rehabilitation	NRs 5, 6, 7	ADB	2000	2003	74.8
Road Improvement	NR 6	Japan	2001	2002	10.4
Bridge Reconstruction	NR 6	Japan	2001	2002	11.3
Road Improvement	NR 7	Japan	2001	2003	15.4
Port Modernization	Sihanoukville	Japan	2001	2007	–
Emergency Flood Repair ^a	NR 11	ADB	2002	2003	14.0
Road Rehabilitation	NR 51	Japan	2002	2003	5.0
Road Rehabilitation	NR 2	Japan	2002	2003	10.0
Emergency Flood Repair ^a	Various	World Bank	2002	2003	50.0
Road Reconstruction	NR 48	Thailand	2002	2004	7.6
Road Rehabilitation	NR 3, 6	World Bank	2002	2004	45.0
Road Rehabilitation	NR 51	World Bank	2002	2004	5.0
Road Improvement	NR 1	Japan	2003	2005	31.2
Road Reconstruction	NR 48	Thailand	2006	2008	–
Road Rehabilitation	NRs 5, 6, 56, 68	ADB	2006	2008	60.0
Bridge Construction	NR 1	Japan	2007	2009	–
Road Maintenance	NRs 33, 56, 68, 72	ADB	2008	2011	–
Total					754.0

Source: Ministry of Public Works and Transport

15.3.2. Road Maintenance

At present the country's major roads—national and provincial—comprise a length of 6,000 km, of which half is tarmac. The 2,000 km of national roads are 80% tarmac with each kilometer of resurfacing costing between US\$20,000 and US\$300,000. Providing adequate funds for road maintenance is crucial for Cambodia to fully profit from this asset that already exists. The main sources of funds available for maintenance of the road network are vehicle licensing fees, tolls, international transit fees, tax collected on fuel, and other related road taxes or fees. It is estimated that US\$100 million in annual funding is necessary for the rehabilitation of the primary and secondary road network including \$30 to \$40 million for maintenance. Additionally, annual needs for rural road reconstruction and maintenance are assessed at about US\$50 million. It seems unlikely that this large amount can be raised from domestic resources or foreign resources. There is no option but to prioritize the needs and frame a detailed program of road network upgrading and maintenance. During the third mandate (2003-2008) of RCG, the government prioritized rehabilitation and repair over 2,000 km of main and national roads, and 1,000 km of provincial roads. The road maintenance and management budget for 2007 is more than double that of 2006, indicating an increasing awareness of the significance of road maintenance.

Figure 15.4. Trends in road maintenance



15.3.3. Present State of Road Traffic

The number of registered automobiles has been increasing at a rate of about 10% each year, and has exceeded 480,000 automobiles in 2004. Approximately 70% of all registered automobiles are motorcycles.

Fig. 15.5a. Trends in number of registered automobiles

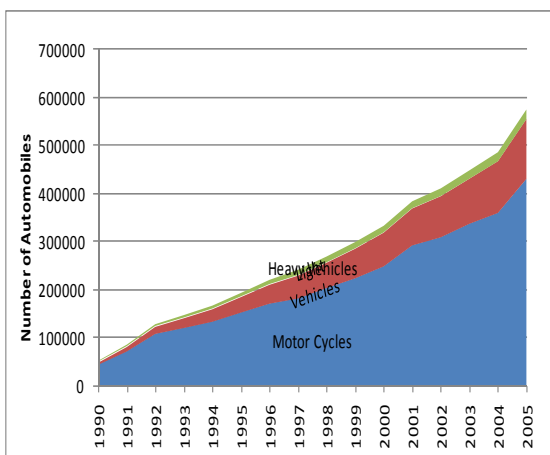
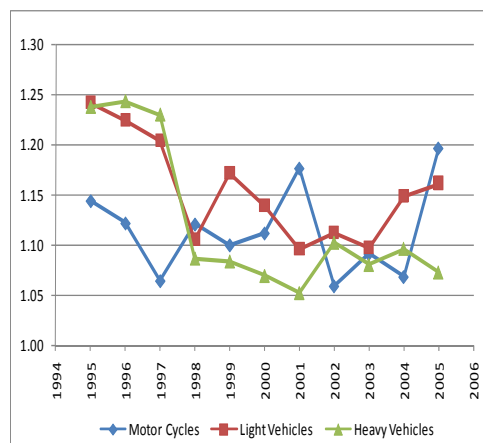


Fig. 15.5b. Year-on-year increase in number of registered automobiles



Source: Statistical Yearbook 2006. National Institute of Statistics

15.3.4. Road Safety

An increasing number of people are owning an automobile in recent years. Reflecting the increasing density of vehicles on the road traffic and the tendency of vehicle drivers to ignore traffic rules, accident fatalities per 10,000 automobiles are increasing and much higher compared with the neighboring countries. There are 21.5 fatalities per 10,000 automobiles in Cambodia compared with 8.34 in Viet Nam, 5.41 in Thailand (2003 estimate) and 0.95 in Japan.

Fig. 15.6a. Trends in traffic accidents in Cambodia

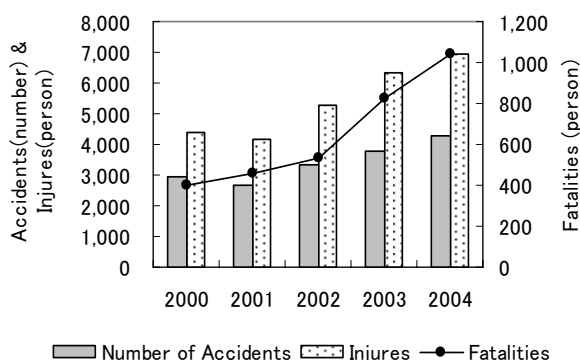
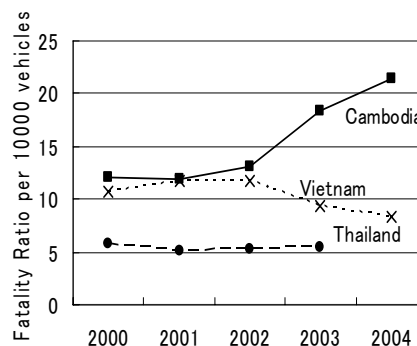


Fig. 15.6b. Comparison of traffic accident fatalities



Source: JICA study, Land Transport Department and Road Safety Committee, MPWT

Fig. 15.7a. Number of accidents by type of road user (2004)

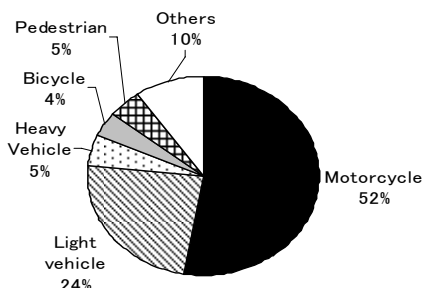
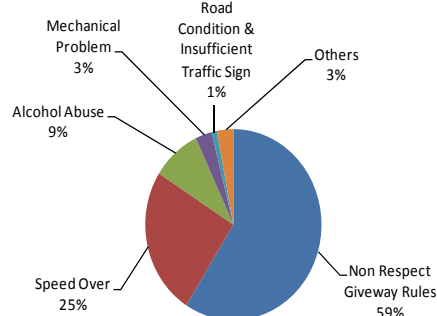


Fig. 15.7b. Causes of road accidents (2004)



Source: JICA study, Land Transport Department and Road Safety Committee, MPWT

15.4. Railways in Cambodia

15.4.1. Present State of Railways in Cambodia

Cambodia's railway system consists of two single-line tracks of 1 m gauge: the first line links Phnom Penh and Sisophon; the second track links Phnom Penh and Sihanoukville (266 km). The metric tracks were built in 1929. They are worn out and can be travelled at a maximum speed of 30-35 km/h. The rolling stock includes 10 locomotives, 5 passenger cars, 35 tank cars, and 80 freight cars.

The railroad system's development commenced in 1929, when work started on the 386-km rail line from Phnom Penh to Poipet. This project was completed in 1942. However, the link between Sisophon to Poipet was completely destroyed during the war in the 1970s. The line from Phnom Penh to Sihanoukville, was begun in 1960 and completed in 1969. Unfortunately, decades of war left the Cambodian railway system underdeveloped and inefficient, a situation that continues to this day.

Despite its 75-year-old history the Cambodian railways are the all-important missing link in the ASEAN railway system, from Singapore to Kunming.

Table 15.7. Railway Infrastructure

Item	Northern Line (NL)	Southern Line (SL)
Length (km)	385 (including 48km missing link)	264km
Section	Phnom Penh - Pursat – Battambang - Mongkol Borey - Poipet	Phnom Penh - Takeo - Kampot - Sihanoukville
Station (number)	49 (Current Operation 7)	27 (Current operation 5)
Construction Year	1929 – 1942	1960 - 1969

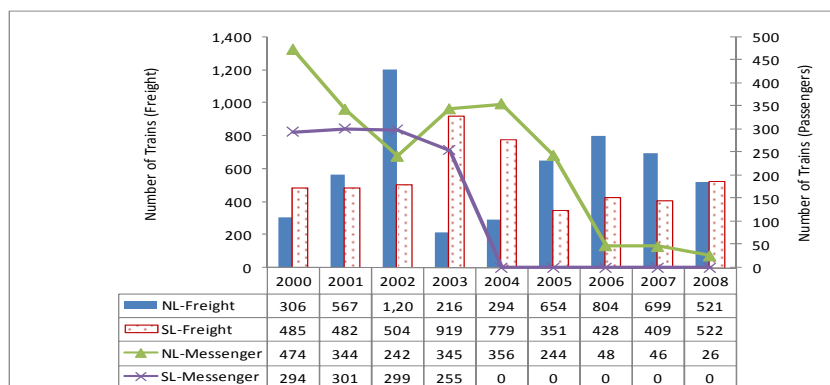
Source: RRC, *Restructuring of the Railway in Cambodia, Strategy Report and Action Plan*, ADB, *GMS Rehabilitation of the Railway in Cambodia, Final Report (Volume II)*, November 2006, ADB.

15.4.2. State of Railway Use

Train service began to decrease in 2002. In 2005, a maximum of 3 trains per day were operated on the Northern Line (NL) and only 1 train per day on the Southern Line (SL). The volume of rail cargo transport began to decrease after reaching 557,000 tons in 2002, due to competition with road traffic. The NL mainly carries cement, and while the SL mainly carries cement and petroleum products.

The number of railway passengers has drastically decreased after 2000, as a result of improvement in Route 5 and Route 6. In 2005, it was about one-tenths the number of the peak period in 1998. The Southern Line has even terminated the operation of passenger trains in 2004. On the Northern Line, the number of round-trip services has been reduced from once a day to once a week, due to the decrease in the number of passengers. Currently, a train composed of both cargo and passenger cars operates between Phnom Penh and Battambang.

Fig. 15.8. Number of trains operated in a year by Cambodia National Railway



Source: *GMS Rehabilitation of the Railway in Cambodia, Final Report (volume 1)*, November 2006, ADB TA6251-REG (Source: RRC)

Fig. 15.9a. Trends in rail cargo transport volume

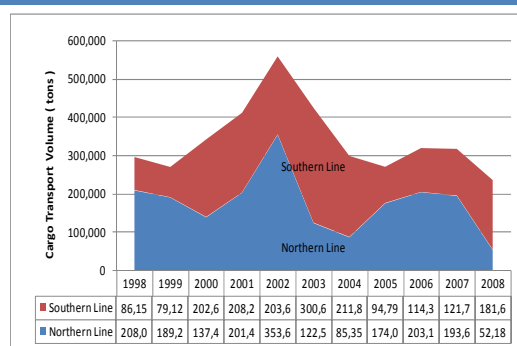
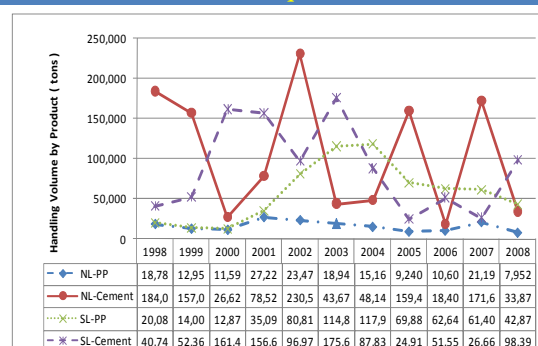


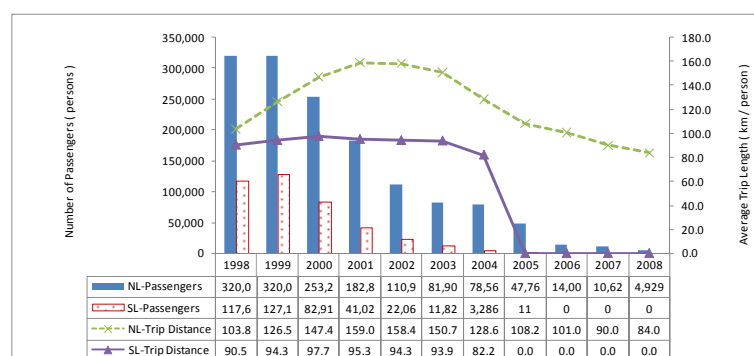
Fig. 15.9b. Trends in transport volume by product



Source: Prepared based on Restructuring of the Railway in Cambodia, Strategy Report and Action Plan, ADB and GMS Rehabilitation of the Railway in Cambodia, Final Report (Volume II), November 2006, ADB.

Despite the huge benefits from the railway system, Cambodia is still unable to fully utilize the potential of this vital transportation network. The railway stands nearly idle, as evidenced by the figure 15.9 showing 1 passenger train per day on average in 2004. Access to safe and reliable regional railway traffic would benefit Cambodia in several ways: (i) reducing heavy truck traffic on the roads, thus cutting down on future maintenance and expansion costs and possibly accidents; (ii) reducing the transport of fuel and other dangerous cargo by road, and thus cutting down on road traffic risks; (iii) providing cheap transport for bulk cargo such as cement and fuel thereby decreasing the cost of importing and distributing basic products; and (iv) increasing competitive pressure on existing transport systems, primarily road transport and the port of Sihanoukville through the establishment of alternative routes and means of transportation. This would help lessen the practice of monopoly pricing. In addition, it would help boost regional integration and trade, as well as tourism, along with the creation of additional jobs for Cambodians.

Fig. 15.10. Trends in the number of railway passengers and the average length of their trips



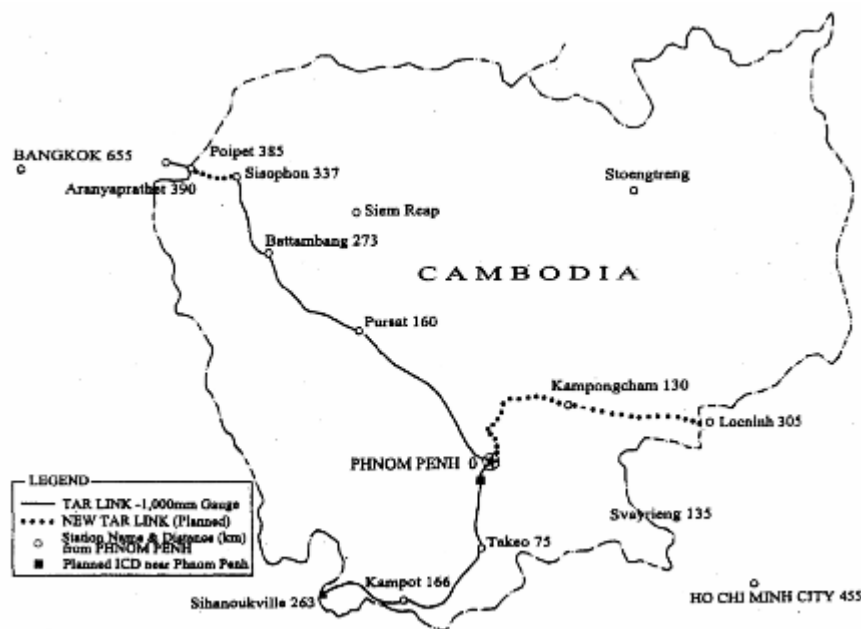
Source: Prepared based on Restructuring of the Railway in Cambodia, Strategy Report and Action Plan, ADB and GMS Rehabilitation of

15.4.3. Rehabilitation of the railway

The completion of the 48 km Sisophon-Poipet link which will connect the Cambodian and the Thai systems is a high priority project. The project is ongoing and expected to be completed by late 2010. The sources of financing are US\$42 million in soft loans from the ADB, US\$13 million from OPEC, rail tracks worth US\$2.8 million donated by Malaysia, and a counterpart budget of US\$15.2 million from the RGC. The rehabilitation would meet international standards. Trains will be able to travel as fast as 50 km/h, and the rails will be able to handle 15- to 20-ton cars. The project is being carried out by the French firm TSO and the Thai-based Nawarat Company under the technical consultation of Nippon Koei Co. Ltd.

China has conducted studies on the railway connection with Viet Nam. The line passes through Kompong Cham and connects with the Vietnamese system, which goes as far as Loc Ninh. The length of rail line to be constructed from Phnom Penh to Loc Ninh is 260 km.

Map. 15.2 Route of the Pan-Asian Railway in Cambodia



Source: Report of the Overseas Information Gathering Survey by the Asia-Pacific Region H Group (Cambodia), March 2004, Japan Transport Cooperation Association

The RGC signed in March 2007 the Rehabilitation of the Railways in Cambodia Project with the ADB for US\$73 million, of which the RGC will contribute US\$15 million. This rehabilitation project will rebuild and repair 652 km of rail lines from Sihanoukville to

Phnom Penh and from Phnom Penh to Poipet. The Prime Minister has also urged the ADB to help Cambodia secure US\$500 million of low-interest loans to build a new 257-km rail line from Phnom Penh to Loc Ninh, Viet Nam, thus completing the connection of the 5500-km Singapore-Kunming railway network. This new line is a long term development priority for ASEAN.

To ensure good management, the Asia Development Bank (ADB) has proposed privatizing the Cambodian railroads. Under the proposal the stock, viz. tracks, equipment, and buildings would continue to belong to the State, and be managed by a railroad authority with full autonomy. The management, maintenance, and marketing will be handed over, through competitive bidding, to competent private operators with appropriate management skills.

Following a process of competitive bidding, the RGC signed in June 2009 a 30-year Concession Agreement with Australian Toll Holdings Ltd. to operate the railways under a public-private partnership (PPP) agreement. Railway infrastructure inclusive of the railway's land will remain the sole property of the Cambodian government but operations have been taken over by Toll Holdings. Toll will share revenues through a concession fee to be paid starting in the 5th year of operations. 670 of the Royal Railway of Cambodia staff will be absorbed by Toll.

The rehabilitation and restructuring of the railway will foster efficient rail freight services, providing cost-effective and efficient railway transport, reduce wear and tear from heavy cargo haulage on the road network by diverting heavy haulage to the railway and improve traffic safety by enabling diversion of passengers and hazardous cargos from road transport to inherently safer railway transport. Over the long run, the restructuring would pave the way for proposed future construction of new railway lines including the link between Phnom Penh and Lok Ninh in Viet Nam.

15.5. Maritime and Ports

15.5.1. Present State of Ports

Among the ports in Cambodia, only Sihanoukville Port and Phnom Penh Port handle international containers. These two ports are managed by the central government, but are financially independent, and autonomously-managed. Sihanoukville Port was constructed in 1961 with French assistance. Japan is aiding the development of a 400m-long and 11m-deep container terminal along the quay, slated for completion in 2008. Phnom Penh Port has a 300m-long pier where container cargo is handled. It also handles cargo using a passenger pontoon and a private petroleum jetty. Other ports besides the two autonomous

ports are extremely small ports, with the exclusion of the petroleum jetty in Sihanoukville city and Oknha Mong Port (private).

Table 15.8. Facilities at Sihanoukville Port and Phnom Penh Port

Port Name	Channel	Berth					Other Facilities & Remarks
		Name	Structure	Length	Depth	Year	
Sihanoukville Port	[South Channel] Length 5.5km Depth: 8.4m Width: 80-100m	No. 1-2	Jetty	290m	9.0m	1960	[Warehouses]
		No. 3-4	Jetty	290m	9.0m	1960	5 buildings, 36,600m ²
		No. 5-7	-	350m	7.5m	1969	[Container yard]
		No. 8-9	-	400m	9.0m	2006	3 yards, 110,000m ²
	[North Channel] Length 1km Depth: 10m Width: 150-200m	(Private Facilities)					-
		Sokmex	Jetty	200m	9.2m	-	
		-	Pontoon	110m	6.5m	-	
		-	Stone Wharf	53m	4.2m	-	
Phnom Penh Port	Maintenance dredging (at Chaktmok) Depth: 7m Width: 60m Length: 1,290m Volume: 159,648m ³	Port No.1					[Container Yards] 2 yards for laden containers, 1 yards for empty containers
		No.1	Jetty, apron width 20m	Total 300m	-	-	
		No.2			-	-	
		No.3			-	-	
		Port No.2 (for passengers)					1km downstream from Port No.1
		No.5b	Pontoon	-	-	-	
		No.5c	Pontoon	-	-	-	
		(Private Facilities)					Between 4 and 13km upstream from Phnom Penh
-	8 facilities for oil berges	Ship size from 600-1,000DWT		-			

Source: Prepared based on the Study on the Master Plan for Maritime and Port Sectors in Cambodia, March 2007, Japan International Cooperation Agency (JICA).

Fig. 15.11a. Annual cargo handling volume at international trade ports in Cambodia (2005)

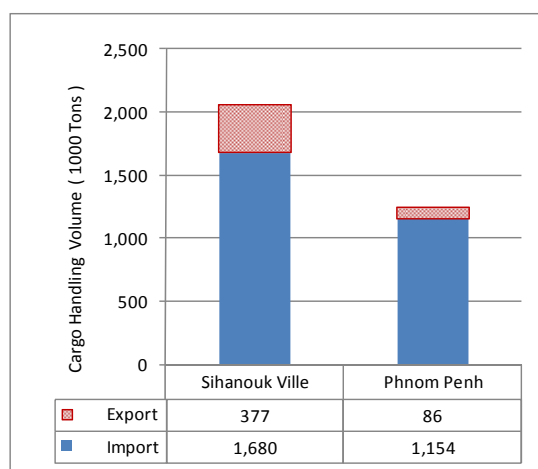
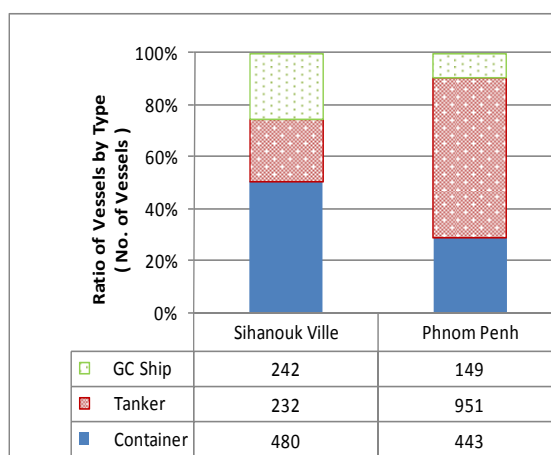


Fig. 15.11b. Number of vessels entering the two international trade ports in Cambodia per year (by type of vessel, 2005)



Source: Created based on the Study on the Master Plan for maritime and Port Sectors in Cambodia,

Fig. 15.12a. Trends in container cargo volume at international trade ports in Cambodia

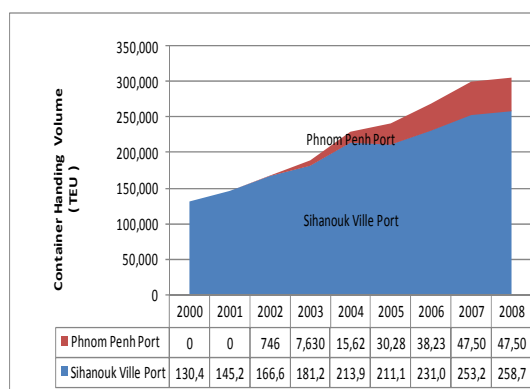
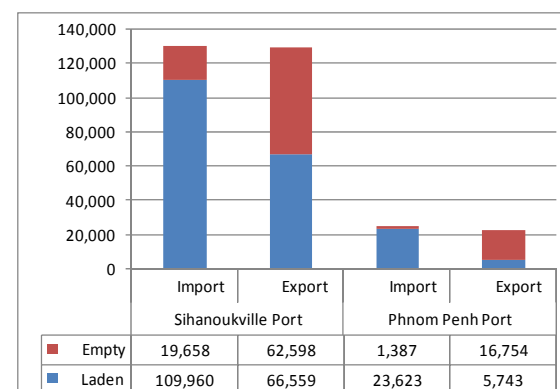


Fig. 15.12b. Ratio of empty and laden containers (2006)



Source: Study on the Master Plan for Maritime and Port Sectors in Cambodia, March 2007, JICA (Source: SPA & PPAP).

15.5.2. Status of Port Usage

Sihanoukville Port has a cargo handling volume of approximately 1.6 million tons, and Phnom Penh Port, approximately 740,000 tons. Both ports have been steadily expanding their handling volume, particularly containers. Sihanoukville Port accommodated approximately 700 vessels in 2005, and Phnom Penh Port 1,070 vessels (mostly small barges). Container vessels account for 60% of vessels entering Sihanoukville Port. On the other hand, tanker barges account for 65% of vessels in Phnom Penh Port. At Sihanoukville Port, the development of a special economic development zone of 70ha that is integral with the port is underway with Japanese aid, in conjunction with the development of a container terminal. Sihanoukville port is making a vital contribution to

Fig. 15.13a. Composition of goods handled at Sihanoukville Port (2006)

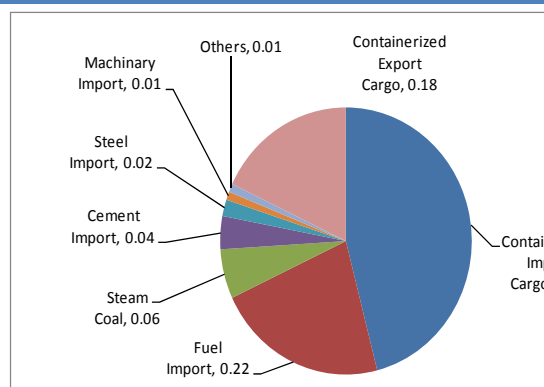
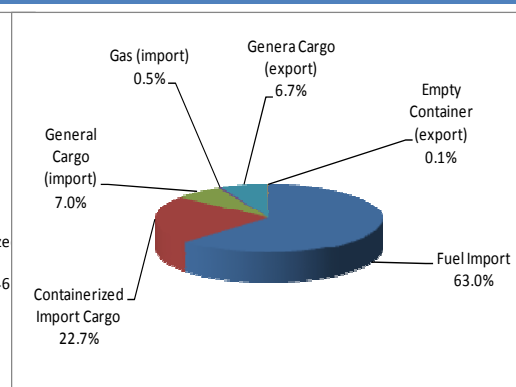


Fig. 15.13b. Composition of goods handled at Phnom Penh Port (2005)



Source: Study on the Master Plan for Maritime and Port Sectors in Cambodia, March 2007, JICA (Source: SPA & PPAP).

the development of oil industry. Six offshore oil fields are being developed off the coast of Sihanoukville. As a supply base for their development, materials and equipment for trial exploration and drilling are stored and supplied at Sihanoukville Port.

15.6. Inland Waterway

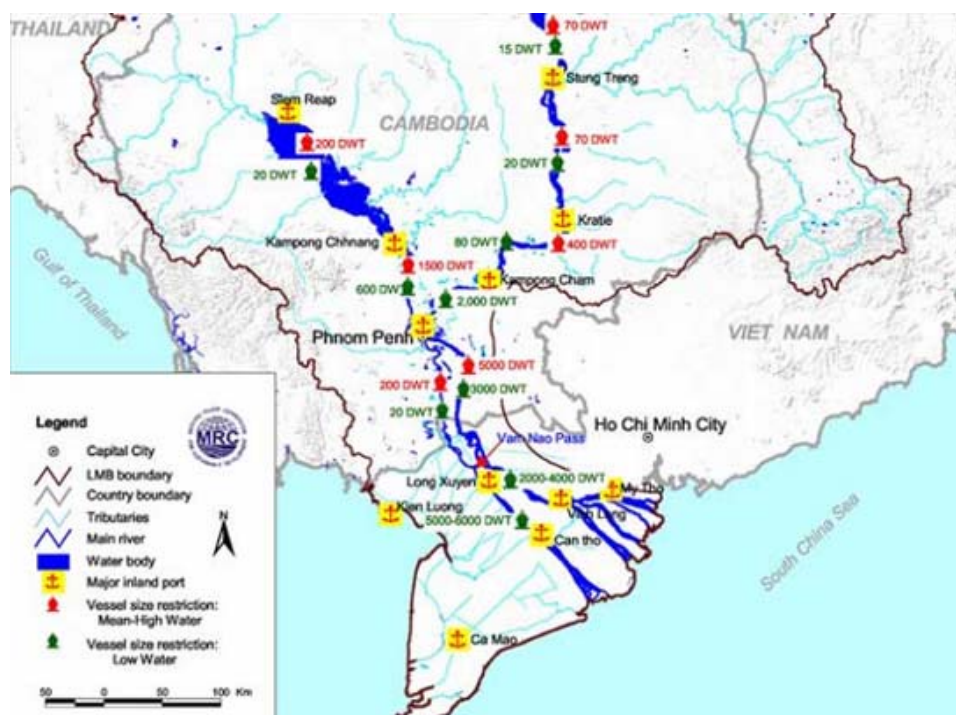
15.6.1. Present State of River Navigation

Cambodia's navigable inland waterways measure a total length of 1,750km. The Mekong accounts for 30% of the total, the Tonle Sap River 15%, the Bassac River 5%, and other tributaries 50%. Year-round navigation is possible through 580km.

Table 15.9. Maximum navigable vessel size in the Mekong River basin by section

	River Section	Length (km)	Year-round navigation possible?	Vessel Size Restriction (DWT)	
				Low Water	Mean-high water
Mekong	Golden Triangle - Luang Prabang	362	Yes - but is limited by rocky passages and strong currents		60
	Luang Prabang - Vientiane	425	Yes - but requires small boats and skilled pilots during dry season	15	60
	Vientiane - Savannakhet	459	Yes	200	500
	Savannakhet - Pakse	261	No "high water" only navigation possible	Less than 10	50
	Pakse - Khinak	151	Yes	50	
	Khinak - Veune Kham	14	No - navigation not possible at any time due to Khone Falls		
	Veune Kham - Stung Treng	30	Yes - with size limitations at low water	15	50
	Stung Treng - Kratie	128	Yes - with size limitations at low water	20	50
	Kratie - Kampong Cham	121	Yes	80	400
	Kampong Cham - Phnom Penh	100	Yes - navigable by sea-going ships	2,000	
	Phnom Penh - Junction of Vam Nao Pass	154	Yes - navigable by sea-going ships	3,000-4,000	5,000
	Vam Nao pass - South China Sea	194	Yes - navigable by sea-going ships	3,000-4,000	3,000- 4,000
Bassac River	Phnom Penh - Junction of Vam Nao Pass		Yes - but not possible by sea-going ships	20	50
	Vam Nao Pass - South China Sea	188	Yes - navigable sea-going ships	5,000	5,000- 6,000
Tonle Sap (Cambodia)	Phnom Penh - 5km South of Kampong Chhnang	94	Yes - navigable by sea-going ships	1,000	2,000
	Kampong Chhnang - Chhnoc Trou	46	Yes - with size limitations at low water	20	150
	Chhnoc Trou - Chong Kneas	109	Yes - with size limitations at low water	20	150
Mekong Delta Waterways	Dense network of man-made canals, natural creeks and Mekong tributaries, with a total navigable length of 4785 km	4,785	Yes - Vessel size restrictions within this network vary from 10-300DWT		
	Se-kong - Mekong tributary (Lao PDR and Cambodia)		Yes - this waterway is navigable between the Lao PDR and Cambodia, providing an alternative international transit corridor to the Mekong which is non-navigable through the Khone Falls		

Map 15.3. Maximum navigable vessel size in the Mekong River basin



Source: Master Plan for Waterborne Transport on the Mekong River System in Cambodia, Final report (Volume 1 Main Report, Draft), September 2006, Belgian Technical Cooperation

Table 15.10. Maximum navigable vessel size in the Mekong River basin

	Mekong Mainstream up to Phnom Penh	Mekong River, Phnom Penh to Kampon Cham	Tonle Sap, Phnom Penh to Siem Reap
Petroleum	Tanker barges 1,000 DWT / 4.0m draught	-	-
Container	Barges 1,900 DWT (120TEU) / Draught 3.8m	-	-
Generak Cargo	Barges 1,500 DWT / Draught 4.0m	-	-
Tourist Cruise Vessels	50-65 passengers Draught 1.5m	-	50-65 passengers Draught 1.5m
Speedboats	25 passengers shallow draught	-	25 passengers shallow draught

Source: Master Plan for Waterborne Transport on the Mekong River System in Cambodia, Final report (Volume 1 Main Report, Draft), September 2006, Belgian Technical Cooperation

15.6.2. Present State of Inland Water Transportation

A speedboat carries passengers between Phnom Penh and Siem Reap one round trip per day, during the seven months from August to February. The number of passengers using inland water transportation decreased from 129,000 in 2002 to 37,000 in 2005. 100-120DWT small ships are used for domestic cargo transportation in Phnom Penh Port, and carry mainly food items, such as fresh produce, and packed cement. Cargo handling volume has been sharply decreasing yearly, and has dropped to an estimated 5,700 tons in 2005.

15.7. Air Transportation

15.7.1. Present State of Airports

There are 11 airports in Cambodia, but regular flights are only available at four airports: the Phnom Penh and Siem Reap International Airports and the Sihanoukville and Rattanakiri Airports. Other than the two international airports, regular domestic flights are available only at Sihanoukville Airport (bound for Siem Reap) and Rattanakiri Airport (bound for Phnom Penh).

The Société Concessionnaire de l'Aéroport (SCA) has been undertaking operational management of Phnom Penh International Airport since 1995, Siem Reap International Airport since 2001, and Sihanoukville Airport since 2006, under BOT Agreements with the RGC. All other airports are managed by the State Secretariat of Civil Aviation (SSCA) of RGC.

Table 15.11. Operating status of airports in Cambodia

Airport Name	Runway (LxW, m)	ILS	Area (ha)	Owner/Managing Entity	Open/Close	Remarks
International Airport						
Phnom Penh	3000x45/Asphalt/4D	☆	387.00	RGC/SCA	Open	ILS for RWY 2003
Siem Reap	2550x45/Asphalt/4C	-	197.00	RGC/SCA	Open	ILS will come into service early 2008
Domestic Airport						
Sihanoukville	1795x34/Asphalt/3C	-	123.84	RGC/SCA	Open	Reopened January 15, 2007
Kampong Chhnang	2400x45/Concrete/4C	-	2011.00	RGC (Army)	Close	The area includes military use land
Battambang	1600x34/Bitumen/3C	-	128.68	RGC	Open	Open Regular and Charter
Stung Treng	1300x20-29/Bitumen/3C	-	112.50	RGC	Open	
Rattanakiri	1300x30/Laterite/3C	-	54.57	RGC	Open	Under ADB Project
Koh Kong	1300x30/Laterite/3C	-	125.31	RGC	Open	Open Regular and Charter
Monduliri	1500x30/Laterite/3C	-	46.27	RGC	Close	Temporary close July 20, 2007
Preah Vihear	1400x30/Laterite/3C	-	165.24	RGC	Close	
Krache	1200x30/Laterite/3C	-	112.50	RGC	Close	

15.7.2. Present State of Airport Usage

Fig. 15.14a. Passengers using Cambodia's international airports

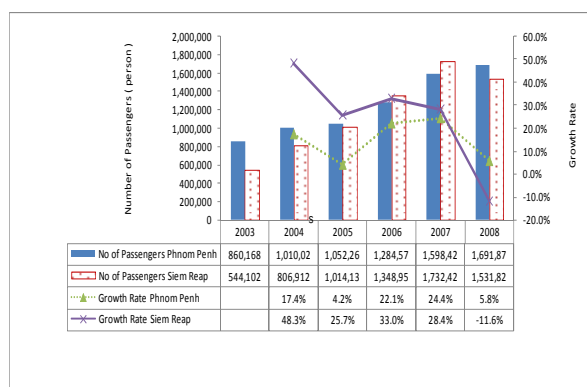
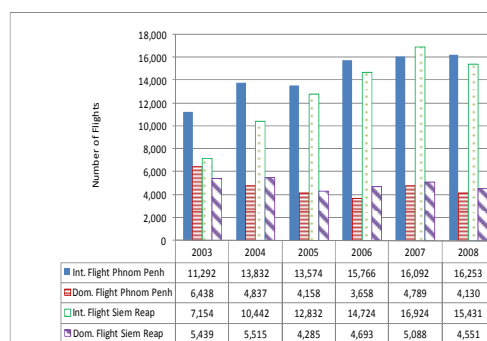


Fig. 15.14b. Flights arriving and departing from Cambodia's international airports



Source: Prepared based on SSCA materials.

The number of flights per year varies slightly from year to year, but between 2003 and 2006, it has increased approximately 1.4-fold at Phnom Penh International Airport and approximately 2.1-fold at Siem Reap International Airport. The number of domestic flights, on the other hand, has been decreasing.

The number of international flight passengers has been increasing yearly at Phnom Penh

Fig. 15.15a. Passengers using Phnom Penh International Airport.

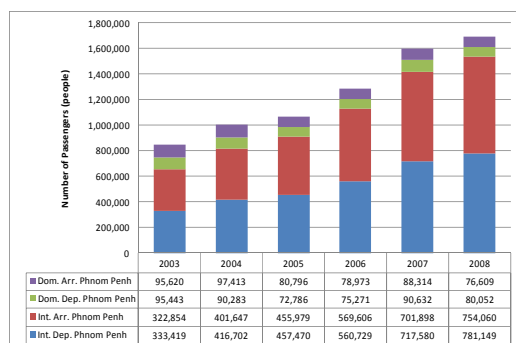
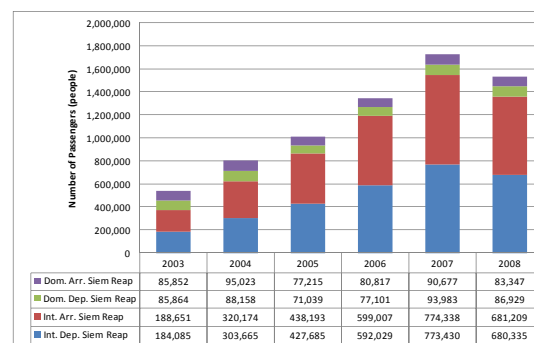


Fig. 15.15b. Passengers using Siem Reap International Airport.



Source: Prepared based on SSCA materials. (Project Profile and Progress (Civil Aviation), SSCA)

International Airport, and reached 1.17 million in 2006. When combined with the number of domestic flight passengers, the airport is used by some 1.3 million passengers a year. Domestic flight passengers have been significantly decreasing since 2005, but the number has remained steady since 2006. At Siem Reap International Airport, the number of

international flight passengers has been rapidly increasing in recent years. In 2006, it accommodated the largest number of passengers of all airports in Cambodia, exceeding even Phnom Penh International Airport. However, like Phnom Penh International Airport, the number of domestic flight passengers has been decreasing.

15.8. Policy Issues in Road Infrastructure

Overall, the modes of transport in Cambodia consists of the road network, inland waterways and air transport. Road transport accounts for the largest share of total volume of passengers and freight. However, road conditions are faced with the following problems: (i) poor pavement conditions; (ii) insufficient road width; (iii) insufficient road standard for international routes; (iv) insufficient road slope protection against flood; and road maintenance problem. Road maintenance has been the most critical problem, as it is key to prolong the life of a road and the lack of road maintenance has caused the deterioration of most roads.

However, railway and inland waterways have higher energy consumption efficiencies per unit of transported volume than road transport and are superior in terms of long distance mass volume transit. They connect Cambodia's key centers and provide linkages with the road network. Moreover, the development of railway and inland waterways will mitigate the negative impacts of road transportation, such as: increase in maintenance costs caused by pavement damage; traffic congestion; traffic accidents; and negative environmental impacts (noise, air pollution and vibration).

The RGC has introduced some innovative approach in air transportation by putting more emphasis on public-private partnership (PPP) in airport reconstruction and management. This allows Cambodia to rapidly modernize air transport infrastructure, especially in the major tourism centers. However, air transport infrastructure in remote provinces with low commercial activities remain in the state of neglect.

Other policy issues are poor provision of traffic safety facilities, missing road links, low paved road ratio, vulnerability to flood, increased road accidents and traffic congestion in major cities and areas.

Infrastructure is sine qua non, but not sufficient to attract foreign investment. Soft infrastructure plays now an important role in socio-economic development. Therefore, in addition to the investment in hardware infrastructure, reforms in soft-infrastructure, such as trade facilitation, efficient cross-border control and the development of trans-boundary insurance scheme will be crucial in industrial corridor development in Cambodia.

Chapter 16

Energy Sector

16.1. Overview

The provision of energy is a major dimension in development; it is a household necessity in a modern society and is a production factor the cost of which directly affects the competitiveness of a range of goods and services where it is a direct or indirect input. The energy potential of Cambodia is still not fully known. A thorough exploration and mapping of the geographical distribution of all available sources of energy is needed for Cambodia to enable a more systematic development of the energy sector. The availability of reasonably priced power is a key ingredient of rural development, particularly in such activities as irrigation, processing of agricultural products, and SME development. The high cost of rural electricity is an important reason for the slow development of the Cambodian rural economy.

16.1.1. Power Sector Strategy

Cambodian's Power Sector Strategy (2001-2005) sets out the priorities and a major investment program to lower tariffs and bring reliable electricity supplies to considerably more Cambodians. The investment program includes: (1) the development of a generation and transmission grid to link large electricity generation units to Phnom Penh and the provincial capitals; (2) rehabilitation of distribution systems in provincial towns; and (3) the development and implementation of rural electrification plan. Rehabilitation and expansion of Phnom Penh's electricity supply system is being continued. Generation capacity is also being expanded with an interconnection from Viet Nam and over the next five years from a new thermal plant in the coastal area. These improvements will enable a more reliable and secure electricity supply to the regions outside of Phnom Penh, which will help deconcentrate the development of industry.

The program to establish the National Generation and Transmission Grid commenced in 2000. The first stage of this program is the construction of transmission line between Viet Nam and Phnom Penh through Takeo Province. The second stage is the construction of transmission line from Sihanoukville to Kampot province. It will allow generating units to be established in the coastal area to provide supplies to provincial cities between Sihanoukville and Phnom Penh and also increase the capacity available to Phnom Penh. By establishing generation capacity in the coastal area, it will lessen the need to transport fuel

on the Mekong reducing the danger of oil spills and environmental damage. The portion of transmission line from Phnom Penh to border of Viet Nam through Takeo will be established first to enable electricity import from Viet Nam. The 220 kV interconnection from Viet Nam will supply power to communities in the south and increase capacity available to Phnom Penh.

The strategy for development of the energy sector envisages the following priorities: (i) production capacity expansion (promotion of motivation to invest in electricity production); (ii) development of energy infrastructure and services through private sector involvement; (iii) funding development activities in the energy sector; (iv) diversifying energy sources; (v) improving and securing access of population to domestic fuels; and (vi) strengthening rural electrification.

16.1.2. Rural Electrification

A five-year rural electrification program including renewable energy is also being implemented. The total cost of the first portion of power transmission and rural electrification project is estimated at US\$89 million. Another 115 kV interconnection transmission line was also established to connect Thailand to Banteay Meanchey, Battambang and Siem Reap provinces to support the Provincial and Rural Electricity Program. The plans also include developing a hydropower project initially in Kamchay and thereafter in Stung Battambang, Stung Atay and Russey Chrum.

Consideration of hydroelectric stations in Cambodian will require achieving the necessary balance between growth, environmental and social equity objectives. Efforts should be made to avoid the mistakes of neighbouring countries, where the development of hydropower has led to environmental, social and economic problems. Rural electrification should be geared to maximize rural employment creation and generate higher incomes for the poor.

RGC set up in 2004, with the support of the World Bank, the Rural Electrification Fund (REF) with the objective of making available access to electricity at a reasonable price to the rural population for economic, social, and domestic consumption. The REF is funded through grants, subsidies, and borrowings. “Smart subsidy” mechanisms envisaged under the REF will encourage entrepreneurs to invest in the production and distribution of rural electricity, in particular in renewable energy projects.

16.2. Electricity Production

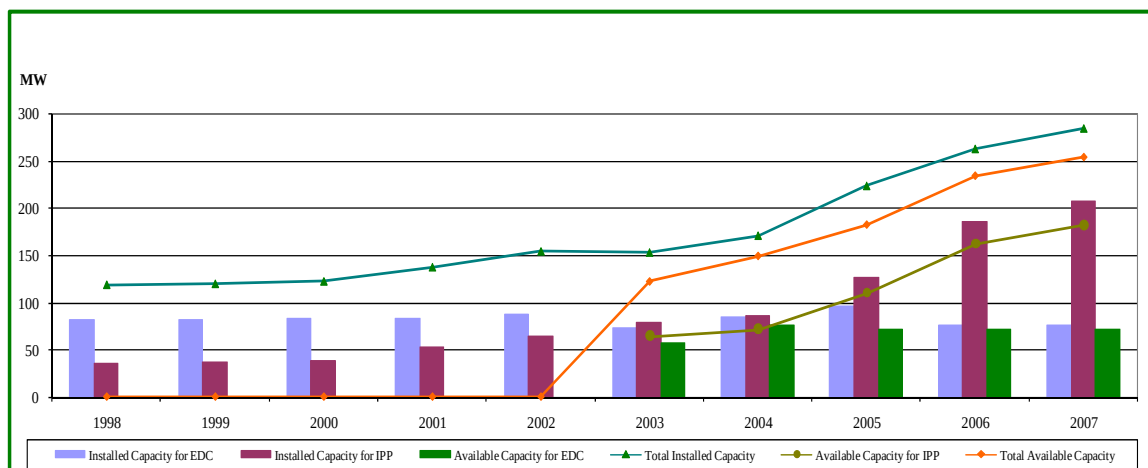
The production and distribution of electricity are assured by Électricité du Cambodge (EDC), an SOE established in 1992. In March 1996, EDC was converted as a public

company with the principal mission of producing, transporting, and distributing electrical energy throughout Cambodia. Despite EDC's effort Cambodia still suffers from serious shortfalls in its electricity supply. The agenda ahead is clear. Electricity supply must first be made more reliable and energy production operations more profitable attract investment. Rural electrification, capacity building at the EDC, and development of financial self-sufficiency in the sector are other key priorities.

16.2.1. Installed Capacity

Figure 16.1. shows the installed capacity for power generation in Cambodia. Installed power capacity in Cambodia increased from 95 MW in 1998 to 129 MW in 2000 and to 157.4 MW in 2002, then to 284.5 MW in 2007.

Figure 16.1. Installed electricity capacity



Source: *Électricité du Cambodge*

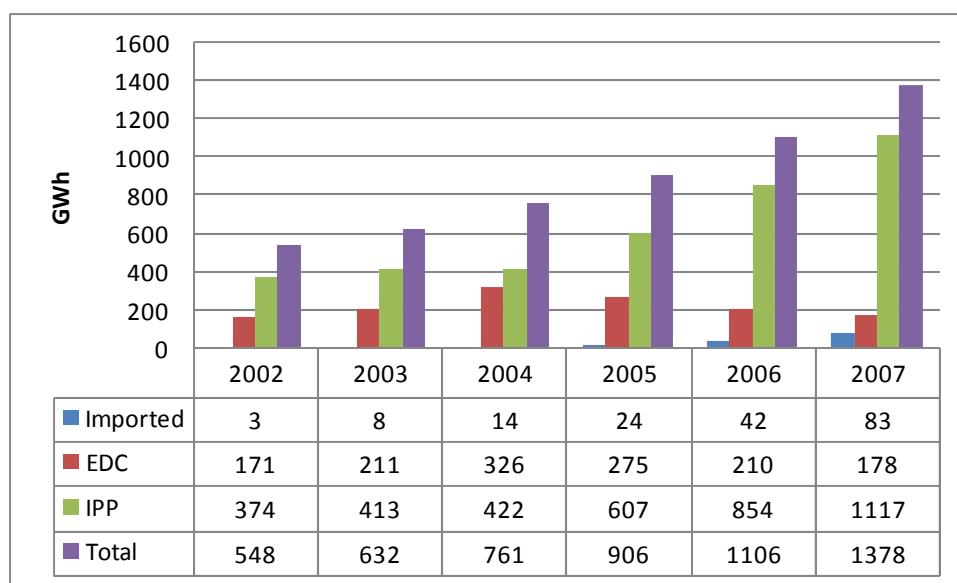
To make up for the gap between demand and supply Cambodia plans to purchase electricity from neighboring countries, Thailand and Viet Nam, and thereby increase the power supply capacity to 390 MW in 2007. Of this, of which EDC's installed capacity accounted for 20%, IPP—53% and imported 27%. Electricity is transmitted through a local production and distribution grid which gives priority to urban areas. In rural zones, where reliable electricity supply cannot be offered, some consumers use generators.

16.2.2. Electricity output

Electricity production in Cambodia increased from 548 GWh (gigawatt hours) in 2002 to 1,378 GWh in 2007. Phnom Penh is the leading electricity producing center, with 90% of

the national generation. IPP's electricity output accounts for 81% of total output, followed by EDC's output (13%) and imported (6%). The cost per kWh produced is about \$0.15, very high in comparison with other countries in the region. The main causes of this high cost are: small power plants, non-optimal mix of energy sources, the relatively low-capacity, diesel-fired power plants, and high management costs. Because of these high costs, the energy sector constitutes a major obstacle to development of the economy in general and of the private sector in particular.

Figure 16.2. Electricity output (GWh)



Source: Électricité du Cambodge

To address the high cost of power supply the government has begun selecting Independent Electricity Producers through a competitive bidding procedure and is promoting private sector investment and involvement in electricity distribution in the large provincial and urban centers and in rural areas. These initiatives have helped increase the total production of electricity in Phnom Penh and in provincial towns from 414.9 GWh in 1998 to 1,378 GWh in 2007, or an average annual growth of 33%. The increased production has been achieved at a marginal cost lower than the average cost of power generation. With the support of Cambodia's development partners and the private sector, a number of energy projects have now been completed or are under construction. The planning of several new projects has begun. Completed projects to date include:

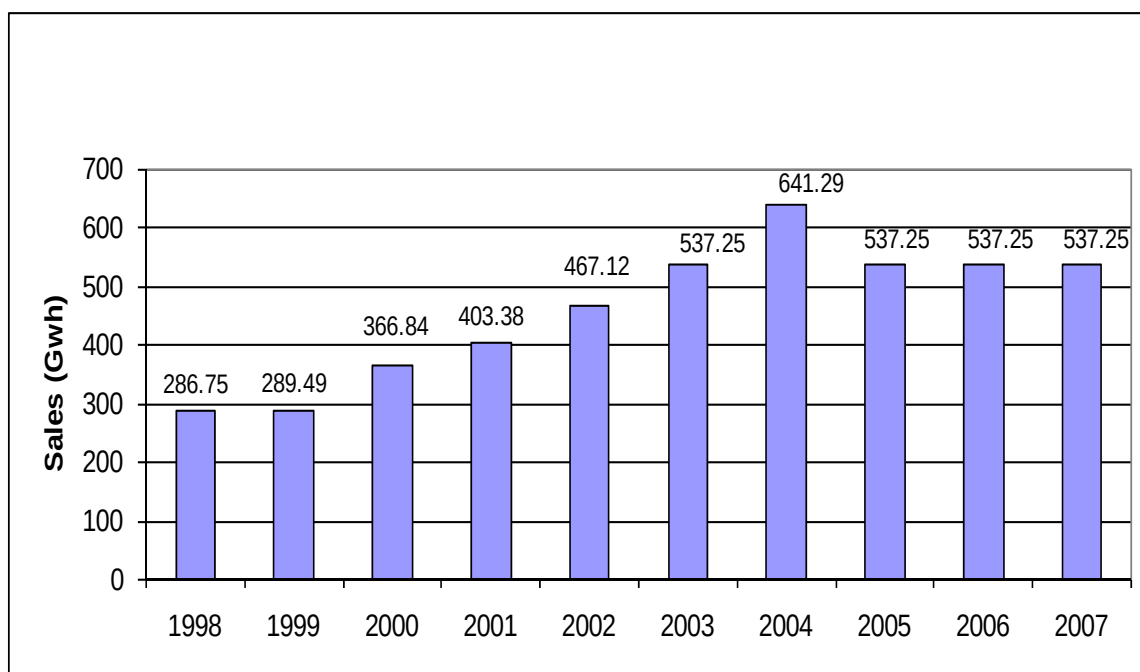
- The electricity grid in four suburban divisions of Phnom Penh completed in 2001 and now serving some 10,000 new users. This project was financed by Japanese assistance (US\$26.8 million).

- Refurbishing the Kirirom I hydroelectric plant, 12 MW, and transmission lines between the power plant and Phnom Penh completed in 2002 under a BOT agreement with a Chinese company CETIC.
- Construction of a new 10 MW power plant in Siem Reap completed in March 2004 at a cost of US\$17.04 million, financed by Japan.

Donors whose focus is on electricity sector rehabilitation include Australia, ADB, the World Bank, France, Japan, and Sweden. The private sector contribution is growing, with the construction of the Phnom Penh power plant IPP1-CUPL (35 MW), completed in 1996 and IPP2-Jupiter (15 MW). Agreements were signed for the construction of the IEP power plant (30 MW) in 2005. Rehabilitation work on the electricity grids of eight provincial towns was completed by in 2005. Projects in seven towns (Kampot, Prey Veng, Banteay Meanchey, Rattanakiri, Kampong Speu, Takeo, and Svay Rieng) were financed by an \$18.6-million loan from the ADB. The eighth project, in the town of Stung Treng, was funded by AFD grant of Euro 3.75 million.

16.2.3. Electricity Sales

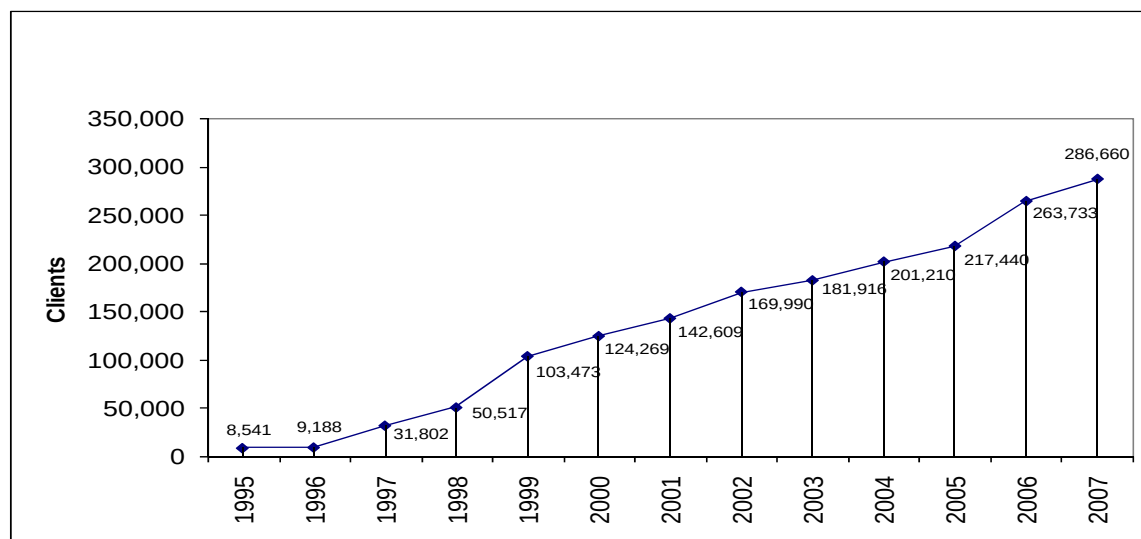
Figure 16.3. Electricity sales 1998-2007



Source: *Électricité du Cambodge*

The sale of electricity has increased from year to year to reach about 537 GWh in 2007, as power demand increased rapidly, on average by 15-20% a year. The number of EDC customers also increased rapidly.

Figure 16.4. Growth of EDC customers 1995-2007



Source: *Électricité du Cambodge*

In 2007, there was an energy deficit of nearly 30 MW in Cambodia. EDC explained this deficit as being due to inadequate generation capacity, the strong upswing in grid demand and the delay in mobilizing the financing necessary for completion of the new investments. The country continues to suffer from the deficit situation from time to time resulting in frequent unscheduled power cuts and consumers resorting to the installation of high cost and inefficient diesel run generation sets to get uninterrupted power supply.

The share of petroleum products and electricity in the business costs remains high. This is due in large measure to the heavy tax on imported oil and oil products used to produce conventional energy and to production inefficiency. This cost significantly reduces the competitiveness of businesses. In addition it affects the well being of households, and is of considerable annoyance to public administration, businesses, as well as trade, and even the health sector.

Reform of the power sector aims to secure and guarantee continuous supply of electricity for communities and businesses at reasonable prices and speed up electrification in both urban and rural areas. The reform provides for the gradual separation of the functions of production, transmission and distribution in order to stimulate competition. To achieve these aims, new laws to establish a legal framework for the regulation and restructuring of

the sector including the creation of the Cambodian Electricity Authority are under preparation.

Table 16.1. Installed capacity and maximum output of electricity (in MW)

Lieu		1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
PHN		66.60	85.00	100.50	95.00	101.00	101.00	121.40	141.90	192.40	200.49
EDC	EDC	41.60	59.00	55.50	50.00	50.00	50.00	58.40	43.00	42.60	42.60
IPP-1	IPP	5.00	6.00	0.00	-	-	-	-	-	-	-
CUPL	IPP	-	-	-	30.00	30.00	30.00	31.00	31.90	31.90	31.99
JUPITER	IPP	-	-	5.00	15.00	15.00	15.00	22.00	22.00	-	-
Tang Heang	IPP	-	-	-	-	-	-	-	-	-	8.00
CITEC	IPP	-	-	-	-	6.00	6.00	10.00	10.00	11.00	11.00
KEP	IPP	-	-	-	-	-	-	-	30.00	45.00	45.00
City Power	IPP	-	-	-	-	-	-	-	5.00	6.90	6.90
CEP	IPP	-	-	-	-	-	-	-	-	45.00	45.00
COLBEN	IPP	-	-	-	-	-	-	-	-	10.00	10.00
SRP		2.40	2.80	2.80	4.00	6.90	6.90	10.50	10.50	15.00	58.80
	IPP	-	1.45	1.45	4.00	6.90	6.90	-	-	4.50	8.30
	EDC	2.40	1.35	1.35	-	-	-	10.50	10.50	10.50	10.50
	IMP	-	-	-	-	-	-	-	-	-	40.00
SHV		8.94	7.80	7.80	7.00	7.00	7.00	6.30	6.20	6.20	13.20
	IPP	-	-	-	-	-	-	-	-	-	7.00
	EDC	-	-	-	7.00	7.00	7.00	6.30	6.20	6.20	6.20
KGC	IPP	.44	.66	.66	2.00	2.00	2.00	4.26	4.26	1.90	1.90
PKK	IMP	-	-	-	-	0.70	0.70	0.70	2.00	2.00	5.00
MMT	IMP	-	-	-	-	1.75	1.75	1.75	3.00	3.00	5.00
TKO		-	-	0.90	-	-	-	-	1.50	1.50	1.50
	IPP	-	-	.90	-	-	-	-	-	-	-
	EDC	-	-	-	-	-	-	-	1.50	1.50	1.50
BTB		6.00	-	-	3.50	5.00	5.00	5.10	6.50	6.50	26.90
	IPP	6.00	-	-	2.70	4.20	4.20	4.30	5.70	5.70	6.10
	EDC	-	-	-	0.80	0.80	0.80	0.80	0.80	0.80	0.80
	IMP	-	-	-	-	-	-	-	-	-	20.00
BVT	IMP	-	-	-	-	0.80	0.80	0.80	2.00	2.00	5.00
KGT	IMP	-	-	-	-	-	1.00	1.00	1.00	1.00	3.00
KPT		-	-	-	-	-	-	-	3.00	3.00	3.00
	IPP	-	-	-	-	-	-	-	-	-	-
	EDC	-	-	-	-	-	-	-	3.00	3.00	3.00
PRV		-	-	-	-	-	-	-	2.35	1.50	1.50
	IPP	-	-	-	-	-	-	-	0.85	-	-
	EDC	-	-	-	-	-	-	-	1.50	1.50	1.50
SVR	IMP	-	-	-	-	-	-	-	2.00	7.50	7.50
BTC		-	-	-	-	-	-	-	3.00	3.00	23.00
	EDC	-	-	-	-	-	-	-	3.00	3.00	3.00
	IMP	-	-	-	-	-	-	-	-	-	20.00
STR	EDC	-	-	-	-	-	-	-	1.50	1.50	1.50
RTK		-	-	-	-	-	-	1.36	1.36	1.36	1.76
	IPP	-	-	-	-	-	-	0.40	0.40	0.40	0.80
	EDC	-	-	-	-	-	-	0.96	0.96	0.96	0.96
TOTAL	EDC	4.00	60.35	6.85	57.80	57.80	57.80	76.96	1.96	71.56	71.56
	IEP	2.44	29.11	9.01	53.70	64.10	64.10	71.96	110.11	162.30	181.99
	IMP	-	-	-	-	3.25	4.25	4.25	10.00	15.50	105.50
	TOTAL	76.44	9.46	105.86	111.50	125.15	126.15	153.17	192.07	249.36	359.05

16.3. Power Development Plan

The RCG policy aims at: providing an adequate supply of energy at an affordable price, ensuring reliability and secure electricity supply and encouraging efficient use of energy.

16.3.1. Power Demand Forecast

According to Power Development Plan of the Kingdom of Cambodia in 2007, electricity demand is expected to face a significant increase for the next 14 years. Electricity generation in Cambodia is projected to grow from 329 MW and 1,548 GWh in year 2006 to 1,539 MW and 8,176 GWh in year 2020. To meet the future demand, The Royal Government has developed *Power Development Plan for a period of 2008-2021*. The Table below depicts the expected power and energy output for Cambodia.

Table 16.2. Projected Power Generation

<i>Year</i>	<i>2009</i>	<i>2010</i>	<i>2015</i>	<i>2020</i>
Power, MW	808	1,015	1,915	3,867
Energy, GWh	1,550	1,895	3,500	8,300

Source: EDC

16.3.2. Generation Master Plan

Generation Master Plan has been developed on the following criteria: (i) Peak thermal generation in Phnom-Penh; (ii) Small and medium size diesel units for base and peak load generation in the provincial towns and cities; and (iii) Expanded hydro development based initially on smaller size hydro easily accessible such as Kirirom, Kamchay and subsequently mid size hydro projects Stung Atay, Middle Stung Russei Chrum, Battambang, Lower Srepok II or Lower Sesan. The Kamchay hydropower plant with 193 MW capacities is under construction and planned for operation in 2010 on BOT basis.

The plan has been developed by taking into account the following strategies: (i) Reduce reliance on imported oil for energy generation (diversification of energy sources); (ii) Increase operational efficiency of the system (minimize losses); (iii) Encourage least cost development of provincial load centers by mixing of grid expansion and local private generation; and (iv) Increase competition in power generation by providing access to competitively priced external sources of energy from Vietnam, Thailand and Lao PDR.

Table 16.3. Generation Plan for 2008-2021

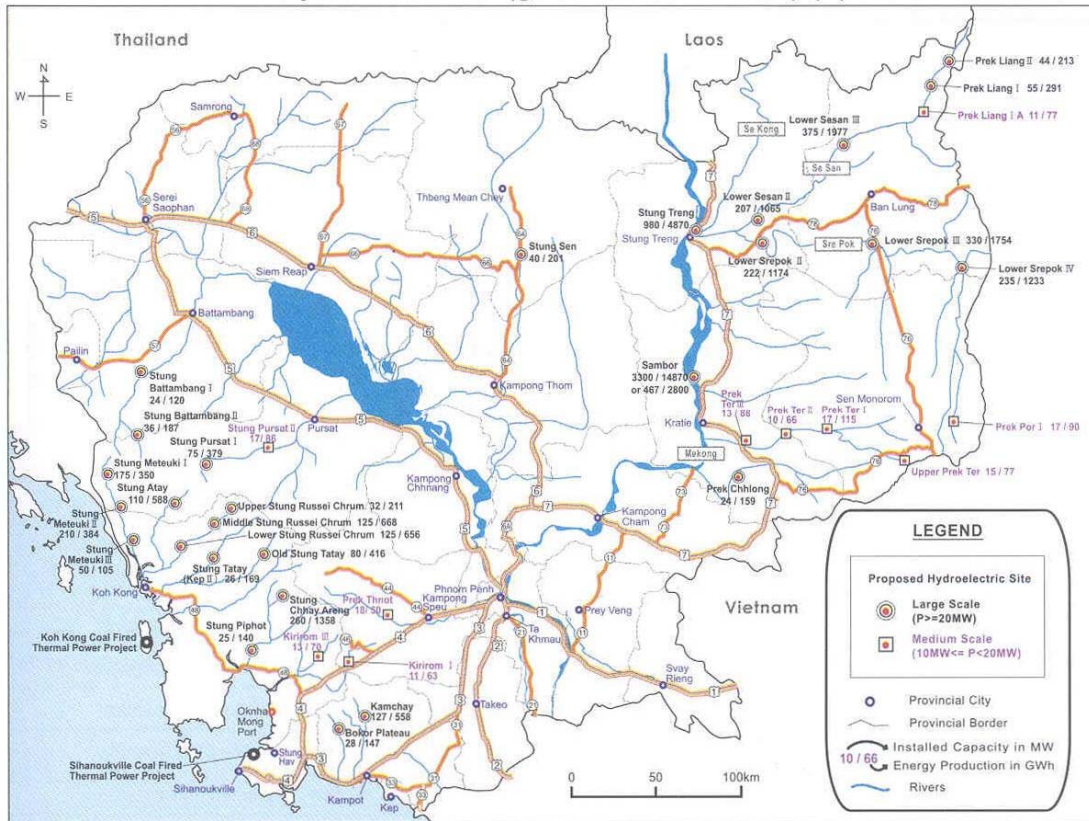
Year	Name of project	High case		
		Line type	Section (mm ²)	Ling length
2008	Establish 230kV Viet Nam-Phnom Penh S/S connection*	D-C	630,400	111
2010	230kV Takeo-Kampot	D-C	400	100
2011	115kV Kampong Cham-Kratie	D-C	630	87
2010	115kV Laos-Stung Treng	D-C	240	56
2010	115kV Vietnam-Suong-Kreak-Kampong Cham	D-C	400	64
2010	230kV Kampot-Sihanoukville	D-C	630	82
2011	230kV Kampot-Kamchay Hydro connection	D-C	630	20
2011	115kV Stnung Treng - Kratie	D-C	400	130
2012	230kV WPP-Kampong Chhnang-pursat-Battambang	D-C	630*2B	310
2012	230kV Pursat-O soam	D-C	630	80
2012	115kV O soam-Attay include S/S	D-C	630	30
2012	115kV GS1-NPP-WPP	D-C	250*2B	28
2012	115kVGS2-SPP- WPP	D-C	250*2B	25
2012	115/230kV NPP-Kampong Cham	D-C	630*2B	120
2013	230kV Lover&upper Russei Chhroum- O soam	D-C	630	30
2013	230kV WPP-SHV include Real Rinh S/S	D-C	630	220
2014	115kV SPP-EPP-NPP	D-C	250	20
2014	115kV EPP-Neak Loeung-Svay Rieng S/S connection	D-C	250*2B	122
2017	230kV Kratie-Lower Se San2 - Vietnam	D-C	630	90
2017	230kV WPP-NPP	D-C	630	25
2017	230kV NPP-Kampong Cham-Kratie-Se san2-Viet Nam	D-C	630	300
2018	230kV Sre Ambil-Koh Kong-O Soam	D-C	400	200
2019	230kV Sambor - Kratie	D-C	630	30
2021	230kV Kampong Cham-Kampong Thom-Siem Reap -Battambang-Thai	D-C	630	350

Source: EDC

Cambodia has considerable potential for hydro power generation, which will allow the country to generate electricity at lower costs to promote socio-economic development. Map 16.1. illustrates hydro potential in Cambodia.

Map 16.1. Cambodia's Hydro Potential

Hydro Potential (greater than 10MW) (3)



16.3.3. Transmission Line

16.3.3.1. Power Interconnection with Thailand

The Power Cooperation Agreement (MOU) with Thailand was signed in 3rd February 2000. At present Electric Power between Cambodia and Thailand is transmitted at 22 kV and 115 kV levels. An agreement was signed with Trat Province (Thailand) to supply power to Koh Kong province (Cambodia) and Poit Pet (Cambodia) by using 22 kV line. The above areas have been connected since 2001. Recently, 115 kV transmission line from Arranh Prathet substation, Thailand connection to Banteay Meanchey, Battambang and Siem Reap provinces has been commissioned in 2007.

16.3.3.2. Power Interconnection with Vietnam

The Power Cooperation with Vietnam was signed in 10th June 1999. Since 2002, EDC is importing power from PC2 to supply to Keo Seima District Monduliri Province, Snuol District Kratie Province, Memut and Ponhea Krek District Kampong Cham Province,

Bavet Svay Rieng Province, Chrey Thom Kandal Province, Kampong Trach Kampot Province. For the areas of Koh Roka Prey Veng Province, Phnom Den Takeo Province, the connection was established in 2008. The interconnection transmission project for import power from Viet Nam to Phnom Penh by 230 kV is under construction started in 2009. Recently the government of Cambodia and Viet Nam is preparing the 115 kV interconnection transmission project between Kampong Cham province and Tay Ninh province of Viet Nam.

Table 16.4. Transmission Planning 2008-21

<i>Year</i>	<i>Name of project</i>	<i>High case</i>		
		Line type	Section (mm ²)	Ling length
2008	Establish 230kV Viet Nam-Phnom Penh S/S connection*	D-C	630,400	111
2010	230kV Takeo-Kampot	D-C	400	100
2011	115kV Kampong Cham-Kratie	D-C	630	87
2010	115kV Laos-Stung Treng	D-C	240	56
2010	115kV Vietnam-Suong-Kreak-Kampong Cham	D-C	400	64
2010	230kV Kampot-Sihanoukville	D-C	630	82
2011	230kV Kampot-Kamchay Hydro connection	D-C	630	20
2011	115kV Stung Treng - Kratie	D-C	400	130
2012	230kV WPP-Kampong Chhnang-pursat-Battambang	D-C	630*2B	310
2012	230kV Pursat-O soam	D-C	630	80
2012	115kV O soam-Attay include S/S	D-C	630	30
2012	115kV GS1-NPP-WPP	D-C	250*2B	28
2012	115kVGS2-SPP- WPP	D-C	250*2B	25
2012	115/230kV NPP-Kampong Cham	D-C	630*2B	120
2013	230kV Lower&upper Russei Chhroum- O soam	D-C	630	30
2013	230kV WPP-SHV include Real Rinh S/S	D-C	630	220
2014	115kV SPP-EPP-NPP	D-C	250	20
2014	115kV EPP-Neak Loeung-Svay Rieng S/S connection	D-C	250*2B	122
2017	230kV Kratie-Lower Se San2 - Vietnam	D-C	630	90
2017	230kV WPP-NPP	D-C	630	25
2017	230kV NPP-Kampong Cham-Kratie-Se san2-Viet Nam	D-C	630	300
2018	230kV Sre Ambil-Koh Kong-O Soam	D-C	400	200
2019	230kV Sambor - Kratie	D-C	630	30
2021	230kV Kampong Cham-Kampong Thom-Siem Reap -Battambang-Thai	D-C	630	350

The Power Cooperation with Vietnam was signed in 21st October 1999. The agreement aims at the cooperation in Power Sector between the two countries. The supply of power to the areas along the border by medium voltage (22kV) line and interconnection between high voltage links are also encouraged. Both countries have discussed and agreed on power interconnection from Southern part of Lao PDR (Ban Hat, Cham Pasak Province) to Stung Treng of Cambodia by 115 kV line.

Interconnections between the isolated grids of the countries within the Mekong Basin (Cambodia, Laos, Thailand, Vietnam, Yunan-China and Myanmar) or even a further extension of this grid to include Malaysia and Singapore have been subjected to a number of studies which aim at improving the utilization of energy resources. An ASEAN interconnection Master plan has been adopted in 2002 to develop ASEAN Power Grid (APG).

PART VI

HUMAN RESOURCE DEVELOPMENT

Chapter 17. Poverty Situation

Chapter 18. Education

Chapter 19. Health



Chapter 17

Poverty Situation

At the end of the Khmer Rouge regime the entire population of Cambodia was living below the poverty line. Economic liberalization in the 1990s returned normalcy to the country and development over more than two decades has improved the poverty situation. Poverty receded from 43% in 1993/94 to 30% in 2007.

17.1. Dimensions and Characteristics of Poverty

17.1.1. Updating the Poverty Line

Cambodia's poverty lines consist of a single national food poverty line (based on an unchanging reference food bundle) and three region-specific nonfood allowances. The Cambodia poverty lines are expressed as daily per capita levels of food and nonfood consumption in the current prices of each region (i.e., Phnom Penh, Other Urban and Rural).

17.1.1.1. Updated Food Poverty Lines

The food poverty lines for each region are based on the estimated cost of consuming a single national reference food bundle providing an average subsistence diet of 2,100 calories per day (i.e., averaged over persons of all ages and both sexes). A three-step procedure was used to update the 2004 food poverty lines to 2007: (1) use the village food price data collected in the CSES in all three regions (i.e., Phnom Penh, Other Urban, Rural) and the quantity weights from the 1993/94 baseline reference food bundle to estimate spatial (regional) differences in food prices in 2004 and 2007, (2) estimate food price inflation in Phnom Penh using price data from the Phnom Penh CPI and quantity weights from the 1993/94 baseline reference food bundle, and (3) combine the temporal price index for Phnom Penh with the spatial price index to obtain temporal price indices for the remaining two regions.

Poverty line is defined as the income threshold below which the household (or individual) is considered poor. The individual poverty line set by the government is based on the consumer expenditure necessary to obtain 2,100 food calories a day, plus a minimum of non-food items computed according to the level of development of the commune.

Table 17.1. presents the updated food poverty lines for 2007 that are obtained by multiplying the food poverty lines for 2004 in column 1 by the 2007 values of the temporal price indices.

Table 17.1. Updated food poverty lines, 2004 and 2007

<i>Region</i>	<i>2004*</i>	<i>2007*</i>
Phnom Penh	1,782	2,445
Other urban	1,568	2,274
Rural	1,389	1,965

Source: WB (2009). Poverty Profile and Trend in Cambodia.

17.1.1.2. Updated Nonfood Allowances

Table 17.2 presents the inflation-adjusted regional nonfood allowances and the overall poverty lines (i.e., the sum of the updated food poverty lines in Table 1 and the updated nonfood allowances).

**Table 17.2. Updated nonfood allowances and overall poverty lines
(current Riel per capita per day), 2004 and 2007**

Region	2004*	2007*
Updated nonfood allowances (current Riel)		
Phnom Penh	569	647
Other Urban	384	430
Rural	364	402
Updated overall poverty line (= food poverty line + nonfood allowance)		
Phnom Penh	2,351	3,092
Other Urban	1,952	2,704
Rural	1,753	2,367

Source: WB (2009). Poverty Profile and Trend in Cambodia.

17.1.2. Characteristics of Poverty in the 1990s

The RGC's 1999 Socio-economic Study, the 1998 census, and the 1999 poverty indexes of the World Food Program (WFP) can be used to determine communes affected by food insecurity. In 1999, 36 % of the 13 million inhabitants of the country live below the poverty line; 43% of them are under 14 years of age, and thus do not contribute fully to the country's economic activity. Nearly 85% of the population lives in rural areas, and agriculture constitutes the main source of food and income for families. Nearly 50% of

Box 17.1: Poverty in the 1990s

The Poverty Profile of Cambodia, based on 1999 data, shows that an estimated 35.9% of the population is poor and the poverty rate is higher in rural areas (40%), which is four times higher than poverty in Phnom Penh (10%). Rural households, especially those for whom agriculture is the primary source of income, account for almost 90% of the poor.

The poor are more likely than the better off to live in households that are numerically larger in size. Poverty incidence increases from 24 % for a household of 4 people to 45 % for one with 10. Poorer households also tend to have a larger number of children. Poverty incidence increases from 27 % for a household with one child to 49 % for a household with more than 3 children.

Poverty rates rise with age, reaching a maximum for the 36-40 year old group of household heads, and then decline. The relatively lower poverty rate for people living in households whose head is aged 50-60 years and above may reflect the wealth accumulation that this elderly head achieved or it could be there is a younger generation within the household whose economic success is sufficient to allow them to support their elders within the same household.

One of the legacies of war and armed conflict in Cambodia is the relatively large proportion of the population is living in female-headed households (17%). However, there is no difference in poverty rates between male and female-headed households, although women experience poverty more acutely than men because of their multiple burdens of child rearing and care, household work, having to work to earn income, and also involvement in community activities. Moreover, in urban areas female-headed households are at a disadvantage over those living in male-headed household.. Women's experience of poverty have had consequences such as intergenerational transfer of poverty to children, especially girls, substitution of women's work by young girls in household maintenance, and low investment in the education and health of the girl-child, particularly if a trade-off has to be made against the survival needs of the household.

Those who are poor because of the war or landmine-related disability of their household head are among the poorest of the poor in Cambodia. They are a group of the poor deserving special attention because their standard of living has fallen precipitously below the poverty line and their capacity for participating in economic activities is limited by disability.

children under the age of five suffer from developmental abnormalities and 20% from severe malnutrition.

17.2. Defining Features of Poverty

Ordinarily, poverty incidence is accelerated by war, internal conflict and economic crises that cut off access of households, especially the most vulnerable, to resources which are needed for livelihood. The lack of owned resources except labor by the poor promotes a continual deterioration of living conditions, aggravates inequalities, and leads over time to destitution and extreme poverty. In the absence of public assistance and sustained community solidarity because of changes in ethical and cultural standards, a breakdown of social bonds occurs alienating the most disadvantaged in their own country.

The most noticeable signs of poverty are: food insecurity due to loss of earning power, unemployment, and lack of health care, education, and decent housing. Thus, the priorities

in a strategy to fight poverty should be (i) creation of jobs particularly for the young people; (ii) access to basic health care; and (iii) the education of children.

Poverty also arises due to damage to the ecosystem and the consequences thereof. Natural factors most often cited by affected people are: (i) natural disasters such as floods or successive periods of drought; (ii) deterioration of the soil which becomes increasingly poor, resulting in low yields; and (iii) unsustainable use of natural resources.

Other reasons for falling into poverty, particularly reported in towns and cities, also stem from natural processes, notably the death, retirement, or loss of employment by the main wage earner, as well as physical disability resulting from old age or a debilitating illness.

17.2.1. The Most Vulnerable Groups

Cambodia's most disadvantaged groups consist of internally-displaced people and returned refugees, war widows, orphans, street children, squatters, people with disabilities and isolated ethnic minorities. They have poor access to education, training and employment opportunities.

Until recently many people were displaced as a result of armed conflicts. Between 1992 and 1993, in addition to the 370,000 refugees repatriated from the Thai border camps to Cambodia, another 180,000 internally displaced persons were returned to their place of origin. A large proportion was female heads of household with children. Most of them lack appropriate skills and receive hardly any material and moral support.

The civil war and the genocidal regime, resulted in an unconscionably large number of war widows and orphans. This was particularly disastrous for the children who represent nearly half of the population of Cambodia, in the worst cases leading them to be homeless, disabled, or petty criminals. Increasingly they are also coming under the influence of drug abuse.

CSES 1999 estimated the disabled population of Cambodia at 169,000 or 1.5 % of the total population, of whom 20 % live in urban areas and 80 % in villages. 44% of the disabled population are amputees or those who are unable to use one or more limbs mainly due to injuries suffered during the civil strife. Ill health and disease are the principal cause of disability. Disabilities in one out of five disabled persons were caused by congenital factors. Landmine explosions were the cause of disability of 11 % of the disabled population. The cause of disability of more than one out of ten was reported as war or armed conflicts.

Isolated ethnic minorities consist of some 30 to 35 ethnic groups living in the hilly and mountainous areas of Cambodia. Their isolation and the harshness of their habitats increase their vulnerability and often cause extreme poverty.

17.2.2. Economic Environment / Inadequate Income

The average annual growth rate of the economy at about 9.4% per year in the last decade and the narrow base of growth has allowed for only a marginal improvement in real income per capita and in employment. Furthermore, this growth is occurring largely in the garment industry and tourism. Added to this is a growing inequality in income distribution.

Equitable growth has not yet been realized. It has been noted that the annual average growth in the agricultural sector was 4.6% during 1994-2008 which is slightly more than the population growth for the same period. Agricultural growth was fragile because of weak productivity, insufficient competition in the supply of inputs and vulnerability to exogenous shocks (droughts, fluctuations in commodity prices). The situation of the primary sector, which remains precarious, combined with sluggishness in the insufficiently competitive secondary sector and its inability to absorb the increasing numbers in the rural labor force, has been a leading constraint to job creation and income improvement, leading to a continuous deterioration of rural household living conditions. Moreover, the weakness and still inadequate diversification of exports in terms of products (garments comprise 60-70% of total exports) continues to inhibit substantially the country's growth potential. The high dependence on agriculture on rainfall introduces excessive uncertainty that does not encourage substantial investments in rural activities which alone can help increase productivity and income.

The current macroeconomic framework, although on a healthy footing, has not resulted in broader access for the poor to financial and other resources leading to the creation of productive, well-paying jobs. There is noticeably insufficient development of micro-enterprises and the informal sector. The latter has been the major provider of jobs, given that the employment level of the civil service has remained constant for several years, and recruitment in the formal sector has advanced very slowly.

The RGC has realized the importance of supporting infrastructure, especially physical infrastructure, in economic activities intended to reduce poverty. The insufficiency of road and port infrastructure has sharply escalated transportation costs. Quantitative as well as qualitative deficiencies in the electricity supply constitute another major constraint. All told, only 30% of the population has access to electricity, although the demand is by and large met in the larger cities. Overcoming the lack of infrastructure is a major part of the fight against poverty.

17.3. Strategy, Policy and the Status of Poverty

Cambodia has to address several concerns in the fight against poverty including: (i) achieving the MDG target of reduction of poverty by half by 2015 along with other MDGs in particular in health and education; (ii) enhancement of basic infrastructure; (iii) good governance, peace, and conflict prevention; (iv) development of agriculture; (v) capacity building through new information and communications technologies; (vi) preservation of culture and (vii) gaining access to the markets of the large industrialized countries.

Cambodia's poverty reduction strategy is implicit in the Rectangular Strategy and in the strategic directions of the National Strategic Development Plan 2006-2010. These broad elements of the strategy include: (i) promotion of good governance and strengthening the rule of law; (ii) strengthening local development through the deepening of decentralization and good governance; (iii) speeding up the implementation of basic infrastructure in order to widen access for all to basic social services to capture greater value from the human capital; (iv) increasing investment and building competitiveness in the productive system, especially through the implementation of adequate support infrastructure for production; (v) continuing to strengthen sub-regional integration and international cooperation; (vi) dissemination of information to develop and promote the use of research results and new information and communications technologies (NICT); (vii) pursuing the rational management of natural resources and the environment for sustainable development; and (viii) strengthening the management of vulnerable groups by improving their productive capacities and reducing gender disparities.

The current Global Financial Crisis is expected to have an impact on poverty reduction. An average growth of 7-8% is needed over the medium-term if the progress in poverty reduction is to be sustained. However this growth by itself may not be sufficient if it does not benefit the rural poor. Therefore the strategy must stress agricultural development and its contribution to GDP growth.

17.3.1. Poverty Reduction Strategy

Articulation of a poverty reduction strategy means: (i) promoting opportunities for wealth creation in Cambodia; (ii) creating a level playing field in order to bring about these opportunities, notably through the capacity building of poor communities; and (iii) ensuring the protection of vulnerable groups. These are also the cardinal principles of the government's strategy to fight poverty. The strategy also aims at better management of unfavorable demographic patterns in accordance with the Population Policy Declaration as renewed in 2003. Likewise, the culture of peace, tolerance, and solidarity must remain a cardinal value of Cambodian society in order to prevent the exclusion and marginalization of minorities.

To alleviate the suffering of resourceless people and promote social integration for marginalized and vulnerable categories and sub-groups, government policy intends to (i) improve the social status of vulnerable and marginalized groups; (ii) facilitate access for poor populations to social services, infrastructure, and basic facilities; and (iii) implement programs of wealth creation appropriate to these target groups, notably through microfinance; and (iv) promote community development.

To achieve these objectives, the government will work to (i) consolidate and strengthen social investment programs and projects; (ii) establish a system to monitor the impact of projects with the grassroots communities; (iii) build the capacity of community organizations to identify, prioritize, and carry out their projects.

This approach will be underpinned by (i) ongoing improvement in the functioning of the primary health care system and the capacity of the system to include children from poor populations that are presently excluded from receiving good quality, affordable medicine, a greater openness of access to health care facilities; (ii) promotion of health education for poor mothers and children; and (iii) maintaining the successful outcomes of national health programs such as the Expanded Program on Immunization (EPI) and the National Nutrition Program (NNP).

An analysis of causes, determinants, manifestations, and the actual conditions of the poor in Cambodia suggest that poverty can be impacted upon by using four key levers: creation of wealth, capacity building and promotion of basic social services, improvement of the living conditions of the most vulnerable groups, and a participatory approach to project implementation, monitoring and evaluation based on decentralization. Cambodia's poverty reduction strategy emphasizes the judicious use of all these levers.

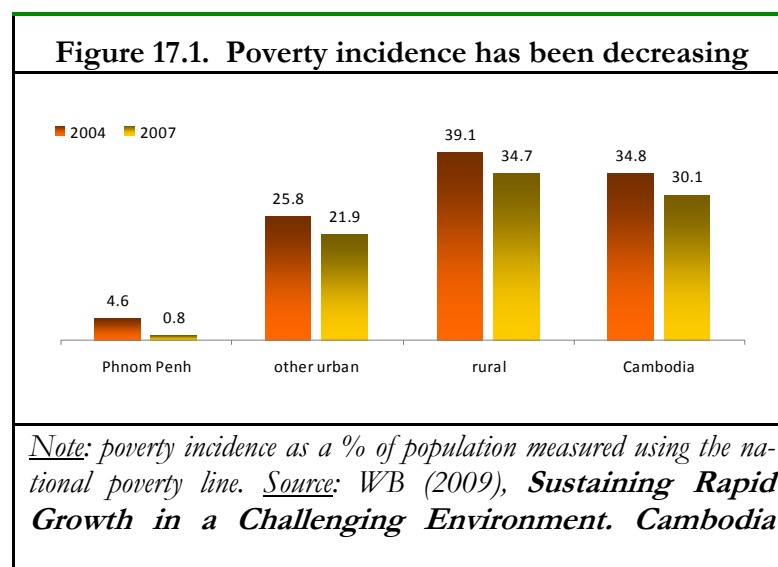
The experience of countries in East Asia show sustained growth is linked to human capital formation. Also, social capital (good governance, decentralization, etc.) and sustainable management of natural resources play a critical role in sustaining growth. It is for these reasons that Cambodia has emphasized capacity building and access to basic social services as cornerstones of its poverty reduction strategy. The strategy has also recognized that to achieve sustainable growth the stock of human, social and natural capital should be raised in a manner consistent with the demand of the community. Moreover, the community must be involved in the management of their basic community business, through such reforms as a genuine policy of local development and administrative decentralization.

Protection of vulnerable groups (children, women, the disabled, the elderly, youth, etc.) is a powerful way of tackling poverty at a truly basic level. The government is implementing targeted programs to alleviate social exclusion factors such as gender, age, physical disabilities, or unfortunate circumstances (victims of floods, drought, or social and political

conflicts). The poverty reduction strategy should aim at the following outcomes: (i) promoting opportunities for wealth creation in Cambodia; (ii) bringing about a level playing field to make these opportunities available to the excluded sections of society through programs for the capacity building of the poor; and (iii) ensuring the protection of vulnerable groups. The design, implementation and monitoring-evaluation of all anti poverty programs will follow an approach that recognizes and addresses all issues of social exclusion including gender.

17.3.2. Economic Growth and Poverty Reduction

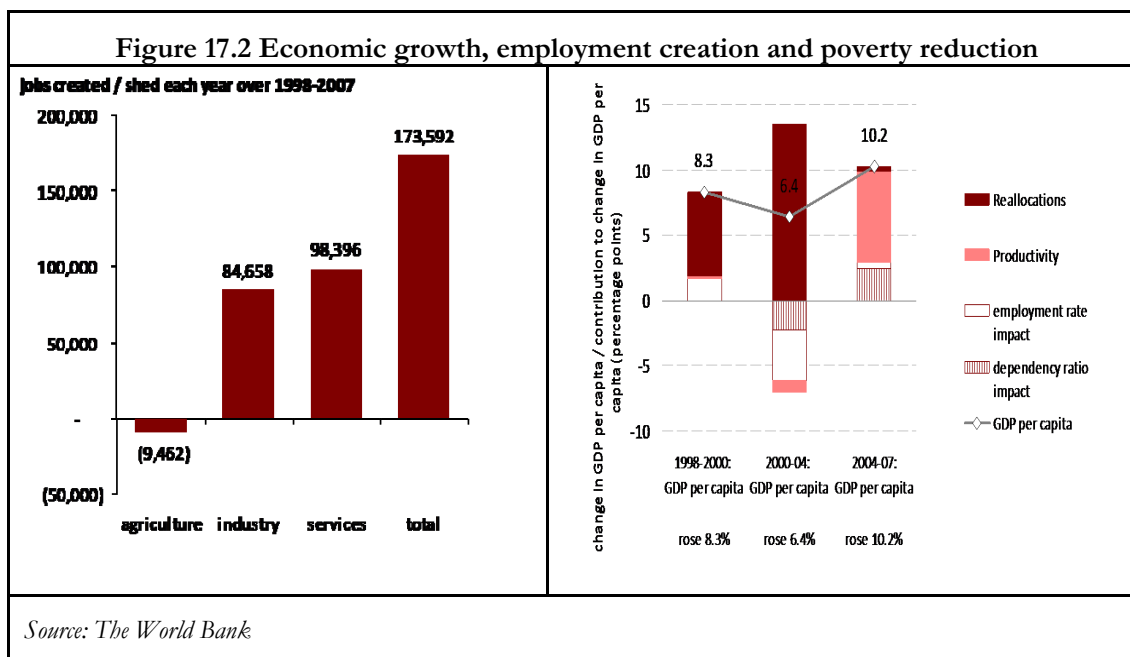
Overall, economic growth over the last decade has raised living standards and reduced poverty headcounts. Using the same geographical sampling framework for comparison the national poverty rate fell by more than 15 percentage points over the last 15 years, from a projected 45-50 % in 1993-1994 to 34.8% in 2004, then to 30.1% in 2007.



Poverty in Phnom Penh declined from 4.6% in 2004 to 0.8% in 2007, while poverty in the rural areas dropped from 39.1% in 2004 to 34.7% in 2007. Poverty rates in other urban also decreased from 25.8% in 2004 to 21.9% 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 during 1998-2007. Inequality has been increasing during the years in several dimensions – between rich and poor; across regions; between urban and rural areas and also within the rural areas.

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. Poverty has fallen at much faster rate in urban areas such as Phnom Penh and coastal provinces than in other regions of Cambodia. In some remote and mountainous areas poverty incidence has even increased.

Sustained and more equally shared growth is therefore a fundamental prerequisite for any significant reduction of poverty. High economic growth averaging 9.4% during the last decade has contributed to poverty reduction by creating jobs and increasing per capita income. During 1998-2007, a total of 173,593 jobs were created per annum, of which 98,396 in the services sector and 84,658 in industry, while job losses in the agricultural sector amounted to 9,462 per year. Per capita income grew by 8.3% during 1998-2000; 6.4% during 2000-04 and 10.2% during 2004-07. Cambodia's objective is to reach a sustained growth of at least 7-8% per annum, in the medium term. Meeting this target in a manner that helps poverty reduction would mean an increase in public and private investment, increase in official development assistance, influx of foreign direct investment, better targeting of economic and social development projects to benefit the vulnerable groups, increase in investment efficiency and improved agricultural performance.

The accumulation of capital will contribute to growth in a very substantial way. But it should be efficiently used. An important objective of the poverty reduction strategy is establishing a climate conducive to private investment. Healthy macroeconomic policies accompanied by reforms in diverse areas including privatization, the equity markets, foreign trade, financial and labor markets, the regulatory environment, and judicial system, are all needed to attract private investments. Another necessary condition for growth is adequate

resource domestic mobilization by the public sector in the provision of better social and economic infrastructure.

Growth will eventually impact on poverty through trickle down effects. But this may take too long and not socially desirable. For growth to impact on poverty immediately the development strategy should target raising the incomes of the poor through creating ample employment opportunities. Investments must be preferentially located in the areas and sectors where the poor and the vulnerable groups reside. This will mean giving higher priority to rural investments and the development of remote areas in resource allocation and biasing the incentive structure in favor of such investments. Pro-poor growth must therefore emphasize rural areas, boost productivity and income from agriculture, and be labor-intensive.

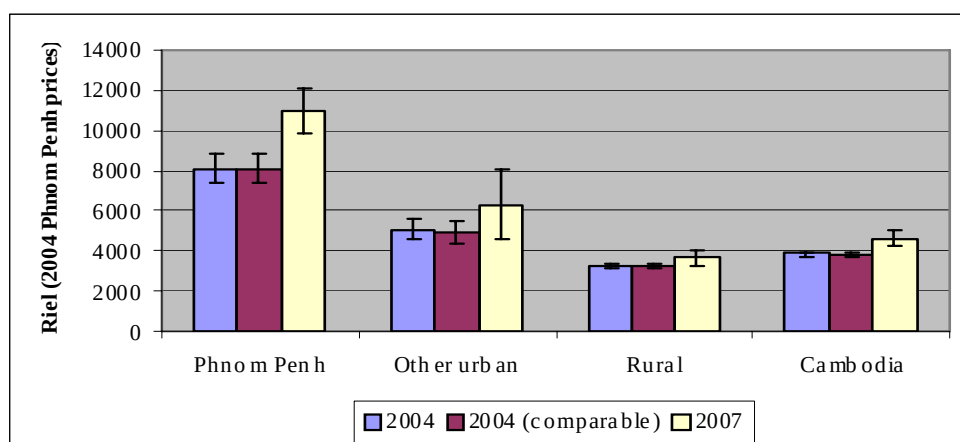
The role of the private sector in poverty reduction is crucial. Public investment alone can not bear the burden of absorbing the steady additions to the labor force occurring due to population growth and the rising proportion of the youth in the population due to demographic transition. Government should support the private sector through policies that encourage linking the poor to private sector activities such as exports and processing of agro products for domestic markets. Overall all incentives should be provided to private sector to step up investment.

17.3.3. Household Consumption

17.3.3.1. Estimates by Region

The data indicate that real per capita consumption increased between 2004 and 2007 in every region, although by considerably less in Rural areas.

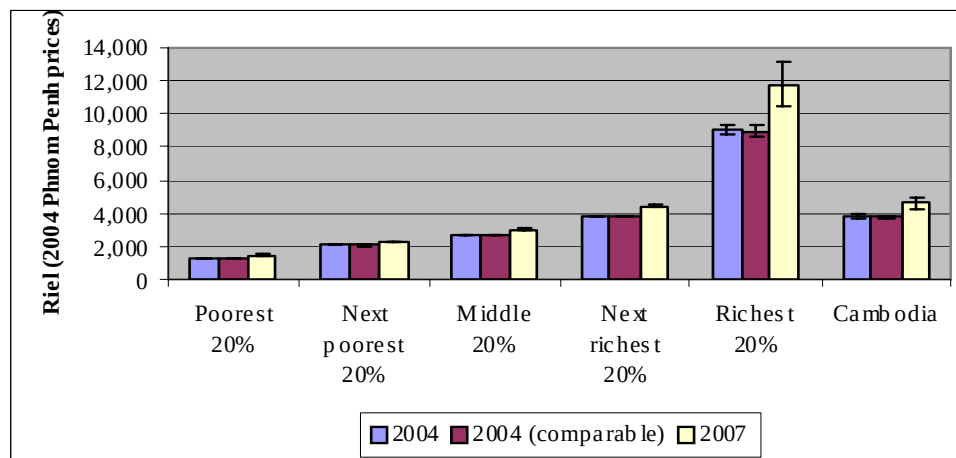
Figure 17.3. Sample means of per capita daily household consumption in constant prices (Riel, 2004 calendar year average Phnom Penh prices) by region



17.3.3.2. Estimated Shares of Food Consumption in Total Household Consumption

During the earlier 10-year period, real per capita consumption was estimated to have increased by only 8% in the poorest quintile, while it increased by 45% in the richest quintile. By comparison, the income gains during the period 2004-2007 have been more equitably distributed than during the period 1993/94 to 2004. The fact that the increases in current income between 2004 and 2007 were more equitably distributed than the increases in real income is due to the much higher rate of inflation in food prices than in nonfood prices during this period, which adversely affected the poorer quintiles more than the richer quintiles.

Figure 17. 4. Sample means of per capita household consumption in constant prices (Riel, 2004 calendar year average Phnom Penh prices) by per capita consumption quintiles, 2004 and 2007

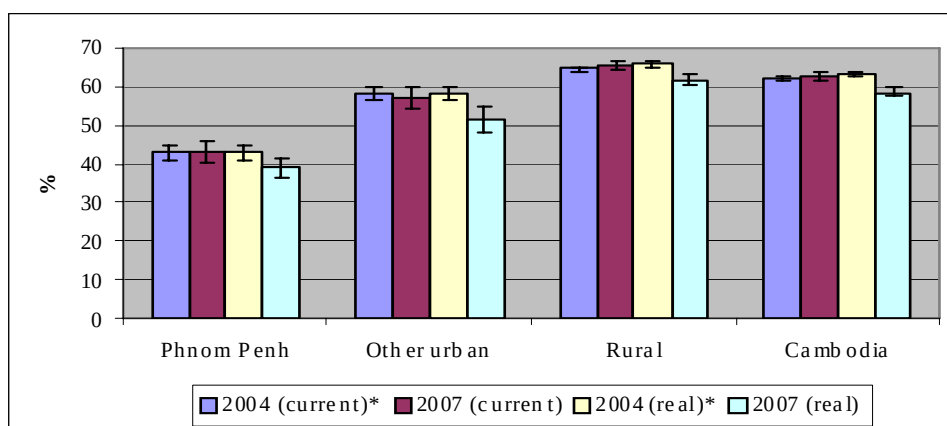


Source: WB (2009)

17.3.3.3. Estimated of Overall Inequality in Per Capita Household Consumption

Figure 17.5 indicates that food shares decreased in real terms between 2004 and 2007 in all regions and in all quintiles, including in the poorest two quintiles. What has likely happened is that Cambodian consumers at all income levels have responded to rising real income levels and rising relative prices of food by substituting nonfood consumption for food consumption, as evidenced by the declining food shares in real terms.

Figure 17.5. Food consumption as a share (%) of total household consumption by region, 2004-2007



Source: WB (2009)

17.3.3.4. Estimates of Overall Inequality in Per Capita Household Consumption

Rapid economic growth between 2004 and 2007 has been associated not only with falling poverty but also with rising levels of inequality. While all quintiles and all domains have experienced gains in real per capita consumption, the rate of this increase has varied quite widely. Poverty reduction would have been greater had real income growth not been so much higher in the richest quintile and in urban areas (especially Phnom Penh) than in less rich quintiles and rural areas.

Table 17.3 Estimated Gini coefficients (with estimated standard errors in parentheses) by region, 2004 and 2007

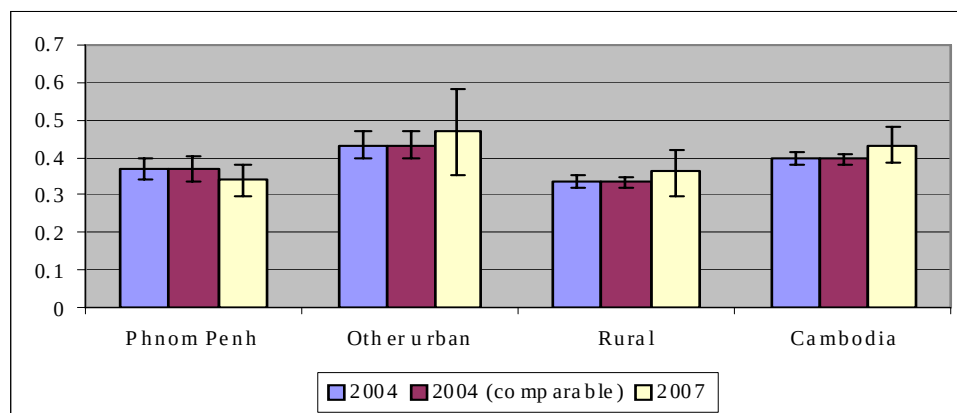
Region	2004	2004*	2007
Phnom Penh	0.369 (0.014)	0.367 (0.017)	0.340 (0.020)
Other urban	0.435 (0.016)	0.431 (0.019)	0.468 (0.060)
Rural	0.342 (0.010)	0.334 (0.007)	0.360 (0.031)
Cambodia	0.396 (0.008)	0.393 (0.008)	0.431 (0.024)

Source: WB (2009)

Table 17.3 presents estimates of the Gini coefficient for real per capita consumption by region in calendar years 2004 and 2007 (including for the comparable 2004 subsample of

villages included in the 2007 CSES sampling frame). Estimated standard errors are also reported in parentheses under each estimated Gini coefficient. The Gini coefficient is the most commonly used summary measure of income inequality. It ranges in value from zero—corresponding to complete equality in the distribution of income—and one, which would signify complete inequality, i.e., all consumption or income received by a single individual.

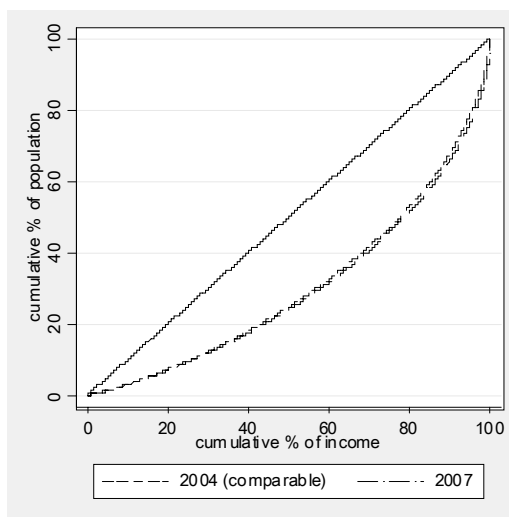
Figure 17.6 Gini coefficients of income inequality by region, 2004 and 2007



Source: WB (2009), 2004 and 2007 CSES.

The overall Gini coefficient for Cambodia increased from 0.39 to 0.43 in a comparable sample of villages, although this estimated increase is not statistically significant at even the 0.10 level. Although income inequality in Phnom Penh is estimated to have decreased during this period, the estimated decrease is also not statistically significant.

Figure 17.7. Changes in the Lorenz curve for Cambodia as a whole between 2004 and 2007



Lorenz curves showing differences between regions in the size distribution of real per capita consumption in 2007, while Figures 17.7 show shifts in the Lorenz curves by region between 2004 and 2007.

17.3.3.5. Poverty Estimates

Poverty measures are calculated in Cambodia by comparing the estimates of per capita daily consumption in current Riel for each individual in the sample to the updated poverty lines for the region in which each person resides. Three different poverty rates (in percentage terms) are calculated, i.e., the poverty headcount index (P0), which is the percentage of the population with per capita consumption below the poverty line, the poverty gap index (P1), which is the average percentage difference between a person's per capita consumption and the poverty line (with a zero value assigned to individuals above the poverty line), and the poverty severity index (P2), which is the poverty gap squared before it is averaged over the population, thereby giving greater weight to larger poverty gaps.

The poverty estimates indicate that the poverty headcount index relative to the overall poverty line for Cambodia decreased from 34.8 % in 2004 (in comparable villages) to 30.1% in 2007. The poverty headcount index relative to the food poverty line for Cambodia also decreased during this period, but only from 19.7% in 2004 (in comparable villages) to 18.0%. The relatively rapid inflation in food prices during this period accounts for this difference. The results also indicate that the poverty headcount index, relative to both the overall poverty line and the food poverty line, decreased in every region, i.e., the decreases in poverty during the period 2004-2007 were balanced regionally. The same conclusions apply equally to the poverty gap and poverty severity indices.

The World Bank report finds that poverty reduction observed over the previous decade (1994-2004) continued over the period 2004-2007. The poverty headcount index for Cambodia as a whole relative to the overall poverty line fell from 34.8% in 2004 to 30.1% in 2007. The decline in poverty during this period reflects substantial and significant growth in real per capita household consumption (the measure of living standards used in Cambodia). This increase (averaging 21% for the population as a whole) was driven by rates of economic growth during these years that exceeded 10% per annum.

17.3.3.6. Socio-Economic Indicators

The conclusion that poverty has continued to fall is supported by other indicators. These include changes in ownership of consumer durables amongst households in the bottom two quintiles (i.e. the poorest 40% of the population as ranked by per capita consumption). It is also supported by more gradual improvements in housing size and quality.

The picture of welfare improvements amongst the bottom two quintiles is reinforced by improvements in a wide range of variables related to service delivery and human development outcomes.

Gains are most notable in education, health and nutrition. Physical access to public services has improved, as measured in terms of average distances to the nearest health center or school; and an improved road network and rising real incomes. All of this helps explain improving rates of school enrolment and health-seeking behavior.

17.3.4. Implementing Poverty Reduction Strategy

The main policies RGC will pursue in the fight against poverty include:

- Consolidation of peace, stability and social order
- Domestic resource mobilization
- Investment promotion
- Allocating investment to priority sectors including education, health and agriculture
- Building institutional capacity and strengthening good governance
- Integration of the Cambodian economy into the region and the world
- Human resource development
- Consolidation of the partnership with the donor community and civil society.

First, the consolidation of peace, stability and social order is being pursued by taking concrete steps to strengthen the rule of law, uphold human rights, and promote democracy with the view to establishing favorable political and security environment for sustainable development over the long term.

Second, actions are continuing to increase domestic resource mobilization and implement budget reforms aimed at enhancing and rationalizing public expenditure. This is needed to ramp up the poverty fighting programs. Both private and public sectors must participate in increasing the national saving rate.

Table 17.4: Linking Poverty Diagnostics to Government Poverty Reduction Programs

Dimensions of Poverty	Government Policies
<i>LACK OF OPPORTUNITIES</i> -Low average income -Low level or inadequate farming technology -Extensive poverty, especially in rural areas -Landlessness and lack of access to land -Low education for girl -Poor access to assets and skill training -Lack of infrastructure -Problem of landlessness	<i>PROMOTING OPPORTUNITIES</i> -Macroeconomic stability -Economic growth -Promoting private sector development -Improving physical infrastructure including irrigation and rural roads -Measures to promote agriculture. -Land reform
<i>VULNERABILITY</i> -Poor access to credit and capital -Crop failure -Weather conditions -Environmental degradation -Increased violence against women - rape, domestic violence, trafficking of women and children -Health problems and vulnerability of women to HIV/AIDS infection -Land mines	<i>CREATING SECURITY</i> -Micro-finance schemes -Safety net programs -Environmental protection -Access to health services -Mine clearance -Improve irrigation and drainage facilities -Crop mixes manipulation for increased biological stability and economic viability
<i>LOW CAPABILITIES</i> -Low outcomes, especially education -Bad water and sanitation -High costs of healthcare	<i>STRENGTHENING CAPABILITIES</i> -Service delivery -Increase public spending on health, education, agriculture and rural development
<i>SOCIAL EXCLUSION</i> -Illiteracy -Lack of access to decision making -Corruption -Discrimination on the basis of sex and ethnicity -Low representation of women in key decision-making positions -Heavy burden placed on women for household work, child rearing and child care as well as care of the sick and the elderly	<i>GENERATING EMPOWERMENT</i> -Judicial reform -Education policy -Fostering enabling environment for NGOs -Governance and anti-corruption -Decentralisation

Third, investment promotion and facilitation will continue as a priority. Cambodia needs

Box 17.2: The Priority of Productive Employment Generation

While the emphasis on investing in rural areas should continue, urban investment can also be pro-poor if it creates productive employment for surplus rural labor migrating to urban areas in search of employment. Growth of labor-intensive manufacturing such as garment production, for example, has a dual impact on poverty. The current competitiveness of Cambodia's textile and apparel exports may provide a solid foundation for increasing real income per capita and hence reducing poverty. In addition, development of labor-intensive manufacturing by drawing labor from rural areas can generate increases in average agricultural productivity and rural household incomes thereby reducing poverty at its most potent source.

Employment generation is a priority because about 250,000 jobs have to be created each year to employ new labor market entrants, which has to be added to those new job seekers generated by planned demobilization of the armed services and reform of public administration.

Rural labor force is growing much faster than real production in the agricultural sector resulting in the decline in agricultural labor productivity. Farmers are becoming poorer, as the size of farmland per household is decreased making them also more vulnerable to food insecurity. The RGC and donor agencies should focus on raising rural household incomes through increasing agricultural productivity. The strategy should also promote growth of non-farm employment opportunities through enhancement of demand for non-farm goods and services.

massive infusion of investment during the next few years to generate the targeted growth rate. Much of it will have to be mobilized from abroad since Cambodia's domestic resources are limited. The time is opportune to increase foreign assistance to Cambodia—not scale it back. However, Cambodia should also pay attention to ensuring an environment conducive to stability, security, transparency, accountability and predictability, which will favor and promote investment in Cambodia.

Fourth, pro poor development means shifting expenditure outlays to the priority sectors where returns to poverty reduction will be the maximum. Strengthening and developing effective agricultural support services including agricultural research, extension, on-farm water management, quality inputs supply and distribution, developing suitable infrastructure such as small-scale, farmer-controlled irrigation facilities, MFIs and farm-to-market roads, formulating and implementing a comprehensive water resources management program, combating land grabbing and landlessness, developing and implementing sound land tenure and land use policies and protecting the environment are examples of pro poor initiatives which can be accelerated through larger allocations.

Fifth, building institutional capacity and strengthening good governance is crucial to the concept of sustainable and equitable development and is a top priority for the government. This is also linked to the establishment of the rule of law, pursuit of administrative reforms, the promotion of transparency and accountability and the combat against corruption, which will have direct impact on poverty reduction.

Sixth, integration of the Cambodian economy into the region and the world is being pursued vigorously since Cambodia being a small sized economy needs access to larger markets for economic efficiency. Cambodia needs to be an efficient producer if poverty reduction is to be achieved through a market friendly economic policy. Public welfare will also benefit from greater factor mobility and cheaper imports which globalization and regional integration bring.

Seventh, the experience of a number of developing countries show that investment in human capital, especially investment in education, agricultural research, vocational training, job creation and health, is key to ensuring economic take-off and reducing poverty. Cambodia's poverty reduction effort will continue to include these elements.

Eighth, maintaining and strengthening partnership with the donor community, NGOs and the civil society is also important for succeeding in the fight against poverty. Cambodia has earned substantial goodwill from the donor community and the civil society from the commitment it has shown to reform. Cambodia will build on this foundation and marshal all the resources available to fight poverty.

17.3.4.1. Promoting Opportunities

This section highlights the most important areas for action in the fight against poverty as summarized in Table 17.4. In addition, there are some key cross-cutting issues, like revenue mobilization and relations with donors that are dealt with at the end of the book.

The basic approach to promoting opportunities is via strengthening macroeconomic performance, accelerating economic growth, promoting private sector development, developing physical infrastructure, strengthening the energy sector, ensuring sustainable development of the agricultural sector, improving water resource management, advancing rural development and decentralization, ensuring a sound natural resource management, encouraging income generation activities, embarking on land reform and increasing access to microfinance for the poor. Though well-targeted programs for rural areas could have quick impact on the rural population, poverty reduction strategy should also give due emphasis to the development of the industry and service sectors which is needed for a long term solution to poverty.

17.3.4.1.1. Fostering Macroeconomic Stability

Prudent macroeconomic management combined with economic openness and market orientation is at the center of the anti-poverty program. Cambodia needs to continue to deepen its integration with the region and global economy and maintain outward looking and market based economic, financial and trade policies, including maintaining a market-

based exchange rate policy and a liberal exchange system. Trade reform will also continue in the context of AFTA and WTO. A key focus further capacity building to ensure a stable macroeconomic environment conducive to economic growth.

17.3.4.1.2. Accelerating Economic Growth

Apart from stepping up investment, accelerating growth will require paying attention to several other intangible matters including development of stronger, economic, social and political institutions to obtain better governance of Cambodia. Broad-based growth will also need to be accompanied by an emphasis on improving the access of the poor to credit, education, health and infrastructure as well as drinking water and sanitation. The other programs of RGC which will help improve the pro poor orientation of investment include building rural roads, providing information and developing rural markets

17.3.4.1.3. Facilitating Private Sector Development

The RGC is committed to developing and strengthening the legal and regulatory framework and institutional capacity conducive to private investment and business activities in Cambodia. Private sector development has been constrained by the lack of secure legal and regulatory institutions and the limited financing sources. Government's program to assist private sector development include harmonizing laws and regulations, adopting a comprehensive commercial code, strengthening the rule of law and good governance, maintaining Cambodia's competitiveness vis-à-vis the region and improving the quality of the judicial system. The main components of new commercial law have been submitted to the Council of Ministers.

17.3.4.1.4. Developing Physical Infrastructure

Provision of physical infrastructure can help reduce the barriers to participation of the poor in economic activities. Infrastructure improvement together with more access of the poor to market, credit, education and health would ensure that the positive impacts of growth filter down to the poor. Key physical infrastructure priorities include the creation of an efficient power sector, rural electrification, the repair and maintenance of the national road system, improved water supply and sanitation, better telecommunications, establishment of provincial/municipal master plans, preparation of topographical, administrative and sector maps and rural housing development. Agricultural infrastructure such as rural roads, irrigation and drainage facilities and markets are also a part of physical infrastructure development. It is important that for the full benefits of the investment to be derived, physical infrastructure development should go hand in hand with capacity building for the improved delivery of essential agricultural support services including agricultural research,

policy planning monitoring and evaluation, provision of agricultural inputs and the transfer of technology and knowledge to farmers must go hand-in-hand with the development of infrastructure.

17.3.4.1.5. Strengthening the Energy Sector

In rural areas only 2 % of the households have access to grid-provided electricity, while another 5.4% uses privately generated electricity. The quality of education and healthcare in rural areas is constrained by the lack of access to electricity, which perpetuates rural poverty. Rural electrification is important for improving the quality of social services to the poor and boosting labor productivity in agriculture.

17.3.4.1.6. Promoting Sustainable Development of Agriculture

The major programs are in: (i) accelerated development of small-scale, cost-effective, short gestation, private irrigation systems such as shallow tube wells and low-lift pumps; (ii) improving rice productivity; (iii) improving farming systems including crop diversification and intensification; (iv) expansion and improvement in livestock production; and (vi) community-based agro-forestry. Small-scale, farmers' controlled irrigation offers the best prospects of quick gains in agricultural productivity. Livestock production can also be improved to benefit the majority of the rural poor. Backyard production of poultry and swine, development of feed processing facilities and household based aquaculture including raising fish in inundated paddy fields are other poverty fighting programs.

17.3.4.1.7. Improving Water Resource Management

Lack of access to drinking water is one of the manifestations of rural and urban poverty. Both the shallow and deep aquifers of the country could be used for both irrigation and domestic water supply. Where technically and economically feasible, the rehabilitation of existing irrigation facilities would be carried out to provide equity in access to irrigation water and to boost agricultural production in food insecure areas.

17.3.4.1.8. Advancing Rural Development and Decentralisation

The emphasis is on bottom-up, integrated, participatory, decentralized rural development. This will allow active community participation in grassroots institutions and increase the ownership of development projects, by shifting decision-making and accountability closer to individuals, households and communities. RGC has planned to further decentralize its system of administration and introduce financial devolution at the grassroots level.

17.3.4.1.9. Ensuring Sound Natural Resource Management

The plight of the poor can be improved by widening their access to forest, fisheries and water resources in a sustainable way. Therefore, poverty reduction programs would be tailored to the specific situations faced by the poor scattered in various provinces. For example, ensuring freer access to forest resources by hill-tribes respecting their forest-based agricultural practices is important for reducing poverty in the Northeast of Cambodia. Providing access to fisheries and water resources is critical to improve the living standards of the people living in the Tonle Sap region.

17.3.4.1.10. Implementing Land Policy

The core program of land reform comprises the development of a national land policy, improved management of the national land stock, commencement of systematic land registration, land tax reform, establishment of a legal framework to enforce property rights including a new Land Law and implementation of the National System of Land Registration, the establishment of provincial, municipal and national master plans and zoning and the development of rural housing. Land use classification will be determined for demarcating different types of land, such as permanent estate forest, fishing lots and other agricultural land, which can help the poor to gain access to land, improve land tenure and engage in traditional fisheries.

17.3.4.2. Creating Income Security

Programs address providing credit for income generating activities and reducing vulnerability to fluctuations in income which is the prime cause for distress land sales. Providing rural insurance and creation of savings associations for providing consumption loans are effective in smoothing consumptions flows. Security can be enhanced through expanding safety net programs, promoting environmental protection and clearing landmines.

17.3.4.2.1. Access to Micro Credit for the Poor

Micro-finance operations of NGOs are virtually the sole financial service providers in rural areas. The commercial banks have not had much headway in their rural operations so far. Overall the rural credit gap is estimated at US\$60-70 million annually. Rural Development Bank (RDB)'s main objective is to ensure sustainable development of micro-finance. The RDB's financials are being strengthened with the view to enable its intensified involvement in the development of micro credit.

17.3.4.2.2. Coping with Globalization

Cambodia continues to strengthen its international relations and deepen its commitment to open markets and trade as a member of ASEAN. RGC will intensify its involvement in the Mekong River Commission, Greater Mekong Sub-region and the ASEAN. While globalization has brought greater economic opportunities particularly to some women in the garments and textiles industry, many others have been marginalized, due to deepening inequalities among and within countries. Government will address this problem through programs to provide training, improve skills, and widen access to credit and enable the vulnerable segments of the population to compete in the global network.

17.3.4.2.3. Safety-net Type Programs

Economic growth that raises the real consumption levels of the poor can have a powerful effect on the elimination of poverty. Targeted programs will deliver benefits to the poor, in the form of augmentation of their human and physical assets and through interventions that improve the returns they get from those assets.

17.3.4.2.4. Environmental Protection

The high priority environmental protection programs include: development and protection of coastal zones; improving environmental management including the Tonle Sap eco system and protection of critical watersheds; erosion control; control of urban and industrial pollution; strengthening capacity for protected area management; capacity building for environmental planning and resources management; and establishing various community based organizations including forestry communities, fisher communities, water user associations and rural road maintenance communities.

17.3.4.2.5. Mine Clearance

Systematic and concerted efforts with the help of the donor community are being taken to clear landmines in agricultural lands, raise public awareness of the dangers of land mines, provide training on mine disposal and increase assistance to landmine victims.

17.3.4.3. Strengthening Capabilities

The programs address improving service delivery and capacity building of local institutions. The focus is on the quality and availability of services for the poor and designing the programs keeping in view the comparative advantage of the government, non-government organizations and private sector agencies in the efficient provision of these services. While

RGC is committed to decentralization the pace at which it will proceed will be matched with the progress in the capacity building of the local institutions.

17.3.4.3.1. Health

The key programs include: (i) promoting women and child health through basic care service delivery for all women; (ii) reducing the incidence of communicable disease such as malaria, dengue fever, tuberculosis, diarrhea disease, acute respiratory infection, and sexually transmitted disease, particularly HIV/AIDS; (iii) improving the coverage of good quality service; (iv) upgrading the skills of health staff; (v) providing drugs, equipment and materials; (vi) strengthening the capacity of the referral hospitals through the use of improved technology and management techniques; (vii) facilitating the development of the private health sector; and (viii) promoting public awareness about sanitation and hygiene.

17.3.4.3.2. Water and Sanitation

Preparatory work is being undertaken to establish a water supply and sanitation policy framework, which will focus on financial autonomy, tariff adjustment to achieve cost recovery, private sector participation, donor coordination, water resource allocation, and regulatory responsibilities. The early adoption of this policy and its implementation will improve the quality of service delivery to the poor in this critical sector. Currently close attention is given to making better use of the existing water resources, strengthening institutional capacity, bringing the production level of existing clean water processing plants to design capacity, improving their performance and expanding connections to end-users. Rural wells are being expanded through increased government budget allocations and donor support and with the active participation of the beneficiaries - particularly women who are primary collectors and users of water - in their operations and maintenance.

17.3.4.3.3. Education Policies

The government's key program to ensure equitable access and quality improvement in education is the ***Education for All*** program which seeks to provide 9 years of basic education to all children, particularly girls, by 2010. For post basic education Government's priority is to enable more equitable access for the poorest, alongside a growing public/private partnership in financing and management of education. A cross cutting priority is to strengthen legislative and regulatory frameworks for quality assurance and sector performance monitoring across all sub sectors. It is recognized that public expenditure on education has been below what is necessary to achieve these policy objectives. RGC plans to more than double the education recurrent budget over the next 3 years as an initial step in securing policy implementation with clearly defined pro poor

policies such as reducing direct and indirect costs to parents (the major access barrier) through a significant increase in performance based teacher salaries. It is also proposed to significantly increase school-operating budgets which will be increasingly managed at provincial/district and school levels.

17.3.4.4. Generating Empowerment

17.3.4.4.1. Better Governance

Priority programs include: Establishing Merit Based Pay Initiative (MBPI) and Priority Mission Groups (PMG) of government officials to improve service delivery and increase productivity; introducing decentralization and de-concentration of the system of administration to increase accessibility of essential services to the people; accelerating implementation of demobilization, administrative and fiscal reforms; deepening judicial reform and establishing a national program for judicial reform; and implement the measures outlined in the Governance Action Plan (GAP).

17.3.4.4.2. Law Enforcement

The concern is that the present of laws and regulations are biased against the poor. This requires a review of laws and regulations that may adversely affect the poor and identify actions to remedy them including issues of land reform, land tenure, land access, gender equity and the rule of law. Priority interventions in land reform will be targeted towards strengthening regulatory and enforcement capacity and effectiveness and establishing competent dispute settlement processes, including identification of the status of landless people, expansion of agricultural land through land clearance, and prevention of land usurpation, encroachment by influential groups and concentration of land by a single owner. Cadastral administration will be strengthened by ensuring the adoption and strict enforcement of the new land law, establishing a transparent system of land titling and land registration, enhancing the institutional capacity of land administration and protecting the state estate.

17.3.4.4.3. Fostering enabling environment for NGOs

NGOs can be partners in development and poverty reduction with the RGC at all levels. To do so, a transparent and supportive framework for collaboration is needed. The proposed NGO Law will provide clear guidelines for NGO activities so that the operating environment is transparent. The law would enable NGOs to contribute to poverty reduction by allowing them to respond quickly and creatively to problem situations when they occur. Government regulation will structure a framework that will provide adequate

information on development activities and the fiscal impact of NGOs on the country's development. The framework will also encourage self-regulation.



Chapter 18

Education

Human resource development is both an outcome and a driver of the economic and social development of a country. Skills acquired by the people, their values and attitudes, are necessary to increase productivity. This by itself may not be enough since “work productivity is subject to the health and nutrition of the work force. People need the necessary physical and mental endurance, first to learn economically useful techniques, then to apply them to the workplace.” As a country develops it is able to devote an increasing part of its resources to human development. The development challenge is to establish this virtuous cycle.

18.1. Background

The foremost task in development is providing primary education for all. The investment in primary education can have important benefits, including high rates of productivity and laying the foundation for higher education which is necessary for innovation and growth. A better educated population is also more sensitive to the evolution of civil society and unlikely to tolerate violent conflicts.

Three obstacles should be overcome in the provision of education: limited education opportunities, unequal chances of access to these opportunities, and the poor quality of teaching. Education is the primary tool to break the vicious circle of poverty that entraps rural population.

Cambodia’s educational system was totally reconstructed in 1979, with the establishment of the Ministry of National Education. The first primary school was re-opened in Phnom Penh in September 1979, followed by the reopening of the Sisowath High School. In the area of high education, the Faculty of Medicine was the first to be reopened to respond to the challenges of health issues following the Khmer Rouge period. In 1981, the Institute of Technology, staffed with Soviet teachers and professors, was re-opened to respond to the need for Cambodia’s reconstruction.

However, by the late 1990’s the sector was faced with national education service that lacked coherence. The services delivered were not always sufficiently equitable and did not always provide full national coverage (Quinn, 2009a, p. 3).

Cambodia's education reform began in 1999. The first steps comprised formulation of an education policy and a strategic framework that established the overarching priorities of the sector, goals for the subsectors, and a framework for allocating expenditures over the medium term. The Education Strategic Plan (ESP) prepared in 2001 was reviewed periodically to fine tune the programs so that they complied with the strategic priorities. Following an evaluation of the ESP, a more detailed education system support program (ESSP) was prepared, with a view to implementing a joint action plan between the stakeholders, mainly the RGC, donors, and NGOs. This education reform focused on primary and secondary education. The key issues driving this reform were (Quinn, 2009a, p. 4, ESP 2001-2005):

- To reestablish the role of the state for the provision of equitable public services in education;
- To strengthen the accountability structures of the education sector to the public, to whom the Ministry was ultimately accountable under the new and emerging democratic principles of nation;
- To expand and universalize free and equitable services at primary and basic level in accordance with national commitments;
- To establish mechanisms that assured resources were available for the provision of education services at the point of service delivery;
- To harness and re-direct both internal and external financial and human resources allocations in a coherent and planned fashion, and in accordance with key national pro-poor and economic development priorities;
- To establish internal accountability and performance assessment mechanisms to strengthen managerial processes, system effectiveness and performance management;
- To reform its internal managerial and institutional structures and mandates to create an enabling environment for the envisaged and emerging reform agenda.

In response to this reform, the Ministry of Economy and Finance (MEF) introduced in 2000 the **Priority Action Program (PAP)** in order to shift spending priority from military-security to social and economic sectors such as Ministry of Education Youth and Sports, Ministry of Health, Ministry of Rural Development, Ministry of Agriculture Forestry and Fishery. The PAP budget procedures are based on the following:

- Budget allocations were provided directly to schools through Budget Management Centers (BMC) at the district level;
- Budget line items were abolished and replaced by a block grant consisting of only one line item, Chapter 12, to provide flexibility in spending;
- Ensuring the quality change by reducing ex-ante control and moving towards ex-post audit to achieve the policy in driving development to reach district and commune;
- Disbursements through an advance system were provided by the National Treasury at the central level on a quarterly basis. Expenditure was acquitted by the BMC with the Provincial Treasury;
- Procurement was decentralized to the school level to meet the differentiated needs of schools.

While provision of basic education is the top priority in education, RGC is also giving importance to higher education (secondary, technical and vocational, and advanced) in order to lay a firm foundation for sustained growth. The adoption of a holistic approach to the development of education is a hallmark of the government's education policy.

For promoting social equity in line with its poverty reduction strategy the government will focus on extending services to disadvantaged groups (in particular rural and semi urban communities, and hill tribes), including the poor and youth living in remote areas. In order to widen access to education, the government's education policy is putting emphasis on reducing school attendance costs through the elimination of the parental contribution at the beginning of the school year and other informal payments. The government has also given priority to enlarging access to education for girls and women by promoting a school environment more favorable to girls and a program of awareness-raising for parents regarding gender parity.

18.2. Performance of the Education Sector

Gaps in the education system are hindering the smooth achievement of the objectives of development. Funding for technical and vocational education and training (TVET) in Cambodia is insufficient, which follows from its lower ranking in the country's economic and social system compared with college and university education. A large number of Cambodian workers are not technically qualified, which compromises industrial productivity. On the other hand, many who hold a high school leaving certificate cannot find employment. Such contrasts are indicative of distortions in the allocation of resources

to education. The educational system must be reviewed so that concerns related to vocational training could be incorporated in the education policy.

Higher education in Cambodia was long considered to be the way into the civil service. But with the advent of programs of adjustment and the secular decline in government recruitment, the career prospects in government are limited. Nevertheless, university enrollment has continued to grow. Two conclusions are obvious: (1) it is essential to develop the formal private sector in order to boost the demand for graduates; and (2) education must be reformed to prepare the youth to meet the requirements of the private sector. The needed reforms must be carried out with the growing involvement of the local authorities, households, and development partners.

The government's education policy aims to boost school enrollment, reduce the failure and early drop-out rates (students leaving school because of inability to pay fees) through upgrading teacher salaries, providing equipment and school supplies, building schools, eliminating both formal and informal payments by parents, granting scholarships to poor students, and making dormitories available for girls. The Ministry of Education, Youth and Sports (MEYS) is especially concerned about the pre-service and in-service training of an adequate number of teachers and inspectors, and making available curriculums and instructional materials that improve the quality of the teaching. However, the poor salaries of the teachers, paid out of an increasingly tight budget compromise quality of teaching and continuity of the service. Informal payments by families to teachers are the inevitable response which penalizes the poor. This important problem is being addressed.

18.2.1. Basic Education

Basic education for all, including literacy for youth and adults, is the single most important program in education. Basic education includes preschool, elementary education, and non formal education. Elementary education comprises two segments, six years of primary education and three years of junior secondary education. The program is to be completed by the enrolled person over a 9 year period.

The reform is addressing the issue of fairness and efficiency by extending the length of the school day, increasing the supply of teaching materials, and raising teacher salaries. Elimination of contributions by parents, an improved operational budget for schools, and remedial teaching classes have had some beneficial impact.

Education policy should not only be limited to knowledge provision but must be geared to prepare the student to join the employment market after he or she graduates. At a more general level, education must not be isolated from the problems of the real world. The

interconnectedness between the education and other economic and social sectors, as well as the private sector should be addressed while preparing the scholastic curriculum.

Table 18.1. Education performance indicators

	Actual values				Targets	
	2003	2004	2005	2006	2010	2015
Education expenditure as % GDP	1.9	1.9		2.1	2.6	
Share of total Government recurrent budget	17.1	18.7	17.7	17.74	20.85	
Primary ed. share of ed. budget (recurrent costs)				68.0	71.0	
Gross Intake Rate		119.9	119.7	124.0		
Girls' GIR		115.1	114.4	118.6		
Primary Completion Rate (Reconstituted Cohort Method)		46.77	42.90		100.0	
Girls' PCR	46.5	53.8	61.9	77.1	100.0	
Primary Completion Rate (Gross Intake Rate - Grade 6)	65.9	76.1	83.1	90.3		
Girls' PCR (GIR G6)	60.8	73.4	82.0	88.7		
Repetition rate (% repeaters of total enrolled)	10.2	10.6	13.9	12.8	100.0	
Student enrolment ('000)	2,747	2,747	2,682	2,558	2,472	
Girls' enrolment ('000)		1,291	1,266	1,209		
Pupil teacher ratio	56.7	55.4	53.5	50.8	50.0	
% of private education				0.9		

Source: WB, FTI Country Information Form

Cambodia has made important strides with regard to improving access to education under the Education for All (EFA) program. The national literacy campaign has yielded satisfactory results. The primary school enrollments rose from 2000 onwards due to the successful implementation of the Priority Action Plan (PAP). Reforms have had a positive effect on the improvement of school enrollment rates independently of the social conditions of families and gender. All the same, although the net rate of school enrollment has grown to 86% for those aged 6-11 years, it remains one of the weakest in the region. Moreover, the completion rate is also still somewhat low. The government is encouraging families and communities to pay attention to early childhood development and care needed by young children. Positive responses will contribute to improved primary school achievement results.

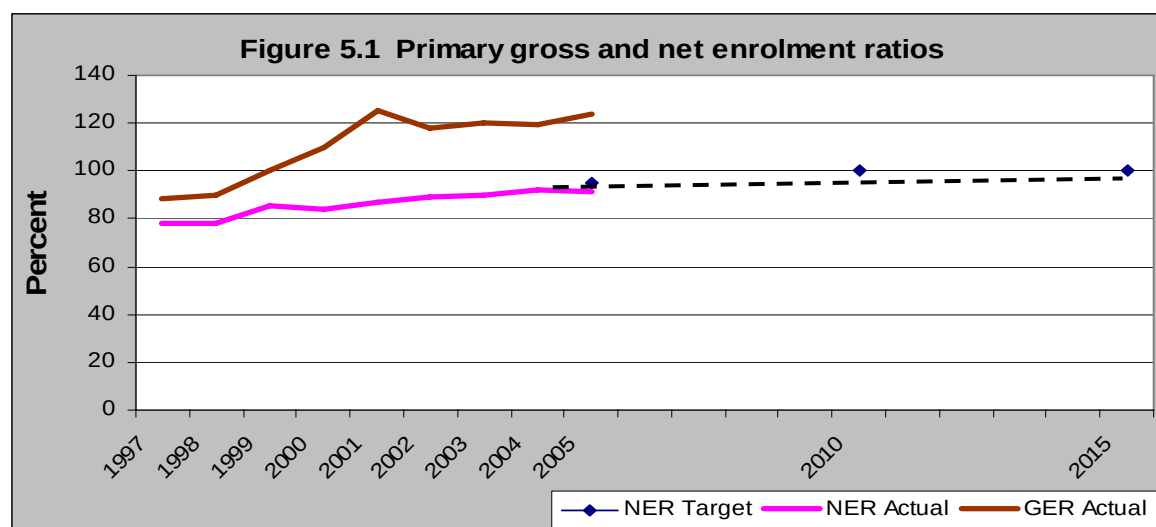
The total enrolment in pre-school has grown from 77,899 children in school year (SY) 2006/07 to 79,599 (of whom 39,996 are girls) children in school year 2007/08, indicating an increase of close to 2%. There is strong gender equity in the pre-school program with equal number of participating boys and girls. The number of public pre-schools has grown from 1,524 schools to 1,634 or (a 7.2% gain) i.e. almost each commune has one or two pre-

schools. Furthermore, there has been strong growth in the community and private sector provision of Early Childhood Education (ECE) in the various forms of community pre-schools, home-based ECE and private pre-schools.

The gross enrollment rate (takes account of all children enrolled, especially the large proportion of over-aged children) at the primary level rose from 110% in 2000/01 to 118% in 2002/03. The most substantial growth was in quintile 1 comprising the poorest population with a growth rate of 3.5%, followed by quintiles 2, 3, and 4, and a negative result of -2.3% for the highest quintile. The share of quintile 1 went up from 15.1% in 1999/00 to 17.1% in 2002/03. The number of enrollments at the primary level in poor communes (quintiles 1, 2, and 3) were much higher than in the better off communes. This trend continues and in 2006 GER increased to 124, of which girl's GER increased to 118.6. The GER typically rises until virtually all over-aged children have been absorbed, and then gradually declines towards 100% as the over-aged children progress through and out of the system.

Underprivileged children have greatly benefited from government policy in education, notably with the construction of schools in remote areas and the distribution of scholarships. Nevertheless, conditions in the schools should be further improved to facilitate education for girls.

Figure 18.1. Primary gross and net enrolment ratios



Source: WB and UNICEF. FTI.

The primary net enrolment ratio (NER) between 1997 and 2005 shows a slowing of growth, with a slight decrease recorded for 2005. NER is based on an enrolment of the appropriate age range (6-11 for primary) divided by the population of the same age range,

expressed as a percentage. It is a general experience that the closer a country comes to achieving full net enrolment, the higher the unit cost of including those children not yet in school. It will probably require one or more policy interventions (for example, to increase the promotion rate or to reduce drop-out) to shift Cambodia closer to the targets (WB and UNICEF, 2006, p. 13). As is apparent in figure 18.1 above, the primary GER shows a stronger growth trend than does the NER. The difference between NER and GER is most marked in remote rural areas.

Moreover, the gender gap has been considerably reduced in primary schools and junior secondary schools with the progress being made in improving the enrollment of girls. In fact the enrollment rate for girls at the primary level has exceeded boys'; 27% for girls and 22% for boys.

The number of pupils in primary education increased from 2.3 million in 2001 to 2.7 million in 2002, but reduced to 2.5 million in 2006. In 2008-09 almost all children between the ages of 7 and 10 are enrolled in school (Quinn, 2009c, p. 7).

The number of pupils completing primary school increased from 65.9% in 2003 to 90.3% in 2006. In 2008 the number of children reaching primary grade 6 was 293,632 (142,555 females, an increase of 100,000 compared to 2000. It is equivalent to 86% (88% female) of Cambodian children receiving complete primary education (Quinn, 2009c, p. 8). Repetition rate is high, at 12.8% in 2006.

The increase in the completion rate at the primary school level accompanied by the growing number of primary school entrants means that the inflow of students to the junior secondary school will rise.

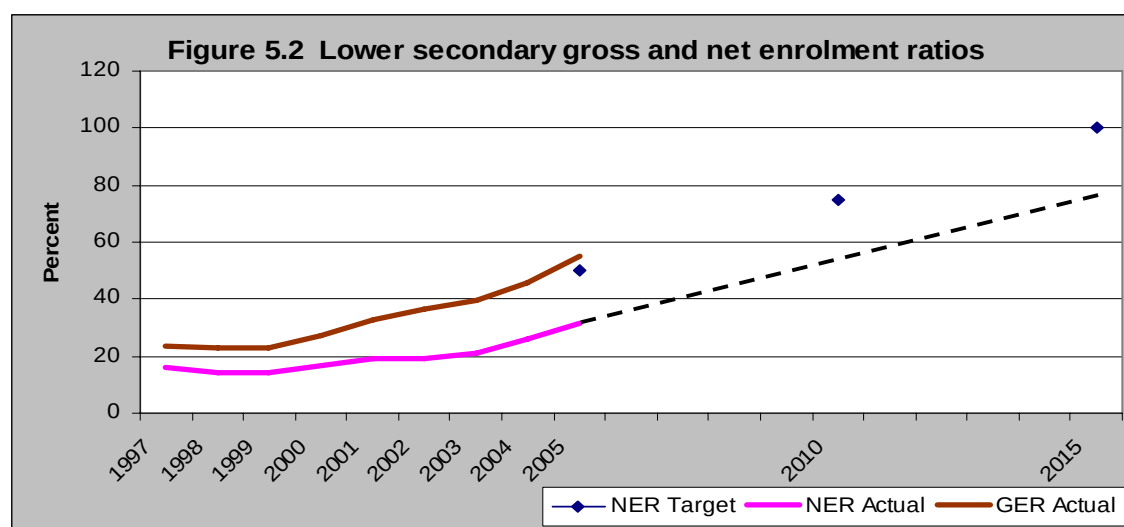
18.2.2. Secondary Education

The secondary level includes general secondary education along with technical and vocational education. In the area of general secondary education, the government's priorities are: (a) promoting the expansion of facilities by financing the construction of new school buildings in all districts, extending or rehabilitating existing facilities, and adopting approaches such as double shifts to increase the number of pupils enrolled; (b) assigning sufficient public resources to school facilities; and (c) improving the quality and effectiveness of the educational system by strengthening the pre-service and in-service training of teachers, and through provision of adequate teaching materials (books, equipment, etc.).

Recent reforms have concentrated on lowering school fees, especially for girls, raising academic standards, and cutting down the number of girls who repeat classes through

ongoing enhancement of the quality of education. Schooling of girls is continuing to get better, with girls accounting for a third of all students enrolled. Efforts at narrowing the gender gap will continue. Education reforms have also addressed the expansion of teaching services for senior secondary school in the regions that are inadequately served, increasing the number of subjects taught, mobilization of an adequate operational budget, and measures to ensure fair access for the poorest families.

Figure 18.2. Lower secondary gross and net enrolment ratios



Source: WB and UNICEF, FTL.

Actions supporting the upper level of primary studies and junior secondary studies, such as the provision of scholarships for the disadvantaged, have increased the number of students staying in school, as well as the number attending school in disadvantaged communities. The government has also facilitated private sector involvement in the establishment of teaching services in senior secondary schools.

The lower secondary (LS) education net enrolment ratio, which was only 15 percent in 1997, and by 2001 had increased only to 19 percent, subsequently accelerated its rate of growth, reaching 31 percent in 2005. The RCG's objective is to increase NER at the lower secondary level to at least 65% by 2015.

The lower secondary gross enrolment ratio, which includes over-aged children in the count, shows a stronger increase relative to the NER, as is the case in primary. At the middle school level, the gross rate of enrollment rose from 27% in 2000/01 to 50% in 2005. Meeting the target of 100% by 2015 is a challenge.

Education in LS has also been formidable. In 2008 the number of new children reaching LS grade 9 was 165,342 (76,641 females), representing over 100,000 more children entering grade 9 education in 2008 than in 2000. It also means that 44% (42% female) of Cambodian children receiving complete basic education (Quinn, 2009c, p. 9)

Equity is also improving in the provision of secondary education; gross enrollment rose by 30% in poor communes and 10% in the better off communes. However children in the poorest communes account for only 6.7% of middle school students and 1.8% of high school students, compared to 35% and 52% respectively for children living in wealthier communes.

The inequality of access to education is more severe at secondary school level, where children coming from wealthier communes make up 52% of enrollments compared to 1.8% of enrollments from the poorest communes. Gender balance is also lacking. Only 33% of Cambodian girls of secondary school age were enrolled; girls account for 25-30% of enrollment in vocational training or higher education institutions.

Upper secondary education has made rapid improvement and expansion, as a result of RGC's policy to establish an upper secondary school in all districts. Student enrolment in upper secondary school increased from 105,086 (33,465 females) in 2000-01 to 292,423 students (123,334 females) in 2008-09. The number of successful grade 12 graduates has also increased from 17,713 (5,786 females) in 2000-01 to 51,565 students (22,394 females) in 2008-09 (Quinn, 2009c, p. 10).

The main obstacles to the involvement of girls in the education system include: the absence of middle schools and secondary schools in the poorer districts and communes, and the level of poverty which prevents girls from attending school since they have to attend to family responsibilities at home.. Hence, the government is giving priority to the construction of new school facilities in all districts, and to a more targeted awarding of scholarships to poor students, especially girls.

18.2.3. Technical and Vocational Education and Training

The lack of technical and vocational education and training is an impediment to increasing productivity. However, arguments in favor of a proactive role for the State in TVET are not as easy to come by as for basic education, since businesses in theory should pay for the training of their employees and employees should also be willing to pay for their own training. Nevertheless, gaps in market operations (lack of information and financing, externalities, indivisibilities etc.) can result in an inadequate training supply. TVET has played a major role in the Asian “miracle.” Cambodia can benefit from the experiences of

its neighbors. In particular, vocational training programs need to be flexible and respond to the expectations of the job market.

In Cambodia, TVET is considered a sub sector of education. It includes a “higher technical and vocational education” component, and a “mid- and secondary level technical and vocational education and training” component. During its third mandate (2003-2008), the RGC created the Ministry of Labor and Vocational Training, which is charged with job creation and provision of TVET. The national TVET Development Plan (NTDP) for 2008 was reviewed and updated in early 2008, and is well aligned with the Ministry of Labor and Vocational Training’s (MoLVT) Strategic Plan (2006-2010).

In the private sector, there has been a strong growth in the supply of short-term vocational training (6 months, 1 year, or 2 years) since the 1990s in almost all branches of economic activity (trade, management, accounting, business, computer science, and tourism). However, continuing skills development remains a problem, except for workers who have the financial means to cover the cost of their own training in local fee-charging learning facilities.

A new training policy is now under consideration for promoting private sector employment. The new training policy should include the following elements:

- Rationalization of the financing of technical vocational education and training. The coordination of resources made available for TVET by the State, private enterprise, and development partners is crucial to avoid wastage.
- The development of private programs of vocational training should proceed in parallel with university education so that students do not lose valuable time in pursuing both in sequence. The involvement of the private sector in this new approach is logical since apart from the social contribution, it is also seeking to increase profits by training its future work force in probable work-related assignments even before the workers are formally employed.

In the area of TVET, the government will diversify its programs and improve their quality and management. It will promote flexible education systems and TVET at secondary school level in response to emerging labor market demand. This approach requires close coordination between the government and the private sector. MoLVT has 38 institutes and centers serving 24 provinces and offering programs from basic skills training to advanced degrees. They train approximately 5,000 individuals each year due to limited government budget. The Ministry of Women’s Affairs (MoWA) has 11 Women’s Training Centers offer a range of traditional programs. They graduate around 3,000 trainees a year. There are also an estimated 300 private trade schools, largely in the information technology

(IT) and mechanics areas and currently unregulated. It is estimated that around 20,000 trainees graduate per school year from private skills providers. The formal sector creates approximately 50,000 new jobs each year while the workforce increases by 300,000 people annually. Overall, active labor market programs are limited.

MoLVT is exploring different strategies to develop skills and link them to employment as measures to reinforce labor market regulations. The National Qualification Framework, Accreditation of TVET courses, is being developed and a National Employment Agency is being established. Furthermore, pilot programs are being designed to address growing labor force, in particular youth under 30 years of age covering about 70% of total population.

18.2.4. Higher Education

Cambodia is confronted with a number of new development challenges, such as rapid globalization of the economy and the ever growing importance of science and technology, notably computer science and IT in all walks of life. To remain competitive the education system of Cambodia including the TVET component should stress both the imparting of knowledge to all sections of the population relevant for life in the modern world as well as stepping up the quality of education. The curriculum at all levels of education should be continuously reviewed and improved to reflect the new knowledge that is constantly emerging. The teaching and training community must be dedicated enough to be continuously updated on new developments and knowledge. The challenge is huge but there is no option for Cambodia but to catch up with the rest of the world in education. Institutions of higher learning must also find the right balance between three objectives: addressing the mission of higher learning, financial viability and preservation of traditional values.

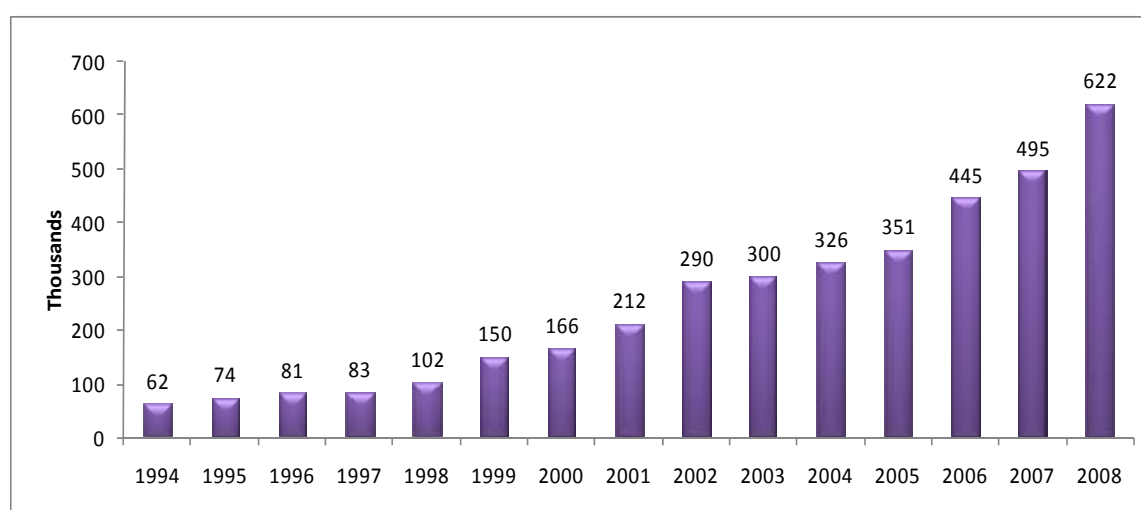
To meet the need for higher education graduates, the RGC has introduced policies of encouraging private higher education institutions. As a result, the number of higher education universities and institutes increased rapidly. However, the academic quality of higher education graduates has been low and has not been so much appreciated by the labor market. In response to this problem, the RGC put in place the Accreditation Committee of Cambodia (ACC), charged with outside evaluation of the quality of institutions of higher learning. Much remains to be done to increase the average of higher learning universities and institutes up to the regional level.

18.3. Sector Funding Mechanisms

In order to correct the under-funding in the education sector and allow mandated programs to be carried out with reasonable efficiency it is estimated that the budget allocated to education should be gradually brought up to 15% to 18% of public expenditures.

Government expenditure on education rose from 1% of GDP in 1996 to 2% in 2002. Education accounted for 18.3% of the government's current expenditures in 2008 compared to 9% in 1997. If investment expenditures are also included, education is probably the State's largest single expenditure item, more than defense. The enlargement of the fiscal outlays has been accompanied by the implementation of the Priority Action Program (PAP) focusing essentially on the poorest of the poor, with more than 60% of the budget devoted to primary education. However, the education sector is not spared when delays occur in the remittance of allocated funds, including through the Priority Action Plan (PAP).

Figure 18.3. Education expenditures
(in billion riels)



Source: Ministry of Economy and Finance

Education spending increased from 62 billion riels in 1994 to 622 billion riels in 2008. The budget for education increased substantially since 1999, as a result of the RGC's education reform policy. The education budget in 1999 increased by 47%, compared to 1998. During the last decade education expenditure has quadrupled and reached 622 billion riels (US\$152 million) in 2008. On top of government spending, development partner's assistance to education amounted to around US\$50 to US\$60 million a year. The State's share in total education expenditure is only 50%; parents continue to assume 35% of the cost (40,000 riels per child per year on the average in primary school, and 300,000 riels in secondary school), with the remaining 15% coming from foreign aid.

However, it was estimated that the funding gaps in the education sector is equivalent to US\$100 million a year. The overall financing for education is under extreme pressure, particularly as a result of the expansion in education services and enrolment over the last

few year. An estimate of unit costs suggests that unit costs in primary are around US\$28 per child per annum and lower and upper secondary unit costs are around US\$70 and US\$80 per child per annum respectively (Quinn, 2009a, p. 13).

To meet the funding gap the RGC has applied and received additional financing under the global Fast Tract Initiative (FTI) to increase education expenditure for 2007-2009.

Table 18.2. Education Program Cost

(in USD million)

	2006	2007e	2008e	2009e	2010e
Education Program Cost	343.1	330.1	338.2	347.1	357.3
Domestic funding	166.2	185.1	197.9	150.0	166.5
Of which General Budget Support	0	7	7	7	0
External support	60.3	51.4	28.9	23.4	19.6
Funding gap	116.6	93.6	111.4	173.7	171.2
Basic Education Program Cost	289.2	289.2	289.2	289.2	289.2
Domestic funding	113.0	126.8	136.6	105.0	118.2
External support	54.8	44.1	22.8	17.6	12.2
Funding gap	121.4	118.2	129.9	166.5	158.8
General Budget Support		35.0	35.0	35.0	35.0

Note: e for estimated.

Source: WB, FTI Country Information Form .

The above funding gap was an estimate of resources needed to fully implement education reform under the FTI. The education program costs are based on a model that was used to calculate the resource needs for implementing the sector plan.

18.4. Conclusion

The Government recognizes that expanded equitable access to, and enhanced quality education are critical to sustainable economic development. Policy, strategy, and program priorities to realize the mentioned goals are highlighted in the Education Strategic Plan (ESP) and the Education Sector Support Program (ESSP) 2006-2010. The 2007 Education Law makes a significant contribution to expanding opportunities for equitable education and improving the quality of education and its service delivery. Implementation of Program Budgeting (PB) in the sector has increased the opportunities for systematically linking budget execution and programmatic achievement.



Chapter 19

Health

19.1. Background

The health sector in Cambodia is characterized by under-developed infrastructure and low quality service provision. Health care staffing is in short supply, of increasingly unequal distribution, but disinclined to work in the rural and remote areas of the country. There are limited means of transferring patients out, especially in poor, from remote areas of the country. The results of the perceptions survey of communities on access to health care services and the quality of care confirm this assessment. Much remains to be done to improve the health and sanitary conditions for the majority of people to an acceptable level, especially in the rural areas. The use of public medical and health care facilities is low both because of low income and insufficient health infrastructure and personnel.

The RCG has given high priority to the provision of health services in the Rectangular Strategy since lack of access to health services by the poor worsens the deprivation caused by income poverty. Low income limits access to health care. Conversely, poor health limits one's physical and mental capabilities leading to loss of earning potential and thus contributes to the person's descent to poverty. Thus key health parameters are rightly recognized as MDGs by the UN.

There have been some success stories in public health sector in the last few years, notably the eradication of poliomyelitis, the lowering of the death toll from malaria, and an expansion of the health care apparatus across the country. Notwithstanding these Cambodia is facing considerable challenges in the health sector. In the struggle against the spread of HIV/AIDS, Cambodia has made rapid progress in reaching the relevant MDG. The rate of prevalence of HIV/AIDS in Cambodia has dropped by nearly one third, declining from 3.9% of the population in 1997 to 1.2% in 2003, and improved further to 0.9% in 2007. But this achievement masks the substantial increase in the cases of transmission of the disease from husband to wife and from mother to child and the increase in the HIV/AIDS prevalence among young people, especially the vulnerable group. To combat this trend, government action is focusing on screening, psychological counseling, and prevention of transmission from mother to child, paying particular attention to young people, teenagers, and women.

Malnutrition among children under 5 years of age continues to be a major public health problem. In 2006, 36% children under 5 are stunted or underweight, showing signs of chronic malnutrition or emaciation. The mortality rate among children under 5 years and the infant-child mortality rate dropped drastically in the last few years, but remain very high compared to other countries in the region. Cambodia thus will have difficulty in reaching the CMDG of reducing the rate of maternal mortality, as this indicator remains very high.

The RCG's priorities in the health sector include implementation of prevention programs, communicable disease control, promotion of maternal and child health, and strengthening of emergency services and health education and awareness raising, in particular in rural communities. The poorest of the poor will be given free access to medical services in referral hospitals and health centers. A **community-based health insurance** scheme has been developed to mitigate health issue burden on the poor. **Equity funds**, conceived in order to facilitate access for the poorest to quality medical care, will be strengthened and extended. The government will enact and enforce medical legislation and regulations in order to guarantee medical services and medical practices of high quality, along with food security. The government will continue to promote recourse to traditional medicine, with appropriate information and supervision, in conjunction with modern medicine.

19.2. National Health Care Strategy

In 2003, the RCG adopted a number of strategic documents aiming to improve the provision of health care and nutritional services, including a five-year Strategic Plan for the Health Sector (2003-2007) and the Cambodian plan for investment in nutrition (2003-2007).

The 2003-2007 strategic plan emphasizes the provision of high-quality health services, establishing an equity fund to relieve the poor of direct payments in order to widen access, changing the behavior of health personnel, increasing the transparency of institutions responsible for the management of care, mobilizing resources, including private insurance premiums and community insurance based on prepayment. Guidelines for implementation of these policies highlight the need to enhance benefit to vulnerable groups, the necessity of being in tune with public needs, sustainable funding, involvement of rural communities, human resources capacity building and development, as well as partnerships.

The government policy on health care is based on the following priorities: provision of basic health care for all the population of Cambodia; provision of specialized essential services; decentralization and deconcentration of the financing, planning, and administration functions within the health care sector; optimizing of human resources; prevention and control of communicable diseases and certain selected non-communicable diseases; quality care for mothers and children; enforcement of laws relating to health;

active promotion of behaviors linked to good health or healthy living among the population; quality, effectiveness, and efficiency of service provisions; increased promotion of effective public and private partners to streamline the health care sector; effective use of the health information system in order to assure the implementation, follow-up, and performance-based evaluation of results in the health sector, and promotion of equitable access to priority services, especially for the poor.

A new Health Strategic Plan for 2008-2015 was adopted in 2008, which sets the following strategic objectives: reducing the health, social and economic burden of communicable diseases; combating HIV/AIDS, tuberculosis and malaria; preventing and reducing disease, disability and premature death from chronic, non-communicable conditions, mental disorders, violence, injuries and visual impairment; reducing morbidity and mortality and improving health during key stages of life, including pregnancy, childbirth, the neonatal period, childhood and adolescence, and improving sexual and reproductive health and promoting active and healthy ageing for all individuals; reducing the health consequences of emergencies, disasters, crisis and conflicts, and minimizing their social and economic impact; promoting healthier environment, intensifying primary prevention; improving nutrition, food safety and food security; improving health services through better governance, financing, staffing and management; and ensuring improved access, quality and use of medical products and technologies.

The objectives for the health strategy are to improve the health indicators of the Cambodian population, with special emphasis on the poorest of the poor. The indicators relate to reduction of infant and maternal mortality, control of communicable diseases, and improvement of nutrition for women and children. The improvements will be achieved through enlarging access to health care services and the knowledge and skills level of parents and others caring for children, and encouraging childbirth assisted by qualified personnel. The needed actions are technical interventions targeting the main causes of death, such as malnutrition, diarrhea, illnesses preventable through vaccination, parasitic infections and illnesses. The effectiveness of these actions depends on an efficient system of public and private medical and health care structures and adequate financing.

19.3. Performance of the Health Sector

Considerable progress has been made in improving health status in Cambodia since the 1990s. The key health indicators are provided by the Cambodia Demographic and Health Survey conducted in 2000 and 2005.

19.3.1. General Health Status of the Population

The Cambodia Demographic and Health Survey 2005 provides an updated and reliable data on fertility, maternal and child health, nutrition, malaria, prevalence of HIV/AIDS, women's status and domestic violence.

Table 19.1. Health indicators

	CDHS 2000	CDHS 2005
Live expectancy (years)		
Female	58	64
Male	54	58
Mortality rates (per 1,000 live births)		
Infant mortality	95	66
Child mortality	33	19
Under 5 mortality	124	83
Maternal Mortality (per 100,000 live births)	437	472

Source: Cambodia Demographic and Health Survey 2005; NIS.

Average life expectancy increased from 58 years for women and 54 years for men in 1998 to 64 years and 58 years in 2005. Infant, child and under 5 mortality rates dropped drastically, reflecting increase in health financing during the last decade. Infant mortality rate declined from 95 per 1,000 live births in 1998 to 66 in 2005, while child mortality rate dropped from 33 to 19 during this period. Under 5 mortality reduced sharply from 124 per 1,000 live births in 1998 to 83 in 2005. However, the challenges remain, as maternal mortality remains very high, at 472 per 100,000 live births in 2005. Further improvement in tertiary health institutions is required to make a real impact on the status of women's health in Cambodia.

19.3.2. HIV/AIDS, Tuberculosis and Malaria

Cambodia has been successful in the struggle against the spread of HIV/AIDS. The rate of prevalence of HIV/AIDS declined from 3.9% of the population in 1997 to 1.2% in 2003, and further to 0.9% in 2007, due to the implementation of the Cambodia's National Strategic Plan for HIV/AIDS 2006 – 2010. In 2007, the Ministry of Women's Affairs developed its five-year Strategic Plan on Women, the Girl Child and HIV/AIDS 2008 - 2012. Women represent around 88% of the consultations, provided by government and NGO clinics. Access to care and treatment services is a major concern for rural areas due to the complexity of anti-retroviral therapy (ART) services. The percentage of people with advanced HIV infection receiving anti-retroviral combination therapy has improved

further. The number of adults receiving ART has increased from 18,344 in 2006 to 24,123 adults (51.2% women) in 2007; the number of children receiving ART also increased from 1,787 in 2006 to 2,541 children (47% girls) in 2007; an additional 11,235 HIV positive people (including 1,840 children) were receiving OI (opportunistic infection) prophylaxis and 39 operational districts (ODs) have a full Continuum of Care. The proportion of adult people still alive 12 month after commencing ART is around 87.6%, above the 2007 target of 85% of NCHADS. The number of facilities providing prevention of mother to child transmission services increased to 99 in 2007, covering all provinces; and the number of ODs having at least one health facility providing such services increased from 39 to 59 for the same period.

But this achievement masks the substantial increase in the cases of transmission of the disease from husband to wife and from mother to child and the increase in the HIV/AIDS prevalence among young people, especially the vulnerable group. To combat this trend, government action is focusing on screening, psychological counseling, and prevention of transmission from mother to child, paying particular attention to young people, teenagers, and women.

The National Health Strategic Plan for Tuberculosis Control 2006 – 2010 aims to reduce TB (tuberculosis) prevalence and the number of TB deaths. In 2007, all 957 health centers and 74 referral hospitals provide the full DOTS program (directly observed treatment, short-term program) for TB patients free of charge. The proportion of smear-positive TB cases detected is up from 60% in 2003 to 65.4% in 2007, approaching the global target of 70% case detection, having for many years surpassed the 85% WHO target for treatment success. Collaborative TB/HIV activities increased from 222 health centers in 2006 to 522 health centers in 2007.

Between 2006 and 2007, the number of malaria cases has decreased from 100,000 cases to 59,000 cases, as a result of complementary control strategies implemented by the National Center for Parasitology, Entomology and Malaria Control (NCPeM) and its partners. The number of deaths from malaria decreased from 2.81% to 1.68% for every 100,000 people, due to better health education, wide-scale distribution of insecticide treated nets and training of village health volunteers to test blood and provide medication. Around 81% of malaria endemic villages received treatment and insecticide-treated nets in 2007.

19.3.3. Malnutrition

Diet and food security also have a crucial influence on the state of health of the poor. Almost half of Cambodia's children are malnourished, and an eighth of them die before the age of five, largely because of avoidable diseases. More than 50% of Cambodia's population of 13 million is under 18 years of age. Guaranteeing that they will become healthy, educated

adults fit to contribute to the sustainable development of their country is a formidable challenge.

Malnutrition, with its effects on the immune system, aggravates the risk of illness and the seriousness of infections. When combined with other factors, it is the cause of more than half of infant deaths. For this reason, the government pledges, in close cooperation with bilateral and multilateral partners, to improve food security for Cambodians, in both rural and urban communities, using targeted programs which encourage a healthy diet for mothers and children.

Malnutrition among children under 5 years of age continues to be a public health problem. However, nutritional status of children has improved in the past 5 years. Currently 37% of children are stunted and 7% are wasted, compared with 45% and 15% in 2000 (CHDS, 2005). Stunting is most common in Pursat (62%) and least common in Phnom Penh (22%). Women also suffer from nutritional deficiencies. 47% of women have some degree of anemia. 20% of Cambodian women age 15-49 considered thin, while 10% are overweight.

19.3.4. Access to Health Care Services

Overall the basic health care coverage in remote areas of the country has improved but the progress has been slow. The number of health centers with qualified staff and adequate equipment rose from 678 in 2000 to 768 in 2007. But only 82% of the 991 health centers of the country were able to dispense the basic care required by their mandate and deliver the minimum package of activities. Only ten district hospitals (out of 171) currently handle surgical cases of a complexity equivalent to that available in specialized hospitals; this is not adequate for Cambodia's remote regions. Furthermore, less than 55% of population lives within 10 kilometers of a public health center, which explains why they are seldom used by poor people.

The health system reached more children; health centers (HCs) implementing IMCI (integrated management of childhood illness) increased from 456 HCs in 2006 to 533 HCs in 2007. Programs exist to prevent micronutrient malnutrition; from 2006 to 2007, the percentage of children under one year, fully immunized (3 times) for diphtheria, pertussis or whooping cough, and tetanus (DPT3) increased from 80% to 82% and vaccinated against measles increased from 78% to 79%. Vitamin A capsule coverage for children 6 – 59 months improved, from 78% in 2006 to 86% in 2007.

Public health centers have been most often used in both urban and rural areas. Health centers in rural areas were twice as likely to be visited for first treatment than health centers in urban areas (14% compared with 8%). However, factors hindering the use of public health care services include: health facilities are located too far away, no link roads from the

village to the health facility, prohibitive cost of travel (transport and time), prohibitive cost of services, especially medication and hospital stays, application of draconian cost recovery procedures, absence of competent personnel in the health facilities, and the bad condition of infrastructure. Private pharmacies were much likely to be visited for first treatment in urban areas than in rural areas (25% compared with 7%). Trained health workers and nurses were more commonly sought out for first time treatment in rural areas than in urban areas (CDHS, 2005).

To improve the coverage of health care services, priority has been given to strengthening the implementation of the minimum package of activities (MPA) and the complementary package of activities (CPA) throughout the country; and to the establishment of efficient systems of distribution and supply of documentation, medicines, and equipment. Within the framework of strengthening mother and child health (MCH) services, special attention will be given to the implementation of integrated management of childhood illness (IMCI) services, with a fair balance between curative and preventive services. The referral mechanisms will be strengthened in order to facilitate access to health care services by even the poorest of the poor. The RGC has brought about the necessary institutional and organizational changes necessary to integrate national programs, especially at the provincial and local level, develop an approach based on quality and interventions based on necessity, and promote both private sector and local community involvement in the planning and practice of medical care.

In the key area of behavior change and communication, particular attention will be paid to enforcement of the code of ethics for health personnel. Training in communication, especially communication with the target groups (mothers, children, and adolescents) will be dispensed in order to improve the quality of health services for the MCH components and for young people. To facilitate access for all and for the poorest of the poor in particular, the confidence of the users in health care services will be built up by informing them about the medical services available in their area of residence.

In order to boost quality of service throughout the sector, priority will be given to designing, implementing, and applying accreditation mechanisms for health personnel and institutions. Ensuring the involvement of consumer groups in the quality building initiatives will be an essential component of the strategy to strengthen health care services. Merit-Based Pay Initiative (MBPI) and Priority Mission Group (PMG) have been implemented in the health sector in order to give incentives to health workers.

Building motivation among teams, particularly the development of mechanisms of supervision, discipline and rewards is a top priority. An option that government will consider is granting bonuses to personnel who agree to work in remote locations, as well as adjusting training facilities in order to meet the needs of people living in remote areas. An

accelerated strategy for the deployment of midwives in rural and remote areas will be studied.

19.4. Financing the Health Care System

To ensure the proper implementation of health policy the RGC will increase the budgetary allocations of the health sector and continue promoting international community and private sector involvement to increase investments in this sector. A top priority is to improve the management and financial viability of the public health system.

A Strategic Framework for Health Financing, 2008-2015 was adopted in 2008 to ensure the successful implementation of the Second Health Strategic Plan, 2008-2015. It aims to put the various existing forms of health financing under a single coherent plan. The financing of Cambodia's health care systems comes from three main sources: government (12% of national budget or more than 1% of GDP; US\$6 per capita per year in 2007), donor support (US\$103 million or US\$7 per capita per year in 2007), and direct patient payments (two-thirds of all health expenditure or US\$25 per capita per year). Out-of-pocket expenditure go to either user fees in public facilities or the private sector. The achievement of the national health care objectives necessitates resources and intensive cooperation between the national authorities, multilateral organizations, donor countries, communities, the private sector and other stakeholders.

The Strategic Framework for Health Financing, 2008-2015 is based on the following mixed model: (i) the wealthiest section of the population finances their specific needs in the private health sector and by purchasing complementary private health insurance if needed; (ii) the formal employment sector of civil servants and private-sector employees are to be covered by Social Health Insurance Schemes; (iv) the not-so-poor (those living just above the poverty line) will protect themselves by community-based health insurance (CBHI); and (v) the poorest part of the population (those living below the poverty line) will be protected through a range of social protection measures including fee exemptions, health equity fund (HEF) and other subsidies for health care costs, such as voucher schemes. It has the following strategic objectives: (1) increase government budget and improve efficiency of government resource allocation for health; (2) align donor funding with Ministry of Health strategies, plans and priorities and strengthen coordination of donor funding for health; (3) remove financial barriers at the point of care and develop social health protection mechanisms; (4) efficient use of all health resources at service delivery level; and (5) improve production and use of evidence and information in health financing policy development.

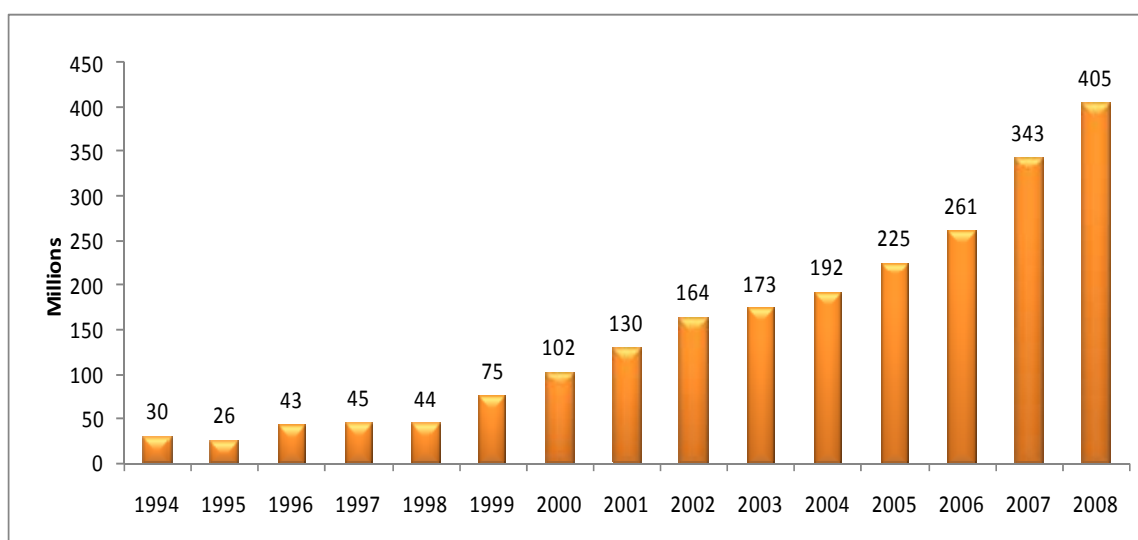
19.4.1. Government Health Expenditure

The effectiveness of health care systems depends on adequate financing. Public expenditures for health care have increased sharply by more than five folds during the last decade in nominal terms at an annual average rate of about 54%, reaching 405 billion riels in 2008, compared to 75 billion riels in 1999. As a proportion of the GDP, public expenditure for health grew from 0.4% in 1998 to 1.08% 2008; in per capita terms it rose from US\$1 in 1998 to US\$3 in 2003, then to US\$6 in 2008. Some 27% of the budget is allocated to Provincial Health Department (PHD).

The government intends to pursue the high case scenario for funding the health sector. Even in the low case the highest priority will be to improve the coverage and quality of service in the remote areas. Equity in the provision of primary health care is another key issue. To bring it about, the inequalities in accessing health services and their use in addressing leading health care issues need to be surveyed, and the most disadvantaged people identified.

In 2000 the Ministry of Economy and Finance provided some supplementary financial resources for implementing the Priority Action Plan (PAP) for health care activities in seven provinces and cities and the eight national programs. Resources have also been allocated to promote health care in 32 districts covered by the Accelerated District Development (ADD) program.

Figure 19.1. Expenditure for health care (in billion riels)



Source: Ministry of Economy and Finance

The provinces (Provincial Health Department), where 90% of Cambodia's inhabitants live, receive only 45% of State funds, despite the more advantaged situation enjoyed by the population in the former. At the service delivery level, Operational District (OD) receives 7% of the government funds, referral hospital—26% and health centers 32%.

Salaries account for less than 12% of current government expenditures. The extremely low salaries prompt some government medical personnel to work in the private sector. Moreover, a large part of the budget allocated for health care is released only in December mainly due to the slow public procurement procedures for medicines. To tackle this problem the RGC has introduced MBPI and PMG to provide more incentives to the medical workers, especially those who work in the rural areas.

The government is particularly concerned with rural urban migration. To stem the outflow of rural population a key initiative is to upgrade rural health facilities. By increasing salaries and introducing a system of geographical bonuses for working in disadvantaged areas and among the vulnerable communities, the delivery of health services to the poor can be upgraded.

Other incentives strategies to improve service delivery include non-financial benefits such as on-the-job training and opportunities for rotation and promotion. There is also a proposal to recruit and train people who live in remote areas that agree to work in their home region.

During 2004-2008 the government has devoted considerable attention to health sector reform. A key initiative is decentralization of resources and the decision-making process to the district level. Having the local people involved in planning and delivering health care will ensure that the services are demand based and the service providers are made accountable to those who receive the services.

Performance contracts and salary and wage systems linked to performance and results-driven management is being practiced since the early 2000s. Performance contracts are agreements concluded between the Ministry of Health and district hospitals and NGOs who are the service providers. The contracts set out the objectives and anticipated outcomes for a given period. These are formulated on the basis of priorities that are set at the policy level, NGO missions, and budgetary ceilings.

19.4.2. Development Partner-Funded Health Expenditure

In addition, health care expenditures covered through international aid amount to \$7 per capita person per year, an increase from US\$4 in 2003. In all, per capita health expenditures financed by the RCG and development partners have risen to US\$13.

Despite the recent sharp increases in the government budget allocation, the health care sector is still chronically underfinanced. The capacity to fund the health care sector will be influenced by the success in resource mobilization, improving efficiency in resource allocation and availability of foreign aid for the sector. Cambodia therefore is characterized by high dependency on development partner's funding for health care, reaching US\$103 million in 2007.

As a result of this dependency, a number of different health finance mechanisms have emerged: donor funding, donor funded pools (Health Sector Support Project and SwiM), user fees at public facilities, fee-exemptions for the poor, contracting of public delivery (contracting out to NGOs or contracting in to referral hospitals at the provincial level), Health Equity Fund (HEF), community-based health insurance (CBHI) and proposals for different social health insurance scheme (SHI).

19.4.3. Health Equity Fund

Cambodian households bear considerable burden of health expenditure, as health care expenses incurred by families are estimated at about US\$25 per year, bringing the total health expenditure in Cambodia to US\$38 per capita per annum. Of the \$25 expenditure, only \$0.8 was the expense to the public health sector. Therefore, if there is a calamity requiring a huge outlay of medical expenses the poor have no recourse except to sell whatever meager assets they hold including land which leaves them further impoverished. It was estimated that 26% of patients must borrow money or sell property to pay for their medical expenses.

To supplement the public health spending, public health facilities have resorted since the early 2000 to collecting user fees from patients. This has the effect of reducing access by the poor to public health services. To address this problem, a Health Equity Fund was piloted in order to provide the poor with fee exemption. Since 2005, the HEF is a government-development partner funded project, while NGOs are contracted to monitor the exemption scheme from user fees. A system of poverty ID was introduced to facilitate this task. In 2007 some 1.3 million of Cambodians were exempted from the user fee system at the public health facilities.

Currently, the benefits of health care are eluding the poor. The middle class obtains the major share of the benefits. The 40% of the poorest population level consumes only 30% of public expenditure for health care. An improvement in the effectiveness of the system will come about through salary raises for medical personnel, exemption from consulting fees for the 30% of the population living below the poverty line, and priority given in the budget for improving local health care facilities.

19.4.4. Social Insurance Scheme

The community-based health insurance (CBHI) is still being piloted and implemented in a few referral hospitals. Only about 46,000 Cambodians have been CBHI members.

19.4.5. Private Health Service Provider

The growth of private sector investment in health care infrastructure has improved the quality of care in the country, especially in the tertiary sector (hospitals and highly specialized clinics). The private sector offers working and salary conditions that are more attractive, but this aggravates the lack of medical and nursing personnel in public sector establishments and in rural communities, which are the only recourse available to the poor.

Regulation of services in the private sector, pharmacies, and clinics, has been strengthened to ensure compliance with the laws currently in force. Notwithstanding the regulation, the number of pharmacies and clinics operating illegally remains high. It is estimated that there are currently 1,876 locations providing private health services, including medical care, dental care, blood tests, and aesthetic surgery. About 80% of these clinics are operating illegally. There are altogether 114 private clinics, for a total of 500 beds.

SECTION VII

PUBLIC FINANCE

Chapter 20. Tax System

Chapter 21. State Budget



Chapter 20

Tax System

Cambodia's tax system is organized around two regimes: the self-assessment regime and the estimated regime.

20.1. Self-Assessment Regime

Based on the declaratory principle, the self-assessment regime implies that taxable persons determine themselves their basic taxable amount and pay their tax without the intervention of tax authorities.

To start with, the tax authorities receive the tax return from taxable persons. They then audit the tax return that has been submitted of the taxable person's own accord in order to check whether the income declared complies with the information included in the taxable person's file and whether the latter complies with the regulatory provisions in force in terms of taxation.

This system has the following benefits:

- Liable persons are responsible for the information contained in their tax return.
- They submit their tax return of their own accord and pay the tax calculated from the information declared.
- Administrative expenses are reduced.
- The tax authorities have more time to check taxable persons in breach of regulations (undeclared activities or using organized tax evasion networks).
- Enforcement of laws is strengthened.

Persons subject to the self-assessment regime are all kinds of import, export or investment companies with a minimum annual taxable turnover of:

- a. 500 million riels for companies providing goods.
- b. 250 million riels for service sector companies.

- c. 125 million riels for companies that are bound by contract with the government.

In late 2008, Cambodia had a total of 11,196 companies; 2,933 of which were small-, medium- or large-size activity companies (and that have submitted their tax return to the Tax Department). They are divided into 1,793 large-size companies, and 9,403 small/medium-size companies. Self-assessment regime now spreads over all provinces and 7 districts in Phnom Penh. Revenue originating from taxes of taxable persons subject to the self-assessment regime account for 90 percent of the total revenue of the tax department with regards to taxes on industrial profits.

20.2. Estimated Regime

The estimated regime is for small economic activities. They account for 39,086 enterprises that have an annual turnover lower than that of taxable persons subject to the self-assessment regime. Receipts from taxable persons subject to the estimated regime account for 20 percent of the total revenue of the Tax General Department with regards to taxes on industrial profits.

The Tax General Department is responsible for collecting government taxes and provincial taxes. This taxation regime goes beyond the declaratory system: calculation of tax liability is made by the administration and based on various factors:

- Location of activity (capital city or province).
- Number of employees.
- Type of activity.

Then, the administration undertakes the collection of taxes in the field. It is a more involved procedure since, for a rather low return, it demands the mobilization of a large number of officers to collect liabilities from people who are often rather ill-informed of “tax compliance.”

20.3. Destination and Type of Tax

Taxes can generate revenue for the national budget, as follows:

- Income tax.
- Profit tax.
- Tax on rental of houses and land.

- VAT.
- Excise duties.
- Specific taxes on certain goods and services.
- Slaughter tax.
- Stamp duties.

Taxes can contribute to generate revenue for the provincial and municipal governor budget, as follows:

- Tax on unused land.
- Registration tax.
- Trade license tax.
- Slaughterhouse tax.
- Tax on motor vehicles.
- Tax on tobacco and alcohol.

The current tax system of Cambodia comprises direct tax, indirect tax and various duties and fees. Customs duties (CD) on foreign trade (imports and exports) are indirect levies considered separately.

Direct taxes are taxes levied on wages of physical persons, on capital profits and gains.

In Cambodia, a distinction is currently made between:

- Tax on industrial and commercial profits (ICP)
- Income tax.
- Property tax, for the time being in the form of a single asset tax, rental income tax.

Indirect taxes are taxes on goods and services: they are payable on the production and consumption of goods and deliveries of services, from import to release for end-consumer use, and are passed on throughout the commercial cycle of the good or service delivered. In Cambodia, the system currently lists 5 categories of indirect taxes:

- ***Turnover tax***—ToT in the flat-rate regime—and a value-added tax, VAT in the real regime.

- ***Excise duties*** or specific taxes on certain local or imported goods—carbonated drinks, spirits and alcoholic beverages, cigarettes, cigars and cigarillos, petroleum products, gasoline and lubricating oils.
- ***Transport duties*** or conveyance and vehicle taxes, in the form of registration stickers.
- ***Fees for transactions*** and legal acts and registration fees on transfers.
- ***Customs duties.***

20.4. Description of Each Type of Tax

20.4.1. Tax for the National Budget

20.4.1.1. Income Tax

Income tax consists of tax on the wage deducted at source by the employer who remits the sum to the Tax General Department each month. This tax applies to wages, bonuses, overtime, fringe benefits and additional benefits.

The following are not subject to tax:

- Occupational expenses incurred by the employee in the interest of the company or for people with limited resources.
- Severance pay as defined by the Labor Law.
- Additional fringe benefits specified in the Labor Law.
- Free or low-cost supply of uniforms or workplace equipment;
- Fixed allowances for mission expenses or travel costs.

Income tax rates are incremental:

- The employer deducts a 20-percent tax on additional monthly income.
- For non-residents, the tax is deducted when remittance is made with a 20-percent rate on taxable earnings.

20.4.1.2. Profit Tax

The Tax on Profit is the debt of a resident taxpayer on income from Cambodian sources and from foreign sources. For a non-resident taxpayer, this tax is assessed on income from Cambodian sources only.

Taxable monthly incomes			Tax rate
From 0.00 riels	up to	500,000 riels	0%
From 500,001 riels	up to	1,250,000 riels	5%
From 1,250,001 riels	up to	8,500,000 riels	10%
From 8,500,001 riels	up to	12,500,000 riels	15%
Over 12,500,000 riels			20%

The underlying principle is the submission of the annual return including balance sheet, outturn account or income statement and appendixes which bring about tax application after deduction of any advances that may have been paid throughout the year.

In any event, this annual return is the legally binding document opposable against the liable person regarding the previous fiscal year.

20.4.1.2.1. Profit Tax Rates

Tax rates on taxable profits are the following:

- ⇒ 20% for legal entities (enterprises), 30% for oil and natural gas operations or natural resource operations.
- ⇒ 9% for Qualified Investment Projects (QIP) approved by the Council for the Development of Cambodia (CDC) for a 5 year transitional period.
- ⇒ 0% for QIPs during the tax exemption period defined by the CDC.
- ⇒ From 0% to 20% according to an incremental rate for individuals and members of development groups.
- ⇒ 5% of gross premiums received over the year by insurers or reinsurers.

For liable persons subject to the estimated regime, the annual return is to be submitted annually to the Tax General Department by October 31 at the latest and shall be paid monthly based on profits in the flat-rate regime.

Profits are calculated by the taxable person and checked by the Tax General Department; in case of discrepancy, the amount is discussed with the taxable person or his/her representative.

These profits are calculated according to the type of operation. In a declaratory regime, the underlying principle is taxation based firstly on the information declared. The tax rate on fixed-rate profits is defined for 3 or 6 months, or for 1 year.

20.4.1.2.2. Withholding Taxes on Dividend Distribution

- ⇒ 20% for dividend distribution in case an enterprise pays the profit tax at a rate of 0%.
- ⇒ From 11% up to 19% for dividend distribution in case the enterprise has already paid the profit tax at a rate of 9%.
- ⇒ 0% for the payout of retained profits in case the enterprise has already paid the profit tax at a rate of 20%.

Enterprises receiving dividends after tax shall record these dividends in their books.

During the next distribution, taxes on additional dividends are exempted. Since a tax deduction has already been made beforehand, there cannot be a second deduction on a second payout (equalization tax or tax credit system).

20.4.1.3. Minimum Tax and Advance Payment of Profit Tax

Prepayment of Profit Tax—The self-assessment regime taxpayers including qualified investment project under the profit tax rate of 9% must file and pay, on a monthly basis, the prepayment of profit tax at the rate of 1% of the turnover (inclusive of all taxes except for VAT) realized in the previous month by the 15th of the following month. The turnover of the qualified investment project within the tax exemption period shall be exempted from this prepayment. The prepayment is deductible against the tax on profit at the annual liquidation of the tax.

Minimum Tax—The Minimum Tax is a separate and distinct tax from the tax on profit. This tax is subject to the self-assessment regime taxpayers except for the qualified investment project (QIP) recognized by the Council for Development of Cambodia (CDC). The Minimum Tax is imposed at the rate of 1 percent of the annual turnover inclusive of all taxes except for VAT, and is payable at the time of the annual liquidation of the tax on profit. The minimum tax may be reduced by the annual tax on profit that is actually paid.

20.4.1.4. Withholding Tax Payable by Residents

Withholding taxes payable at source amount to:

- ⇒ 15% for: (1) revenue of people providing services, (2) royalties on intangible assets and mineral resources and (3) interest paid by taxable residents (who are not bankers) to other taxable residents.
- ⇒ 10% for revenue coming from rentals of movable and immovable property.
- ⇒ 6% for interest paid by a bank to the residents holding a time-deposit/term account.
- ⇒ 4% for interest paid by a bank to the residents holding a bank account for an indefinite period.

Deduction of taxes pursuant to this Article only applies to interest paid to banks and to exempted incomes defined in this new Article 9.

Withholding taxes shall be applicable to payments (interest, royalties, rentals...) between enterprises taxable under the same self-assessment regime. These taxes are not applicable to the income of enterprises of the real regime operating services, managerial services, consulting and similar services.

20.4.1.5. Withholding Taxes on Payments Made to Taxable Non-Residents

Taxable residents who run a business and remit income to taxable non-residents shall pay the withholding tax, at a rate of 14%, on interest, royalties, rentals, managerial services and payment of dividends.

20.4.1.6. Value Added Tax (VAT)

The VAT has replaced turnover tax since January 1, 1999. VAT applies to taxable persons under the self-assessment regime: all types of enterprise, import, export and investment companies. Regarding sole proprietorships, VAT is applicable with a turnover starting at 500 million riels for supply of goods, 250 million riels for delivery of services and 125 million riels for government contracts.

Exempted deliveries (or exempted enterprises) are:

- Public postal services.
- Hospital/clinic services, medical/dental care services.

- Entirely State-owned passenger transport services.
- Insurance services.
- Basic financial services.
- Importing of personal effects exempted of customs duties.
- Non-profit public interest activities.
- Deliveries for diplomatic missions and international organizations.

VAT rate:

⇒ 10% on the taxable value of taxable deliveries.

⇒ 0% on the taxable value of goods for export and services provided outside Cambodia.

The VAT is to be remitted to the National Treasury, calculated on the difference between total VAT-out and total VAT-in in the month. The tax return and VAT shall be submitted and paid to the Tax General Department by the 20th day of the following month at the latest.

20.4.1.7. Turnover Tax

Turnover tax is payable each month at a rate of 2% and is applicable to taxpayers subject to the estimated regime (liable persons with low incomes who are not included in the self-assessment regime).

20.4.1.8. Tax on Rentals of Houses and Land

Tax on rentals of houses and land amounts to 10% for high rents sourced by rentals of buildings, houses, factories, warehouses, land lots, metal ore or coal mines, lakes and rice fields and salt marshes. This tax is payable by owners or those enjoying right of usufruct. Rents included in profits subject to the self-assessment regime and security deposits are exempted.

20.4.1.9. Miscellaneous Duties

Miscellaneous duties are applicable to certain goods imported or manufactured in Cambodia, and on certain products such as: cars, motorbikes, cigarettes (10%), alcohol and beer (30%), entertainment services (10%)... international and domestic passenger air transport (10%).

Notional amount for calculation of miscellaneous fees:

- For goods manufactured in Cambodia, the tax is calculated based on the ex-factory price mentioned on the invoice.
- For services, the tax is calculated based on the price shown on the invoice.

20.4.2. Taxes for the Budget of Provinces/Municipalities

20.4.2.1. Tax on Unused Land

This tax applies to land lots without buildings or with unused buildings located in municipalities and regions that shall be determined by the Appraisal Committee for Unused Land (Comité d'Évaluation des Terrains Non Utilisés – CETNU). The rates are set by the Department General of Taxation to reflect the value of the land.

20.4.2.2. Registration Fees

The rate is 4% for transferring ownership of movables, vehicles and land lots through sale, trade-off or transfer of shares for companies.

The fee amounts to 100,000 riels for registering the establishment or the merger of a company and for supply contracts with the government.

This tax is payable by the buyer and is calculated on the real value or the value determined by the Ministry of Economy and Finance.

20.4.2.3. License Taxes

License taxes are annual taxes applicable to all types of enterprise (commercial, industrial or service). For existing enterprises, the basis for calculation of this tax is the turnover of the previous year. For new enterprises, the basis of calculation is the estimate. The amount of this tax is applicable from 15,000 up to 1.1 million riels.

20.4.2.4. Slaughter Tax (1991)

This tax amounts to 3% and is applicable to the price of cattle, buffalo, hogs...

20.4.2.5. Motor Vehicle Tax

This tax is applicable annually to means of transportation and all types of vehicle. It varies between 3,000 riels (motorbikes with a cylinder capacity of 70 cm³ or lower) and 1,200,000 riels (cargo vessels of over 2,000 freight tons).

20.4.2.6. Tax on Alcohol and Tobacco

It amounts to 10%, 20% and 30% on alcohol, 10% on cigarettes and 25% on cigars (imported or manufactured in Cambodia).

20.4.2.7. Stamp Duty (Article 46-1994)

This tax applies to administrative, judicial and extrajudicial documents and to declarations such as: school registration application, birth certificates, civil status certificate, submission of company by-laws, public announcements, trade mark registration.

The value of stamps varies between 100 riels (primary school registration application) to 10,000 riels (operating, import/export, hotel and foreign investment licenses). Public announcements and trade mark registrations are taxable according to size based on the calculation of the surface area.

20.5. Tax Performance

20.5.1. Tax Policy

Along with the announced tax reforms, the efforts of the Royal Government and the Ministry of Economy and Finance, the Tax General Department has increased resources deriving from taxes and duties from 151.8 billion riels in 1998 to 1,735 billion riels in 2008, i.e. an eleven-fold increase over these past 11 years.

From January 1, 1999, VAT has been applicable to enterprises subject to the self-assessment regime with the self-submitted return. VAT is currently applicable to large- and medium-size enterprises.

Table 20.1. Tax revenue of the Tax General Department (in billions riels)

Year	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Tax	151.8	185.1	270.9	292.9	318.8	384.3	481.1	634.3	8856	1,259	1,735

Source: Ministry of Economy and Finance

Since 2005, the Tax General Department applied the self-assessment regime taxation system to medium-size enterprises in 16 provinces/municipalities. All enterprises subject to the self-assessment regime are liable for VAT payment. Self-assessment Regime is now implemented in all provinces and 7 districts in Phnom Penh. In late 2008, Cambodia had a

total of 11,196 companies. They are divided into 1,793 large-size companies, and 9,403 small/medium-size companies. The Tax General Department strengthened enforcement of the tax law amended in 1997 and continued to enforce it in 1998.

In 2003, certain provisions of the tax law relating to the investment law were amended to put special emphasis on:

- Modification of the exemption period for QIPs.
- Establishment of special depreciation rates of 40% for investment projects that do not opt for the tax exemption period on profits.
- Modification of the depreciation system by adopting the straight line method for buildings and the incremental balance method of depreciation for other non-current assets.
- Imposition of the tax on additional profits sourced from dividend payout.
- Reduction of rate of taxation at source for payments to non-residents.
- Reduction of rate of taxation at source for payments of interest to residents by banks, from 15% down to 6% and from 5% down to 4%.
- Increase of the tax rate on wages for non-residents from 15% to 20%.
- Discontinuance of the minimum tax rate and advance payment of profit tax of 1% for investment projects.
- Modification of rules in order to strengthen tax collection.

The Department established a Large Taxpayer Unit (LTU) for large taxable entities in order to observe and manage 1,793 large companies and compel them to pay their taxes via the Central Bank. This Unit has generated around 80% of the total tax resources of the Department. At the same time, the management unit for taxable medium-size companies was established.

20.5.2. Tax Administration

The Tax General Department has developed services for taxpayers by setting up units in the provinces/municipalities with the objective of improving relationships with taxpayers.

The Department conducted audits of large- and medium-size companies and has also

increased, in parallel, information exchanges between the different departments of the Ministry of Economy and Finance and other ministries in order to support the conducting of audits of liable persons. The Tax General Department also increased the number of audits and of audited enterprises. It also prepared the amendment of the regulations and tax audit program for companies.

Table 20.2. Outcome of tax audit for large- and medium-size enterprises, 1998 to 2008 *(in billions of riel)*

Year	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Tax out-	3.6	13.1	26.4	122.5	73.4	104.5	148.3	351.8	487.5	467.5	751.7

Source: Ministry of Economy and Finance

The Department reinforced tax collection measures in implementation of the tax law on enterprises that owe money to the State. Measures include freezing of accounts at the Central Bank and National Treasury, stopping of import/export operations by the Customs Department, cancellation of licenses, termination of exemptions for projects submitted by the CDC, prohibition to participate in public procurement, etc.

Table 20.3. Outcome of tax collection between 1998 and 2008

(in billions of riel)

Year	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Tax out-	0.5	10.9	33.4	15.3	33.0	70.8	41.0	39.4	56.4	53.9	44.5

Source: Ministry of Economy and Finance

From 1998 to 2008, the Tax General Department trained over 1,800 civil servants in the fields of general accounting, English language, computer science and international conventions on taxes, etc. The Department also recruited civil servants: 29 in 2001, 60 in 2003, and 212 in 2007.

The information system of the Department was reinforced through the creation of a new data recording and observation system. Certain offices of the Department and provincial units are equipped with computers so as to collect data and tax returns from enterprises subject to the real regime taxation system.

20.5.3. Comparative Analysis of Tax Administrations

The French Inspectorate-General of Finance conducted a comparative study on the functions of tax administrations in nine countries in order to make an inventory of models of organization, practices and costs (www.finances.gouv.fr/actualites).

Several points emerge from this study:

- The notion of “spontaneous and voluntary compliance” with the tax law is used in virtually all tax administrations; it enables a distinction to be made between taxpayers who comply with the tax law and those who do not, and leads to the conclusion that voluntary acceptance of the tax law is more effective than repressive actions, such as tax audits. This brings about a new direction that involves replacing the culture of suspicion with an approach that encourages voluntary acceptance of the tax law (by developing the services provided to the taxpayer) and redirecting the audit conducting process towards risk tax payers only.
- Development of information technologies lies at the heart of strategic concerns; tax information services are evolving, for instance:
 - ⇒ From an organization focused on tax types to a target group organization.
 - ⇒ From focus on internal organization to focus on the needs and characteristics of taxpayers.
 - ⇒ From paper documents to electronic documents.
 - ⇒ From batch processing to real-time processing.
 - ⇒ From non-selective processing to risk-based processing.
- A transformation of tax organizations converging towards a shared model with an acceleration of the transformations of these administrations. The most frequent model combines territorial organization with a unit specialized in large-size firms. Some tax administrations implement tax collection for other regional or local authorities. Certain countries organize their tax administration on the model of agencies detached from the Ministry of Economy and Finance, endowed with a measure of autonomy of management and empowered to use management rules that are more stimulating than those of the central government. The counterpart is accountability on set purposes that are subject to strict controls down the line.

With regard to the countries visited, there is an average 10 generalist local units per million

inhabitants or 150 for 100,000 km².

Management cost for tax administrations varies between 0.5 and 1.7% of the amounts collected (for an average of 1.1%).

Chapter 21

State Budget

The budget is the instrument through which the government implements its fiscal policy; it addresses four key financial functions of the State, namely: (i) resource mobilization; (ii) allocation of resources; (iii) distributive justice; and (iv) macroeconomic stabilization.

Prior to 1970, the Cambodian financial system drew its inspiration from the French system and this was repeated with Law No. 1 NS 93 of December 28, 1993 on the Finance Laws and Budget System respecting the financial system and finance laws. This law was updated and replaced by the ***Law on Public Financial System*** adopted on 4th April 2008 and promulgated by the Royal Kram No. NS/RKM/ 0508/016 of May 13, 2008. Cambodia's financial and accounting regulations were consolidated by a series of government decrees, namely:

- ⇒ Government Decree No. 82 of November 16, 1995 on General Regulations for Public Accounting.
- ⇒ Government Decree No. 81 of November 16, 1995 instituting Financial Control.
- ⇒ Government Decree No. 105 of October, 18, 2006 on the Procedures for Public Procurement.

These regulations prescribe the legal framework applicable to public financial management. They established the conditions under which financial and accounting operations resulting from implementation of the Budget Laws are performed, recorded in the books, and audited.

21.1. Technical Framework of the Budget

In Cambodia, public finance is based on budget principles, rules, and practices linked to the doctrine of the market economy. The technical framework of the budget is determined by the following principles: authoritativeness; annual budget or a twelve - month financial year; comprehensiveness; unity; universality; specialty; balance; accountability; transparency; stability; and achievability. However, the core principles are annual budget, unity, universality, specificity and balance.

The annual budget rule prescribes that the State budget be prepared in a yearly framework; the government also produces a three-year budget forecast called the Medium Term Expenditure Framework (MTEF). The budget year starts on January 1 and ends on December 31. The Minister of Economy and Finance (MEF) submits to the Prime Minister a comprehensive budget based on a preliminary set of expenditure priorities and a macroeconomic framework. Once the Prime Minister has approved the budget in principle, the MEF prepares a more detailed budget including such details as the baseline receipts and expenditures envelopes, by negotiating with the line ministries and the Council of Ministers and coming up with the allocations among the ministries. Once approved by the Council of Ministers, the Draft Budget Law is submitted to Parliament—by the end of October at the latest. Parliamentary debate of the budget is to be completed before December 31.

The single budget rule prescribes that all the resources and expenditures of the State should be accounted for in one document to be approved by the National Assembly. According to this rule, any collection of receipts or performance any expenditure outside of the approved budget document is prohibited.

The gross budget (non-deduction) rule states that adjustments between revenue and expenditure categories is not allowed after the budget is approved by the National Assembly; a ministry or government agency is not allowed to use appropriations of another government entity or use private resources to increase the appropriations allocated to it under the budget law. Exception can be made to this principle only with the approval of the National Assembly as in the recent case concerning the National Election Committee Law. A special account of the Treasury was created outside the approved budget to meet the election expenditures and financed from specific assigned sources. The principle of non-contraction also applies to the gross budget rule. It means that the gross receipts and expenditures must be fixed in the approved budget and that there can be no adjustment in the size of the budget by reducing or increasing receipts and expenditures in a compensatory manner.

The rule of budget balance states that the budget is in true balance when the operating account and the investment account are separately voted as balanced, with a transparent assessment of receipts and expenditures in both accounts.

21.2. Budget Preparation

21.2.1. Preparation of the Budget Strategic Plan (March to May)

During the first week of March, the Minister of Economy and Finance draws up the framework for the mid-term macroeconomic and public finance policy consistent with the national development policy framework in order to submit it to the Council of Ministers.

During the first week of April, the Minister of Economy and Finance issues a circular on the preparation of the strategic plan based on the mid-term macroeconomic and fiscal policy adopted by the Council of Ministers.

Ministers, heads of government agencies, provincial and municipal governors, draw up the budget strategic plan for their central administrations, their provincial and municipal departments and entities under their authority, using as a benchmark the circular for the preparation of the budget strategic plan, prospects, priority goals, programs and action plans of ministries and agencies serving the sector priority policy and of the national development policy. These budget strategic plans are forwarded to the Minister of Economy and Finance by May 15.

21.2.2. Preparation of Budget Allocations (June to September)

During the first week of June, the Minister of Economy and Finance draws up a draft circular on the budget preparation technique by specifying the conditions and procedures, as well as notification and supporting documents, then sends the draft budget to the Council of Ministers for approval, after which he forwards it to ministries, agencies, provinces and municipalities so that they can draw up their detailed revenue and expenditure estimates.

Ministers, heads of government agencies, municipal or provincial governors draw up their detailed revenue and expenditure estimates for their central administration, the municipal and provincial departments under their authority, using as a benchmark the technical circular for preparation of the draft budget and their policy priorities. Draft budgets are to be transmitted to the Minister of Economy and finance by July 25.

The Ministry of Economy and Finance consolidates revenue and expenditure estimates from the ministries, agencies and provinces and municipalities.

During the month of August, the Ministry of Economy and Finance invites the ministers as well as the municipal and provincial governors to discuss their draft revenue and expenditure estimates in order to perform necessary adjustments, in accordance with the guidelines of the budget directive, by cutting down expenditures deemed to be inequitable and by increasing revenue estimates.

During the month of September, the Ministry of Economy and Finance consolidates data in order to establish a balance of revenue and expenditure and then draws up a draft finance law together with a statement on this draft law.

21.2.3. Adoption of Budget (October to December)

During the first week of October, the Ministry of Economy and Finance submits the draft budget law to the Council of Ministers; then to the National Assembly during the first week of November, for discussion and approval. Finally, the draft budget law is submitted to the Senate during the first week of December for adoption prior to December 25.

This calendar could include an additional step between late May and early June, which would be a debate on the direction the budget should take. Such a debate would enable an agreement between the executive and legislative powers on allocations by “functional classification” of the government and would thus speed up the budget adoption stage.

21.2.4. Classification of the Functions of the Government

The government’s structure varies over time and in space (from one country to another), which makes it difficult to draw comparisons in time for one country, and in space between countries.

To cope with this difficulty, the IMF has developed a Classification of the Functions of Government, known as COFOG, reviewed and elaborated by the United Nations.

This classification of the functions of government involves organizing in a universal and permanent manner the functions of public administrations.

21.2.5. Budget Organization into Programs and Actions

Article 17 of the 1993 Law No. 1 respecting finance laws and the budget system was amended by the 2007 finance law for management in order to introduce the notion of programs and sections:

“Budget appropriations made available by the finance law are allocated in detail within each category according to their nature and purpose. These appropriations are subject to consolidations through program budgets and sections. Allocation in program budgets is made effective by order of the Minister of Economy and Finance...”

Previously, the budget used to be presented only by economic nature (of means); until 2006, this economic nature (chapters, articles and paragraphs) was not developed in depth. One of the reforms implemented with the 2007 budget involved replacing this coding system by simple nature with a coding system which is similar to the private sector chart of accounts, while taking into account the specificities of the government.

Program refers to group of independent sub-programs and/or group of independent sets

of activities with close linkages and developed to contribute to achieve a common policy objective, and that states activities to be implemented, annual performance, final results, and indicators, which are bases for review and assessment of the achieved results from programs implementation. Program can be divided into sub-programs. A program usually consists of coherent activities that correspond to identified operational targets and under the authority of only one officer. The cost of activities and means of a program must also be clearly identified.

Objectives corresponding to a program must be formulated and anticipated results and their assessment shall be spelled out.

21.2.5.1. Budget Structuring into Programs and Activities and into Sections, and Identification of their Costs

Activities are an itemization of programs. They identify community services rendered to users, the action policy goals or duties performed.

The cost of each activity is to be identified, including its personnel expenditure and identification of the material and asset means made available.

Expenditures are to be justified in detail: presentation by voted services / new measures will be gradually dropped in favor of a “zero-sum” budgeting corresponding to the program approach.

Analysis of the nature of expenditure is conducted according to the new economic nomenclature and budget rules (salary expenses, other expenses, multiannual commitments and annual appropriation requirements, annex budgets and special accounts of the Treasury, public institutions).

Selection of objectives must reflect policy priorities and ministerial strategies.

21.2.5.1.1. Consolidation by Section

Sections contain activities of sectoral policies and services, as well as activities related to inputs which cannot be defined in the form of programs; these sections are in support of program implementation and are expected to gradually become programs of their own right or be in whole or part allocated in programs.

21.2.5.1.2. Objectives

Objectives, more specific than headline goals of policies and more open-ended time wise must be spelled out in concrete terms enabling assessment of the anticipated results: they

are tied in with outcome indicators.

Objectives, their indicators and targets, shall be broken down into several performance pillars: socio-economic effectiveness, quality for the user, management efficiency.

21.2.5.1.2.3. Indicators

Program implementation and performance is monitored by means of indicators.

Indicators may refer to a monetary approach (revenue and expenditures, for instance), or qualitative (food deficiency, satisfaction rating, for instance).

Indicators are obtained through administrative data or statistical systems or surveys (household surveys, taking inventories and conducting satisfaction surveys).

Indicators must be relevant, straightforward, objective, sensitive to variations in the specific item they are intended to measure, sufficiently accurate, reliable, verifiable and available at a reasonable price.

21.2.6. Programs and Projects

The budget has always included a list of self-financed or co-financed capital cost projects or projects financed by development partners.

The notion of capital cost project is therefore familiar; there is abundant literature on project management by all donors. We have already quoted the “Project Cycle Management Handbook” of the European Commission.

As a rule, any project is unique: the building of a school; a program is a set of activities which unfolds in time: a program for the building of schools (a series of projects).

A project that involves capital cost only: project for public finance computerization; within the new budgetary approach, a program relates to routine activities delivered by the government: provision of medical care, education, repairing roads, for instance, but also encompasses the notion of projects.

21.2.7. Priority Action Programs

It is obvious that the increase in budget allocations for the social sector will not bring the anticipated results as long as budget disbursements continue to be slow, unpredictable and suffer delays. It is therefore necessary to speed up and cut down on budgetary disbursement procedures in spending ministries. This imperative requirement prompted the

Royal Government of Cambodia to introduce the Advanced District Development (ADD) scheme for the health sector in 1996 and the Priority Action Program (PAP) for priority ministries in 2000. The objective of the PAP mechanism is to disburse budgetary resources as provided for in the voted budget and avoid the reduction of resources intended for the key spending ministries in accordance with the policy aiming at reducing military expenditure and increasing social expenditure in order to maintain macroeconomic stability and reduce poverty.

At the same time, the PAP was one element of public finance reform involving disbursement via advance payments and a post audit of budget expenditure. This system aims at giving more opportunity and responsibility to spending ministries in drafting, implementing and managing their budget, in phase with the financial decentralization policy. Moreover, the PAP mechanism laid the basis for budget reform with the abolition of budget lines, by classifying the PAP budget in program Chapter 13. The PAP has provided spending ministries with incentives to implement reforms in the mid-term. This mechanism aims at increasing budgetary resources for priority ministries, provided that good performance of budgetary implementation outcomes is achieved.

At the same time, in order to facilitate implementation of the PAP, it is necessary to set up an efficient and high performing budget management system to ensure the accounting, transparency and efficient use of funds for public expenditure. For this reason, success of public finance reform depends on the capacity and accountability of spending ministries, of the quality put into program preparation, forecasts and budget programming.

The PAP was carried out in the framework of a special program (Chapter 13), voted on as a whole for the concerned ministries. While the ADD program aims at bypassing the regular budget implementation system by introducing direct disbursements from the National Treasury budget to health operational districts, the PAP is a results-driven, program-focused decentralized budget system. Budget managers hold the power to decide on the use of funds in order to produce the anticipated results. Expenses are post-audited so as to speed up budget implementation. Moreover, budget decision-making power has been decentralized from the Minister to the chief of the Budget Management Center (BMC).

The PAP system allows the Minister of Education, Youth and Sports and the Minister of Health to introduce elements of the mid-term budget planning, the program concepts and the results-driven budget. This system has enabled an improvement in budget transparency and facilitated introduction of budget support by donors, i.e. to finance government expenditure in exchange for a guarantee from the government to maintain mid-term finance envelopes at an acceptable level and make progress in the implementation of reforms. Furthermore, establishment of BMCs at all levels has enabled the ministries concerned to decentralize budget planning and implementation.

The PAP also has its weaknesses for this budget reform was implemented as a separate measure for want of a systemic change. The PAP mechanism was perceived as a deviation from the regular system. There is also resistance within the Ministry of Economy and Finance (MEF) as well as within the spending ministry that did not want to grant power to BMC chiefs.

Regarding the health sector, emphasis was put on running hospitals, health centers, operational districts and provincial administrations. Managers should have been more flexible in the use of budgets. But, in reality, public health officials are continuing to use the PAP budget in the spirit of a budget with line-item budget.

Moreover, seven years after implementation of the PAP, the post-audit system has not yet been set up and the PAP system is perceived by managers as an expense without a paper trail and audit. This makes the PAP system one that departs from the principles of public accounting and has exacerbated the trust risk of public expenditure.

Lack of a clear operational framework has caused uncertainty and misunderstanding at all levels and has undermined the trust of budget managers. Lack of clear procedures has routinely created difficulties in the area of institutional capacity building.

The PAP has nonetheless shown that management of change is vital for public finance reform. The PAP is a steering instrument for the drawing up and implementing the program budget within the Public Finance Management (PFM) reform now underway. Along with the PAP budget decentralization, the MEF has decided to assign financial controllers to spending ministries in order to cut down on budget procedures and speed up budget disbursements.

21.3. Budget Execution

21.3.1. Allocation of Appropriations

Appropriation allocation in main budget areas is voted by Parliament as specified in the finance law. Once the finance law has been voted by the National Assembly and Senate, it is to be promulgated by a Royal *Kram* signed by His Majesty the King of Cambodia.

The detailed breakdown is the responsibility of the government within the framework of budget allocation sub-decrees. Following promulgation of the finance law, the Ministry of Economy and Finance is to submit to the Prime Minister a decree which finalizes the detailed allocation of budgetary appropriations by ministry, chapter and program. The public accounting and budgetary nomenclature reforms established in 2007 introduced new codes:

- Classify expenditure according to their economic nature (Chapter 60 - Purchase; Chapter 61 - External charges for services; Chapter 62 - Other external charges for services; Chapter 64 - Personnel expenses; Chapter 65 - Capital subsidy and social welfare; Chapter 63 - Taxes and duties) following an outline that corresponds to that followed by national accounting and the new chart of accounts.
- Classify expenditure according to the activity sectors to which they correspond. The sectoral or functional coding shows appropriations as allocated to general, social and economic administrations, and also to security and defense. In each administration category, appropriations are allotted by ministry.
- Classify expenditure according to programs.

Appropriation allocation in each chapter by account and subaccount is under the responsibility of the Ministry of Economy and Finance within the framework of circulars on appropriation allocation. Following the adoption of the decree approving allocation of appropriations, the Ministry of Economy and Finance establishes budget nomenclature for ministries by allocating appropriations by account and subaccount and by central administration and external departments in the provinces.

Ministers and heads of similar public agencies are the main authorizing officers for the budget, for revenues sourced from their sectors; they are the main authorizing officers for their respective budgets for expenses of the central administration and external departments under their responsibility in the provinces. Ministries and heads of similar public agencies entrust, via a circular, provincial and municipal governors with the capacity of delegated authorizing officer for financial transactions of the provincial department budget within their territorial constituency.

21.3.2. Modifications of Appropriation Allocation

The possibility for the government to modify appropriation allocation in the course of implementation is necessary, based on inevitable uncertainties at the preparation stage.

Transfers of appropriations from one ministry or similar public agency to another *are carried out by the amended finance law. However, appropriation transfers from one ministry or similar public agency to another, necessitated by a governmental or an administrative restructuring, are performed by sub-decree, on condition that they do not modify the nature of the expenditure and allocation of appropriation by chapter.*

Appropriation transfers bring about a correction of a totally different consequence, as they modify the nature of expenditure for which appropriations had been forecast. For this reason, transfers can only be carried out by decree of the Prime Minister upon

recommendation of the Minister of Economy and Finance. Transfers of appropriations from one chapter to another, *within the budget of a ministry or a similar public agency, are carried out by sub-decree, provided that capital (investment) appropriations will not be converted into current operating expenses.*

Decrees voted at the level of the Council of Ministers upon proposal of the Minister of Economy and Finance may allocate the amount entered under the chapter of unforeseen expenses, in the form of additional appropriations in favor of other chapters of the ministries or similar public entities in order to meet unforeseen expenses.

Additional appropriations may be made available by a Decree on advance payments approved at the level of the Council of Ministers, upon report of the Minister of Economy and Finance, beyond budgetary allotments entered under the chapter of unforeseen expenses, in case of disasters or imperative needs of national interest. Transfers of appropriations which involve moving appropriations from one department to another without modifying the purpose of the expense for which they had been envisaged, are decided by order of the Minister of Economy and Finance. Transfers from one account to another account or from one subaccount to another subaccount within the same chapter are authorized by order of the Minister of Economy and Finance.

21.3.3. Categories of Budget Appropriations

According to their use, current budget appropriations can be divided into:

- **Provisional appropriations** (crédits provisionnels): Article 17 of the Law 93-01 dated 28 December 1993 governing the Financial Laws and the Budget System stipulates that the reserve funds are not allocated to any ministry. They are earmarked for various spending administered by the Minister of Economy and Finance. Provisional appropriations are provided for those expenditures that cannot be accurately identified during the time of the adoption of the budget. Allocations of provisional credits are made by a government sub-decree at the proposal of the Minister of Economy and Finance. This means that the amount of such appropriations are tentative. If needed, for example in the case of natural disasters, the Minister of Economy and Finance can supplement these appropriations from the Reserve Funds by adopting a Sub-decree on supplementary credit (décret d'avance).
- **Capped appropriations** (crédits limitatifs): Article 18 of the Law on Budget System states that for capped appropriations, spending commitments and orders to pay are capped by the Financial Law. This type of spending can only be increased by the Amended Budget Law. For example, appropriations for Operations and Maintenance (O&M) are considered as capped appropriations.

- ***Estimated appropriations*** (crédits évaluatifs): Article 18 of the Law on Budget System stipulates that estimated appropriations refer to the types of spending, which are compulsory, which cannot be projected adequately during budget preparation. It means that the amounts of estimated appropriations are tentative and the budget figures are only estimated. Spending of the estimated appropriations can be increased beyond the voted budget. Estimated appropriations refer to spending on public debt, salary or any expenditure determined by the Financial Law.

Article 20 of the Law on Budget System stipulates that capital budget appropriations can be divided into three categories of appropriations:

- ***Program appropriations*** (crédits de programme): determine the programs or projects, with global costs fixed, to be undertaken by the State during the year. Program appropriations allow the government to commit spending for the overall implementation of the project or a coherent part of the project that can be operationalized without any additional investment. However, program appropriations will commit spending by the government within the cap of the committed appropriations adopted by the Financial Law.
- ***Committed appropriations*** (crédits d'engagement): Committed appropriations are provided to the budget authorizing officer so that he or she can commit necessary spending in order to carry out investments as envisaged by the Financial Law. Committed appropriations can be used without a time limit. They are transferred from one year to another until they will be eventually nullified.
- ***Payment appropriations*** (crédits de paiement): Payment appropriations are designed to prepare the orders to pay the amounts to be paid by the State within the framework of the relevant committed appropriations. Unused payment appropriations will be nullified at the end of the year. New payment appropriations will be made available next year.

21.3.4. Budget Review

Implementation of the budget, regardless of the quality of the draft budget, requires modifications in order to stick very closely to reality. These modifications follow the principle according to which whoever has authorized is the one who modifies. Parliament votes on the budget according to an allocation by ministry and by similar public entity as described in Tables “B” and “C1, C2 and C3” annexed to the finance law; any modification of these allocations must fall within the scope of the (amended finance) law, except that it must be seen if some of the allocations are due to the executive arm, which shall inform the legislative arm and therefore remains competent to modify some of the allocations. Within one class, allocation of appropriations is made by order of the Minister of Finance (new

Article 39 of the 1993 Law as amended by the 2007 finance law). This allocation may therefore similarly be subject to modification by order of the Minister of Economy and Finance: this is what is actually provided for in new Article 42 of the 1993 Law, as amended by the 2007 finance law.

21.4. Public Accounting Principles

21.4.1. Strict Segregation of Duties between Authorizing Officers (Budget Managers) and Accountants

The two types of functions which are involved in budget implementation are *authorizing officers* and *accountants*. The two functions are incompatible. This principle of strict segregation of duties encounters statutory derogations, such as the petty cash system, and illegal departures (de facto managements).

21.4.1.1. Authorizing Officers

“Authorizing officers can be Chief Authorizing Officer (for example, Minister) or Delegated Authorizing Officers (for example, the Provincial Governor is delegated to manage the provincial department budgets) and they may be deputized if they are absent or prevented from attending to their duties.” (Article 4 of Decree 82)

An authorizing officer by delegation or a deputy authorizing officer acts per delegation of signature and not per delegation of jurisdiction (or power). An authorizing officer who acts per delegation of jurisdiction from a chief authorizing officer is known as “secondary”; this possibility has not been envisioned within the framework of Sub-decree 82 on public accounting. However, new Article 48 of Law 93-1 of 28 December 1993 governing finance laws and the budget system, amended by law 99-15 of December 25, 1999 on the finance law for the year 2000, provides for it in its Article 8 (of Law 99-15) that “Ministers and heads of government agencies, i.e. the chief authorizing officers for their respective budgets, may also, after receiving the opinion of the Minister of Economy and Finance, confer to the provincial governors or to the municipal governors the power of delegated authorizing officers in order to implement the budget falling within their remit in the province or municipality.”

Chief authorizing officers may be in charge of central government budgets (ministers and heads of government agencies) or of decentralized budgets: budgets of administrative public institutions, provincial governor budget, municipal budget, communal budget and budget of any existing or future local or regional government.

Therefore, the provincial governor is the chief authorizing officer of his own provincial governor budget and, at the same time, acts as delegated authorizing officer of the budget

of provincial departments in the province.

21.4.1.2. Public Accountants

“Public accountants shall be responsible for accounting items.

Any accounting heading shall be entrusted to one single accountant.

Accountants may delegate their power to one or several proxy holders authorized to act on their behalf and under their responsibility.” (Article 14 of Decree 82)

“Public accountants shall be appointed by the Minister of Economy and Finance or with his approval. The instrument of appointment shall be published. Before assuming office, they are obliged to swear in. They are accredited by authorizing officers and, where appropriate, to other public accountants with whom they deal. They must submit their accounting report at least once a year.” (Article 15 of Decree 82)

Two categories of public accountant (Article 18 of Decree 82 respecting general rules on public accounting) can be distinguished: direct Treasury accountants and financial administration accountants.

21.4.1.3. Segregation of Duties

21.4.1.3.1. At level of Authorizing Officers: Administrative Phase

“Authorizing officers prescribe implementation of revenue and expenditure.” (Article 3 of Decree 82; see the definition of the operations below.)

In the area of revenue, authorizing officers (administrative phase) draw up the statement of revenues and then proceed with their collection.

In the area of expenditure, authorizing officers incur, clear and certify expenditures.

A. Revenue

“State revenue includes taxes, duties, fees and other equivalent revenue, non-tax revenue, fines and other pecuniary penalties, as well as other authorized incomes...” (Article 26 of Decree 82)

“The full amount of revenue is brought in without any offsetting between revenue and expenditure” (Article 26 of Decree 82): this reminds us of the principle of universality.

Under any circumstance, revenues shall be validated before being collected. ... The

purpose of validation is to determine the debt amount to be paid by the persons liable for the payment.” (Article 27 of Decree 82)

“Any revenue debt validated shall be subject to a revenue order (Article 27 continued)

The passing on of revenue orders to the “assigned” accountant constitutes the collection enforcement; this process usually takes the form of a periodic summary statement that is used for entry in management accounting (i.e. in the authorizing officer’s accounting) and forwarded to the accountant for take over. Supporting documents are to be attached.

B. Expenditure

“Public expenditure is to be estimated in the budget and in accordance with the laws and regulations” (Article 45 of Decree 82).

“Before payment, expenditures shall be committed, validated and ordered for payment” (Article 46 of Decree 82). Expenditure therefore consists of four phases: (i) commitment or origination of spending (engagement); (ii) validation of expenditure (liquidation); (iii) order to pay (ordonnancement); and (iv) payment (paiement).

I. Commitment

“A commitment (engagement) is the act by which the State creates or recognizes an obligation binding upon it, from which expenditure will arise.” (Article 47 of Decree 82)

“No public expenditure of the Budget or of a special Treasury account (or annex budget) may either be committed or implemented by senior authorizing officers or authorizing officers by delegation, unless the authorizing officers have made a commitment proposal in writing and provided that such proposal, to which the stamp of approval of Financial Control shall be duly affixed, has been sent back to the authorizing officer.” (Article 3 of Sub-decree No. 81 of November 16, 1995 on the establishment of financial control on budget expenditures within the ministries, external departments in the provinces and public administrative institutions).

Distinction is usually made between legal commitment and accounting commitment.

A *legal commitment* is the act by which the State creates or recognizes an obligation binding upon it, from which an expenditure will arise: recruitment contract for a civil servant, public procurements, contract for the purchase or maintenance of a computer, etc.

To carry out such legal commitment, the authorizing officer must vouch that he has available appropriations entered in a budget that shall be duly drawn up. He deducts from his appropriations the amount of the envisaged expenditure under the budget item proposed and submits his request to Financial Control; this process is the *financial or*

accounting commitment. Financial Control verifies that the commitment proposal submitted by the authorizing officer is consistent with an existing budget item and that appropriations are available.

If the budget item and appropriations do exist (and provided that the lawfulness and regularity of the proposal have been verified), Financial Control then certifies the commitment request.

The financial controller deducts the amount proposed from the amount of available appropriations under the budget item so that his financial commitment accounting is consistent with that of the authorizing officers.

If the financial (or accounting) commitment has been rejected by Financial Control, the authorizing officer has to “release” the amount in his accrual accounting by making an entry of the opposite commitment entry amount (in red if accounts are kept manually) so as to restore appropriations.

A question often arises: What amount must be committed so that commitment accounting accurately reflects legal commitments? Commitment accounting must reflect the reality of legal commitments so that available appropriations that the books show are actually available and enable sound budgetary control and sound management planning, either for future commitments or for appropriation freeze.

Indeed, if commitment accounting underestimates legal commitments, expenditure may be committed in excess of the authorized budgetary appropriations.

For instance, a one-year lease contract cannot be initiated per quarter; it has to be taken out for the annual lease amount and, if allowed by the regulatory framework (multiannual commitment authorizations), it even has to be subscribed for the full duration of its commitment authorization and for its annual amount in payment appropriations; such a multiannual system has not yet been set up in Cambodia.

A maintenance contract, which is payable quarterly, but taken out for one year, must be committed for its annual amount; in order to have a quarterly commitment, it needs to be renegotiated and an extendible quarterly amount must be budgeted unless the contract is terminated.

Staff expenditures must also be committed for a one-year period or for the duration of the contract if less than a year.

All definite or compulsory expenditures must be committed at the beginning of the year. (See Article 12 of Decree 81 on Financial Control and also the section on financial control.)

A question arises from these commitment and entering principles: Can cash and cash equivalents be regulated by commitments?

The provision of Article 49 of Decree 82, which stipulates that “rhythms of monthly commitments is to be set by the Minister of Finance according to the collection of revenues”, should therefore be understood in light of the above-mentioned development.

II. Validation of Expenditure

“Before being paid, expenditures shall be... validated...” (Article 46 of Decree 82) “The purpose of validation of expenditure (liquidation) is to check the status of the debt and determine the expenditure amount. Validation is carried out upon consideration of the documents that establish the rights of the creditors.” (Article 51 of Decree 82)

Certification of “service performed” is a crucial element of the validation process: the general principle is that the payment can be made only when the service has been performed (wages, provision of goods and services, etc.). During the validation process, the authorizing officer or his delegate verifies that the supplier has met his/her obligations, as stipulated in the order: quantity delivered, quality and compliance with deadlines; he or she then determines the exact expenditure amount.

III. Order to Pay

“Before being paid, an order shall be made to pay the expenditures.” (Article 46 of Decree 82) “An order to pay (ordonnancement) is the administrative act issuing, in compliance with the validation statement, the order to pay the central government debt.” (Article 53 of Decree 82). “The authorizing officers shall make an order to pay the expenditures. For that purpose, authorizing officers shall issue orders to pay. Orders to pay issued by chief authorizing officers are debited from the appropriations allotted by the budget. Orders to pay issued by authorizing officers by delegation are debited from the appropriations allocated by chief authorizing officers by delegation order.” (Article 54 of Decree 82)

“Orders to pay and appropriation delegation orders shall be submitted to the financial controller’s prior approval...” (Article 55 of Decree 82) “Orders to pay issued by ministers acting as chief authorizing officers and by heads of central government administrations acting as authorizing officers by delegation shall be assigned to the Treasury’s senior accountant. Orders to pay issued by governors of provinces or cities acting as authorizing officers by delegation shall be assigned to the Treasury’s reporting accountant of the province or city of residence of the governor.” (Article 56 of Decree 82)

To facilitate the monitoring of orders to pay, they are usually put together on one expenditure slip and forwarded, with the supporting documents, to the accountant assigned. These slips are then numbered in one continuous series (per fiscal year). Orders

to pay are received by accountants.

IV. Payment

After having checked the validity of the order to pay, the public accountant, as cashier, is to make payment, “an act by which the State acquits its debt.” (Article 57 of Decree 82) “Subject to the exceptions provided for in laws and regulations, payments shall not be made before the maturity date of the debt or performance of service. However, deposit and advance payments may be granted to contractors or suppliers under the conditions provided for in the regulations in force.” (Article 57 of Decree 82) “Designated accountants make payment of payment orders.

Settlements are made in cash, by check or transfer.” (Article 58 of Decree 82) “... when an amount exceeds 2.5 million riels, settlement shall be made by check or bank transfer.” (Article 8 of Order 4/MEF implementing Decree 82) “If, when the check is made ..., discrepancies are found, public accountants shall put payments on hold and notify the authorizing officer. Payments are also put on hold when public accountants have successfully established that certification (of services performed) are misstated.” (Article 59 of Decree 82)

21.4.1.2. The Accountant's Work: Accounting Stage

“Public accountants only are entrusted with the following tasks:

- Assumption and collection of revenue orders that authorizing officers have submitted to them, accounts receivables recorded by a contract, a title to property or any other document for which they are to ensure safekeeping, as well as cash collection of fees and receipts of any kind that the State is empowered to receive.
- Payment of expenditures by order from accredited authorizing officers.
- Safekeeping and safeguarding of funds and assets belonging to the State and other government entities.
- Handling of funds available and cash assets.
- Safeguarding of transaction supporting documents and accounting documents.
- Bookkeeping of the accounting post that they manage.” (Article 12 of Decree 82)

In terms of revenues and expenditures, the designated accountant is to fulfill operations and then make collection or payment after carrying out the controls within his field of jurisdiction.

A. Revenues

(i) Recording Revenues

After checking and signing a revenue order transmittal form, the accountant is to check the identification of the debtor, examine the supporting documents and “check to see that the revenue order is in due form”. (Article 13 of Decree 82) The accountant is to then record the revenue, i.e. he enters the registration in the accounting records (or sends the revenue order back to the authorizing officer with the grounds for not recording it).

(ii) Collection

The public accountant then notifies the debtor of the amounts to be paid and receives the remittance. “In the absence of amicable collection, enforced collection action is to be taken by means of legal procedures under a legally binding document.” (Article 30 of Decree 82) Payments may have been carried out automatically; the public accountant then receives them, notifies the authorizing officer and requests an adjustment receipt order from him.

B. Expenditure

(i) Recording of expenditure

Public accountants are successively entrusted with two duties: the duty of paymaster, which results in a control exercise, then the duty of cashier, which involves settling the central government’s debt by paying the recipient, the creditor, so that the payment is in full discharge.

Contrary to what is provided for in terms of revenues, the Sub-decree 82 does not formalize the assumption of expenditure; however, it seems that it imposes itself: the accountant receives orders from the authorizing officer, is to duly check them and decide whether they shall be rejected (sent back to the authorizing officer) or assumed.

“In terms of expenditure, public accountants shall carry out... checks of:

- Capacity of the authorizing officer or his delegate.
- Availability of appropriations.
- Exact assignment of expenditures under the relevant chapters according to their nature or purpose.
- Supporting documents for the service performed and confirming the accuracy of the validation of debt.
- Existence of approval stamps of financial controllers on commitments and orders.
- Production of claim statements of grounds.

- Application of claim prescription and forfeiture rules.” (Article 13 of Decree 82).

21.4.2. Infringements of the Principle of Segregation of Duties Between the Authorizing Officers and Accountants

Requisition is the first infringement of the principle of segregating duties between authorizing officers and accountants; the use of a petty cash system and the petty cash management officers (régisseur) is the second; both infringements are admitted. De facto management, which is illegal, the third.

21.4.2.1. Requisition

What happens if the accountant refuses to pay? “When accountants have ... put the expenditure payment on hold, authorizing officers may ... request, in writing and under their authority, the accountants to effect payment.” (Article 8 of Decree 82) “... the latter shall defer to the requisition and report to the Minister of Finance. Requisition orders issued by authorizing officers are forwarded to the Audit Office (National Audit Authority) by the Minister of Finance.” (Article 60 of Decree 82) “... accountants shall refuse to defer to requisition orders when the grounds for suspension of payment are the following:

- Unavailability of appropriations.
- Absence of financial controller’s approval on the order.
- Absence of supporting documents of the service performed;
- Settlement not in full discharge.

In the event that the requisition is rejected, accountants shall immediately report to the Minister of Finance who shall consult with the relevant minister.” (Article 61 of Decree 82)

21.4.2.2. Petty Cash and Petty Cash Management Officers

Sometimes, one person handles the duties of both an authorizing officer and the duties of accountant: the petty cash management officers (régisseur), who is an officer acting under the authority of the authorizing officer (contrary to the public accountant who is acting under the authority of the Minister of Finance) and who has the capacity to perform transactions of disbursement and payment.

For disbursement, the term revenue petty cash account (régie de recettes) is used; for payments, advance payment account (régie d’avances). “Revenue accounts and advance payment accounts are created by joint order of the Minister of Finance and the relevant

ministry.

The State's public accountants, on behalf of whom such account officers carry out their transactions, are accountants designated by the authorizing officer responsible for the account.” (Article 23 of Decree 82) It can be deduced therefrom that in Cambodia, petty cash management officers are appointed by joint order of the Minister of Finance and the relevant minister. In France, the officer is appointed by order of the authorizing officer upon assent of the designated accountant.

“Revenue account officers (régisseur de recettes) and advance payment officers (régisseur d'avances) subject to audit by the authorizing officer they are placed under, and by the designated accountant.” (Article 24 of Decree 82)

21.4.2.3. The Revenue and Advance Payment Accounts

21.4.2.3.1. Revenue Account

The revenue account officer has the capacity to cash receipts; for instance.

“Fines and summary offences regarding traffic violations are collected by police stations which are set up as revenue accounts by joint order of the Minister of Interior and the Minister of Economy and Finance. Policemen who take down particulars shall hand an offense investigation report to the offender while inviting him/her to go to the police station to pay the fines imposed.” (Article 3 of Order No. 4/MEF of January 15, 1996, implementing Decree No. 82 of November 16, 1995 respecting general rules on public accounting)

“... Revenue account officers must remit at least once every 25th day of the month, and on December 31, as well as each time that their cash on hand exceeds a ceiling amount set by the Minister of Finance.” (Article 4 of Order 4)

21.4.2.3.2. Advance Payment Accounts (and Salary Payment Officers)

“... for some categories of expenditure and for spending on goods purchase and maintenance under 500,000 riels, advance payment accounts are created. Moreover, salary payment and spending on social security and invalidity benefits are to be settled through salary payment officers...” (Article 9 of Order 4)

“Unless exemption is granted by the Minister of Finance, only the following expenditures can be paid through advance payment accounts: petty equipment expenditure, the cost of which does not exceed the amount set by order of the Minister of Finance; staff salaries;

exceptional and emergency spending; and travel expenses and mission allowances.” (Article 64 of Decree 82)

The funds of the advance payment account officer are made available by the accountant to whom he reports: “Advance funds are made available to each account officer; the amount of which is set by the law establishing the accounts and, if applicable, revised in the same forms. Except for exemption granted by the Minister of Finance, the amount of each advance installment shall be at the most equal to one eighth of the annual estimated expenditure amount to be paid by the advance payment account officer. The advance is remitted by the designated accountant at the request of the advance payment officer endorsed by the authorizing officer.” (Article 65 of Decree 82)

The officer carries out expenditures, the nature of which is determined under the order establishing the account: “Under the same terms as for public accountants, the advance payment officers shall make payment for expenditure by transfer or check on their account at the Treasury, or in cash.” (Article 66 of Decree 82)

From time to time, he submits to the accountant supporting documents for expenditures that have been carried out in order to replenish the petty cash account, up to the amount shown in the supporting documents and of the amount of the account: “The advance payment officer submits the supporting documents for the expenditures paid that he himself pays to the authorizing officer within one month at the latest from the date of the payment of expenditure. The authorizing officer issues an *expenditure clearance order* (*mandat de régularisation*) for the amount of the validated expenditures for the benefit of the advance payment officer.

The petty cash advance is replenished through the entry of the amount of the expenditure clearance order credited to the account of the account officer in the books of the designated accountant.” (Article 67 of Decree 82) When closing the account, the advance payment officer justifies his transactions and receives a clearance certificate if the account does not have a debit balance (he then must refund the debit balance amount) or a credit balance (he is then refunded the amount of expenses borne by him).

21.4.3. Other Infringements of the Principles of Prior Commitment, Validation and the Order to Pay

21.4.3.1. Commitment: Infringements of the Principle

The principle is that “no public expenditure charged to the State’s budget or to a special account of the Treasury (or to an annex budget) shall either be committed or approved by chief authorizing officers or authorizing officers by delegation, unless such authorizing officers have made a commitment proposal in writing and provided that such proposal, to

which the approval stamp of the financial controller shall be duly affixed, has been sent back to the authorizing officer.” (Article 3 of Sub-decree No. 81 of November 16, 1995 on the establishment of financial control of budget expenditures within the ministries, external departments in provinces and cities, and public administrative institutions).

Expenditures paid for from an advance payment account may be considered as departing from the principle of prior commitment; similarly, any order that would be committed and authorized for payment at the same time (meaning that the order was made without prior commitment and the invoice was received). Sub-decree 81 also provides for prior approval exemption (thus an obligation of prior commitment if the authorizing officer so wishes) for “casual expenses, the amount of which is set by order of the Minister of Economy and Finance.” (Article 11). This article also excludes certain expenses “concerning the military field and security in the Kingdom, which are confidential.”

“From December 1 of each year and within the limits of the twelfth of the current year’s appropriations, commitments of recurrent expenditures may be taken in case of emergency from the appropriations of the following year. These commitments specify that performance of the service shall not occur before January 1.” (Article 110 of Decree 82): this is an *infringement of the principle of yearly cycle of the budget*.

12.4.3.2. Validation of Expenditures: Infringement of the Principle

The departure only occurs in the case of payments of advances or payments of deposits for public procurement (see section on public procurements).

21.4.3.3. The Order to Pay: Infringements of the Principle

Certain countries exempt the debt service and payment of wages and pension benefits from prior payment order.

Bank charges are levied without any prior commitment or payment order; they are to be brought to the knowledge of the authorizing officer for validation.

21.5. Internal Controls

Financial and accounting operations involving execution of the State budget are subject to diverse controls by qualified officials, including financial control prior to expenditure commitments and control of expense prior to payment. Both levels of control are exercised by MEF the Department of Financial Control and National Treasury.

Financial and accounting operations of the State budget include receipts, expenditures, treasury operations, and an assets base, all of which are to be in conformity with specific

rules and recorded in the official books kept according to standards set by MEF. The financial accounting of the Budget is in Riel and accounts are maintained with the Treasury. The Treasury functions as the Accountant-Paymaster of public expenditures and ministries; public sector enterprises must no longer have accounts with the Treasury.

The Cambodian budgetary system involves a complex and relatively invasive process of ex ante and ex post controls on other ministries and agencies performed by various directorates within the MEF. Expenditure authorizations are granted by the authorizing officers of line ministries. Prior to being acted upon, such authorizations must have the approval of the financial controllers under the MEF (in two ministries, Education and Health, financial controllers work in both ministries). The expenditure goes through another verification by the public accountants of the Treasury within the MEF before payment is made by the Treasury.

21.5.1. Financial Controller

A priori controls are exercised essentially by financial controllers and public accountants. Government Decree No. 82 of November 16, 1995 on General Regulations for Public Accounting makes mandatory the bookkeeping of expenditures incurred in each ministerial department. The financial controller is an officer of the MEF who simultaneously plays the role of adviser to the minister of the concerned line ministry. He/she has two functions:

1. As controller of commitments he/she appraises the propriety of the commitment transactions made by the ministry and authorizes them. The controller verifies all acts that translate into expenditure. He/she verifies the budgetary sanction for the expenditure, the availability of appropriations, the accuracy of the computation for expenditure and compliance with laws and regulations.
2. As Controller of payment authorizations, the financial controller also approves payment authorizations prior to signature by the Minister. He/she makes sure that the expenditure has been covered by an authorized commitment and that the payment authorization is consistent with the commitment. Should a discrepancy be found, the controller signs “with compliance” and the accountant can go ahead with the payment only with the authorization of the Minister of Finance.

21.5.2. Public Accountant Control over Authorizing Officers

Public accountants belong to an administrative hierarchy independent from authorizing officers. Their role is to audit the receipts and expenditure operations ordered by the authorizing officers. The accountants have the following mandates:

(i) In terms of receipts,

- Control the authorization to collect the receipt under the conditions provided for each category of public agency under the relevant laws and regulations.
- Within the limit of the appropriation approved, control collection of the debts of the public agency and the legality of any reductions or cancellations of receipt orders.

(ii) In terms of expenditures,

- Verify the legal capacity of the authorizing officer, his delegate or deputy.
- The availability of appropriations.
- The precise charging of expenditures consistent with the budgetary nomenclature that governs them, according to their nature or object.
- Validity of the claim or debt.
- Whether or not the settlement effects a release from claim or debt.

Public accountants are under obligation to give special attention to the validity of the claim or debt they are to pay off by verifying:

- Proof of the service performed and accuracy of the close-out calculations.
- The prior intervention of regulatory controls and submission of supporting documents.
- The existence of the approval signature/stamp of financial controller on commitments and payment orders issued by authorizing officers.
- Application of the rules of limitation and lapse of the claim or debt.

21.5.3. Inspection of Finances

The MEF also has an auditing agency: the General Inspectorate of Finance (GIF). Its area of control covers the entire public sector. The GIF's jurisdiction includes all accounting officers, officers of the MEF, authorizing officers, and all agencies receiving public funds. Upon arriving in an accounting facility, the GIF immediately closes all activities of the

departments including the cash flow (inventories the funds and securities) and book entries, and checks the funds and records.

21.6. External controls

An independent and superior authority must certify that the accounts are in compliance with the Budget Law. The National Audit Authority (NAA) was instituted in 2002 to act as the highest level of scrutiny of the conformity of the actual budget implementation with the Budget Law. This Authority is an independent entity (Articles 1 and 14 of the 2000 Law); it has its own separate budget funded by the national budget (Article 17). It is subject to the public finance regulations (same article). The NAA is to report directly to the National Assembly and to the government for information purposes (Article 14); at least the report on budget settlement is to be deemed a public document (Article 29).

The NAA's jurisdiction covers: the different ministries and their officers; senior officials of the National Bank; public financial institutions and public financial joint-ventures; state-owned enterprises and establishments; provincial and municipal government offices; local and regional administrative authorities; contractors supplying goods and services to the government under contract; various organizations that have received government financial assistance; tax-exempt organizations or organizations that have received other concessions or benefits; non-profit organizations; and private investment enterprises (Article 2 of the 2000 Law).

The overall budget process is subject to an ex post audit by the NAA, that works with the internal audit teams of the line ministries in order to ensure greater transparency and accountability on the part of the public officials in charge. The NAA submits regular reports on the effectiveness and efficiency of government programs to the National Assembly. The scope of the audit involves the whole public sector, authorizing officers, and any agency receiving public funds. The audit is carried out on the basis of supporting documents right in the premises of the entity being audited. Questionnaires are used and the written replies submitted by the audited agency's managerial staff provide a continuous information exchange between the NAA and the audited entities.

21.7. Budget of Provinces and Municipalities

Since 1993, the MEF has been working on budget reform. The early reforms succeeded in centralizing all public revenues and expenditures under a unified budget. Sector services in the provinces were directly tied in with the budget of the sector ministry. In this framework, the provincial-municipal administrations were viewed as state services that simply manage the central budget in the administrative constituency, i.e. they were deconcentrated administrations. They had no powers of their own other than those delegated to them by

the central government, nor any budget or resources independent from the central authority.

It quickly became obvious that provinces and municipalities have needs that are not necessarily linked to any identified national sector. These expenditures however are in the provincial interest. Instead of centralizing these expenditures it would be more efficient to leave local matters to be dealt with by the concerned province or the municipality. The list of expenditures of this nature can be stretched or cut back depending on the availability of local resources. But a minimum local service must be provided by the province-city, giving the citizens administrative information, facilitation of local life, neighborhood solidarity, proximity of amenities, etc.

To enable such expenses to be met, the 1995 Finance Law provided for a *modus operandi* that individualized the needs specific to provinces and municipalities as compared to the traditional activities of the central ministries on the territory of the constituency. This interim system operated according to Chapter 12 of the State Budget, giving provinces and municipalities some resources for which they themselves determined the expenditures.

The Law on the Fiscal and Asset Regime of Khet (provinces) and Krung (municipalities) (Kram No. 0298-03 CS-DR of February 25, 1998) put in place a stable and carefully calibrated system similar to deconcentrated local authorities. The 1999 Budget Law allocated the first autonomous budget to Khets and Krungs sourced through a transfer of tax and non-tax revenue from the State budget, along with a matching subsidy, in addition to the creation of new revenue sources for their use.

Another step was taken with the law of February 25, 1998 which sought to (i) make the Khets and Krungs into empowered local authorities entrusted with the management of the local interests of the constituency, and providing public services meeting the needs of the community; (ii) make available for their use an assigned assets base; (iii) transfer for their benefit a number of financial resources pending acquisition of their own-source taxation system; (iv) set forth the fiscal regime applicable to Khets and Krungs along with the conditions for management of the assets that the State assigned to them.

The budget of provinces and municipalities must be balanced and no deficit is allowed. Provinces and cities are to assume the following expenditures:

- Upkeep of the provincial or municipal headquarters.
- Costs of the safekeeping of certificates and documents.

- Expenses relating to staff salaries, grants to villages, communes and wards.
- Operating costs for administrative services under provincial jurisdiction, as well as public utilities such as lighting, firefighting, and household waste disposal, as well as social welfare, hygiene, and health care services.
- Expenses for the installation, upkeep, and major repair of public buildings, community amenities of any nature assigned to the province or city, including government buildings, schools, hospitals, public markets, sports and cultural facilities.
- Costs of upkeep, alignment, leveling of thoroughfares, roads or streets, public parks.
- Maintenance costs of water supply lines, canals, and bodies of water, hydrants, and sewage or rainwater drainage canals.

Receipts for the provincial and municipality operating budget include tax and non-tax revenue sourced from the State budget or specifically created for the provinces and municipalities, such as: (a) tax on unused land; registration fees; license fees; slaughterhouse fees; tax on means of transportation and vehicles; and (b) non-tax revenue: electricity and potable water supply in the provinces; receipts from the provincial-municipal water authority; fees for occupancy of the public properties (markets, parking lots, ferries, auction markets) and other non-tax revenue of the provinces.

The Seila program—the most significant example—has been implemented in five test provinces using UNDP-CARRERE funds and with local community involvement. The Khets and Krungs both local deconcentrated authorities—have been contributing to the funding of the program since 1999. The new budget framework for Khets and Krungs facilitates gradual extension of these projects into other provinces and municipalities and in due time account for all national initiatives at the level of the provincial and other local authorities.

21.8. Commune Budget

In terms of decentralization and deconcentration, the following statutes have been put in place:

- Law on the administration and management of communes and sangkats (Kram No. 301/05 of May 19, 2001).
- Subdecree of February 16, 2002 on setting up the Commune/Sangkat Fund.

- Subdecree of April 26, 2002 on the commune financial management system.

The risk in the proliferation of institutions and levels of budget authority is that they may set up inconsistent systems of control which are not compliant with the constitutional and legal provisions, are cumbersome to apply, and do not meet the expectations of the served communities. However,, it is expected that the commune should provide a minimum delivery of local service in the following areas:

- Upkeep of the commune/sangkat headquarters.
- Expenses relating to staff salaries, as well as grants to communes and wards.
- Operating and maintenance costs of local infrastructure that comes under commune jurisdiction.
- Costs of preparing the Commune Development Plan.
- Budget for investment in commune projects.
- Expenditures that national laws and regulations make incumbent upon communes.

Commune/sangkat operating budget revenues are made up of tax and non-tax revenue originating from the State budget or created specifically for communes/sangkats from tax and non-tax revenue. The commune budget must be balanced and no deficit is allowed.

The Commune Fund was created to transfer receipts from all sources to the commune budget. Funds for communes taken from the State budget are covered by direct transfers from the State budget. This Fund will also receive the proceeds from foreign aid and foreign loans. It will fund investments and distribute solidarity grants to communes that do not have sufficient resources. Funding may also take the form of loans. Grants could also be provided to the most disadvantaged communes. The board of directors of the Commune Fund is chaired by the representative of the MEF and is made up of representatives of the Ministry of Interior, Ministry of Planning, CDC and three additional commune council representatives.

The 2005 budget saw an upswing in the State's effort to strengthen the decentralization process. Communes received a grant of 58 billion riels (US\$14.5 million) from the State budget to meet their needs.

An open-ended framework allows these Local or regional constituencies have been allowed the time to learn accountable and autonomous budget management and move their constituencies forward economically and socially. As local governments improve their budget management and their financial opportunities the central government intends to expand the scope of delegation.

The coordination of the decentralization initiative will be carried out in the following framework (i) in its legal and organizational aspects, it comes under the Ministry of Interior, acting in concert with the leaders of the concerned sectors and, (ii) with regard to the budgetary, fiscal and assets management regime, it comes under the MEF.

21.9. Public Investment Management

The budget allocated to public investments, from 1994 until the present, increased from 5.5% of the GDP in 1994 to 6.1% in 2005 and to 1,785.13 billion riels, i.e. 5.73% of GDP amounting to 31,137 billion riels in 2007 and expanding by 6.5% in real terms. The volume of capital expenditure thereby went up from 33.6% of the total budget expenditure in 1994 to 37% of the budget expenditure in 2005, and to 38.62% of that of 2007. Public investments therefore gradually became one of the major components of public expenditure.

21.9.1. Direct External Financing

Incorporating the direct external financing of public investments into the budget of the Kingdom of Cambodia involves entering in the budget, under external investments directly financed by outside sources, the forecast outturns of such investments: these forecasts are not budget appropriations subject to prior authorization for expenditure and therefore are not expense authorizations intended for the Cambodian government. These estimates only show the level that will be reached by expenses to be covered by external financing sources during a given fiscal year, in the financing of the investments that these external sources will cover directly themselves on behalf of the Kingdom of Cambodia and in line with the competent authorities of the Royal Government.

For the 2007 fiscal year, the total amount of expenditures carried out by external sources within the framework of project aid (direct externally financed investments) would thereby be estimated at 1,110 billion riels in the budget law.

Based on these budget forecasts, follow-up work is required to identify projects that actually started and the actual levels of disbursements made via the financing sources for implementation of such and such investment project that these bilateral or multilateral sources are financing.

In the final analysis, the follow-up work involves implementing the budget from the angle of forecasting the input from external financing for public investment, the expenditure mechanisms of which do not provide for financial control by the Finance Ministry and do not yet imply entry of the operations into the accounts by the National Treasury which, in any event, does not implement the payments.

21.9.2. Locally Financed Investments

Locally financed investment expenditures (direct investment expenditure and local counterpart expenditures for externally financed projects) are investments financed out of the national budget, from its own-source available funds—thanks to the current budget surplus of current revenue over current expenditure—and sourced through the budget support supplied by donor commodity aids. The volume of investments is certainly restricted by tight financial envelopes. This type of investment, however, plays a significant part in the reconstruction policy. Firstly, it helps cover *the counterpart funds of direct externally financed investments*. Secondly, it makes it possible to finance emergency projects of small or medium dimension involving the construction and repair of buildings, roads, irrigation systems, utility equipment, administrative logistics equipment and the like. Thirdly, these investments are often needed as preparatory projects or a means of coaching more substantial projects. Above all, locally financed investments are bound to become the backbone of national capital cost expenditures with the creation and development of national savings, as well as the capacity building of Cambodia's managerial level officials to meet the needs of the country.

Expenditures at this level follow the usual budgetary procedure for expenditure within the framework of public finance control; monitoring is therefore directly implemented through the follow-up and registration process of authorizations for expenditure, once approved by financial control. This follow-up, as well as the apportionment of expenditure authorized by the Ministry, are directly carried out through financial control and use of the database.

As far as financial control and database use are concerned, local expenditures, as a local counterpart of externally financed projects, also follow the same expenditure procedure and registration process.

As for local expenditures, they normally transit through the budget and control services and are therefore recorded at the point where authorization for expenditure is processed. These expenditures are monitored on the basis of each external project being carried out for which the expenses are authorized, while at the same time being monitored by the spending ministry.

21.9.3. Budget Support

Budget support is one component of the assistance that bilateral and international organizations grant a country in the form of loans or in the form of monetary or in-kind donations, which aim at contributing to the settlement of certain national or sectoral budget expenditures that the country has already committed or that it has programmed to carry out. The relationship of budget support with the National Budget and budget balance is very appreciable and essential.

This is why the issue of implementation of such aid based on donor pledges and commitments is so crucial for any country undergoing economic recovery and adjustment.

Indeed, if commitments are not honored or only partially honored because of a delay and, as a consequence, budget support is not implemented or is implemented with a delay, the relevant issue of budget balance will make itself sharply felt: balance cannot be maintained. To achieve that, new resources have to be released or severe budget cuts made in certain essential expenditures, which inevitably results in a budget review.

For example, budget support provided under the Poverty Reduction and Growth Operations (PRGO).

21.9.4. Monitoring System of Donor Assistance and Outcomes

Collecting data on investment expenditures that do not transit through the Budget is a major challenge facing MEF. The challenge is daunting in view of the large share of the directly channeled funds in the total scheme of development expenditure. However, the data collecting operation is crucial to ensure a systematic financial monitoring of public investments and to take into account the substantial contribution from foreign sources to Cambodia's development.

In systematizing this work, a permanent information system has been gradually introduced to monitor the financial execution of investment projects on a monthly basis. The data collected are used for :

- Collating investments undertaken using external financing, by source of funding and by category of funding (loans and grants).
- Analyzing the distribution of the investments by sector/ministry, based on the budgetary nomenclature.

- Preparing financial statistics for the Table of Government Financial Operations (Tableau des opérations financières de l'État - TOFE);
- Preparing the records in the Treasury's bookkeeping of classification of expenditures as grants and loans.
- Providing a benchmark for PIP preparation, particularly for including projects being undertaken with external funding, at least for the first year of the PIP.

21.10. State-Owned Enterprises

State-owned or public companies are companies whose capital is owned in whole by the government (Article 30 of the law of June 17, 1996 defining the status of public enterprises). The same general provisions as those on public institutions of an economic nature (or with economic characteristics) apply: the board of directors, chairman and managing director or CEO. Moreover, the ministry or the administrative authority adopts the statutes with the consent of the Ministry of Economy and Finance; it has the trade name entered in the Registry of Companies and completes the formalities provided for under commercial company law. (Article 32)

Notwithstanding the commercial company law, general meeting powers are granted to the board of directors. (Article 34) Public or State-owned companies are subject to verifications by a statutory auditor, as is the case for public economic institutions and semi-public companies. "The financial statement... comprising balance sheets, profit and loss statements and analysis of accounts..." are audited by the National Audit Authority. (Article 5 of Law No. 10 of March 3, 2000 on audit in the Kingdom of Cambodia)

Semi-public companies (Joint Venture) are companies, whose capital is partly owned by the central government, a public institution or a State-owned company. This portion of the capital is known as the "public share" (Article 37); it may be a majority or minority share.

The company is considered as a public enterprise when the public share exceeds 51% of the capital or voting rights. (Article 38) The Ministry of Economy and Finance is in charge of administering the public share. (Article 39)

General provisions relating to State-owned companies apply; furthermore, representatives of the government, public institutions and State-owned companies on the board of directors are exempted from the common law security deposit. The civil liability of representatives of the government, public institutions and State-owned companies is covered by the State, but these representatives remain personally liable for any criminal offense. (Article 44) The State is represented by a special rapporteur at the general meeting

of semi-public companies. (Article 47)

Table 21.1. State-Owned Enterprises by Ministries

Number of SOEs	State Comp.	Public Esta- blishment	JV	Total
OVERSIGHT MINISTRIES AT CENTRAL LEVEL				
Ministry of Agriculture	9	3	2	14
Ministry of Public Works	6			6
Ministry of Finance	4			4
Ministry of Industry	1			1
Ministry of Commerce	1			1
Ministry of Education	1	1		2
Ministry of Communications	1		6	7
Ministry of Health				1
Council of Ministers		1	1	1
MUNICIPAL LEVEL				
Phnom Penh Municipality	1			1
Total	24	5	9	38

Source: MEF

Semi-public companies are subject to verifications by a statutory auditor, as is the case for public economic institutions and State-owned companies. “The financial statement... including balance sheets, profit and loss statements and analysis of accounts...” shall be audited by the National Audit Authority. (Article 5 of Law No. 10 of March 3, 2000 respecting audit in the Kingdom of Cambodia) (Decree 97-41 and 42, circular No. 5 of November 27, 1997).

21.11. Public Financial Reform

The goal of public financial management is maintaining a sustainable equilibrium of receipts and expenditures in public finance and progressively increasing budgetary allocations for the social and economic sectors, through the reduction and rationalization of public expenditure, enlargement of the tax base, prevention of tax evasion, and strengthening the Tax Administration in order to seal leakages and capture additional revenue. A prudent budgetary policy has been recognized as fundamental for ensuring price stability in a highly dollarized economy such as Cambodia’s.

The implementation of Public Financial Management (PFM) reform poses a considerable challenge for MEF since it involves introduction of a complex set of new systems including

a new approach to ministerial budgets, a new accounting system, new modes of management, and new information systems.

21.11.1. A New Approach to Ministerial Budgets and Structuring of Programs and Actions

Public finance improvement is a long-term undertaking requiring the political will for budgetary discipline. The cooperation of line ministries is paramount for ensuring the success of the reform. To reform and modernize the government's budgetary mechanisms, the MEF is considering the following modalities in the budget-making process:

- A medium-term budgetary framework.
- Prudent economic forecasts.
- Improvement of the status of the treasury.
- Instilling a sense of accountability in management of public funds.
- Emphasis placed on results.
- Budgetary transparency.
- Modern methods of financial management.

Under the Public Financial Management Reform Program, the MEF has undertaken to reform the budgetary system by changing from budgetary lines to budget preparation by program, i.e. going from a budget of means to a budget of results. The proposed new budget presentation will be at two levels: programs (missions) and actions.

A program, as defined at the ministerial level, groups together the appropriations identified with a public policy. Programs outline a set of measurable performance goals that will be reached throughout a fiscal period, goals involving both the budget and personnel. Each program corresponds to a coherent body of actions entrusted to an officer designated by each concerned minister, referred to as the “program coordinator.” This officer receives a bulk, fungible appropriations package that allows him or her to select the most suitable means of achieving the set goals. The “programs,” or units of specially earmarked appropriations, constitute limited packages and include a personnel expense subceiling.

Actions are subsets of programs, into which expenditures are broken down. Actions are crucial for reaching the goals and objectives of the program. The action specifies information on the destination of budgetary monies. At the actions level, expenditures are planned and their execution monitored for information purposes: the program coordinator steers a series of actions without being bound to limited appropriations.

New modes of management, include a list of national programs that have been deconcentrated (program operational budgets) and management discussion between the central administration and the deconcentrated department (management control, reporting procedures, etc.). A new codification will allow for distinctions to be made: the level of execution, location by province, and economic function concerned. For example, the two-digit code designates the chapter, the three-digit code the account, and the four-digit code the sub-account. Thus, the notion of articles, chapters, paragraphs, and sub-paragraphs disappears, being replaced by chapters, accounts, and sub-accounts.

With the vote on budgetary appropriations by purpose under aggregate packages, and not only by nature of expenditure, the definition of expected results measured by numbered indicators makes it possible to move government management from a logic of means to a logic of results.

The identification of relevant, reliable indicators will subsequently make it possible to formulate objectives for ministerial policies. Globalization and the asymmetric fungibility of appropriations offer new freedoms to managers. On the other hand, they agree to produce results and render an accounting in performance reports, in order to ensure the efficiency of public policy.

21.11.2. Introduction of Accrual Accounting

The accounting reform involves introduction of accrual accounting and a changeover of the conceptual framework and accounting norms, based on the corporate charter of accounts that has been adapted to the specificities of the State. In parallel, it entails a necessary change in the role of the public accountant.

The MEF will move to the accrual accounting method or double-entry accrual basis of accounting. This is a decisive reform with an upgrading of government accounting to international norms:

- Debts will be recorded as of the date they are incurred, and put in the fiscal year that saw them come into being, receivable or payable:

- ⇒ Revenue to be collected on tax and non-tax proceeds, grants in kind, and gifts of equipment through international aid will be brought into the government accounts.
- ⇒ As for expenditures, accountancy norms are to be reestablished in order to know at all times the status of the “suppliers” debt, meaning “outstanding payment orders
- The most sensitive issue is the case of advances granted to the ministries to execute expenditures relating to the Priority Action Programs (PAP), which are considered as paperless payment orders. This departure from the rules of public accounting is currently authorized to accelerate payment of priority expenditures. It is also a means of balancing the appropriations of certain ministries so that they will not be lost for the following year.
- Patrimonialization of the debt and investments will be ensured along with requirement to establish paper trail of authorizations and payments, and preparation of statement of assets and liabilities, including bookkeeping of fixed assets, property, and securities, and long- and short-term debts.
- An accounting nomenclature, based on the French charter of accounts, satisfying international norms will be adopted. The accounts of class 4 and class 5 have been adopted and applied since January 2005. The work of developing class 1 – Capital accounts; Class 2 – Fixed assets; Class 6 – Budgetary expenditures, and Class 7 – Budgetary revenue –has been finished.

21.11.3. New Information Systems

A Financial Management Information System (FMIS) will be developed in all central administrations, along with the development of ministerial management information systems. This reform is based on successful pilots, information exchanges, pooled skills, and a realistic roadmap. The reform will result in a new culture of performance and efficiency measurement contained in the Budget Law and could lead to its amendment (for e.g. fungibility of appropriations). To implement the reform effectively, the ministries must structure a management dialogue between program coordinators and the operational departments on the operational budget of the program.

21.11.4. Steps of the Reform

The roadmap for reform is as follows:

- Legal development and updating of legislation relating to the Budget Law by the Budget Department.
- Review of the required legislative changes by Parliament while deliberating the 2007 Budget Law.
- Framing of a new budgetary model by the Budget Department.
- Work on the accountancy section to be completed in 2006.
- For the budgetary part, application of the new model will begin in 2007.
- Development of performance indicators to appraise the impact of public policies that are reflected in the programs.
- Training of all personnel involved at the stages of budget preparation and execution.

During the preparation of the 2007 Budget line ministries were requested to aggregate appropriations, apply the new modes of management (program operational budgets, new management of staff and personnel expenditures, management of commitment authorizations) and to begin a policy of training to have these mechanisms adopted widely. Following the initialization of the presentation framework of annual performance proposals, a pilot presentation of the budget, according to the new budgetary architecture was implemented in the 2008 Budget.



PART VIII

INTERNATIONAL ECONOMIC RELATIONS

- Chapter 22. Foreign Trade
- Chapter 23. External Debts
- Chapter 24. Regional Integration



Chapter 22

Foreign Trade

22.1. Trade Liberalization in Cambodia

The principal goal of Cambodia's foreign economic policy is to expand and strengthen economic ties and international cooperation through the integration of the Cambodian economy into the regional and world economy. This goal is designed to utilize the advantages of international division of labor to promote economic development and improve the welfare of the population.

Since the late 1980s and especially in the early 1990s Cambodia has embarked on trade liberalization and integration. The private sector was enabled to establish trading companies with a maximum foreign participation of 49 percent. Since 1993, the general licensing for most goods has been eliminated when registered companies undertake such trade.

22.1.1. The Role of Tariff

There are several arguments in favor of tariffs:

- to maximize benefits from strategic application of tariffs. Tariffs could increase a country's welfare by enabling excess profits to be shifted from foreign to domestic firms;
- as instruments for temporary protection of a specific "infant" industry. It is argued that certain industries are initially uneconomic but they may become competitive (at world price) in the long run because costs may decrease over time through learning-by-doing effects;
- to raise budget revenue. Trade taxes however are not optimal instruments for achieving a revenue objective because they distort production and consumption choices. Preferred instruments for raising revenue are taxes such as income taxes or commodity taxes (excise taxes, VAT), which are applied neutrally to domestically produced and imported goods;
- to reduce imports as a remedy for balance of payment problems.

22.1.2. The Advantages of Uniform Tariffs

The advantages of a uniform tariff is as follows:

- **Administrative convenience.** If tariff is uniform, there is no incentive to misclassify goods. This enables customs authorities to concentrate on ensuring that the value of the imported goods is not understated and could reduce to corruption related to customs clearing. Thus, it will lower the administrative costs of trading.
- **Reduced smuggling.** Diverse tariffs provide an incentive to smuggle products that are subject to high tariff. If the tariff is uniform, these strong incentives for smuggling are considerably reduced.

Worldwide experience in the past 50 years demonstrates the benefits of open trade regimes. However, many developing countries initially attempted to promote industrialization behind high protective barriers of tariffs.

But in the past decade, there is growing evidence that high rates of protection significantly depress economic development, and that open trade regimes are more conducive to growth (WB. 2002:526).

Countries that have been successful have been based on strong growth of industrial exports. Exporters have been successful either because there were low barriers to imports or because regimes were developed to provide incentives to exporters.

22.1.3. The Rationale for Low, Uniform Tariffs

The RGC's economic goals include higher rates of industrial growth and development based on an expansion and diversification of exports and improved competitiveness of import competing industries. If these goals are to be achieved to any significant degree, resources must be employed in their most productive uses.

The dominant role of the private sector in allocating resources means that it is essential that policy based incentives does not distort their assessment of the returns to alternative investments. In other words, the large differences in effective rates of protection noted above need to be substantially eliminated. This in turn implies moving away from a cascading tariff structure.

The primary policy objective for the tariff system should be the adoption of a low, uniform tariff rate structure with only a few tariff bands. In other words, a few tariff bands that applies to all or virtually all imports would facilitate enforcement, discourage smuggling of imported goods and bureaucratic costs. The sole purpose of the tariff system would be as a source of revenue. The determination of the appropriate level of tariff rate would be set to

achieve the required revenue. The Integrated Framework suggested that a low uniform rate on (or virtually) all imported capital goods, raw materials and finished goods would ensure that local producers are not disadvantaged vis à vis competing imports.

22.2. Tariff Restructuring

22.2.1. Tariff Barriers

An effective trade policy is crucial for Cambodia's integration into the world economy. 'Trade policy forms the transmission mechanism through which international trade affects domestic resource allocation, the efficient and competitive restructuring of industry and agriculture, access to new and diverse technologies, improved incentives to exporters, and reduction to smuggling, rent-seeking, and corruption in customs (WB. 2002:526)'.

Tariff policy is the centerpiece of trade policy in a market system. Tariffs are, with few exceptions, the only acceptable policy tool for protection under the GATT/WTO. They are superior to alternative instruments of protection such as non-tariff barriers (NTBs), i.e. quotas, licenses, and technical barriers to trade (TBTs).

Trade policies, particularly tariffs, influence domestic prices and these in turn affect investment and production decisions. Industries that do not face import competition because of tariffs, subsidies, and quantitative restrictions have an incentive to produce for the domestic market and not to export. It is sometimes argued that a country can protect designated import competing industries, while at the same time allow exporters to source imported materials at competitive world prices through various duty exemption schemes, thus, achieving the dual objective of promoting exports and import competing industries.

Before embarking on the tariff restructuring, Cambodia's tariff schedule consists of 6,821 tariff lines with 12 bands: 0 percent, 0.3 percent, 7 percent, 10 percent, 15 percent, 20 percent, 30 percent, 35 percent, 40 percent, 50 percent, 90 percent and 120 percent. Three bands of 40 percent, 90 percent and 120 percent were for vehicles. The rate band of 50 percent was for cigarettes, petroleum products, beverages and spare parts for vehicles. Substantial proportion of Cambodia's imports fell within the bands of 7 percent, 15 percent, 20 percent and 50 percent.

More than 90 percent of the tariff lines were under three bands: 7 percent, 15 percent and 35 percent. This means that any restructuring, which retains the tariff bands of 7 percent, 15 percent and 35 percent would not have a major impact on revenue. Therefore, the tariff restructuring undertaken by the Ministry of Economy and Finance consisted of consolidating all rates above 35 percent at 35 percent; unifying the three rates of 10 percent, 15 percent and 20 percent at 15 percent; retaining the 7 percent rates; and combining the 0.3 percent and the 0 percent at 0 percent.

Table 22.1. Cambodia: Tariff Restructuring

<i>Tariff Band</i>	<i>1997</i>		<i>2000</i>		<i>2001</i>	
%	Number	Share,%	Number	Share,%	Number	Share,%
0	107	2.1	290	4.3	297	4.4
0.3	7	0.1	9	0.1		
7	2,112	40.7	2,731	40.0	2,758	40.4
10	14	0.3	14	0.2		
15	1,184	22.8	1,861	27.3	1,936	28.4
20	46	0.9	68	1.0		
30			4	0.1		
35	1,575	30.4	1,569	23.0	1,832	26.9
40			8	0.1		
50	133	2.6	256	3.8		
90			6	0.1		
120			6	0.1		
Total	5,186	100.0	6,822	100.0	6,823	100.0
Average Tariffs						
Unweighted Average		18.4		17.3 (13.6)		16.5 (11.9)
Import-Weighted Average		15.9		16.77		16.87a
Effective Tariff		n.a.		10.8 (12.4)		n.a.

A. Figures in parenthesis are standard deviations, which measure the dispersion of tariff rates. The Effective tariff rate is the ratio of revenue from tariffs over the value of imports. Import weighted average tariff rate for 2001 is calculated using year 2000 import data.

Sources: Customs Department and Ministry of Economy and Finance.

However, such tariff restructuring would result in revenue loss from the following sources: a loss in import duties; a loss in excise duties; and a loss in VAT. It is worth noting that excise duties and VAT are calculated on the basis of customs value plus customs duties and excises. And it was estimated that the restructuring would result in a loss of between 40 to 50 billion CRs.

As a compensatory measure for the tariff changes, the government increased excise tax rates on these major products. The advantage of shifting away from tariffs to excise taxes as a revenue raising measure is that it avoids the negative effects of high tariffs on domestic resource allocation, since an excise tax applies equally to domestically produced goods and imports.

However, not all goods and products are subject to excises. Therefore, in order to ensure that there would be an increase in revenue after the restructuring, the government decided to increase the excise rate on some products more than the reduction in the tariff rate. The MEF also increased the nominal excise rates on domestically-produced excisables to

maintain uniform excise rates on all excisables regardless of origin.

22.2.2. Tariff Reform

On 25 May 2001, the Royal Government reduced the number of tariff bands from 12 to four with the maximum rate falling from 120 to 35 percent (Naron, 2001). The tariff bands of 35 percent protects several semi processed goods and consumer goods such as processed meat and dairy sectors, processed vegetables and fruits, wheat flour; beverages and tobacco; garments and footwear; plywood and jewelry. Under this tariff band fall a fifth of all imports.

By the end of 2002 the MEF reduced the un-weighted average tariff rate to below 15 percent. The fewer the number of rates, the narrower the range of rates, and the lower the average rate, the less costly the tariff structure will be to the economy in terms of misallocation of resources.

In addition to the customs duty, two indirect taxes are levied on the value of imports: excise tax and value added tax (VAT). Overall, Cambodia generates almost 76.41 per cent of its tax revenue from taxes on imports, of which indirect taxes represent approximately 51 per cent of total taxes on imports in 2001.

Excise taxes are levied on five product groups: beverages (including mineral water), tobacco, passenger vehicles, motorcycles, and petroleum products. The VAT is a uniform 10 per cent rate. With few exceptions, both taxes are levied on imports at the same rates and conditions as on domestically traded goods. Exporters are zero VAT rated for imported materials used for producing exportable goods.

Typically, the protection pattern involves low tariffs for unprocessed commodities and raw materials and much higher tariffs for processed final goods. The Cambodian tariff schedule is characterized by low tariffs on intermediates and high tariffs on selected final goods – a situation known as tariff escalation. This causes problems of inefficient resource allocation.

In the long run this escalating tariff structure that tends to favor production of final goods at the expense of intermediates encourages assembly-type activities while discouraging production of intermediate goods.

Most of the rapid growth in the industrial sector has been driven by export-oriented sectors, notably garments and more recently, footwear. Instead, further tariff reform will produce greater benefits in the medium term. A low, uniform rate would signal to investors that Cambodia wishes to be a platform for investment in activities where Cambodia has a comparative advantage. This should attract new Foreign Direct Investment (FDI) into these sectors.

A low, uniform tariff rate would allow investors to source raw materials at world prices (or close to them) and this ensures that producers supplying the domestic market (including SMEs) will not be disadvantaged vis à vis imports; this in turn encourages development of competitive import competing industries.

22.2.3. Adjustment Costs of Tariff Reform

Countries that have liberalized their trade policy regimes have experienced varying short-term adjustment costs. In particular, countries that had in the past made extensive use of tariff and NTBs to protect their inefficient industrial bases typically experience the greatest adjustment costs. Often these costs included temporary, but high unemployment as inefficient sectors restructure and resources move to uses that are more productive.

The most important adjustment costs for Cambodia is the impact of tariff restructuring on budget revenue. To compare this impact, we need to analyze revenue collection from import duties, VAT, excises and turnover tax in the first half of 2002, compared to the same period of 2001. Revenue from the four taxes increased by 1.6 percent from 477.7 billion CR (import duties was 178.9 billion CR, VAT-205.7 billion CR, excises - 89.7 billion CR and turnover tax - 3.4 billion CR) in the first half of 2002 to 470.3 billion CR (import duties-195.7 billion CR, VAT - 205.0 billion CR, excises 63.7 billion CR and turnover tax 5.9 billion CR) in the first half of 2001.

We expect that tariff restructuring would result in revenue loss from the following sources: a loss in import duties; a loss in excise duties; and a loss in VAT. We have seen that import duties dropped by 16.8 billion CR, while excises increased by 26 billion CR. VAT collection increased by 0.7 billion, though efforts have been taken by the Ministry of Economy and Finance to expand the real regime tax collection to five provinces and expand the tax base in Phnom Penh. At the same time revenue from turnover taxes fell by 2.5 billion CR, since some taxpayers have been transferred from the assessment regime to the real regime of tax collection.

If we exclude the revenue from VAT and turnover tax from our calculation, we can come to the conclusion that the tariff restructuring has yielded a revenue increase by almost 11 billion CR.

Thus, Cambodia has not faced the same short-term adjustment costs that some other countries experienced when they liberalized their trade structures. The reason is that, Cambodia does not have an inefficient industrial sector built around high tariffs. For many activities, remaining high tariff rates either are redundant, because little domestic activity is undertaken in these sectors or because smuggling of goods keeps domestic prices close to world prices.

Table 22.1. Summary of the Customs Tariff of Cambodia, 2009

<i>Sector / Base rate</i>	<i>Number of Tariff Line</i>				<i>Total</i>
	0%	7%	15%	35%	
Live Animal and Animal Products	27	6	168	125	344
Vegetable Products	34	196	109	52	391
Fats and Oils	0	150	0	0	150
Prepared Foodstuffs	0	116	87	183	386
Mineral Products	21	92	71	13	197
Chemical Products or Allied Industries	153	695	76	174	1098
Plastics	98	159	67	68	392
Hides and Leathers	0	42	5	38	85
Wood and Wood Articles	0	64	53	19	136
Pulp and Paper	9	211	0	4	224
Textiles and Apparel	0	598	86	243	927
Footwear	0	21	32	10	63
Stone/Cement/Ceramics	0	115	52	18	185
Gems	13	62	0	0	75
Base Metal and Metal Articles	125	474	127	100	826
Machinery and Electrical Appliances	38	159	1340	266	1803
Vehicles	33	8	319	67	427
Optical, Precision and Musical Instrument	18	53	221	47	339
Arms	6	0	0	22	28
Miscellaneous Manufactured Articles	43	45	75	49	212
Antiques and Works of Art	10	0	0	0	10
Total of Tariff Line	628	3266	2906	1498	8298
Percentage of Tariff Line	7.57%	39.36%	35.02%	18.05%	100.00%

Source: MEF

Cambodia's tariff structure is based on four broad tariff bands, which correspond more or less, to whether goods are final goods or raw materials. The tariff rates cascade down, with higher rates for finished goods, to lower rates for intermediate goods and raw materials. Several major sectors — food and beverages, textiles and garments, basic metal products — have very distinct 'cascading' tariff structures.

- The 0 percent rates apply to breeding animal, vegetable seed and special medicine.
- The 7 percent rates are imposed on chemical raw materials, raw materials for textile and clothing (in practice are exempted for garment factories), metal ores, base metal, wood in rough, wool and mineral fertilizers.
- The 15 percent rates apply to capital goods, locomotive, machinery and electrical appliances, finished industrial products and semi-finished agricultural products.
- The 35 percent rates are imposed on finished agricultural products, finished industrial products, alcohol, precious stone, precious metal, motorcycles, cars and petroleum products.

This ‘cascading’ tariff structure has important implications for the government’s export led economic development and poverty alleviation strategy. By setting high tariffs on semi processed and consumer goods, Cambodians are required to pay above international prices for basic needs, unless smuggling of imported goods circumvents these high prices. To promote the garment industry the government provides tax exemption on imported raw materials for garment in compliance with the Law on Investment.

As a result of such tariff structure, downstream users of the products must pay a relatively high price for intermediate products as an important ingredient into production of their goods. The higher costs of production are then passed onto consumers through higher retail prices. Thus, those who lose from a high tariff are the consumers of the product.

22.3. Non-Tariff Barriers

Most non-tariff barriers (NTBs) to trade have been eliminated. Those that remain are the temporary export restrictions on rice and import licensing for pharmaceuticals. Exports of wood products are subject to annual export quotas and non-automatic licensing. Owing to its low customs duties, Cambodia has become a hub for transit trade in the region, especially with Vietnam. However, re-exports to Viet Nam have experienced a gradual decline since 1996 with Viet Nam’s own opening up to the world.

22.3.1. Import Restrictions and Controls

With a few exceptions, all official quantitative restrictions on imports were eliminated in 1994 as part of a comprehensive program of trade reform measures. The import license system was also eliminated in 1994, except for selected items such as pharmaceutical products, gold and silver, armaments and ammunitions and various cultural and medical materials. Ministerial authorization is required for importing these items. A few bans on imported goods remain. Recent examples of import prohibitions include pig meat, used motorbike tires, right hand drive autos, and used footwear.

Otherwise, firms face no restrictions in importing goods as long as the importer is a registered firm incorporated under Cambodian law. Foreign trading companies are free to operate in Cambodia, as long as they are incorporated under Cambodian law and registered with the Ministry of Commerce. While a few state trading companies continue to operate, for most they compete with private trading companies in the same markets.

22.3.2. Export Prohibitions, Quotas and Charges

Licensing is used to administer quotas and conditional prohibitions on certain export goods. These measures are typically in place for public health and security reasons as well

as to implement agreements with trading partners, notable concerning textiles and clothing to the United States (US) and European Union (EU).

Currently, Cambodia has an absolute ban on exports of logs. There are items subject to export licensing: (i) processed wood products (including furniture, wooden handicrafts, etc.), (ii) weapons, (iii) all vehicles and machinery for military purposes, and (iv) pharmaceuticals and medical materials. Ministerial authorization is required for the export of these items.

22.3.3. Garments Export Quotas

A quota was put in place on garment exports to the US since 1999. Quota restrictions were imposed on 12 broad categories of garments. The quota agreement is effective initially for three years ending in December 2001. Under that arrangement, the quota restriction will be eased by 6 per cent per annum.

Up to an additional 14 per cent easing of the quota was provided if Cambodia ‘substantially complied with certain labor standards including those set according to Cambodia’s labor laws and the four core conventions under the International Labor Organization (ILO). Following an assessment of Cambodia’s labor standards, the US government granted a 9 per cent increase in quota, effective 2002.

The government implemented a flexible quota system whereby 80 per cent of the quota is allocated to firms operating in Cambodia since 1998 and based on their export history and production capacity. Up to 10 per cent of the quota can be allocated to exporters as a reward for current export performance and compliance with the country’s labor laws. The remaining 10 per cent was auctioned to garment producers through competitive bidding. The government charges a specific fee (known as visa fees) per dozen of garments sold under the quota to the US and EU.

The garment quota arrangement raised several important long-term competitiveness issues. First, institutional labor arrangements — such as relatively high minimum wages and restrictions on work shifts as well as compliance costs to these standards are raising the cost structure of the garment sector. These institutional rigidities constrain the development of other potential export sectors since these create a relatively high cost structure in the labor-intensive sectors where Cambodia has a comparative advantage.

Much of the export facilitation and documentation process revolved around ensuring that Cambodian garment exports meet requirements on rules of origin. For example, garment exporters require up to 11 documents from three ministries and five departments before their shipments are permitted to leave the port.

The above facilitation and documentation process was costly and time consuming, since it was heavily dependent upon the physical inspection of shipments by three agencies. The process was also very much open to abuse by petty officials.

Garment export quotas were abolished in January 2005, when the WTO Agreement of Textile and Clothing (ATC) was phased out.

22.4. Cambodia and AFTA

Cambodia was admitted as the 10th member of the Association of Southeast Asian Nations (ASEAN) in April 1999. The Royal Government of Cambodia has redoubled its efforts to meet the demands of ASEAN membership - from changing laws to bringing finance, investment, commerce and trade sectors into alignment with ASEAN standards. Under the ASEAN Free Trade Agreement (AFTA), Cambodia has firmly committed to reduce the majority of its tariff lines to 5 percent and below by 2010 and the remaining tariff lines (which are mostly sensitive agricultural products) by 2017 within the framework of the Common Effective Preferential Tariff Agreement (CEPT).

22.4.1. CEPT Implementation in Cambodia

The CEPT process requires that Cambodia classify all of its tariff lines or categories into one of four (4) lists:

- ***Inclusion List:*** goods for which the CEPT rates will be reduced either along the 'normal' or 'fast' tracks;
- ***Temporary Exclusion List:*** goods that are viewed as too sensitive to be subject to immediate rate reductions;
- ***Sensitive List:*** products that are declared sensitive and will have a longer time frame for phase into the Inclusion List; and
- ***General Exclusion List:*** that is intended to include a relatively small number of goods for which trade is restricted based on safety or cultural reasons.

The Royal Government of Cambodia reviewed its trade patterns and strategy and implemented the CEPT lists as follows:

- First, 46 percent of all tariff lines are in the Inclusion List. The bulk of goods are in the Temporary Exclusion List while the remaining 2.7 percent of lines remain are in the Sensitive List and General Exception List;

- Second, the reduction in tariff rates will occur quite slowly. Goods in the Inclusion List will not be fully liberalized to the 0–5 percent range until 2007. Moreover, goods in the Temporary Exclusion List will be phased into the Inclusion List only between 2003 and 2007 with the commitment that their tariff rates will be between 0–5 per cent by 2010.
- It is important to recognize that goods in the Temporary Exclusion List would not be eligible for the lower CEPT tariff rates if exported to other ASEAN member states. In addition, Cambodia can choose to accelerate its tariff reductions anytime.

There are good reasons for Cambodia to transfer virtually all goods from the Temporary Exclusion List to the Inclusion List immediately and accelerate tariff reductions to 0–5 per cent before 2007. First, the acceleration of tariff reductions will make Cambodia a viable base for exports to the rest of ASEAN. However, Cambodia will only be a potential site for ASEAN oriented investment only for those goods that can be exported to member countries at the lower CEPT tariff rates. For this to happen, goods must be on the Inclusion List and the transitional CEPT rate must be 20 per cent or less. A more effective way to establish Cambodia's place as a potential investment site would be to ensure that most tariff lines are immediately placed in the Inclusion List, and that the maximum rates are reduced to no more than 20 per cent, preferably less.

A second reason for more aggressive action on tariffication and tariff reduction is the strong competition from the other new ASEAN Member States. Investors intending to locate in the ASEAN region will tend to select sites in one of the low wage, new members. Therefore, by delaying tariff reductions, Cambodia is not taking the advantage in this process.

22.4.2. CEPT Strategy for Cambodia

For Cambodia to emerge as one of the more attractive platforms for investment, it will need to undergo rapid and comprehensive integration into AFTA/ CEPT framework, thereby ensuring the best possible prospects for ASEAN oriented investment relative to her neighbors. This suggests the need for accelerating tariff reductions.

A third reason to accelerate the implementation of CEPT tariff rates is the need for the RGC to establish predictability in its trade policies. The RGC expects most goods to be subject to preferential CEPT tariff rates between 0–5 percent by the year 2010. However, the interim of eight years is a long time and the less clearly defined is the tariff adjustment process, then the less confidence investors will have.

Stability and transparency are two essential characteristics of an effective industrialization strategy. However, the implementation of the CEPT system entails a large Temporary Exclusion List and this feature may create significant instability and uncertainty in the

policy framework, especially during the next four to eight years as these goods are phased into the Inclusion List.

In implementing the CEPT tariff rates, there would be benefits if the difference between Cambodia's CEPT preferential tariff rates and her Most Favored Nation (MFN) rates for the rest of the world remain small. The reason is that the larger the difference between the two rates the greater the probability that the preferential trade area would divert Cambodia's trade away from the rest of the world to AFTA rather than create new trade partners for Cambodia. Recent analysis suggests that if this occurs, the benefits to Cambodia in joining the AFTA would be small. Indeed, an increasing proportion of Cambodia's trade is with partners outside the ASEAN. Further, the maintenance of a large margin between CEPT rates and MFN rates encourages Cambodian firms to source more expensive materials from ASEAN producers. Thus, the Cambodian government might consider ways of reducing MFN rates in parallel with CEPT rates to keep the wedge between the two small. This is permissible under AFTA rules.

Cambodia is also committed to promoting other mechanisms of economic cooperation like the ASEAN Investment Area (AIA), Liberalization of Trade in Services, and the ASEAN Industrial Economic Cooperation (AICO) system. As a participant in the AFTA, Cambodia will be able to increase its competitiveness against other regional groupings, increase trade and investments amongst ASEAN members and to the third countries, and in the end achieve higher growth of its economy. Moreover, Cambodia enjoys bilateral trade benefits such as the Generalized System of Preferences (GSP) granted by the United States in 1997 and the Preferential Rules of Origin for ASEAN members provided by the European Union in 1999.

22.5. Liberalization of Financial Services Under the ASEAN Framework Agreement on Services (AFAS)

22.5.1. Liberalization for Trade in Services

Trade liberalization involves providing greater market access to foreign firms by lowering the barriers to trade. However, it is more complex for services, where of trade and the types of barriers are very different. There are four mode of supplying services trade, reflecting the for at least some interaction between the consumer and the producer of services:

- **Cross borders trade** - electronic or physical transactions across borders, such as air or maritime transport and financial trading (mode 1)
- **Consumption abroad** - movement of the consumer to a foreign country for reasons such as tourism or education (mode 2)

- ***Commercial presence***-direct investment for the purpose of delivering services such as local telecommunications or electricity (mode 3)
- ***Presence of natural persons***-temporary movement of a producer to provide services such as consulting or construction (mode 4).

Commercial presence tends to be the dominant mode of supply for all but transport and tourism services; cross-border trade is the next most important. Trade through the presence of natural persons is typically small for all sectors, and consumption abroad is only significant for tourism.

Barriers to trade are typically regulatory in nature. They include measures that restrict market access by foreign firms (for example, by reserving supply for a public monopoly or through non-recognition of professional qualifications) or that discriminate against them once they are in the market through, for example, different tax treatment or local borrowing limitations for foreign firms.

Liberalization of trade in services therefore involves the reduction of regulatory barriers to market access and discriminatory national treatment across all four modes of supply.

Trade liberalization is to ensure that existing regulation does not discriminate against foreign participation in the market. Trade liberalization is consistent with countries' continuing to regulate industries for: the purposes of consumer protection, prudential management of the economy, control of natural monopolies, or the achievement of social goals.

Another key policy area that comes under the spotlight in services trade liberalization is the treatment of foreign direct investment (FDI). Commercial presence is a key mode of supply for services, and developing countries have historically placed significant restrictions on FDI in order to encourage domestic ownership of capital, limit repatriation of profits, and increase the linkages of the multinational firm with upstream suppliers. Full liberalization of the commercial presence mode of supply would outlaw most of these measures in the services sectors.

Creating a suitable environment for foreign investment extends beyond regulatory certainty; it may include strengthening the legal system, stabilizing the macroeconomic environment, and permitting the repatriation of profits.

22.5.2. Sequencing and Timing of Liberalization

Once the foundation for liberalization has been laid, the next step is to devise a trade liberalization strategy aimed at maximizing the gains and minimizing the adjustment costs.

The strategy needs to set out in detail the sequence and timing of liberalization across the different sectors, the modes of supply, and the two groups of barriers (market access and national treatment). It also needs to focus on what concessions are desired from trading partners across these various dimensions. A degree of caution should be observed when designing the liberalization process, as some of the key sectors have a profound impact on the workings of the economy.

The sequencing and timing of liberalization in different services sectors will depend in part on progress in laying the institutional foundations for reform. Complications at this stage may affect the feasibility of going ahead with reform. Ideally, reform should initially be targeted at those sectors that are likely to bring about the most significant gains for the country.

These would consist of services that provide important intermediate inputs to the rest of the economy or to specific sectors that the country wishes to promote, or sectors in which protection has resulted in a considerable inefficiency cost to society. Sectors that have an economy-wide downstream effect, such as communications, transport, finance, and electricity, yield the most gains for liberalization effort. They also serve as inputs into other services sectors whose successful liberalization may well depend on prior liberalization of the intermediate services.

The next choice is which modes of supply to open and which barriers to remove. This process can be simplified by eliminating any technically infeasible modes. If liberalization is to have a significant effect on the sector, the dominant mode of supply should be opened up. In most cases this is the commercial presence mode, which is in any case popular as a target for liberalization because of the potentially greater gains and lower adjustment costs.

Merely opening a sector to commercial presence may, however, not be the most effective route in all cases. If the domestic market is limited in size, and if scale economies are site-specific, then opening up only to commercial presence may severely restrict the extent of possible competition and product differentiation, thereby limiting the gains from trade. In this case, opening cross-border supply may be necessary in order to realize the potential gains.

Inadequacies in the country's stock of human capital may also limit the gains from opening up commercial presence only. For example, liberalization of the financial sector in Cambodia created additional demand for skilled labor. In this instance, simultaneous liberalization of the movement of persons mode of supply allowed entry of foreign professionals, possibly preventing excessive wage inflation.

The move toward full trade liberalization can be made in stages, with the extent of competition and foreign ownership being two of the crucial variables.

22.5.3. Financial Service Liberalization under AFAS

Following the signing of AFAS in 1995, to-date seven (7) packages of services commitments had been signed by the ASEAN Economic Ministers (AEM), three (3) packages of financial services commitments had been signed by the ASEAN Finance Ministers (AFMM), and two (2) packages of air transport services commitments had been signed by the ASEAN Transport ministers (ATM). It is expected by the end of this 2009 and of 2010 there will be additional AFAS packages signed by the ATM and AEM, respectively. In addition, there had also been seven (7) Mutual Recognition Arrangements (MRAs) signed by the AEM and one (1) MRA signed by the ASEAN Tourism Ministers (M-ATM). On the other hand, the ASEAN Economic Community (AEC) Blueprint calls for timely implementation of the various economic integration measures (including in the services sector) by 2015, which is only six years away. Implementation of the Blueprint measures has been challenging for many ASEAN Member States.

The liberalization of services will also complement the establishment of the ASEAN AFTA since the competitiveness of ASEAN manufacturers, producers of food and raw materials will be enhanced by strong transport, telecommunications and financial systems within the region.

Among the benefits from the liberalization of services is the generation of more foreign investment in the services sector, particularly from other ASEAN countries. To the extent that investment embodies new technology, it would also enhance the transfer of technology and expertise and can play a catalytic role in developing such critical services areas as finance, telecommunications, and transport.

The future liberalization of services under the AFAS is guided by the objective of a free flow of services by 2015. However, the liberalization of financial services should be gradually implemented, taking into account the various levels of financial sector development in each country as well as the need for prudential regulation, effective supervision and capacity building to guide its full implementation.

ASEAN member-Countries are allowed flexibility in scheduling the liberalization of their financial services sub-sectors and in removing limitations on the four modes of supply under each sub-sector as guided by the GATS provisions on market access, national treatment and the MFN principle. ASEAN members have set the milestones by having a new round of negotiations every three years to keep the momentum going until year 2020.

The ASEAN has identified the common sub-sectors to be further liberalized as follows:

Insurance and Insurance-related Services

- a. Direct insurance (including co-insurance):

- life;
- non-life;
- b. Reinsurance and retrocession;
- c. Insurance intermediation, such as brokerage and agency; and
- d. Services auxiliary to insurance, such as consultancy, actuarial, risk assessment and claim settlement services.

Banking and Other Financial Services (excluding Insurance)

- a. Acceptance of deposits and other repayable funds from the public;
- b. Lending of all types, including consumer credit, mortgage credit, I factoring and financing of commercial transaction;
- c. Financial leasing;
- d. All payment and money transmission services, including credit, charge and debit cards, travellers cheques and bankers' drafts;
- e. Guarantees and commitments;
- f. Trading for own account or for account of customers, whether on r an exchange, in an over-the-counter market or otherwise, the following:
 - money market instruments (including cheques, bills, certificates of deposits) ;
 - foreign exchange;
 - exchange rate and interest rate instruments, including products such as swaps, forward rate agreements;
 - transferable securities.
- g. Participation in issues of all kinds of securities, including underwriting and placement as agent (whether publicly or privately), and provision of services related to such issues;
- h. Asset management, such as cash or portfolio management, all forms of collective investment management, pension fund management, custodial, depository and trust services; and

Advisory, intermediation and other auxiliary financial services including credit reference and analysis, investment and portfolio research and advice, advice on acquisitions and on corporate restructuring and strategy.

22.6. Cambodia's Membership in the WTO

Cambodia applied for accession to the World Trade Organization (WTO) in December 1994 under Article XII of the Marrakech Agreement establishing the WTO. In June 1999, Cambodia submitted its Memorandum on its Foreign Trade Regime (MFTR) to the WTO Working Party. In May 2001, the first meeting of the Working Party took place, opening the way for the detailed accession negotiations which were completed a little more than two years later in July 2003.

On 22 July 2003 Cambodia submitted its acceptance of the terms and conditions of membership set out in the Accession Protocol, which was approved by the WTO Ministerial Conference in Cancun on 11 September 2003 subject to ratification by Cambodia. But it was only after ratifying the membership agreement on October 13, 2004 that Cambodia became the 148th member of the WTO. Cambodia, along with Nepal, was the first Least Developed Country (LDC) to have succeeded in accession to the WTO, since WTO's transformation from the GATT in 1995.

Some of the expected benefits from WTO membership are:

- Assurance that after 1st January 2005 textile and garment exporters will have unrestrained access to the US, the EU and other WTO members markets.
- Access to the international rules based system of trade with MFN terms for all goods extended as a right on a secure, predictable, and nondiscriminatory access to the markets of 147 trading partners.
- An improved domestic investment climate due to goods and service liberalization
- An opportunity to move away from an incremental approach to one incorporating economic, financial, judicial, and structural reforms to stimulate foreign direct investments as well as domestic investment.
- Access to the WTO's dispute settlement mechanism to defend the country's rights and enjoy protection from unilateral trade sanctions.

22.6.1. Legislation In Support of WTO Membership

As part of its commitments to accede to the WTO, the Government adopted an ambitious multi year Legislation Action Plan (2001 – 2004) setting forth the national legislative agenda in support of Cambodia's membership. The agenda encompassed some 55 laws or regulations to be passed in order to complete the legal framework, in particular: the customs law; business enterprises law; commercial court law; commercial contract law; commercial arbitration law; numerous intellectual property rights legislation; laws on rules of origin, anti-dumping and countervailing measures; and law related to technical barriers to trade and sanitary and phyto-sanitary legislation. The Government established the Legal and Judicial Reform Council with the aim of, notably, improving the effectiveness in the adoption of commercial laws and regulations and ensuring the respect of other WTO's obligations like the transparency requirement, as contained in GATT Article X, and the provision of an independent judicial review. In the preparation and adoption process, ministries and government agencies are required to ensure full compliance of the Cambodian legislation under the various WTO Agreements. To speed up the negotiation process, Cambodia has submitted to the WTO secretariat more than 85 pieces of law, draft laws, and regulatory instruments. Due to its history where the country legal framework had to be rebuilt almost from scratch, bringing the legislation in compliance with WTO rules is one of the most challenging tasks that Cambodia must achieve.

22.6.2. Implementation of WTO-Related Laws

Since becoming a WTO member, much effort of the government has gone into speeding up its legislation adoption agenda. With regard to the financial sector development, laws pertaining to commercial transactions, including accounting, negotiable instruments, secured transactions, commercial enterprises, bankruptcy, and contracts, were given first priority. The Accounting and Auditing Law, the Law on Commercial Enterprises, the Insolvency Law were promulgated to enable capital market development. And in line with the adoption of the civil code and code of civil procedures, the Secured Transactions Law and the Negotiable Instruments Law were passed to underpin commercial activities and financial transactions. The Government adopted the Law on Government Securities and the Law on the Issuance and Trading of Non-Government Securities to operate the capital markets. The key intellectual property rights laws, like trademark, patent and copyright, were passed in line the government's initiatives to promote this field.

The Law on Standards and Metrology were adopted to comply with many of the provisions of the WTO Agreement on Technical Barriers to Trade and, for that matter, might create undue new barriers to Cambodian exporters. Considerable progress has also been achieved in the area of trade facilitation. The Customs Law was passed providing the legal framework for the Government to, inter alia, introduce the Single Administrative

Document (SAD) to streamline customs documentation, to pilot ASYCUDA at Sihanouk Ville port, and to establish a risk management unit (RMU) at Customs central office. Going forward, the Government will need to continue to implement economic, trade and legal commitments made under its WTO accession agreement. These commitments include compliance notifications of technical barriers to trade (TBTs), customs valuation, Sanitary and Phyto-sanitary Standards (SPS) and other potential non-tariff barriers (NTBs). Finally, Cambodia remains committed to a reform agenda focused on economic diversification in order to accelerate achievement of WTO commitments. The objectives of these reforms support the Government's Rectangular Strategy and National Strategic Development Plan 2006-2010. The success of the reform in these areas is essential to improved investment climate, continued high growth, employment, and thus brings in poverty reduction.

22.7. Foreign Trade Performance

22.7.1. The Role of Trade Policy

Foreign trade has helped Cambodia avail opportunities which are beyond what could be accessed solely on domestic market conditions. In particular exporting enables the productive use of land and labor resources hitherto left unused due to the weakness of the domestic demand. Imports have allowed the Cambodian consumer to purchase high quality goods at lower prices thereby adding to economic welfare.

Foreign trade has helped the private sector expand and is a key job provider in urban areas, but can play an more forceful role in the development of the Cambodian economy. Strategies should address such issues as improvement of the information system for markets, market diversification of export and import products, better consumer accessibility for imported staple goods, and increasing contribution from the private sector in marketing of locally produced goods and services.

Broader access to modern technologies is enabling Cambodia to benefit from appreciable gains in productivity through technology transfer without having to devote domestic resources for innovation and technology development. In the wake of the liberal reforms instituted by the RGC and normalization of external relations, in 1996, the US granted Cambodia the status of most-favored nation. Since 1997, Cambodia has also benefited from the Generalized System of Preferences (GSP). Cambodia did not benefit from the zero duty access given by the US to countries of Africa and the Caribbean Basin.

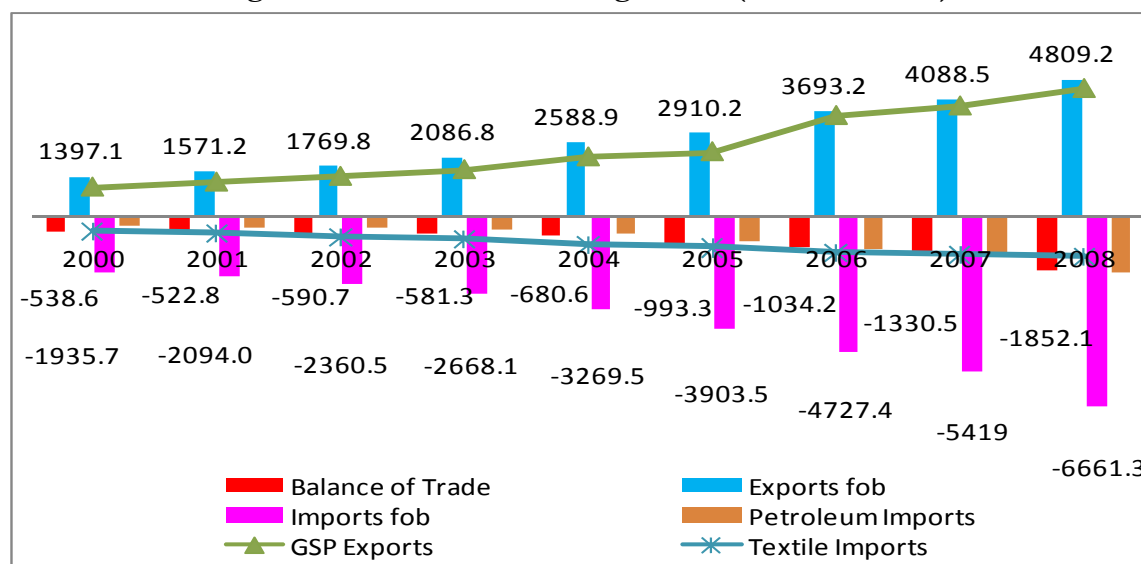
Cambodia has also strengthened trade relations with the European Union (EU), which granted Cambodia the Generalized System of Preferences (GSP) in 1994 and enabled it to benefit from the "Everything But Arms" (EBA) initiative in 2001. These arrangements allowed Cambodia to obtain a tariff reduction of 20% on textile exports to the EU that

complied with certain rules of origin. Cambodia's garment export industry for which fabrics are a key raw material is unable to benefit due to the requirement of the rules of origin. To benefit from the EU's rules of origin, the country must also produce the textiles (spinning, weaving, and finishing). Only about 27% of Cambodia's exports come under the zero duty access to the EU market. For example, since September 2009, rice export from Cambodia has been given a zero-duty access to the EU.

22.7.2. Trade Balance

Cambodia has witnessed rapid increase in foreign trade. The total volume of trade (imports plus exports) increased by more than 14 times, from US\$769 million or 21% of GDP in 1993 to US\$11 billion or 107% of GDP in 2008.

Figure 22.1. Cambodia's foreign trade (in US\$ million)



Source: National Bank of Cambodia.

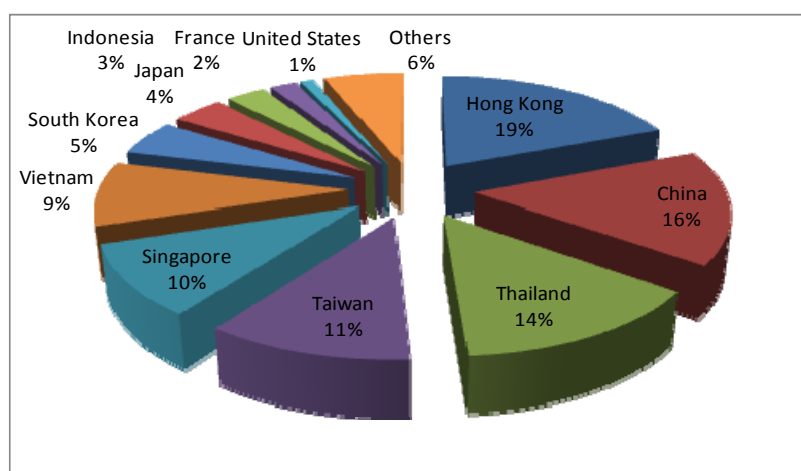
During the last 16 years, from 1993 to 2008, the total volume of trade increased on average by 19.7%. Two factors were attributable to this dynamics: the increase of both imports and exports.

22.7.3. Imports

Imports increased from US\$486 million or 19.6% of GDP in 1993 to US\$6.6 billion or 64.4% of GDP in 2008, an average annual increase of 19 percent on nominal terms. Of the US\$6.6 billion imports in 2008, US\$6.5 billion were retained imports and US\$120 million were re-exports to neighboring countries. Cambodia imported goods from Hong Kong

(19%), China (16%), Thailand (14%), Taiwan (11%), Singapore (10%), Vietnam (9%), South Korea (5%), Japan (4%), Indonesia (3%), France (2%), United States (1%) and others (6%).

Figure 22.2. Origin of Cambodian imports in 2007 (%)



Source: National Bank of Cambodia. Balance of payments.

The major import categories are: Petroleum products (31% of total imports), materials for textile and garment production (20%), equipment and materials related to investments, and other goods such as cars, electronic goods, food, etc.

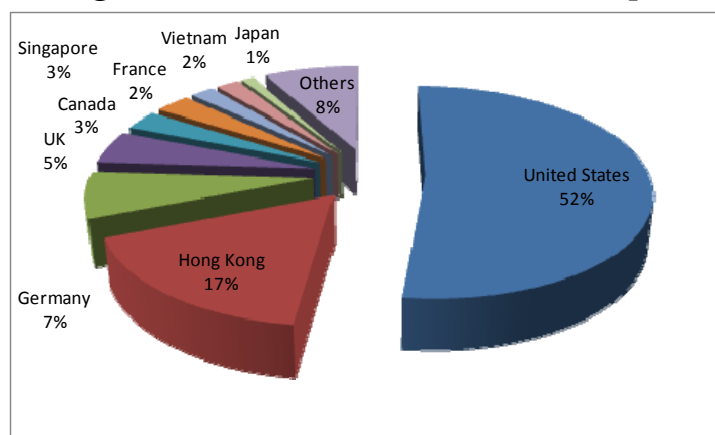
Soaring crude oil prices negatively impact on Cambodia's economic growth since it is a net importer of oil. The global demand for raw materials is increasing sharply, partly driven by speculation. The newly arrived big countries—China and India—along with Brazil and Russia are garnering the available supplies. The long term trend is for oil and other commodity prices to rise. This development will put Cambodia's balance of payments management under stress. Cambodia follows a policy of passing on the international prices to the consumer. Cambodia allows tax free imports of goods brought in as foreign direct investment. Tax-free imports account for 60% of the value of imported products.

22.7.4. Exports

Exports increased from US\$283 million or 11.4% of GDP in 1993 to US\$4.4 billion or 43% of GDP in 2008, an average annual increase of 15% on nominal terms. Garment exports increased from US\$4 million in 1994 to US\$2.9 billion in 2008, an average annual increase of 31%. Garment exports started to grow in 1995, after Cambodia has been granted MFN/GSP status by the United States and the European Union. GSP status allows Cambodian products to enter developed countries' market with low tariff rates.

Furthermore, the U.S.-Cambodia Bilateral Textile Agreement of 1999 offered Cambodia a quota in market segments, which could be increased by up to 14% per year based on adherence to a set of labor standards. Under the Multi-fiber Agreement (MFA), a quota regime was imposed until January 1, 2005 to enable the textile industry of developed countries to adapt to competition from less developed countries (LDCs) where salaries are low. Investors in some countries that were depleting their export quotas relocated their production to Cambodia, which benefits from the MFN and GSP status. 90% of textile enterprises in Cambodia are owned by foreign capital. This has resulted in a strong growth of over-quota exports, accounting for 40% of Cambodian textile exports.

Figure 22.3. Destination of Cambodian exports



Source: National Bank of Cambodia. Balance of payments.

The strong concentration of trade on a limited number of products is symptomatic of the weak supply capacity in Cambodia and weakly diversified demand for its exports. In terms of value, exports involve only seven major categories of products. Textiles and garments account for over 65% of Cambodian exports in 2008.

The US accounts for over 52% of exports from Cambodia. This share rose sharply throughout the last decade and now seems to have stabilized. The second largest country for export volume is Hong Kong, capturing 17% of exports from the country, followed by Germany (7%), the United Kingdom (5%), Canada (3%), Singapore (3%), France (2%), Vietnam (2%), Japan (1%) and others (8%).

Bilateral trade relations with Thailand are growing stronger. Cambodia imports around US\$2 billion worth of products from Thailand and export US\$90 million, mainly agricultural products to Thailand. Cambodian trade with Thailand is registered under the border trade and is not fully accounted for in the official trade statistics.

Thailand has approved a list of 310 items granted to Cambodia in the framework of the ASEAN Integration System of Preferences to boost trade with the country. Under the ACMECS (Ayeyawady-Chao Phraya-Mekong Economic Cooperation Strategy) One Way Free Trade Policy or Duty Free Import, Thailand has reaffirmed its commitment to purchase a number of Cambodian agricultural products, including soybeans, corn, castor beans, potatoes, cashew nuts, eucalyptus, and peanuts. Other ACMECS initiatives include: a feasibility study on setting up a wholesale/export market in Cambodia and a feasibility study on the establishment of special economic zones in Koh Kong, Poipet, and Pailin. However, ACMECS cooperation was almost stopped after the coup d'état against Thaksin in 2006 and it is unlikely that the ACMECS projects will be undertaken, due to the recent political turmoil between Cambodia and Thailand.

In 2002, Cambodia and Viet Nam renewed the agreement on goods in transit to promote exports from Cambodia to third countries via Viet Nam. In 2001, the two countries signed an agreement on trans-border trade to enable trade in traditional goods between the people of the two countries living along the borders. Cambodia imports more than US\$2 billion worth of products from Vietnam. As relationships with Thailand gets sour, trade volume with Vietnam increases rapidly.

In order to maintain the contribution from exports to poverty reduction in Cambodia, special attention is to be given to increasing the share of added value generated locally in all items destined for export and to opportunities of developing new export markets. In this sense, industrial wood growing and specific wood harvesting, agro-food, fish farming, and fish processing, along with services requiring skilled labor (such as software programming) are areas that have a good potential. In addition to increasing the share of local added value for exports, Cambodia must also regionalize and decentralize its export production in order for the spin-offs of globalization to be more equally distributed throughout the country.

Many studies have been conducted during the last five years with the support of development partners: development of the Phnom Penh-Sihanoukville corridor, improvement of the mechanisms for marketing and controlling the quality of rice after harvest; feasibility study on the establishment of a paddy rice market; assessment of the private sector and development of SMEs; assessment of the agro-industry sector in Cambodia; Export-Based Poverty Reduction Program (EPRP); study on the supply capacity of diversified agriculture and the agro-food industry; strategy of bridging the gap by means of E-commerce; and impact of export promotion zones on poverty reduction. The findings of these studies will be studied to further strengthen trade relations with neighboring countries.



Chapter 23

External Debt

23.1. Definitions

23.1.1. Central Government Debt

The central government debt includes:

⇒ In the strict sense:

- Domestic and foreign loans taken out by the government.
- Domestic and foreign loans guaranteed by the government.
- Treasury bonds (and other public securities).
- Treasury debt towards the Central Bank.

⇒ In the broad sense, the following items are also included:

- Deposits of Treasury correspondents (private persons, companies and agencies authorized to deposit funds on Treasury accounts).
- Any budget arrears.

Given the current organization of the Ministry of Economy and Finance in Cambodia, government debt management is shared among three agencies:

- ***Treasury Directorate***: for the domestic debt, except for domestic loans in foreign currency that are managed by the Directorate for Investments and Cooperation (DIC).
- ***Debt Management Unit of the DIC***: for the foreign debt, as well as for domestic loans in foreign currency.
- ***National Bank of Cambodia*** (NBC): for the balance of payment support loans granted by the International Monetary Fund.

23.1.2. Foreign Debt

The foreign debt of a country is the total of long-term debts owed by residents of this country to non-residents. This definition and the following ones are provided by the World Bank. They are of high importance for at least two reasons:

- Debt data make it possible to measure the country's debt-servicing capacity and are necessary to draw up the balance of payments.
- *Long-term debt means* a loan or an obligation with a maturity of more than one year from the date it was issued.

The length to be considered is that which separates the date of loan agreement signature (loan commitment date) from the last payment due date.

(It is noteworthy that debts with an initial maturity of less than 2 years rather than 1 year are considered as short-term debts by certain countries. However, the World Bank definition is the one we will use, as it serves as the basis for the compilation of international statistics.)

Non-resident means any person or organization which has no physical presence in the country concerned: non-resident natural persons, foreign companies (except for their branches in the country concerned) and international organizations. This definition tallies with that of the Balance of Payments Manual.

Foreign long-term debt comprises two categories: Public debt and private debt.

23.1.2.1. Foreign Public Debt

Foreign public debt includes:

- Foreign debt of the public sector
- Private foreign debt guaranteed by the public sector.

The Ministry of Economy and Finance's Debt Management Office monitors carefully each of these debts, from incurrence to extinguishment. A file is opened for each debt. On the other hand, the private foreign debt is not monitored in detail.

It is therefore necessary to define precisely the meaning of public sector. The public sector comprises the following institutions:

- The State, i.e. the government with its ministries and administration.
- The government's foreign debts are easy to inventory and monitor since they are entered in the budget under resources at the time of their incurrence and under expenditures for interest payment and repayment of the principal.
- Regional and local authorities: provinces and municipalities; (in Cambodia, it was not until 1997 that regional and local authorities were granted financial autonomy and, until then, they could not take out loans).
- Central Bank (National Bank of Cambodia).
- Standalone public institutions, such as public institutions.
- National companies (state-owned companies);
- Companies in which the government holds more than half the shares along with the right to vote or where more than half of the members of the board of directors are government officials (semi-public companies).

The debt secured (or guaranteed) by the public sector refers to debts of private agencies for which the government or a public body has made a commitment to ensure payment of interest and repayment of the principal, should the debtor default.

Loan guarantee from the government, i.e. contingent liability, is to be granted very cautiously or even refused altogether as regards private companies. However, the government often grants guarantee on loans taken out by public entities or semi-public companies when the lender hinges granting of the loan upon such guarantee.

Until now, Cambodia's foreign public debt is composed mainly of loans directly granted to the government. However, more and more it also includes loans guaranteed by the government for a number of power plant construction projects by Chinese companies.

23.2. Foreign Public Debt Management

23.2.1. Features of the Debt Management Unit

The unit in charge of foreign public debt management is a specialized unit within the Directorate for Investments and Cooperation at the Ministry of Economy and Finance. Its tasks are specific and therefore require special training for the officers who have been entrusted with these tasks.

This unit is to be located within the Ministry of Economy and Finance. Interest payment and capital repayment (debt service) amounts are payable from the national budget.

Even though specialized, this unit keeps maintains a close relationship with all the administrations involved in debt processes, more particularly the directorates responsible for the budget, Treasury and Central Bank.

A debt management unit may be entrusted with tasks that may be classified into three categories: administrative, accounting and statistical.

23.2.1.1. Administrative

The main responsibility of the unit is to see that payment of interest and principal repayment are carried out by the maturity date in a timely manner. This requires that:

- The debt unit is informed of all loan agreements signed by the government.
- The officers in charge of the budget have entered debt servicing charges in the budget estimates.
- The Treasury and Central Bank proceed with due diligence in order to ensure payments and transfers.

23.2.1.2. Accounting

The debt management unit is to open an account for each loan for which all relevant transactions are to be recorded.

The first step is to record the initial commitment amount, disbursement estimates and tentative schedule of interest payments and repayments. Actual disbursements are then recorded. Afterwards, when the first interest or principal payments are being processed, the payment procedure shall be recorded in the loan account. Finally, if any delay in payment occurs, arrears shall be recorded and treatment of arrears shall be monitored separately in the borrowing account.

23.2.1.3. Statistical

Compilation of debt statistics is based on accounting records. Statistics are compiled at least once a year; simplified statistics may be published on a quarterly basis. Thanks to computerization, what used to be in the past long, tedious task can now be performed almost instantaneously.

23.2.2. Administrative Debt Management

23.2.2.1. Monitoring of Commitments

The first step is to inventory all existing loans which come under the definition of foreign public.

Next, the debt management unit is to maintain close contact with all administrations in charge of negotiating new loans and constantly update its inventory.

A. Numbering

Each loan shall receive a number for identification purpose. The numbering system required for notification at the World Bank (which makes it possible to have only one numbering system) can be adopted, or another numbering system can be developed.

B. Loan Files

For each loan, a file must be opened and divided into two sub-files:

- The first sub-file is to contain the original loan agreement, or at least a copy, as well as all subsequent documents which could modify, complement or throw light on the terms of the loan; these documents are to be kept indefinitely or at least until the loan is fully repaid (40 years for loans from the World Bank, ADB, etc.).
- The second sub-file is to include correspondence, statements, maturity notices, etc. These documents are to be bundled by year and archived after 3 or 4 years.

C. Guaranteed Loans

Loans guaranteed by the government are to be monitored in the same way by the unit: numbering in the same series and opening of a file. However, information regarding these loans (disbursements, interest or principal payments, etc.) will not directly reach the unit; they have to be collected from the entity that has received the loan.

D. Monitoring of Disbursements

Disbursement of loans shall be monitored from day to day, or at least on a monthly basis, for several reasons. First, the debt unit has to be able to determine the available amount for each loan (commitments less disbursements).

The amount and date of disbursements are also needed in order to calculate the interest due to lenders.

Monitoring the disbursements is one of the most demanding tasks of the unit as the issue varies according to the nature of the loan taken out:

- Cash loans (for which disbursement is made in cash).
- Export credits (loans for importing goods).
- Commodity loans (loans for importing donations).
- Project loans

1. Cash Loans

Cash loans are easy to administer as their disbursement is recorded by the bank designated by the government (e.g.: IMF loans).

2. Export Credits

A foreign bank lends funds to a Cambodian buyer so that he can pay cash to his supplier (as a rule from the same country as the bank): this is **buyer credit**. Data collection is more complex. Disbursement is made on the delivery date of the goods or services. The unit often has not been informed of this transaction; it has to work in close liaison with the administration receiving the goods or services. The foreign supplier may himself ask his bank for a loan (supplier credit) and the terms of payment are passed on to the Cambodian buyer who will thereby make deferred payment; he can make a deferred payment without taking out a loan himself. Such deferred payment practices are prohibited.

3. Commodity Loans

In most cases, resale of goods generates counterpart funds which constitute a budgetary aid for the government; the debt unit has to establish links with the department with the special charge of implementing these forms of financing.

4. Project Loans

In general, a Project Management Unit (PMU) is set up within the recipient administration from which the debt management unit will get information on disbursements.

For this type of loan, there are three disbursement procedures. For each type of procedure, it is necessary to specify the date on which the disbursement is to be recorded:

- In a direct payment procedure, the lender directly pays the supplier, which payment

corresponds to the disbursement.

- In an advance payment procedure, the lender puts an advance payment for the borrower into a special account administered by the Project Implementer Unit (PIU). The PIU makes the purchases, pays the suppliers and then claims for replenishment of the advance. The disbursement is made up of the first advance payment and the successive replenishments of this advance.

As a general rule, disbursement occurs when the loan is drawn down on behalf of the borrower. The lender is to draw up monthly statements to be forwarded on to the debt management unit.

23.2.2.2. Debt Service Payment Monitoring

The paramount responsibility of the debt management unit is to make sure that debt service payments (interest payment and principal repayment) are made on time.

- ⇒ It is to be the main consignee of the maturity notices sent by the creditor.
- ⇒ Sending of these notices by the creditor does not exempt the unit from monitoring maturity payments; it will get in touch with the creditor if the maturity notice has not reached the consignee one month or so from the scheduled maturity date.
- ⇒ It is responsible for the preparation of payment orders, submission of such orders for approval at various levels and for following up the procedure up to the transfer of funds by the Central Bank.
- ⇒ It is to record the various operations in its accounting system: issuance of the payment orders, then the payment.
- ⇒ Finally, the unit is to constantly reconcile each loan account with the statements received from the lender.

The debt service payment procedure is a simplified procedure. In the normal expenditure control procedure, the file is submitted twice to financial control: the first time before the commitment in order to verify the existence of appropriations, the second time following issuance of the payment order.

Regarding the debt service payment, only after issuance of the payment order, financial control grants its approval. Budget appropriations allocated to debt payment are indicative, rather than being limitative. Even if there is a lack of appropriations, debt installments must be paid as they are compulsory expenditures; debt service can therefore be paid in excess of

the budgetary appropriations under the relevant heading. However, balanced implementation of the budget requires that the appropriations under the heading “Debt” be complemented by a transfer of appropriations so as to fill the overrun.

Another reason is that debt payment and capital repayment are not new commitments; from a legal standpoint, commitment is incurred when the loan agreement is signed; obligations arising from this do not constitute new commitments.

The payment of interests and debt amortization may be an over-expenditure but this does not mean that utilization of the earmarked appropriations can be anything but carefully monitored.

First, such appropriations must be estimated accurately during the budget preparation process. The debt management unit is primarily responsible for this estimation; the unit holds all the accounting data needed for an accurate estimate of these expenses.

If despite everything appropriations prove to be insufficient, the payment must be carried out although overshooting original estimates raises the issue of budget balance. Proposal must be made to the Minister of Finance to increase these appropriations, either via a transfer from another chapter, or on the occasion of supplementary estimates (revision of the budget by a remedial finance law).

The debt management unit must not consider its task completed once the payment order has been drawn up and signed by the Minister. It must follow the file procedure until actual payment is made by the National Bank by order of the Treasury (or of the Directorate for Investments and Cooperation). The Treasury or the DIC will grant priority to debt service payments over other expenses.

Timely debt service payment reinforces the credibility of the debtor country among donors. On the contrary, payment delays undermine their trust and impair further financing assistance. Delays in meeting payment deadlines may result in the suspension of loan disbursements, which interrupts the implementation of the projects financed under these loans.

23.2.3. Accounting Function of the Debt Management Unit

The accounting function is linked to the administrative function just dealt with. It involves recording chronologically on an individual loan sheet a number of data in a way that shows at all times the status of the mutual obligations of both lender and borrower, as well as the progress of the interest and/or principal payment procedures.

It is not partial double-entry bookkeeping but partial single-entry accounting, easy to keep.

The record sheets can be manually entered or computerized.

Firstly, if there are not many loans, manual keeping of individual loan sheets may be used. This procedure is also recommended during the setting up and testing phases of the computerized system. Lastly, it is of didactic interest.

Whether manual or computerized, the keeping of individual loan sheets facilitates drafting the debt report.

23.2.4. Statistical Function of the Debt Management Unit

Detailed debt monitoring enables the production of figures, statistics, ratios and diagrams on the status of the debt in Cambodia.

23.3. Debt Restructuring—the Paris Club

During the last four decades, the debt crisis in low-income countries has been the major focus as far as worldwide economic development issues are concerned. To cope with the debt crisis in debtor countries, creditor countries have organized themselves. Two multilateral forums have been created:

- **The Paris Club** as an umbrella for public creditors (States and other public legal persons) who have loaned funds to governments or other public legal bodies or to State-owned companies with government approval.
- **The London Club** for private creditors (banks) that have loaned funds to governments, other public legal bodies or to private companies with government approval.

Whether public or private, all creditors require prior agreement between the debtor country and the International Monetary Fund.

The Paris Club is not an official organization. It is an informal group of creditor countries that meet in Paris on an average of once a month in order to work out the restructuring of the foreign debt of debtor countries that have asked for such.

The Paris Club has neither a legal foundation or set membership rules, no institutional structure and no staff.

It is chaired by the chairman of the French Treasury. Its general secretariat is maintained by an office in the French Treasury.

Many debtor countries have made several appeals to the Paris Club. Debt rescheduling proved to be necessary for debts that had already been rescheduled.

Australia, Austria, Belgium, Canada, Denmark, Germany, Finland, France, Ireland, Italy, Japan, the Netherlands, Norway, Spain, Sweden, Switzerland, the United Kingdom and the United States, are permanent member nations of the Paris Club.

The Paris Club is not exclusive; members are not necessarily industrialized countries; some developing creditor countries have already attended its meetings.

In 1997, Russia joined the Paris Club as a creditor nation; it had been previously involved as a debtor nation in negotiation sessions within the Club.

Furthermore, the Paris Club is open to all multilateral organization concerned: the IMF presents its analyses on adjustment program quality and the macroeconomic prospects of debtor nations; the World Bank reports on the quality of investment policies, sectoral measures and mid- and long-term prospects; regional development banks, the OECD, the Commission of the European Communities and UNCTAD may attend the meetings and share their viewpoint.

A debtor country is usually represented by its Minister of Finance assisted by senior officials at the meeting during which its case is examined.

The meetings are held in Paris as convened by the Paris Club secretariat. The proceedings take place in French and English, with simultaneous interpretation in both languages.

23.3.1. Basic Principles

- The principle of consensus: any decision is made by unanimous vote, which implies much effort and good will on the part of the participants. Most of the time, agreements on the terms of debt restructuring are reached within a day.
- The principle of comparability of treatment: the effort put forth by creditor countries to reorganize the debt is not to be indirectly used to advantage other creditors; the effort of all creditors must be comparable.

23.3.2. Operational Rules

Operational rules are practical, adapted, where appropriate, to exceptional cases; while being rigid, the rules are open-ended; over the years, positive progress has been noted in favor of indebted countries.

23.3.3. Extent of Consolidation

Consolidation (or restructuring) does not focus on the total amount of the debt of the debtor country; the Paris Club only deals with the debt service portion that the country is not in a position to pay during a given period, known as the consolidated period; consolidation applies to maturity for the principal and, if needed, to interest payable during this period. The consolidated period is the period covered by the agreement with the IMF—and this period only—which is variable: one year, two years or sometimes longer. As for Cambodia, the consolidated period was two and a half years, from January 1, 1995 to June 30, 1997.

Debt arrears existing at the beginning of the consolidated period can also be restructured; in the case of Cambodia, all maturities that were not paid as of December 31, 1994 were renegotiated.

The consolidation percentage varies depending on the funding need and capacity to pay of the debtor country concerned.

Short-term debt payments cannot be rescheduled so as to safeguard access of the country to new short-term financing packages. This principle also applies to the long-term debt (over one year) which was incurred after a cutoff date; loans and appropriations granted after this date are never rescheduled.

Finally, it must be kept in mind that only bilateral debt can be rescheduled; multilateral debt, which comprises appropriations granted by the IMF, loans of the World Bank and regional development banks (ABD, for instance) cannot under any circumstances be subject to renegotiation.

23.3.4. Treatment of Restructured Maturities

The main lines for reorganizations are determined by the heads of State of the main developed countries on the occasion of summits which are organized periodically.

During the 1988 Toronto Summit, a list of options was developed for least advanced countries (countries benefiting from IDA soft loans). Creditor countries could choose among three treatments contained in the bilateral agreements:

- Cancellation of one third of the structured maturities;
- Reduction of the interest rate;
- Extension of the redemption period up to 25 years, including a 14-year period of grace.

These options have been improved several times (formula referred to as the London or Trinidad Formula in 1991, then the 1994 Naples Summit).

Cambodia was the first country to benefit from the Naples formula which extends debt cancellation up to 70% of the rescheduled maturities, restructuring official development assistance maturities over 40 years.

23.4. Cambodia's Foreign Public Debt: Description

Cambodia's development prospects depend to a considerable extent on its capacity to mobilize both domestic and foreign resources; the mobilization of foreign aid will increasingly take the form of loans, which emphasizes the importance to be given to the assessment of the country's capacity to service existing debt, which is measured on the basis of the status of the debt on the one hand and on its servicing on the other.

Cambodia's debt-servicing capacity will depend on the outcome of the negotiations undertaken with Russia and the United States on the exchange rate and terms of the rescheduling.

23.4.1. Debt Structural Analysis

As of December 31, 2006, Cambodia's debt, including outstanding interest arrears, totaled 3.15 billion dollars or 43.3 % of GDP. Cambodia's two main creditors are Russia and the United States. After rescheduling with both creditors, the total debt for Cambodia amounted to 2.1 billion dollars representing 29% of GDP.

23.4.1.1. Multilateral Debt

The debt load with multilateral creditors (WB, ADB, IFAD and OPEC) amounted to 1.1 billion US dollars outstanding at the end of 2006, or 52% of the total debt. The debt incurred since 1993 is concessional and growing quickly.

Cambodia's debt to the International Monetary Fund is not included in the table below. The debt owed to the IMF serves to support Cambodia's balance of payments. It is composed of 3 successive programs supported by the IMF with a total amount of 103 million dollars in 2003, upon completion of the third program with the IMF:

- STE (Systemic Transformation Facility), in October 1993, amounting to SDR 6.25 million with an interest rate of 5.72%.
- ESAF (Enhanced Structural Adjustment Facility), in May 1994, providing for SDR 84 million (about USD 120 million) with a view to supporting the 3-year adjustment and

reform program. This loan divided into three annual installments of SDR 28 million, was mobilized on December 31, 1996 reaching half of its amount, i.e. SDR 42 million (about USD 60 million). The second drawing of the second annual installment (1995) was cancelled. The interest rate is concessional: 0.5%. Repayments are carried out over 10 years, including a 5½ -year grace period.

- The Poverty Reduction and Growth Facility (PRGF) was granted by the IMF in 1999 in order to support the 1999-2003 reform program at concessional rates (0.5% only) and repayable over a 10-year period (including a 5½-year grace period). Cambodia has conducted 6 PRGF program reviews following which disbursements amount to SDR 58.5 million (80 million dollars).

The National Bank of Cambodia manages these facilities to strengthen its reserves of foreign means of payment. It assumes responsibility for the redemption and interest payment; therefore, this debt servicing is not included in the government's budget estimates, although it does appear in the debt statistics.

In June 2005, the Group of Eight leading industrialized nations (G8) proposed that three multilateral organizations, namely the IMF, the International Development Association (IDA) and the African Development Fund (AfDF) cancel 100 percent of the debt owed them by countries who have reached or who are about to reach completion under the enhanced initiative in favor of heavily indebted poor countries (Enhanced HIPC Debt Initiative) conducted jointly by the IMF and the World Bank. The HIPC initiative rests on a concerted action by multilateral organizations and governments in order to reduce foreign debt burden in the most heavily indebted poor countries to a sustainable level. The Multilateral Debt Relief Initiative (MDRI) goes further by providing full debt relief for these countries so as to free up additional resources to help them reach the MDGs.

To confirm their eligibility for debt relief, these countries must, pursuant to the decision of the IMF Executive Board, be up to date in their obligations to the IMF on foreign indebtedness and make a satisfactory showing of themselves in the following three fields: (1) performance of macroeconomic policies; (2) progress in implementing a poverty reduction strategy; (3) public expenditure management. The Executive Board decided that 19 countries actually qualified for immediate debt relief under the MDRI.

In December 2005, IMF departments decided that Cambodia had met the above-mentioned criteria and could indeed benefit from debt relief under the MDRI. Since 1999, Cambodia has shown robust, double-digit economic growth, moderate inflation, progress on poverty reduction and improved public expenditure management and has furthermore demonstrated its commitment to develop its poverty reduction strategy.

In January 2006, in compliance with the Multilateral Debt Relief Initiative (MDRI), the

IMF granted a 100% cancellation of the debt owed to the IMF before January 1, 2005, i.e. a debt cancellation amount of 82 million dollars. These resources will be made available to the Royal Government of Cambodia in order to help it reach the Millennium Development Goals.

23.4.1.2. Bilateral Debt

The bilateral debt is mainly an old debt and has been renegotiated and concentrated between two major creditors: Russia and the United States.

The bilateral debt comprises:

- Old debts, the major part of which is subject to ongoing renegotiations: debts incurred before 1975 in convertible currencies and debts incurred during the 1980's in convertible rubles.
- New bilateral debts which arose after the Paris Agreements in 1991.

A. Paris Club Creditors

Debts in convertible currencies incurred prior to 1975 required an exhaustively job of cataloging as the debt-related archives were destroyed during the war. The Ministry of Economy and Finance turned to Cambodia's potential creditors through diplomatic channels. Five creditor countries have manifested themselves: the United States, France, Germany, Japan and Italy.

In a letter of October 14, 1994 addressed to the Paris Club chairman, the Minister of Economy and Finance submitted a request with a view for Cambodia to benefiting from debt relief.

Following this request, representatives of the five above-mentioned countries met in Paris on January 26, 1995 (Cambodia was not in attendance at the meeting) and agreed to recommend Cambodia for debt relief to their respective governments by means of a rescheduling or refinancing arrangement under the following terms:

- Scope of the consolidation:

All principal repayments or interest payments for all trade credits or governmental loans falling due after more than one year granted before December 31, 1985 (the cutoff date) to the government or public sector of Cambodia, or benefiting from their guarantee:

- 100% of principal arrears or interest existing as of December 31, 1994.

- 100% of principal maturities or interest due from January 1, 1995 to June 30, 1997.

In fact, this consolidation covered the total bilateral debt in convertible currency, with the noteworthy exception of maturities for 3 loans from the United States.

- Terms of the consolidation:

Trade loans (creditors concerned: France and Germany): 67% written off and 33% refundable in 46 semi-annual installments (23 years) with a 6-year grace period and according to an incremental rate from 0.12% of the principal for the first installment to 7.96% for the last installment.

Interest rates on the consolidated amount to be negotiated bilaterally on the basis of the market rate.

Loans considered “Official Development Assistance” (ODA) (creditors concerned: United States, France, Germany, Japan):

Total debt repayment in 80 semi-annual installments (40 years) including a 16-year grace period and according to an incremental rate from 0.53% of the principal for the first installment to 5.26% for the last installment:

The interest rate on the consolidated amount to be negotiated bilaterally but shall be at least as favorable as the rate applying to consolidated concessional loans.

These consolidation terms represented the first implementation of the decisions made in Naples in 1994 by the heads of State of the developed countries towards developing country debt, and have been thereby regarded as the most favorable terms ever proposed until then. Debt write-off represented only some 9% (26 million US dollars) of the total amount of consolidated debt within the framework of the Paris Club; most of the accountable debts of the Paris Club were considered Official Development Assistance.

The Paris Club set a cutoff date to guarantee future repayments. This cutoff date was December 1985 for Cambodia. Officially, the Paris Club activities only concern credits granted prior to the cutoff date.

Once the Cambodian government accepted the proposals made by the Paris Club creditors, the bilateral negotiation process started with the creditor countries.

(a) FRANCE

Cambodia’s official debt to France dates back to basic infrastructure projects launched in 1964: Sihanoukville port extension, rehabilitation of the Phnom Penh/Sihanoukville railway

track, equipment of the Royal Cambodian Railways, the Sihanoukville refinery, construction of the Prek Thnot dam, etc.

From 1975 to December 31, 1994, the date of the last installment agreed upon, no payment was made for either original supplier financing and original government loans or for the three consolidation agreements. The total debt amount to be consolidated was therefore composed of arrears.

After examination of the original documents by a mission sent to France, negotiations resulted in the signature of a rescheduling agreement on October 26, 1995.

Write-off of commercial debts amounting to 67%, or FF 107 million, or 21 million US dollars. The total amount of Cambodia's debt to France came to 21 million dollars as of late 2006.

(b) GERMANY

Cambodia's debts to ex-West Germany were fully written-off under the terms of an agreement signed on May 6, 1994, prior to the Paris Club meeting. They comprised two loans granted by the KfW to the Central Bank on the one hand, and to the Royal Cambodian Railways on the other, with government guarantee; both conventions were not to be cancelled but amended: the debt commitment was to be transferred from the KfW to the Kingdom of Cambodia which would thereby become the creditor of the Bank and Royal Railways.

Furthermore, ex-East Germany's trade debts have been dealt with under a reduction and consolidation agreement signed on March 7, 1996 on the following terms:

- Conversion of the debt of 15.9 million convertible rubles into a debt amounting to DM 10.8 million; exchange rate used: 1 DM = 0.68 ruble.
- 67% write-off.
- Restructuring of the 33% outstanding pursuant to the Paris Club terms of reference.
- 4% interest rate.

At the end of 2006, Cambodia's total debt to the Federal Republic of Germany amounted to 2 million dollars.

(c) JAPAN

Cambodia's debt to Japan originated from two loan agreements, Nos. CP-1 of October 6, 1969 and CP-2 of February 1, 1971 by the Overseas Economic Cooperation Fund (OECF) for the financing of the Prek Thnot hydroelectricity and irrigation dam project.

The amount due to the OECF was entirely composed of arrears:

- Principal and interest maturities from February 20, 1975 to August 20, 1990, date of the last installment, representing a total amount of arrears 1,612.6 million yen
- Post-maturity interest amounted to 803.3 million yens, i.e. a total of 2,415.9 million yen equivalent to about USD 24 million.

All the past-due maturities were paid in two installments in April and May 1996 for to a total amount of USD 15.2 million, i.e. 1,612.6 million yen. This payment was made by means of budget funds allocated for this purpose from the second commodities aid package from Japan.

Post-maturity interest (803.3 million yen) were consolidated and rescheduled under an agreement signed in October 1996 with the following terms:

- Principal repayment over 15 years, including a 7-year grace period.
- 3.5% interest rate.

New bilateral debts owed to Japan, which arose after the 1991 Paris Agreements, amount to 43 million dollars.

(d) ITALY

Debts owed to Italy were dealt with under a reduction and consolidation agreement with the following terms:

- 70% write-off, i.e. 1.5 million dollars;
- Rescheduling of the 30% outstanding with a 0% interest rate.

Following this rescheduling, the debt owed to Italy amounts to 0.5 million dollars.

B. Debt in Convertible Rubles

The debt in convertible rubles was incurred during the first half of the 1980's, mostly from the ex-USSR and Eastern Block countries. Debts owed to the ex-Eastern Block countries have been renegotiated.

(a) SLOVAK REPUBLIC

Foreign debts owed to the former Socialist Republic of Czechoslovakia have been allocated to the Slovak Republic (1/3rd) and to the Czech Republic (2/3rds). The total debt amount is 268,259 dollars.

(b) CZECH REPUBLIC

Debts owed to the Czech Republic have been renegotiated and amount to 766,518 dollars.

(c) POLAND

A debt conversion agreement consisting of a commitment to have Polish enterprises carry out rehabilitation work on the Royal Palace has been signed by both countries.

This project specifies an existing debt of 1,955,819 rubles which, based on 1 clearing ruble = USD 0.8, corresponds to USD 1.6 million as set out in the draft agreement.

C. Ongoing Debt Renegotiations

(a) RUSSIA

Debts resulting from the 15 credit agreements granted by the USSR to Cambodia between 1980 and 1990 were handled by consolidation under the terms of an arrangement signed on May 18, 1991 between the Foreign Trade Bank of the USSR and the Foreign Trade Bank of Cambodia.

The consolidation terms were as follows:

- Debt amortization by deliveries of goods, to be agreed upon by both parties; however, Cambodia may process the payments in another way to be agreed upon between the parties.
- A 20-year payback period

Figure 23.1. The Naples Terms

In December 1994, confronted with a worsening debt crisis, the creditor countries dealt with the most urgent matters by adopting the Naples terms. Beneficiary countries would be eligible only for IDA financing (World Bank soft-loan window) and have a low GDP-per-capita (\$755 or less). If these criteria are met, non-ODA credits are written off to a level of 50% or 67% (systematically 67% since September 1999). For ODA credits, claims are rescheduled over 40 years, including a 16-year grace period.

1991	62 million rubles
1992	66 million rubles
1993 to 2000	65 million rubles
2001 to 2011	from 16 down to 4 million rubles (digressive)

The agreement provides for rescheduling of the 1991 debt maturity as agreed upon between the parties.

- Interest-free loan.

Besides the consolidated debt in 1991, Cambodia has two other debts to Russia:

- Debt burden resulting from credits granted within the framework of the cooperation and development agreement on natural rubber production, dated September 8, 1983.
- Interest due within the framework of the Agreement of August 26, 1985; these debts, the amount of which have been consolidated until 1991, were to be paid in the form of natural rubber deliveries.

Cambodia and Russia have agreed that the consolidated debts amount to 914.7 million rubles. These debts have been subject to a reduction and consolidation agreement pursuant to the Paris Club Naples terms, with the following conditions:

Conversion of the debt of 914.7 million dollars into a debt of 1,525 million rubles (exchange rate used: 1 dollar = 0.8129 ruble). After this conversion, 70% of these debts were written off and the outstanding amount was US\$457 million.

Pursuant to the Paris Club terms of reference, the outstanding amount of 457 million is divided into two parts: debts prior to the cutoff date and debts after the cutoff date (1985).

Table 23.1. Cambodia's foreign debt (in US\$)					
		As of Dec. 31, 2006	After resched- uling, Dec 2006	After reschedul- ing, June 09	% of GDP
I	Multilateral creditors	1,083,512,063	1,083,512,063	1,425,185,287	13.03%
	ADB	579,956,046	579,956,046	826,846,853	7.56%
	World Bank	461,704,631	461,704,631	531,625,285	4.86%
	IFAD	26,532,450	26,532,450	38,238,477	0.35%
	NDF	-	-	8,025,233	0.07%
	OPEC	15,318,936	15,318,936	20,449,439	0.19%
II	Bilateral creditors	253,140,147	253,140,147	253,140,147	3.48%
	France	21,156,485	21,156,485	25,480,126	0.23%
	Germany	2,074,306	2,074,306	2,526,904	0.03%
	Japan	43,237,398	43,237,398	93,527,543	0.86%
	Slovakia	268,259	268,259	168,593	0.00%
	Czech Republic	766,518	766,518	-	-
	Malaysia	7,000,000	7,000,000	1,492,795	0.01%
	China	102,576,554	102,576,554	340,672,103	3.11%
	Republic of Korea	57,674,436	57,674,436	97,829,540	0.89%
	India	4,771,185	4,771,185	12,732,150	0.12%
	Thailand	13,062,181	13,062,181	58,488,570	0.53%
	Vietnam	552,825	552,825	13,440,351	0.12%
	Poland	976,792	976,792	976,792	0.01%
	Russian/US debts	1,812,865,620	749,585,751	788,520,322	7.21%
	Russia	1,525,000,000	457,585,751	457,776,332	4.19%
	Pre-cutoff Russia		210,788,538	210,979,118	1.93%
	Post-cutoff Russia		246,797,213	246,797,213	2.26%
	United States	287,865,620	292,000,000	330,743,990	3.02%
III	Total debt amount in Cambodia	3,151,561,835	2,088,281,966	2,861,041,075	26.16%
<i>Source: Ministry of Economy and Finance. May 2007</i>					

Debts prior to the cutoff date will be rescheduled at an interest rate of 0.8129% over 33 years, with no grace period.

Debts incurred after the cutoff date are not, in theory, subject to restructuring within the Paris Club. This enables Cambodia to negotiate with Russia in order to obtain acceptable rescheduling terms.

However, Cambodia and Russia have not yet agreed on two important points:

- The rescheduling terms of credits subsequent to the cutoff date, including the payment period, grace period and interest rates. The RGC has argued for a lower interest rate

and rescheduling over 30 years, with a grace period to enable a lower “net present value” (NPV) of the debt.

- The classification of 40 million dollars as credits prior to the cutoff date or as credits subsequent to the cutoff date.

At the end of 2008, Cambodia’s debt to Russia amounted to USD457 millions.

b) UNITED STATES

The Kingdom of Cambodia’s official debt to the United States originates from 3 loans granted for the purchase of agricultural product purchases (cotton, tobacco, rice, vegetable oil and wheat) in 1972, 1973 and 1974. According to the American Department of Agriculture, a total amount of USD 277 million was disbursed corresponding to a contractual value of 322 million dollars.

Pursuant to loan agreements, revenues sourced by the sale of these commodities were to be used by the Government in order to improve production, storage and marketing of agriculture products.

The loan terms were concessional:

- Interest rate at 2% during the grace period and 3% afterwards.
- Repayment of 31 annuities beginning after a 10-year grace period.

Principal and interest maturity payments ceased in 1975.

Through lack of relevant documentation, both governments agreed to fix the amount of credits at 162 million dollars for the principal. Including interest, Cambodia’s debts to the United States amount to 330 million dollars.

D. Bilateral debt incurred since 1993

Bilateral loan agreements have been signed since 1993 with China, Malaysia, the Republic of Korea, India, Thailand, the Nordic Development Fund and Vietnam.

(a) CHINA

China has cancelled a debt incurred prior to 1991 amounting to 58 million dollars. The total amount owing to China was 102 million dollars at the end of 2006.

(b) MALAYSIA

A loan of 35-million ringgits (about USD 14 million) granted by Export-Import Bank of Malaysia Berhad on August 21, 1995 is funding services provided by a Malaysian company for the rehabilitation and construction of naval units.

- The loan is repayable over 10 years, including a 5-year grace period.
- The interest rate is 3%.

23.5. Cambodia's Debt-Servicing Capacity

In developing countries, a balance between savings and investment is seldom achieved. There is a savings shortfall. At the same time, there is a strong need for capital development. The government deficit, the gap between the government's revenues and expenditures weighs down on the administration's capital development capacity. This deficit can be covered through four means: (i) Money creation, which induces inflation; (ii) A call for domestic saving (household and corporate) but the savings capacity is low in developing countries; (iii) Foreign aid in the form of grants, limited; and (iv) External borrowing.

Resorting to external borrowing is an important component of development policies. It enables the acquisition of goods and services abroad despite insufficient foreign currency reserves. Lenders, however, tend to limit risks and try to assess them. Their assessment of the borrower's capacity to refund is paramount in their decision making. There are several ratios or indicators to measure the debt-servicing capacity of a country. These internationally used ratios enable a comparison of the situation of various countries.

At end-2008, Cambodia's total public debt stock was equivalent to around 26 percent of GDP in nominal terms and 20 percent in net present value (NPV) terms, with nearly all external. However, with an expected contraction in the economy and increased assistance

Table 23.2. Cambodia: External Public Debt Indicators at End-2008

	Indicative Thresholds	End-2008
NPV of debt, as a percent of:		
-GDP	30	19.8
-Exports	100	36.7
-Revenue	200	164.9
Debt service, as a percent of:		
-Exports	15	0.9
-Revenue	25	4.2

Source: IMF-World Bank DSA

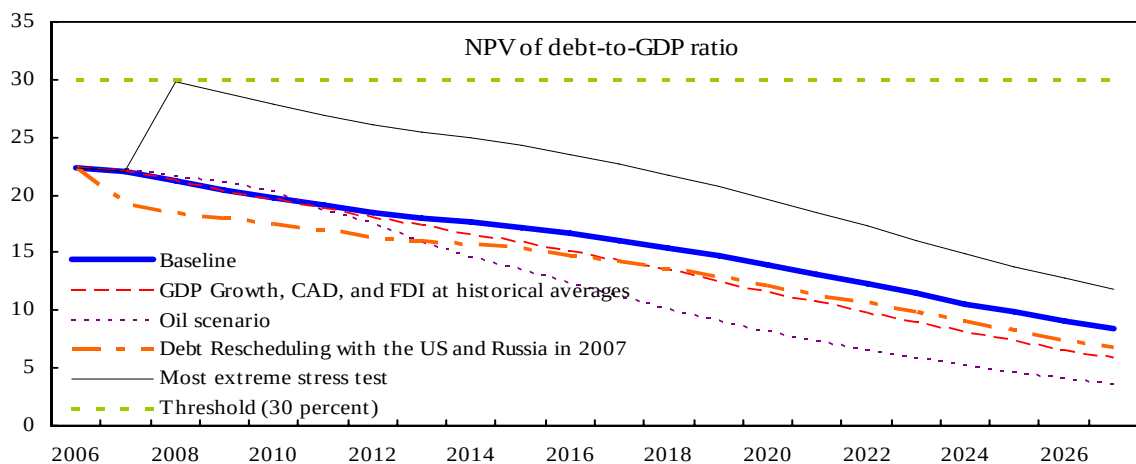
from donors in the face of global recession in 2009, the stock of external public and publicly-guaranteed (PPG) is projected to rise to 29 percent of GDP by year end.

The DSA shows that external debt burden indicators do not breach the relevant policy-dependent indicative thresholds under the baseline scenario. The nominal debt stock in PV terms as a share of exports of goods and nonfactor services and of government revenues is projected at 49 percent and 197 percent in 2009, respectively.

23.5.1. Debt to GNP Ratio

This ratio aims at producing an image of debt-servicing capacity, although there is no direct link between the two ratio quantities. As for Cambodia, The NPV of external debt-to-GDP ratio is expected to remain below 30% indicative threshold through 2029 under the baseline scenario. However, in two bound tests, the indicative thresholds are breached for: (i) net non-debt creating flows; and (ii) a one-time 30-percent nominal depreciation of the Cambodian riel vis-à-vis US dollars..

Figure 23.1. Net present value of debt to GDP ratio (as a percentage)

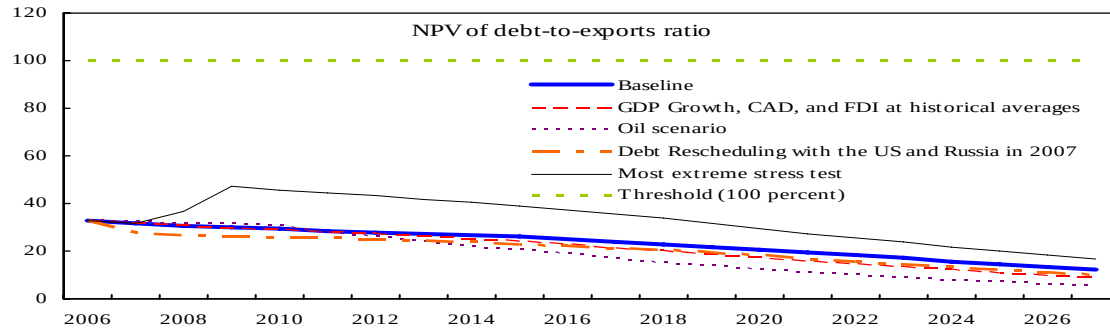


Source: International Monetary Fund

23.5.2 Debt to Goods and Services Export Ratio

This ratio provides an indication of the country's debt-servicing capacity by setting a stock (total outstanding debt) against a flow (exports of goods and services for the year concerned). The NPV of external debt-to-exports of goods and services, which was 32 percent in 2007, is below the reference value of 100%. Nonetheless, Cambodia's sustainable debt-servicing capacity remain vulnerable to exogenous shocks. Poor growth of exports could result in a spiking of the net present value of the debt to GDP ratio.

Figure 23.2. NPV of debt-to-export ratio

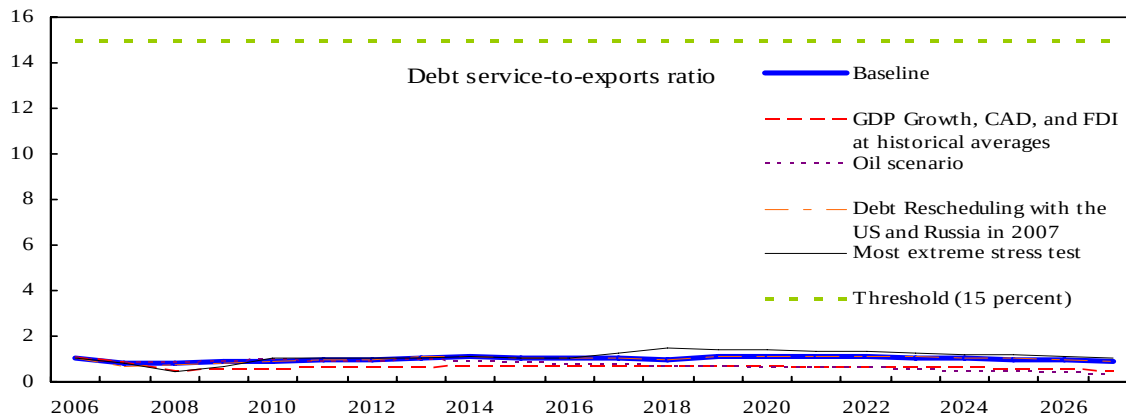


Source: International Monetary Fund

23.5.3 Debt Service to Exports Ratio

It measures the country's capacity to release foreign currencies for debt payment. Debt service remains at a level of 1% of exports of goods and services, well below the indicative threshold throughout the entire projection period, as existing debts are highly concessional.

Figure 23.3. Debt service to export ratio



Source: IMF Staff projections and simulations.

1) Most extreme stress test is the test that yields the highest ratio in 2017 for each of the comparisons.

23.5.4. Interest to Debt Ratio

It enables assessment of the degree of concessionality of the debt.

Chapter 24

Regional Integration

24.1. Cambodia's Integration into the Region

In April 1999, Cambodia became a member of the Association of Southeast Asian Nations (ASEAN). Economic cooperation within ASEAN led to the establishment of a free trade area. Cambodia is also part of the Greater Mekong Sub-region (GMS). Cambodia's regional cooperation activities now include a new regional grouping referred to as "ASEAN Plus Three," that brings in China, Japan, and South Korea to the regional grouping, as well as the ASEAN Regional Forum (ARF), a dialogue facility focusing on issues of regional security. In 2004, Cambodia became a member of the World Trade Organization (WTO) and began to attend other forums, including the Asia-Europe Meeting (ASEM).

As a relatively new member, Cambodia has been able to take advantage of numerous initiatives put in place by the more developed partners for new members and less developed members of ASEAN, including the ASEAN Integration System of Preferences (AISP) (349 articles). Further framework agreements with ASEAN's partners have also brought benefits to Cambodia, among these being the Special and Preferential Tariff (SPT) with China (297 articles), the General System of Preferences (GSP) with Japan (226 articles) and the Republic of Korea (78 articles). Cambodia has continued its efforts to grasp South-South trade development opportunities within ASEAN and with non-member countries. The government is currently studying the potential of integrating the Global System of Tariff Preferences among developing countries that are desirous of promoting trade flows.

Upon becoming a member of ASEAN, Cambodia became a part of the ASEAN Free Trade Area (AFTA). The AFTA agreement was signed in Singapore on January 28, 1992 at the time of the Fourth ASEAN Summit in order to lay the foundation of a common market. The scope of the agreement covers products defined on a sectoral basis, with a certain added value content and originating within the free trade area. Setting up the free trade area was the first challenge for Cambodia in the long term process of integrating with the ASEAN.

The key mechanism to implement the AFTA is the Common Effective Preferential Tariff (CEPT). Under this arrangement members agree to reduce customs duty on goods imported from any of the ASEAN countries at a rate between 0 and 5% within a time frame of 15 years. For 15 goods deemed as priority, reduction of customs duty would be

speeded up by the Fast-Track (FT) mechanism. For FT products, the cutoff date for compliance was January 1, 2001.

Some of the key initiatives undertaken by ASEAN include: “Framework Agreement between ASEAN and China on Comprehensive Economic Cooperation”; “ASEAN-Japan Comprehensive Economic Partnership Agreement”; “India-ASEAN Framework Agreement on Comprehensive Economic Cooperation”; the free trade area between ASEAN and the Republic of Korea; and, forthcoming, the AFTA-CER free trade area (Closer Economic Relations with Australia and New Zealand). Increasing investments, production, and consumption resulting from these will also benefit Cambodia as a member of ASEAN. For example, trade between China and ASEAN nearly doubled, jumping from US\$55 billion in 2001 to US\$100 billion in 2005. ASEAN mainly exports to China intermediate products and raw materials, notably electrical/electronic equipment, hydrocarbons, plastics, chemicals, and paper. China exports to ASEAN electrical/electronic equipment, textiles, and metallurgy products.

A vast free trade area is now being formed between ASEAN and China, pursuant to the “Framework Agreement for Comprehensive Economic Cooperation” signed between ASEAN and China in November 2002 in Phnom Penh during the Eighth ASEAN Summit. ASEAN and China agreed to set up a free trade zone by 2010 linking China and the six most developed countries, ASEAN-6, and by 2015 additionally for the rest, including Cambodia. As part of ASEAN-China cooperation, the railway linking Singapore with Kunming and the Bangkok-Kunming highway which are key projects for the development of the Greater Mekong Sub-region (GMS) will also be fast tracked.

At the Leaders’ Summit in Bali in 2003, ASEAN set as its goal the creation of an ASEAN Community by 2020 that would be based on three pillars: (i) the ASEAN Security Community (ASC); (ii) the ASEAN Economic Community (AEC); and (iii) the ASEAN Socio-cultural Community (ASCC). The objective of AEC is to establish a single production area and market for over 500 million people, with an aggregate gross domestic product (GDP) of over US\$600 billion in 2020.

Other noteworthy sub-regional socio-economic development initiatives include: the Greater Mekong Sub-region (GMS); joint development initiatives under the “Ayeyawady-Chao Phraya-Mekong Economic Cooperation Strategy” (ACMECS) between Cambodia, Laos, Myanmar, Thailand, and Viet Nam; the Cambodia-Laos-Thailand Emerald Triangle; and the Viet Nam-Laos-Cambodia Development Triangle.

The development triangles are an attempt at setting up a mechanism to link contiguous regions in three countries. This concept is based on the time-tested theory of comparative advantages. Thus, by bringing several neighboring areas together and pooling the

comparative advantages, it becomes possible to improve the overall production of the whole by reducing inefficiency and redundancy. For a growth triangle to be successful five conditions must be met:

- Strong political commitment preferably shown through an agreement at the highest level.
- Complementary factors must be favorable: trade can only take place if there are things to be traded.
- Inflow of foreign investment, which in turn requires great political stability.
- The countries involved have the capacity to plan their development.

24.2. Integration into ASEAN

ASEAN is now at an historical crossroads. ASEAN must strengthen integration in order for it to maintain its strategic position in Eastern Asia. At the same time it should be able to meet the challenges posed by the emergence of China and India which are attracting vast amounts of foreign direct investment and making inroads into markets which were earlier the preserves of ASEAN countries.

The Asian Financial Crisis helped the policy makers in the countries of ASEAN, China, South Korea and Japan (ASEAN+3) to realize that their economies are so deeply integrated that if an economic crisis engulfs one of the countries in the region, the contagion would spill over to the other countries. Since the 1997-1998 Asian financial crisis, the countries of Eastern Asia have successfully turned a threat into an opportunity. Since then these countries have developed a number of initiatives in order to forestall critical situations from developing and put in place a regional financial assistance package in case of a liquidity crisis.

ASEAN has become a geostrategic space that acts as a bridge between Asia and Europe. In 2005, ASEAN's economic growth reached 7%. A number of regional initiatives were developed in order to push economic and financial integration within ASEAN and East Asia. Despite progress ASEAN still has a long way to go to achieve all the objectives it has set for itself.

24.2.1. ASEAN's Legal Operating Framework

ASEAN was founded mainly to establish the political security of Southeast Asia. As ASEAN evolved, the economic dimension became the more immediate concern of regional integration. The present policy agenda of ASEAN stresses economic and social stability in the region to promote prosperity among all the members.

In February 1976, at the Bali Conference, the countries of ASEAN signed the Declaration of Concord (Bali I Agreement), the Treaty of Amity and Cooperation (TAC), and the Agreement on the Establishment of the ASEAN Secretariat. The Declaration of Concord reaffirmed the principle of finding a peaceful solution to differences among the member countries. Further, the ASEAN member countries agreed to pursue coordinated investment projects in order to make their differing economic structures more complementary.

In response to the strategic void caused by the dissolution of the Soviet Union and withdrawal of its military base in Viet Nam, as well as by the withdrawal of the United States from its base in the Philippines, the countries of ASEAN created the ASEAN Regional Forum (ARF) in 1993, in order to bolster confidence and promote preventive diplomacy.

The Bangkok Declaration (1967) sets forth the purposes of ASEAN: acceleration of economic growth, social advancement, and cultural development, promotion of regional peace and stability. The Treaty of Amity and Cooperation in Southeast Asia (TAC) describes the principles of ASEAN: respect for the independence, sovereignty, territorial integrity, and national security of all members, non-interference in the internal affairs of the others, peaceful conflict settlement, renunciation of threat or of the use of force.

In the 1980s, the countries of ASEAN became aware of competition from other groups, such as the European Union and NAFTA. That led to a proposal to set up the ASEAN Free trade Area (AFTA).

The ASEAN Vision 2020, adopted in 1997, was intended to reinforce the economic ties of the member countries and to make the economy of ASEAN more thriving, stable, and competitive. The Hanoi Action Plan was adopted in 1998 to operationalize this vision and bring it to a successful conclusion.

ASEAN's commitment to fight terrorism was reaffirmed when its leaders adopted in November 2001 the ASEAN Declaration on Joint Action to Counter Terrorism. In the fight against terrorism the ASEAN countries resolved to (i) strengthen national mechanisms to combat terrorism; (ii) implement all relevant antiterrorist conventions and protocols in the area of combating terrorism; (iii) strengthen links among the control

departments of the member States; (iv) exchange information on terrorists and terrorist organizations, their movements and funding; and (v) cooperate with a view to strengthening the capacities of the member countries.

The highest forum of ASEAN is the Annual Summit of Heads of State/Government. Ministry-level meetings are held annually in the following areas: foreign affairs, finance, economics, and industry.

24.2.2. The ASEAN Charter

ASEAN lacks a charter. ASEAN needs a charter to transform into a more effective organization. The reasons are discussed below.

ASEAN has a unique operational ethos and modalities which are different from other regional models, such as the European Union, Mercosur, etc. ASEAN is viewed as a flexible, consensual organization, with an adaptable, non-intrusive structure. The decision-making process is not binding on member countries. This ethos facilitates a conciliatory approach in decision making through accommodation and consensus. However the consensus approach to be successful requires a sustained interchange based on mutual respect. In recognition of this limitation in the consensual approach for emergent and sensitive matters, the rule of “10 x” has been introduced.

The ASEAN spirit is based on simple inter-statal principles and trust among the leaders. ASEAN’s institutional mechanism is founded on informal practices and policies. These highlight the challenges of managing globalization perceived as both an opportunity and a constraint.

ASEAN’s Secretary General has no authority to place requirements on the member countries and have ASEAN’s agreements complied with. He/she has no legal authority or status to implement the signed agreements. The Secretariat does not have enough staff or resources to function efficiently and effectively.

To meet the challenges that will confront ASEAN in the future, ASEAN’s senior leaders have formulated the following recommendations regarding upholding of fundamental principles and objectives by all members:

- Promotion of peace and stability by enhancing the values of democracy, good governance, rejecting any unconstitutional or non-democratic change of government, primacy of the rule of law, and respect for human rights and fundamental freedoms.

- Promotion of ASEAN's prosperity and resilience through cooperation and closer integration, through such initiatives as setting up of the ASEAN Community, the single market, sounder economic and regional interconnections, and narrowing development gaps.
- Promotion of timely, effective responses on the part of ASEAN to non-traditional, trans-border challenges, and to crises, through mutual assistance and regional and international cooperation; ASEAN should calibrate its traditional policy of non-interference in areas where common interest requires closer cooperation.
- Promotion of ASEAN's identity through extension of ASEAN's cultural heritages, investment in education, and commitment with civil society.
- Determination to put in place the ASEAN Community and ultimately the ASEAN Union.

24.3. Economic Cooperation Framework

The free trade area set up under the CEPT is the first step in regional integration. Country members are removing all customs duties levied on imports from other ASEAN members. However, economic integration within ASEAN is anticipated to go beyond the free trade area, referred to as AFTA Plus. AFTA Plus is based both on trade in goods as well as of services and financial flows, foreign direct investment and portfolio investment. The main purpose of establishing AFTA Plus is to enlarge trade flows several fold and enhance economic welfare in the region.

The AFTA agreement identifies four lists of products:

Inclusive List-II, which includes all products that are not on the Sensitive List and the General Exception List. It has two tracks:

- **The Normal Track**, according to which tariffs on products on the Inclusive List are to be reduced to 0 and 5% and take effect as of 2002 for the six original member countries (Brunei Darussalam, Indonesia, Malaysia, the Philippines, Singapore and Thailand [ASEAN-6]); in 2005 for Viet Nam; in 2008 for Laos and Myanmar; and in 2010 for Cambodia.
- **The Fast Track** for the following products: grease and oil, mineral products, chemicals, plastic, leather and leather goods, pulp and paper, textiles and garments, cement, precious stones, base metals and metal goods, machines and electrical

appliances, and various manufactured items, for which the tariff reductions were to be 20% immediately; and down to 0-5% by January 2000 for the original members; in 2002 for Viet Nam; in 2006 for Laos and Myanmar; and in 2007 for Cambodia.

However, the AFTA agreement contains a safeguard clause enabling a member State to temporarily delay the implementation if its foreign currency reserves are in danger or if its national security is threatened.

By late 2006, the six original members (ASEAN-6) that signed the CEPT agreement saw 98% of their products listed in the Inclusive List (IL). For 99.77% of these products, the tariffs range was 0-5%. Cambodia, Laos, Myanmar, and Viet Nam (CLMV) had 91% of their products on the Inclusive List and for 77% of these products, the tariff range was 0-5%. Customs tariffs in 2006 were 2.82% on average for all 10 countries of ASEAN; 1.74% for ASEAN-6 and 4.65% for CLMV. Implementation of the AFTA agreement is now in its final phase.

The Sensitive List – SL is for unprocessed agricultural products that the member countries consider very sensitive for them. Products on this list are to be transferred to the Inclusive List over a 15-year period, i.e. by 2010.

General Exception List – GEL, for products that are definitively excluded from the agreement because they could be harmful to public health, national security, or the cultural heritage of each country. There is no schedule for the reduction of tariffs on such products. However, some member countries have put some products, including tobacco and alcoholic beverages, automobile parts, and petroleum products on this list. For this reason, the countries of ASEAN are in the process of revising the GEL in order to make it compliant with the original ideas.

Temporarily Exclusive List – TEL: This list is to be built up from the Inclusive List (IL) and Sensitive List (SL). On this list are products that will be moved to the Inclusive List after an adjustment period allowed in the member countries. Products on this list are divided into 5 groups, for which tariffs are to be reduced in 5 steps. Tariffs for products on this list are to be reduced to 0-5%, in keeping with the schedules of each country. At this time, the six original members, Laos, and Viet Nam have not put any products on this list. Cambodia was to have transferred the last tranche of TEL products to the IL by 2007. Myanmar was to follow suit.

Table 24.1. Coverage of Articles By AISP

Country granting preferences	Countries benefiting from preferences				AISP tariffs
	Cambodia	Laos	Myanmar	Viet Nam	
Brunei	8	14	79	1	0%
Indonesia	40	21	262	71	0-5%
Malaysia	174	82	284	234	0%
Philippines	64	76	206	79	0%
Singapore	-	-	-	-	-
Thailand	340	300	850	-	0-5%
Total	631	493	1,681	535	

Source: MEF

The countries of ASEAN have agreed that a product is to be considered as originating from an ASEAN country if 40% of its content originates from a member country, except for agricultural products. The countries of ASEAN are now reviewing the rules of origin under the CEPT agreement in order to harmonize them with those of the bilateral free trade area.

To speed up reduction of development gaps, the six original countries have granted special and differentiated trade treatment to the new members, referred to as the ASEAN Integrated System of Preferences (AISP).

In practice the use of the AISP is very low, i.e. trade flows between the original countries and new members of ASEAN take place outside the AISP.

Trade is one of the pillars of economic growth for the countries of ASEAN. In 2005, exports of ASEAN increased by 13.5% over 2004, while imports rose by 15.4%. Japan is the largest trading partner of ASEAN, with 12.6% of the volume of trade. The United States is the second largest partner, with 12.5% followed by the European Union (11.2%). China comes in fourth (9.3%). There has been a spectacular growth in trade between the countries of ASEAN and China in recent years; China is expected to become ASEAN's largest partner within the next few years.

Despite efforts to move regional integration forward, the share of intra-ASEAN trade accounted for only 25% in 2005, a slight rise in comparison with 24.3% in 2004. Thus, the countries of ASEAN depend on non ASEAN markets for trade, investments, capital, and technology.

ASEAN's members are also working to eliminate non-tariff obstacles to their trade, harmonize their customs nomenclatures, assessment rules and customs procedures, as well as their norms and regulations for products, and improve the CEPT rules of origin. Members have 5 years to gradually eliminate quantitative restrictions and non-tariff barriers once they get tariffs down to 5% or less. ASEAN countries have drafted a program for the elimination of Non-tariff Barriers (NTBs) in order to increase trade among the member countries. Non-tariff barriers include rules and regulations, trading practices, customs, technological, monetary, and fiscal procedures, immigration procedures, and use of foreign currency for settlements.

In an effort to remove non-tariff barriers, the countries of ASEAN need to come to an agreement among themselves on national handling of taxation, financing, and regulations. Also, holistic economic integration requires measures for the harmonization of technical regulations, determination of standards and assessment of compliance, implementation of joint policies regarding competition, taxation, fiscal regime, and investment. There is progress in the harmonizing the technical regulations and standards for electrical and electronic products, cosmetics, traditional medicine, and food control.

The countries of ASEAN have realized that facilitation of trade would enable ASEAN to cut down on transaction costs and strengthen its competitiveness in order to make it into an integrated goods, services, and investment market, and encourage the setting up of a regional production network. But ASEAN still has a long way to go. Implementation time lines are sometimes not complied with, there continue to be extensive non-tariff barriers, and national standards are inconsistent. The authorities are pushing hard for integration, while the private sector is not fully engaged in integration activities. Despite these impairments, the AFTA remains a meaningful tool to give impetus to ASEAN and move it towards a more in-depth level of integration.

Economic integration within ASEAN was speeded up by the adoption in November of the ASEAN Framework Agreement on Integration of Priority Sectors, in order to bring about the ASEAN Economic Community which was agreed at the 2003 Bali Summit. The 11 priority sectors include electronics, e-ASEAN, public health, wood products, automobiles, rubber-based products, textiles and garments, agricultural products, fisheries products, air travel, and tourism, which account for 50% of intra-ASEAN trade. Roadmaps have been adopted to (i) strengthen ASEAN's competitiveness; (ii) step up regional integration by

implementing liberalization measures and facilitating trade and promotion; and (iii) encourage the private sector to get involved in priority sector integration.

The measures adopted for integrating the priority sectors include: (i) liberalization (of the trade in goods and services, and of investments); (ii) elimination of all trade barriers; (iii) facilitation of trade and investments (rules of origin, customs procedures, standards, logistical services, and facilitation of tourism); (iv) movement of business people, experts, and professionals; (v) promotion and monitoring (promotion of trade and investments); and (vi) other integration areas (industrial property rights, development of the priority sectors (intellectual property rights and human resources development).

In 1995, the countries of ASEAN signed a Framework Agreement on Services (AFAS) for eliminating the restrictions on the trade in services and to enhance cooperation in services. Under this framework, ongoing negotiations involve seven priority sectors, viz. business services, air transport, construction, finance, maritime transportation, telecommunications, and tourism. The protocol to implement initial commitments for five services (air transport, business services, maritime transportation, telecommunications and tourism) took effect on March 31, 1998. Protocols for implementation of the second and third packages of commitments, focusing on the seven priority services, came into effect on March 31, 1999 and March 31, 2002, respectively. A third round of negotiations concluded on December 31, 2004. Major progress was made at the fourth round of negotiations that ended in October 2006. The countries of ASEAN agreed to eliminate all forms of restriction that affect national treatment and market access in the services sector by 2015.

The Framework Agreement on the ASEAN Investment Area (AIA), signed in 1998, provides for free cross border flow of investments by 2020. This agreement includes direct investment in the manufacturing industry, fisheries, forestry, extractive industries, agriculture, and services connected to these activities. Reservations expressed by the members and put on the Temporary Exemption List are to be lifted by 2015 for ASEAN investors and by 2020 for all other investors. The six founding members resolved to speed up this process by lifting their reservations concerning manufacturing industry in 2003 for ASEAN investors and in 2010 for all other investors. In 2003, Myanmar lifted its reservations regarding manufacturing industry for ASEAN investors.

ASEAN is exploring other means of reinforcing regional economic integration, including additional measures to remove obstacles that still exist for the trade in goods and services and for investment, by accelerating integration in 11 priority sectors (air transport, automobile industry, agro-industry, electronics, fisheries, health care products, ICT, rubber-based products, textiles and garments, tourism, and wood industry) and by putting in place an effective dispute resolution mechanism modeled after that of the WTO, for ensuring compliance. These measures were to have been phased in starting on January 1, 2004.

24.4. Narrowing Development Gaps

ASEAN is a grouping of countries at different levels of development. With the exception of Singapore, the member countries of ASEAN are basically low-income or middle-income economies with several features in common. However, there is a striking economic gap among ASEAN's member countries. Development gaps between the original members (ASEAN-6) and the new members of ASEAN (CLMV) are both gaping and differ in their nature. Narrowing the development gaps requires concrete economic and social reforms by the new members and full support for the same from the more developed members.

As a means of closing the development gap within ASEAN and helping ASEAN's new members, namely Cambodia, Laos, Myanmar and Viet Nam (CLMV) in the regional integration process, ASEAN launched the Initiative for ASEAN Integration (IAI) in November 2000 at the Fourth ASEAN Summit. The IAI is based on the principle "by helping your neighbor prosper, ASEAN prospers." An Action Plan and concrete projects were drawn up and approved by the Sixth ASEAN Summit in Phnom Penh in November 2002 to implement the IAI. The Action Plan focuses on four priority sectors: infrastructure (transportation and energy), human resources development (capacity building of the public sector, labor and employment, and higher education), information and communications technology, and promotion of regional economic integration (trade in goods and services, customs, standards, and investment) in the CLMV countries. IAI projects number 85 in all, but only 61 projects have found funding sources; 22 projects have already been completed, 13 projects are underway, and 26 projects are on the drawing board. The six senior members of ASEAN (ASEAN-6) have contributed some US\$3.6 million to fund these projects. The IAI is an ambitious program. Among the projects is the construction of a trans-Asian railway between Singapore and Kunming, which will link Singapore, Malaysia, Thailand, Cambodia, Laos, Viet Nam and China.

Financial support from the Plus Three countries is crucial for implementation of ASEAN's projects. Bilateral and multilateral donors, such as JICA and UNDP, and other development partners have already made commitments for the funding of a number of IAI projects. To cover the resources shortfall, an ASEAN Development Fund has been set up for receiving contributions from all member countries.

24.5. Financial Integration within ASEAN

24.5.1. Roadmap for ASEAN's Financial Integration

The Vientiane Action Program (VAP), endorsed by the Leaders of ASEAN in 2004, covers a six-year period and aims to put in place the ASEAN Economic Community, itself based

on three pillars, namely political and security cooperation, economic cooperation, and socio-cultural cooperation.

The VAP envisages important steps relating to financial cooperation, taken from the Roadmap for the Financial and Monetary Integration of ASEAN (RMFMIA). RMFMIA purports to bolster the development capacity of regional financial markets through training programs for ASEAN officials, for improving the capacity for the regulation and supervision of financial markets. These initiatives will help development of market infrastructure, practices and standards, including risk management and building up liquidity.

ASEAN also has the objective of promoting the further integration of financial markets by linking ASEAN stock markets by 2010 into an integrated network. This integration will be realized through the harmonization of standards and practices, facilitation of cross-border access to stock exchanges, and developing ASEAN as a class of assets. For implementing the integration process the ASEAN Ministers of Finance held a series of seminars in order to launch two indices: the FTSE/ASEAN Index, with 180 constituents, serving as a baseline for regional stock exchanges; and the Marketed FTSE/ASEAN 40 Index, made up of the 40 largest enterprises listed on ASEAN stock markets.

Two Working Groups were set up to study the means of reaching this objective: the first will study the mix of and links between ASEAN stock exchanges, the second will examine how to enhance linkages among ASEAN bonds markets.

24.5.2. Liberalization of the ASEAN Capital Account

ASEAN's financial cooperation process provides for the orderly liberalization of the capital account, aiming at supporting economic growth and ensuring financial and macroeconomic stability. The ASEAN Vision is to establish by 2020 a free cross border movement of capital that could help improve economic efficiency and welfare in the region. Meanwhile, the countries of ASEAN are aware of the enormous risks that go along with liberalization if any of the domestic markets lack institutional and human capacity in financial management and supervision.

Mongrué and Robert (2005) show that liberalization of the capital account presents a number of advantages for emerging countries. It helps speed up economic convergence by giving access to global savings. It also helps increase the resistance of the economy when confronted with exogenous shocks by facilitating sectoral diversification. It contributes to improving the efficiency of the banking system by strengthening competition and therefore lowering the costs of financing. Moreover, foreign direct investment (FDA) helps technology transfers. Besides, liberalization of the capital account would make it possible

for the countries of ASEAN to channel regional savings and invest it elsewhere in the world.

The major lesson of the 1997-1998 Asian financial crisis was that modernizing financial systems is a prerequisite for opening the capital account. The following necessary conditions for orderly capital account liberalization:

- The exchange rate régime has to be flexible.
- The macroeconomic environment needs to be stable.
- The financial system must be able to play its role of intermediation and assess its exposure to credit risk (a minimum level of regulation and supervision, strict standards in the area of account auditing, transparency, and disclosure of financial information).
- Market instruments must be developed to a sufficient level, in particular for public debt and money market management.
- The political context must also be taken into consideration, especially the possible moral hazard while bailing out banks that have collapsed.

The ASEAN countries are convinced that liberalization of financial markets would be conducive to economic efficiency, provided that prudential supervision is good, corporate governance is sound, rights of creditors are respected, accounting and auditing standards are transparent, and bankruptcy and insolvency procedures are diligently carried out.

Taking into account the differing economic structures and financial systems of its member countries, ASEAN has adopted a flexible approach in implementing capital account liberalization. Although the member countries have agreed that liberalization of the capital account must take place in an orderly manner and in step with financial liberalization, in order to avoid the harmful impacts of the capital flights that occurred during the Asian financial crisis, each country is free to design its own capital account liberalization program. A Web site on the ASEAN capital account regime was launched in April 2006 during the 10th ASEAN Finance Ministers' Meeting, in order to allow each member country to come up with a system most suitable to it and to take measures for the reform of financial institutions and regulatory authority precedent to capital account liberalization.

24.5.3. Liberalization of Financial Services within ASEAN

The financial services of the ASEAN countries were gradually liberalized under the AFAS signed by the ASEAN Economy Ministers on December 15, 1995. Based on the terms of this agreement, negotiations must be conducted to complete the commitments of the member countries over and above their commitments under the General Agreement on Trade in Services (GATS).

The first round of negotiations aiming at liberalization of trade in financial services took place under the auspices of the ASEAN Coordinating Committee on Services. However, in June 1999, the ASEAN Economic Ministers decided to transfer the negotiating framework on financial services to the Finance Ministers. Negotiations on liberalization of financial services are now carried out under the auspices of the ASEAN Finance Ministers Meetings. A Working Group on ASEAN Financial Liberalization under the ASEAN Framework Agreement on Services (AFAS) was set up to guide this crucial exercise. The short- and long-term parameters for liberalization have been set.

With regard to the short-term parameters, ASEAN member countries reached an agreement to propose a commitment in at least one common subsector for each round of negotiations. These commitments must be beyond their commitments under the GATS for WTO member countries and more favorable than the current regime for non-WTO member countries.

The long-term parameters guiding the financial services liberalization process are as follows:

- Liberalization of financial services must be guided by the goal “Free flow of services by 2020.” However, financial services liberalization must be phased in gradually, taking into account the different levels of development of the financial sector of each country and the need to enhance prudential regulation, efficient supervision, and institutional capacity.
- The member countries are free to set the steps for subsector liberalization and to lift constraints respecting the four modes of delivering services, in keeping with the provisions of the GATS on market access, national treatment, and the Most-Favored Nation (MFN) principle.
- The steps will be determined for the new round of negotiations once every three years, taking into account the results of each round, in order to maintain the speed of liberalization until 2020.

- A review will be conducted in order to ensure that commitments under the AFAS take place as planned and are in compliance with the long-term objectives of the free movement of services.
- All commitments are legally binding.

With the agreement on short- and long-term parameters, the second round of negotiations on financial services liberalization under the AFAS were started in 2001 and concluded in 2002. The Protocol to Implement the Second Package of Commitments was signed by the ASEAN Finance Ministers on April 6, 2002 in Yangon, Myanmar. The third round of negotiations was started in 2003 and the Protocol to Implement the Third Package of Commitments was signed at the Ninth Meeting of Finance Ministers in April 2005, in Vientiane, Laos. The fourth Round of Negotiations on Financial Services started on March 1, 2006 in Siem Reap. This round is based on a positive list approach and was slated for completion by late 2007.

24.5.4. Reinforcement of Monetary Cooperation

To preclude an attack on regional currencies and to establish a regional system of mutual financial cooperation, the countries of ASEAN put in place in 2002 the ASEAN Swap Arrangement, which has become the foundation of ASEAN financial cooperation. To enhance this cooperation, the member countries of ASEAN increased the amount of the ASEAN Swap Arrangement from US\$1 billion to US\$2 billion at the Tenth Meeting of ASEAN Finance Ministers in April 2006. Should a financial crisis occur leading to a lack of liquidity due to withdrawal of foreign capital, the countries of ASEAN could appeal to the Swaps of ASEAN before having recourse to bilateral Swaps with the Plus Three countries. Besides, the ASEAN Secretariat is preparing an ASEAN Surveillance Report, designed to facilitate discussion of the macroeconomic policy of the member countries.

24.6. ASEAN Foreign Relations and Consultation Mechanisms

24.6.1. Post Ministerial Conference and Dialogue Partnership

The ASEAN Foreign Affairs Ministers hold annual consultations, at a post-ministerial conference (PMC), with the Foreign Affairs Ministers of dialogue partner countries (Australia, Canada, China, the European Union, India, Japan, New Zealand, Russia, the United States, Pakistan, South Korean and the UNDP. The post-ministerial conference is preceded by the Meeting of Senior Officials and Meeting of Senior Economic Officials.

The PMC is the main level where regional issues involving Southeast Asia and issues of mutual interest are dealt with. The PMC has two components—a plenary session attended by all ASEAN member countries and their dialogue partners, represented at the ministerial level, and a series of “10+1” meetings between ASEAN and each of the country dialogue partners.

24.6.2. ASEAN Regional Forum

The ASEAN Regional Forum (ARF) was established in 1994 in order to maintain peace and stability and promote development and prosperity in the region. The ARF is made up of the 10 members of ASEAN and 15 participants that have an impact on security in the Asia-Pacific Region: Australia, Canada, China, East Timor, the European Union, India, Japan, Mongolia, New Zealand, Pakistan, Papua-New Guinea, the Republic of Korea, the People’s Republic of Korea, Russia, and the United States. The ARF provides a platform for policy and security in the Asia-Pacific Region.

The main purpose of the ARF is to use open dialogue to diffuse threats to security, including military, economic, political, and social dimensions. The ARF is making progress on three fronts, namely confidence-building, preventive diplomacy, and the creation of conflict resolution mechanisms. The ARF has potential as a model mechanism for the promotion of objectives in the areas of global security, including counter-terrorism, human security, non-proliferation, arms control and disarmament, and conflict prevention.

24.7. Setting Up ASEAN Communities

Balassa (1961) has outlined five steps involved in the economic integration of a country grouping: (i) free trade area (elimination of customs duty among members); (ii) customs union (adopting a common customs rate for imports from outside the Union); (iii) the common market (free circulation of labor and capital); (iv) economic union (coordination of economic policies); and (v) complete economic integration (common currency and integrated budget systems). Some authors propose political union as the fifth step of regional integration.

However, integration within ASEAN is not necessarily following the conventional steps as stated by Balassa. Integration within ASEAN has not been designed using the European model and will take place at a pace more in tune with Asian culture, taking a non-coercive approach. Ultimately, the realization of AFTA, AFTA Plus, the IAI and AIA will make it possible to put in place a regional community capable of confronting the challenges of the future. The decision to create the ASEAN Economic Community by 2020 is a step in the direction of economic integration.

24.7.1. The ASEAN Security Community

The 12 principles of the ASC address enhancement of existing political instruments, such as the Treaty of Amity and Cooperation (TAC), the Zone of Peace, Freedom and Neutrality (ZOPFAN) Declaration, and the Southeast Asia Nuclear Weapon-Free Zone (SEANWFZ) Treaty, that are continuing to play a preponderant role in strengthening confidence building, preventive diplomacy, and peaceful conflict resolution. The ASC also intends to strengthen national capacities of member countries to fight terrorism, drug trafficking, trading in human beings, and other transnational crimes.

A military cooperation network between the countries of ASEAN and other countries of East Asia and South Asia opened a new era of security cooperation highlighting cooperation among the countries in order to address threats from non-traditional sources, such as international terrorists and insurgents, and to maintain peace and regional stability.

However, the ASC recognizes the rights of member countries to conduct their own foreign and military policies, taking into consideration interconnections between the political, economic, and social aspects. Also, the TAC High Council will be a major component of the ASC, this reflecting the commitments of ASEAN to resolve any disputes or conflicts by peaceable means. In this regard, the ASEAN Regional Forum (ARF) will remain a platform for regional security dialogue, with ASEAN playing the leadership role and engaging all friends, dialogue partners, and the United Nations in the interest of promoting peace and regional stability.

24.7.2. The ASEAN Economic Community

The goal of the ASEAN Economic Community (AEC) is the realization of full economic integration of ASEAN which will create a stable, prosperous, and highly competitive economic space, with the free movement of goods, services, investments, capital, and qualified workers. The AEC is aiming to promote fair economic development and to reduce poverty and socio-economic disparities in the region by 2020.

The AEC is also aiming to establish a single market and a single basis for production within ASEAN, by transforming the diversities of the region into opportunities to do business and by making ASEAN more competitive. The AEC is therefore midway in the journey to the realization of the single market. In order to implement the AEC, ASEAN member countries have agreed to accelerate all existing economic initiatives, such as the ASEAN Free Trade Area (AFTA), the ASEAN Framework Agreement on Services (AFAS), and the ASEAN Investment Area (AIA), the enhanced mechanism for settling economic disputes, and the IAI, the initiative to narrow development gaps among the founding members and new members of ASEAN.

The establishment of an integrated economic community requires action in the following areas: human resources development; close consultation between members on macroeconomic and financial policies; facilitation of trade; enhanced infrastructure and communications; development of electronic transactions via the e-ASEAN project; promotion of integrated industries, and strengthening of the private sector.

24.7.3. The ASEAN Socio-Cultural Community

The purpose of the ASEAN Socio-cultural Community (ASCC) is to promote social development cooperation, with a view to raising the standard of living of the people, in particular women, youth, and local communities, through greater investments in basic education and higher education, the development of science and technology, job creation, and social welfare.

The ASCC aims to accelerate cooperation in the field of public health, including the prevention and control of infectious diseases, such as HIV/AIDS and SARS. The ASCC encourages interaction among scholars, authors, artists, and media professionals in ASEAN in order to preserve and promote cultural diversity, while reinforcing ASEAN's regional identity.

At the Tenth Summit in Vientiane the ASEAN Leaders adopted the Vientiane Action Program (VAP). The VAP will be implemented over six years and is a successor to the Hanoi Action Plan. Its goal is to achieve the ASEAN Vision 2020 and the Declaration of ASEAN ("Bali Concord II"). The VAP aims to implement the action plans of the three pillars of the Declaration of ASEAN ("Bali Concord II"), and enhancement of regional integration, while narrowing development gaps within ASEAN.

24.8. Challenges of ASEAN Economic Integration

ASEAN has a non-invasive structure; the member countries had no intention of institutionalizing ASEAN. They favored cooperation and were reticent about a supranational agency. However, this non-intrusive structure makes it challenging to coordinate implementation of the trade agreements and integration projects. These structural constraints give rise to a deep concern for ASEAN's competitiveness vis a vis other coalitions and large countries such as China and India.

Because of its non-invasive structure, ASEAN has had to hold numerous meetings and conferences on its priority and focus areas. ASEAN holds over 700 meetings each year. The institutional deficiency is inconsistent with the increased need to step up the integration process. To be credible and relevant, the ASEAN should give itself sufficient

clout and become a more formal structure in order to provide firm coordination for the implementation of integration initiatives.

ASEAN is still perceived as a juxtaposition of ten countries with fragmented trading outlets at the borders. There still exist many trans-border obstacles among ASEAN's ten member countries. The economic structures of the member countries are competitive rather than complementary. The countries of ASEAN have not been successful in building on their strengths. Investors have been discouraged by the problems resulting from ASEAN's limited integration, and they do not consider ASEAN as a single market.

ASEAN markets—small and fragmented—are not attractive to investors, in comparison with the enormous Chinese market and other regions elsewhere in the world where economic and financial integration is deeper. Considerable barriers to trade still exist which hinder ASEAN businesses from specializing and benefiting from scale economies of supplying a vast market.

The costs of business in ASEAN are high. For instance, consumer product companies are subject to avoidable costs as high as 15% of their turnover because of the differences in product standards and customs red tape

If these obstacles could be overcome, ASEAN would have a formidable economic potential. ASEAN has all the resources for economic development. ASEAN's markets are comparable to the coastal region of China for size. Over 75% of exports from ASEAN are sourced from high-growth sectors.

ASEAN's economic integration program could be speeded up by the following measures:

- Free movement of goods, services, capital, and qualified workers.
- Harmonization of tariffs for ex-ASEAN imports.
- Application of fair competition policies.
- Effective technical support for the least developed members.

Quickening ASEAN's economic integration requires the implementation of two measures:

- Implementation of all facets of the integration in 11 sectors (air transport, automobile industry, agro-industry, electronics, fisheries, health care products, ICT, rubber-based products, textiles and garments, tourism, and wood industry).

- Moving ASEAN's institutions in the direction of becoming a more reliable, independent mechanism, capable of driving the integration process, fleshing out the integration policies and strategies, ensuring follow-through on ASEAN's projects, and building investor confidence in conflict resolution.

The countries of ASEAN appreciate that deeper regional integration would strengthen its competitiveness and be a source of substantial economic and political benefits. In particular,

- Deeper economic integration would reduce costs of doing business, facilitate new investments, promote the convergence of best practices in the conduct of business, and encourage innovation and collaboration among the countries of ASEAN.
- Integration would be the catalyst for improving domestic policies (better regulations for products and markets; enforcement of antitrust rules; recovery of taxes; land market reform and enforcement of laws and legal decisions).
- All countries could benefit from integration. The experience of NAFTA and the European Union has shown that the least developed countries stand to benefit more than the most developed countries.
- Closer economic integration would engender a stronger sense of unity and this could help ASEAN overcome challenges such as security and the environment. It could bolster ASEAN's bargaining power in international trade and generally increase ASEAN's geopolitical influence in international forums such as the WTO and APEC.

24.9. Social Costs of Integration

It is crucial to establish a social security and welfare system in order to manage the social repercussions of economic integration within ASEAN, improve ecological sustainability, and consolidate the foundation for social identity and cohesion at the regional level. Right now, the ASEAN integration mechanism makes no provision for compensation for member countries for which integration may have negative consequences.

ASEAN should also pay greater attention to the prevention and control of pandemics, counter-terrorism, drug and narcotics trafficking, drug addiction, and the trafficking of human beings, along with poverty reduction. All these social ills involve negative externalities and are best addressed at the regional level. Funding could be an issue for ASEAN countries with already stretched budgets and they may require ASEAN's support to implement the concerned initiatives.

24.10. Towards the ASEAN Community

Important initiatives to be taken include:

- More frequent meetings of ASEAN's leaders to give greater political impetus to the construction of the ASEAN Community. The ASEAN Summit should be renamed "ASEAN Council Meeting" so that the leaders can meet at least twice yearly.
- Formation of three Ministerial Councils under the auspices of ASEAN's leaders to ensure follow-through on key aspects of building the ASEAN Community (concerning political and security, economic, and socio-economic matters) and address issues that come under inter-sectoral coordination.
- Creation of a common market with the free movement of goods, ideas, and qualified labor, harmonization of regional economic policies, and strengthening of regional interconnections.

24.10.1. Mobilization of Resources and Narrowing Development Gaps

The IAI should be further accelerated adopting the following approaches:

- Respect for the principle of equal contribution in step with equal treatment of member countries.
- Setting up a Special Fund for Narrowing Development Gaps in order to give ASEAN its own-source means to undertake cooperation projects.
- Mobilization of funds and support from the private sector commitments of member countries
- Establishment of a conflict resolution mechanism in all areas of cooperation in ASEAN, including monitoring compliance with the consultation and enforcement mechanisms inherent in the agreements.
- The ASEAN Secretariat must be empowered to monitor compliance with ASEAN's agreements and action plans, and the Secretary General of ASEAN should report regularly to the ASEAN Council and Community Councils.

- ASEAN must vest itself with the authority to take measures to deal with cases involving a serious breach of the objectives, essential principles, and commitments with regard to the principle agreements. The failure to comply with the decisions of conflict resolution mechanisms should be reported to the ASEAN Council. Such measures would include suspension of the member's rights and privileges. The ASEAN Council however should not have the power to expel a member country.

24.10.2. Strengthening the Association's Effectiveness

If ASEAN is to develop as an effective organization and take decisive actions that will move it towards its goals, the following reforms will be needed in its organizational structure:

- The General Secretariat should be given the authority to play a greater role in regional integration and international cooperation efforts.
- The Secretary General should be assisted by four deputy secretary generals in the following areas: political and security matters; economic relations; socio-cultural cooperation; and international, administrative, and budgetary matters.
- Standing Representatives of member countries should be accredited with ASEAN in Jakarta.
- Streamline and reduce the number of ASEAN meetings to increase efficiency.
- ASEAN must be given legal personality and be empowered to take legal action.
- The ASEAN Foundation needs to be revitalized in order to play a more active role and create public awareness of ASEAN.
- An ASEAN Institute to support the Secretary General in research, political analysis, strategic planning, and links with "Track II" scholars/academics.
- Decision making through consultation and by consensus must be the rule for all important, sensitive issues. However, if a consensus cannot be reached, a decision could be made by ballot based on rules and procedures determined by the ASEAN Council.
- "ASEAN x" or "2 + x" formula should be flexibly applied in decision making at the discretion of the Council of the ASEAN Community.

- ASEAN should be promoted as a people-driven association and building a sense of ownership and belonging among the citizens, by facilitating the involvement of and interaction with representatives of ASEAN's member countries, representatives of civil society organizations, the corporate community, human rights organizations, academic institutions, and other stakeholders in ASEAN.
- ASEAN's main body should hold regular consultations with all the above-mentioned parties.

These reform proposals could form the basis of the ASEAN Charter. However, ASEAN has to address several long pending issues before formalizing a charter:

- First, ASEAN must clearly set forth the steps required to establish the single market and the conditions conducive to the free movement of production factors within ASEAN. For this reason it is crucial to envision the architecture of an ASEAN Plus Free Trade Area (AFTA Plus).
- Second, making the AEC a reality will entail a change in the thinking of ASEAN member countries. They will have to embrace regional interests and be prepared to accept the gains from integration as well as the accompanying pains for the common good of the region. The important thing is not the cutoff date of 2015 or 2020 to set up the AEC but how regional integration can be put into operation in a credible, sustainable manner.
- Third, regional priorities regarding trade liberalization need to be articulated more clearly. ASEAN members are committed in a network of Free Trade Areas (FTAs), including bilateral free trade areas, with out-of-region partners. These free trade areas are needed so that ASEAN can beef up its links with the outside, but they must also focus on implementation of measures leading to a deeper integration of markets in the region.
- Fourth, as progress is made toward establishment of the AEC, liberalization of trade in goods and services will not be enough. Major challenges still have to be overcome before ASEAN can achieve free movement of qualified labor and capital. ASEAN is still perceived by investors as a grouping of ten countries, each one with its own laws, guidelines, and regulations. That is the crux of the challenge that ASEAN must address in the face of growing competition from China and India.
- Fifth, a regular review must be conducted to look into investment incentives in the region, in comparison to global benchmarks. Special incentives may need to be created for corporations or conglomerates to be set up in ASEAN.

- Sixth, a well-integrated, smooth running regional financial system is an absolute must for the ASEAN Economic Community to become a reality and for ASEAN to realize its common vision of a prosperous, peaceful Southeast Asia.
- Finally, keener attention must be given to the new members of ASEAN, namely Cambodia, Laos, Myanmar, and Viet Nam (CLMV), so that these countries do not lag too far behind on the development curve. More effort must therefore be put forth to narrow the development gap by putting in place in the CLMV countries, programs for technical assistance, technology transfer, education, and training.

24.11. Beyond ASEAN - Economic Integration in Southeast Asia

24.11.1. East Asia Vision Group (EAVG)

On the incentive of the President of the Republic of Korea, His Excellency Kim Dae Jung, the countries of ASEAN+3 set up in 1999 an East Asia Vision Group (EAVG) for making recommendations on the future direction of cooperation in East Asia. In November 2001, the EAVG submitted recommendations to the ASEAN+3 Leaders at the Phnom Penh Summit.

The final report of the EAVG contains measures for cooperation in the short, medium and long term:

24.11.1.1. Economic Cooperation

- Set up an East Asia Free Trade Area.
- Extend the Framework Agreement on the ASEAN Investment Area to all countries of East Asia.
- Promote development and technology cooperation among countries of the region, and in particular provide assistance to least developed countries.
- Implement a knowledge-based economy and set up a forward-looking economic structure.

24.11.1.2. Financial Cooperation

- Set up a regional financial support facility.

- Set up a system of coordination of foreign exchange management conducive to financial stability and economic development.
- Reinforce the regional monitoring and surveillance process in East Asia in complement to the IMF's global surveillance.

24.11.1.3. Political and Security Cooperation

- Set up standards, procedures, and mechanisms to better manage intra-regional relations on the principles of good neighborliness, mutual trust, and solidarity.
- Set up and bolster mechanisms to resolve threats to regional peace.
- Amplify the voices of East Asia in international affairs and enhance East Asia's role in establishing and moving forward toward a new world order.

24.11.1.4. Cooperation in the Area of Environment

- Institutionalize bilateral and multilateral cooperation in environment both regionally and globally.
- Enhance outreach and education in the area of the environment and engage NGOs in this process.
- Manage water and fisheries resources efficiently.
- Develop jointly and explore new energy sources in the region and promote the efficient use of energy.

24.11.1.5. Social and Cultural Cooperation

- Set up a poverty reduction program with rich countries aiding poor countries to fight against poverty, illiteracy, and disease.
- Adopt a program to expand access to health care services.
- Set up a program for human resources training, giving special consideration to basic education, training, and capacity building.

- Promote regional identity and awareness, along with cooperation on projects for conservation and promotion of the arts and culture of East Asia.
- Establish an Education Fund for East Asia to promote basic education and training in the region.

24.11.1.6. Institutional Cooperation

- Transform the annual ASEAN+3 Summit into an East Asia Summit.
- Set up an East Asia Forum made up of representatives of the governments and NGOs in the various sectors, as an institutional mechanism to promote expanded social interchanges.

Based on the recommendations of the East Asia Vision Group, Senior Officials of ASEAN+3 set up an East Asia Study Group in order to deepen and prioritize these recommendations. The latter proposed 17 concrete measures for short-term implementation and nine measures for mid- and long-term implementation.

24.11.2. ASEAN+3 Cooperation Framework

In the mid-1980s, Japanese firms relocated their production facilities to countries of ASEAN, in particular Singapore, Indonesia, Malaysia, Thailand, and the Philippines. During the 1990s and 2000s, Japanese firms relocated more of their production facilities to China. China has become a key hub for the electronics sector assembly trade in the region for re-export to the United States.

In the aftermath of the Asian financial crisis of 1997-1998, there was greater impulse for economic and financial integration within ASEAN+3. In the mid-2000s, imports from ASEAN countries to China accelerated with the sharp increase in exports from China to the United States. China's spectacular development also created a heavy demand for Japanese semi-finished goods. Japan, which had gone through a decade of economic slowdown, recorded growth of around 2% in 2005 on the back of booming exports to China. Commercial integration in East Asia strengthened manufacturing interdependence between the economies of the ASEAN+3 countries. Although China experienced a trade surplus with the United States, it suffered from a trade deficit with the countries of ASEAN.

Cooperation of ASEAN with the three countries of East Asia—China, South Korea, and Japan—has gathered momentum since 1997 with the institutionalizing of an annual

dialogue between the leaders of ASEAN, China, South Korea, and Japan at the ASEAN+3 Summit and the ASEAN+1 Summit.

The ASEAN+3 process is continuing to deepen. In the area of financial cooperation, the countries of ASEAN+3 have set up a regional surveillance and financial support system, with an agreement on bilateral swaps amounting to US\$78 billion in order to ward off possible financial crises. During the annual meetings of ASEAN+3 Foreign Ministers of these countries discuss emerging political and security issues. ASEAN+3 cooperation is extending to other areas as well.

24.11.2.1. Free Trade Agreements

The effect of integration is generally measured in terms of “trade creation” and trade “diversion” after tariff and non-tariff barriers are eliminated. If the objective is only to reduce tariffs to zero, inasmuch as tariff levels for most of the countries are already very low, the net effects of the free trade area will be marginal.

Sa, Bonzom, and Strauss-Kahn (2005) suggested that, because of the ‘discrimination’ that regional trade agreements (RTAs) introduce de facto towards non-member countries, they are often suspected of creating ‘diversionary’ effects rather than ‘creating’ trade. Yet, empirical studies have shown that RTAs do more trade creating than trade diverting.

The existing free trade agreements (FTAs) have gone beyond reducing tariff and non-tariff barriers and also cover investments, electronic commerce, intellectual property rights, telecommunications services, information and telecommunications technology, as well as other sectors, such as the banking sector, consulting and legal services, etc. These complex FTAs address a great variety of issues that are designed to increase foreign direct investment and reduce transaction costs, promote harmonization of product standards, mutual recognition of product quality control tests, and mutual recognition of qualifications and certificates.

For these reasons, free trade agreements are being used to step up regional integration and increase trade links among the participating countries. Accompanying measures including tariff reductions and harmonization, and legal adaptations and, the materialization of the ASEAN Community with its free movement of goods, services, capital, and qualified labor, are anticipated to create the dynamics to step up regional integration.

24.11.2.2. ASEAN-China Cooperation

Under Framework Agreement on Comprehensive Economic Cooperation between ASEAN and China signed in 2002 ASEAN is in the process of negotiating with China

creation of a free trade area by 2010 for the founding members and by 2015 for the other members. (paras.)

Implementation of an Action Plan under the ASEAN-China Strategic Partnership for Peace and Prosperity has helped strengthen cooperation between the participating countries in all areas—political, economic, and cultural—and in this way improve regional security and development both for the present and in the future.

ASEAN and China also signed the Declaration on the Conduct of the Parties in the South China Sea and the Joint Declaration on Cooperation in the Field of Non-traditional Security. All these initiatives have helped build confidence and to promote peace and prosperity—a sound basis for peace and shared prosperity in the region.

ASEAN-China partnership is built on the basis of common interests. China and ASEAN have built up dynamic economies in Asia and in the Pacific. The spillover effects of the Chinese economic development are continuing to create new, important opportunities for the region and the entire world. ASEAN with its proximity to China is a major recipient of these benefits.

Trade between ASEAN and China has grown rapidly since 2002 after the signing of the 2002 Framework Agreement. There has also been a continuous upswing in investments from China, in particular in the infrastructure sector of the least developed countries of ASEAN, funded through bilateral grants and soft loans. The ASEAN-China cooperation framework has been rapidly extended from five to ten sectors.

Substantial progress has been made in implementing the 2002 Framework Agreement. At the 2007 Twelfth ASEAN Summit in Cebu, Philippines, the Second Protocol to Amend the Framework Agreement on Comprehensive Economic Cooperation between ASEAN and China, the Agreement on Trade in Services, the ASEAN Framework Agreement on Integration of Eleven Priority Sectors, and the Sectoral Integration (Amendment) Protocol were concluded. In 2010, a Free Trade Area between ASEAN and China, with a total population of 2 billion persons, will come into being and put East Asia on a path of sustained high growth.

24.11.2.3. ASEAN-South Korea Cooperation

The Republic of Korea (ROK) became an ASEAN Dialogue Partner in 1991. In 2004, Korea joined the Treaty of Amity and Cooperation (TAC). In 2005, ASEAN and ROK signed the Framework Agreement on Partnership Between ASEAN and ROK and the ASEAN-ROK Action Plan to Implement the Joint Declaration on Economic Partnership to promote closer economic relations, including the setting up of a Free Trade Area

between ASEAN and ROK (AKFTA). ASEAN and ROK agreed to speed up the negotiations that started in early 2005 to set up the Free Trade Area Between ASEAN and ROK. When this FTA becomes operational, at least 80% of products will be reduced to zero level of tariff by 2009; more favorable terms will be applied to the new member countries of ASEAN. In August 2006 in Kuala Lumpur, ASEAN and ROK signed an Agreement on Trade in Goods under the Framework Agreement on Economic Cooperation.

Additionally, ROK decided to increase its contribution to the ASEAN-ROK Special Cooperation Fund and to the ASEAN-ROK Future Oriented Cooperation Project Fund, reflecting its strong commitments to strengthen the partnership and dialogue. Korea also supports the setting up of five projects under the IAI including: (i) a planned feasibility study for the construction of a missing section of railway in the CLMV countries for the railway connection linking Singapore to Kunming; and (ii) capacity building in goods and services trading.

24.11.2.4. ASEAN-Japan Cooperation

Official development assistance (ODA) from Japan has played a key role in the development of Southeast Asia. During the last decade, Japanese ODA to ASEAN amounted to around US\$24 billion, accounting for 30% of Japan's official assistance envelope.

In 2002, Japanese Prime Minister Junichiro Koizumi proposed the principle of “acting together, moving ahead together” and an “honest, open partnership” in the relationship between Japan and ASEAN. The purpose of this partnership is to make East Asia into an open community that shares prosperity, peace, and trust. The partnership promotes investment liberalization and trading in goods and services and will extend cooperation covering a wide range of activities including tourism, human resources development and support for SMEs. It will also help strengthen political and human links and revitalize East Asia through wholesome competition.

The economic partnership between ASEAN and Japan must be strengthened, enabling the exchange of ideas, the movement of persons, goods, and investment in East Asia. ASEAN and Japanese economies are increasingly interdependent. ASEAN is Japan's second largest trading partner, with a trade volume exceeding US\$110 billion a year. Furthermore, Japanese direct investments in ASEAN exceed US\$100 billion. More investment from Japan in CLMV countries would be helpful to bridge the development gaps in the region. However, improving of the business climate in the recipient countries is a prerequisite for increasing Japanese investments in the region.

ASEAN and Japan have made considerable progress in implementing the Action Plan, which is a roadmap for the ASEAN-Japan partnership and a comprehensive framework for targeted cooperation at the regional level, especially with regard to financial and monetary cooperation, including development of the financial markets, liberalization of the capital account, and monetary cooperation. Support has come from ASEAN Development Fund and the ASEAN-Japan Cooperation Fund

ASEAN and Japan are working on the preparation of the Framework Agreement for Comprehensive Economic Partnership between ASEAN and Japan slated for approval by 2012. The implementation of this agreement will help promote liberalization of investments and trading in goods and services. It will likewise strengthen cooperation in a number of sectors, including tourism, human resources development and SMEs.

Cambodia has benefited considerably from Japanese assistance under the GMS Framework work in critical areas including harmonization of institutions and standards, and facilitating the free movement of goods and people. Japan has also provided support for the improvement of transport infrastructure, including roads, bridges, ports, railway lines, cooperation in the electricity sector, information and communications technology, and management of water resources. Japan is also providing training to entrepreneurs in a move to strengthen competitiveness in the local business community. A Japan-Cambodia Center for Cooperation has been set up in recognition of the important role Japan is expected to play in Cambodia's development.

24.11.2.5. ASEAN-India Cooperation

India became a full-fledged ASEAN Dialogue Partner in December 1995, and relations between the ASEAN and India are growing with close cooperation in the areas of agriculture, public health, human resources development, infrastructure, information and communications technology, and science and technology.

The First ASEAN-India Summit was held in Phnom Penh, marking a turning point in relations between the two partners. ASEAN and India began negotiations in 2004 for creating an ASEAN-India free trade area and to establish a comprehensive ASEAN-India economic partnership for trading in goods and services by 2012 for the founding members and by 2017 for the other members. In 2004, the two parties signed the ASEAN-India Partnership for Peace, Progress and Shared Prosperity and the Framework Agreement on Comprehensive Economic Cooperation.

24.11.2.6. ASEAN-Australia and New Zealand Cooperation

ASEAN's cooperation with Australia and New Zealand are particularly strong in areas such as the legal infrastructure for electronic commerce, mutual recognition of qualifications, quality assurance systems for fruit and vegetables, and quality assurance and safety systems for fish and fish products, their processing and packaging.

The countries of ASEAN, Australia, and New Zealand are negotiating for the setting up of a free trade area based on the existing AFTA-CER arrangement in existence from 2002. The proposed cooperation areas include trade and investment facilitation, technical assistance, and capacity building. The negotiations are guided by the following principles: (i) the free trade area should be holistic, covering trading in goods, services, and investments; (ii) its purpose is to push for economic integration among the two regions through the gradual removal of all barriers to trading in goods and services and to investment, and through trade and investment facilitation; (iii) the free trade area will comply with the WTO commitments of the member countries; (iv) it will take into account the different levels of development and capacity in the member countries to share in the liberalization of trade and investments by offering new members of ASEAN a special, differential treatment; (v) technical assistance will be granted to the least developed countries so that they can benefit from the free trade area; and (vi) the free trade area will be set up in the next 10 years and negotiations were to have been finalized by 2007.

24.11.2.7. ASEAN-USA Cooperation

In an attempt to deal with the slow progress in concluding the Doha Round the United States has undertaken many alternative trade initiatives, including regional and bilateral FTAs. The United States has proposed entering into an ASEAN-USA Trade and Investment Framework Agreement (TIFA) under the Enterprise for ASEAN Initiative (EAI) announced by the United States at the annual APEC Summit in October 2002. President Bush expressed his wish that negotiations should continue with a view to signing free trade agreements with the countries of ASEAN under the EAI. Under this arrangement, all prospective free trade countries should not only be members of the WTO, but also be signatories to a TIFA with the US.

The United States puts a great deal of importance on the signature of TIFA because: (i) it helps facilitate and extend access to markets; (ii) it puts in place improved monitoring of multilateral trade agreement implementation; and (iii) lays the groundwork for a future free trade agreements.

24.11.2.8. ASEAN-European Union Cooperation

ASEAN is cooperating with the EU in the areas of trade facilitation, industrial standards, food products, and investment promotion, under the Trans-Regional EU-ASEAN Trade Initiative (TREATI).

24.12. Financial Cooperation within ASEAN+3

Immediately after the Asian financial crisis of 1997-1998, ASEAN+3 countries came up with regional integration proposals designed to guard against future financial crises and the risk of turbulence in Asia's financial markets. These initiatives aim at avoiding the double mismatch of financial transactions, viz. in terms of maturity (long-term assets/ short-term liabilities) and currency mix (assets in domestic currency/ liabilities foreign currency), which was the main reason for the 1997-1998 financial crisis.

The ASEAN+3 Finance Ministers' Meeting and the Meeting of the ASEAN+3 Deputy Ministers and Deputy Governors have stepped up financial cooperation and integration in East Asia to achieve the following:

- Preserve the macroeconomic stability of the financial markets.
- Improve the macroeconomic performances of the region.
- Ward off and manage future crises.

Since 1999, the countries of ASEAN+3 have worked to establish a regional financial architecture with the following components:

- The Chiang Mai Initiative (CMI), based on bilateral swap agreements.
- “ASEAN+3 Economic Review and Policy Dialogue” held at the level of the ASEAN+3 Finance Ministers, Deputy Finance Ministers and Central Bank Deputy Governors.
- Asian Bond Market Initiative (ABMI), to establish efficient, liquid bond markets in Asia, making possible better use of savings in the countries of ASEAN+3 for industrial and infrastructure investments.

24.12.1. Chiang Mai Initiative (CMI)

At the annual meeting of the Asian Development Bank (ADB) in May 2000 in Chiang Mai, the countries of ASEAN+3 agreed to set up the Chiang Mai Initiative (CMI), which involved establishing facilities for regional financial support in the event of a liquidity crisis. In 2001, the countries of ASEAN+3 negotiated and finalized the operating principles of the CMI, empowering them to sign bilateral swap agreements (foreign currency exchanges among the central banks of the countries involved) in the event of a temporary disequilibrium of payment balances.

The CMI envisages that in the event of a crisis, the first line of defense for the countries of ASEAN would be the ASEAN Swap Agreements (ASA) that involve the 10 member countries of ASEAN in an amount of US\$1 billion. If such swaps prove inadequate, the countries of ASEAN could have recourse to a second line of defense, viz. bilateral swaps with China, South Korea, and Japan. Automatic disbursement is limited to 10% of the amount of this facility. Activation of the balance 90% requires setting up an IMF program.

The main purpose of this facility is to make up for the temporary lack of liquidity and thereby keep the financial crisis from escalating. If the 10% amount of automatic disbursement is not sufficient, the economic problem takes on a structural dimension. Therefore an IMF program is required to carry out the needed adjustments. When the bilateral swap procedures approved by the ASEAN+3 Finance Ministers were reviewed in May 2006, the automatic amount was raised to 20% in order to make the facility more flexible and to provide an immediate response instead of losing critical time in negotiating an IMF program. The moral hazard issue is mitigated since the new bilateral swaps procedures for activating this facility envisage group decisions. By late 2006, the number bilateral swaps amounted to 16 among 8 countries for an amount of US\$77 billion.

In order to strengthen the surveillance mechanism, the countries of ASEAN+3 set up a Group of Experts tasked to make in-depth studies of economic and financial issues in the region. Moreover, a Technical Working Group on Economic and Financial Monitoring was constituted to complement onsite surveillance. The countries of ASEAN+3 agreed to carry out studies on the “Multilateralization of bilateral swaps under the Chiang Mai Initiative.”

To bolster regional surveillance and mitigate the volatility of exchange rates between the currencies of the ASEAN+3 countries, the ADB announced in May 2006 at its annual meeting in Hyderabad the launch of the Asian Currency Unit (ACU), an index of ASEAN+3 currencies. The purpose of the ACU is to provide a benchmark for the management of foreign currency exchange fluctuations among the member countries. A working group is finalizing this index with technical assistance from the ADB.

24.12.2. ASEAN+3 Economic Review and Policy Dialogue

ASEAN+3 countries have put in place a viewpoint and information interchange framework focusing on economic issues for each of the ASEAN+3 countries. This dialogue on economic policies aims at complementing peer pressure with a platform for sharing experience on economic and financial issues management and troubleshoot emerging vulnerabilities. The purpose of this dialogue is as follows:

- As needed, obtain a third-party assessment of regional problems to complement assessments of the IMF and other regional institutions.
- Identify and analyze regional problems that are a matter of concern for all countries of ASEAN+3. The proposed remedies could round out the surveillance process set up by multilateral institutions.

Enhancement of dialogue on economic and public policies takes place in two phases. Phase 1 is to strengthen the existing ASEAN+3 Finance and Central Bank Deputies' Meeting process (AFDM+3). The format of the dialogue on economic policies is as follows:

- A one-day discussion of economic issues and public policies at the AFDM+3 meeting.
- An informal meeting of the ASEAN+3 Deputy Ministers and Central Bank Deputy Governors, held mid-year.

The countries of ASEAN+3 are working on the second phase with the following proposed measures:

- Setting up a credible regional surveillance process in order to round out the Chiang Mai Initiative by putting in place an early warning system for the region. At present the AFDM+3 format is made up of: (i) a discussion of current economic conditions and issues; and (ii) selection of a topic of common interest for the region for a focused discussion. The role of the AFDM+3 is to identify emerging issues and vulnerabilities that could develop into an open crisis in the next 6 to 12 months.
- Prepare studies and undertake research on regional issues that will provide an additional source of expert advice for the benefit of the member countries.
- Strengthen risk management capacity in the member countries by preparing studies on the risks and vulnerability of the member countries.

An ASEAN+3 Research Group was set up by the AFDM+3 to undertake studies on topics of common interest. Research institutes in the countries of ASEAN+3 were selected to be on this Research Group. These experts present the results of their research and studies at AFDM+3 meetings. The countries of ASEAN+3 have set up an ASEAN+3 Finance Cooperation Fund to fund this research.

24.12.3. Asian Bond Market Initiative (ABMI)

The main lessons of the 1997-1998 Asian financial crisis for East Asia were: (i) currency and maturity mismatches in financial transactions is a systemic risk and carry the seed for a future financial crisis (ii) liberalization of the capital account must be orderly and must occur only after reinforcement of the capacity of supervisory and regulatory institutions; (iii) a strong dependency of investment on bank loans could be risky for financial stability. Financial instruments such as shares and bonds can be designed to incorporate these lessons.

The ASEAN+3 proposal of the Asian Bond Market Initiative (ABMI) intends to encourage the investment of regional savings in infrastructure and industrial development in the countries of Asia. It is noted today that Asian countries export securitized capital in the form of investment by central banks of their exchange reserves in the assets of developed countries, mainly US treasury bonds and import risk capital in the form of portfolio investments. This has given rise to major global imbalances in the holding of financial assets. The ABMI will alleviate the imbalance. Additionally, local money bond issues are anticipated to reduce the vulnerability of the economies of ASEAN+3 arising from an over exposure to bank loans and the risk of the dual mismatch.

The ASEAN+3 set up six Working Groups to establish the infrastructure for the development of regional bond markets. The six Working Groups are as follows:

Working Group 1: Creating New Securitized Debt Instruments (Chair: Thailand)

The objective of this Working Group is to facilitate issuance of government bonds in the ASEAN+3 countries in Phase 1. Phase 2 will address creation of securitized instruments and corporate bonds. Such bonds could be issued both in local currency and strong foreign currency.

ASEAN+3 agreed that Asian countries need to put in place a legal framework and infrastructure to develop a national bonds market in each country before linking up with one another in an Asian Bonds Market regional network. Further, these countries recognize the different levels of development of the bonds market in each of their economies.

The ASEAN+3 cooperation framework is mainly focusing on the bonds supply aspect, i.e. issuance of bonds by the national authorities. The working group is also working with the central banks to build a demand for these bonds by developing life insurance, the pension system, and infrastructure project funding. .

Working Group 2: Credit Guarantee and Investment Mechanisms (Chair: Korea and China)

Established in February 2003 in Tokyo, this working group has been assigned to create a Credit Guarantee Mechanism for securitized debt instruments.

Working Group 3: Foreign Exchange Transactions and Settlement Issues (Chair: Malaysia)

Working Group 3 made proposals for preparing two studies: (i) a study on transactions and settlement; (ii) a study on obstacles to establishing a clearing and settlement system, particularly the problem of foreign currency control, security, regulation, and taxation matters. The goal of these studies is to set up a transborder transaction system based on lowest costs and to lessen uncertainty in putting through financial transactions.

The member countries must give priority to setting up a national clearing system and get the private sector involved in this initiative.

Working Group 4: Issuance of Bonds Denominated in Local Currency by Multilateral Development Banks (Chair: China)

Since its creation, this working group has investigated the regulatory framework to promote the issuance of bonds at the regional level. The working group is working on a variety of issues including the yield curve that will be used as a benchmark for the bond issue, mobilization of national savings, infrastructure development, capacity transfer, and improvement of the regulatory framework.

To address the risk of capital outflows the working group will also take up issues related to interest rate deregulation, regulation of investments and issuance, strengthening the settlement system and swap arrangements, as well as maintaining economic and financial stability.

Working Group 5: Rating Systems and Information Dissemination on Bond Markets (Chair: Singapore and Japan)

This working group arranged a series of consultations with capital market regulatory authorities and regional and international rating agencies, including the S&P Company and the Association of Credit Rating Agencies in Asia (ACRAA). The conclusions of these consultations were published on the ADB Web site.

Working Group 6: Technical Assistance Coordination (Chair: Indonesia, Malaysia, and the Philippines)

Working Group 6 is assigned to identify technical assistance for the ASEAN+3 countries and technical assistance from the ADB for preparing the ASEAN countries to avail the facility. Japan provided technical assistance to Cambodia and Laos. Viet Nam also received technical assistance from the ADB and Japan.

The working groups encouraged ASEAN+3 officials to use tax incentives (e.g. exemption from tax on financial transactions) in order to promote primary and secondary markets in bonds. The objective is to improve the liquidity of these bonds and improve their attractiveness as a financial saving instrument.

24.13. East Asia Summit

East Asia includes Japan, South Korea and North Korea, China and the ten countries of ASEAN. It embraces nearly a third of the earth's population and accounts for one quarter of the global GDP.

East Asia has been traditionally considered as a region of different nations, cultures, and values. Two factors guarantee the economic buoyancy and interdependence of East Asia: (i) the security alliance between Japan and the United States which lays a foundation for political stability in the region; and (ii) the granting of official development assistance by Japan to the countries of the region.

Japan has been a catalyst in making East Asia into a regional economic powerhouse. Industrial and technology transfers from Japan to the newly industrialized countries of Asia (South Korea, Hong Kong, and Taiwan) in the 1980s, subsequently to ASEAN in the 1990s, and followed by China at present, were based on an international division of labor that inspired the theory of the "flying wild geese" model in economic development. Japan specializes in exporting manufactured products with a high technological content, whereas the other countries of Asia are focusing on intermediate products and manufactures involving low-labor costs..

Today, East Asia is undergoing irreversible change and dynamic economic expansion. Japanese ODA and investments have transformed and modernized the economies of Southeast Asia. Japan also shared with the countries in the region its development model based on infrastructure and human resources development.

The idea of an East Asia Summit was initially brought up by the Leaders of ASEAN+3 at the Singapore Summit in 2000. In 2001, the East Asia Vision Group recommended to the leaders of ASEAN+3 countries that the ASEAN+3 Summit transform into the East Asia Summit. This recommendation was accepted as a high-priority long-term measure.

Thus, at the Eighth ASEAN+3 Summit held in November 2004 in Vientiane, the leaders agreed that the first East Asia Summit would be held in Kuala Lumpur, Malaysia, in December 2005, and would include the countries of ASEAN, Australia, China, South Korea, Japan, New Zealand, and Russia.

The member countries of ASEAN should satisfy the following criteria for participation in the East Asia Summit: (i) be a full-fledged dialogue partner of ASEAN; (ii) have joined or have the intention of joining the Treaty of Amity and Cooperation (TAC); and (iii) have a substantial relationship with ASEAN. ASEAN plays a key role in the East Asia Summit by chairing it. The summit must be held in an ASEAN country as a sideline to the annual ASEAN Summit. The East Asia Summit will be a forum for dialogue on strategic, political, and economic issues of mutual interest, with the ultimate purpose of promoting peace, stability, and economic cooperation in East Asia. The efforts of the summit to promote the East Asia Community must be in step with the implementation of the ASEAN Community and be a part of a regional architecture. Till this vision is realized, the ASEAN+3 Summit must be held to discuss cooperation in concrete and practical terms.

The leaders gave special consideration to cooperation with East Asia in the following 17 areas: countering terrorism, maritime security, good governance and anticorruption, financial stability and tax incentives to attract investments, energy security, trade and investment inflows, a pan-Asian free trade area, infrastructure development, technology transfer, poverty reduction, narrowing of development gaps and capacity building, protection of the environment, natural disaster management, communicable diseases, cultural interchanges and dialogue, contact among the peoples, and enhanced cooperation with regional and international fora.

The RCG recognizes that Cambodia's successful integration with the region and the world will help create an appropriate environment for its sustained growth. In pushing for the closer integration of Cambodia into the region the top priority is narrowing the development gap between the member countries of ASEAN. To speed up the process, Cambodia will build its institutional capacities to implement joint initiatives with its

neighbors, such as the “Four countries-One economy” initiative, the development of economic growth triangles and the creation of trans-border free trade zones.



PART IX

CONCLUSION

Chapter 25. Accelerating Institutional Development- the Key to Progress



Chapter 25

Accelerating Institutional Development- The Key to Progress

25.1. General Development Framework

During its second mandate, from 1998 to 2003, the RGC implemented the Triangular Strategy to focus on achieving peace and stability, normalizing relations with the rest of the world and marshalling resources to accelerate economic development and fight poverty. The strategy was successful in creating an environment conducive to progress, leading Cambodia on the path of reforms and sustainable development. Cambodia transformed from a backward country facing an uncertain future, and ravaged by war, conflicts, and instability, into a zone of lasting peace, security, and public order.

However poverty and inequity in income distribution have emerged as the greatest challenges facing the nation. In order to quickly solve the poverty problem and reach the Millennium Development Goals (MDGs), the RGC launched, in March 2003 the National Strategy for Poverty Reduction, with the following objectives:

- Strengthening peace, stability, and public order through the implementation of concrete measures aiming to improve the rule of law, promote respect for human rights and democracy, and create a political and security framework conducive to continued development.
- Ensure a strong rate of sustainable economic growth, 6-7% per year on average.
- Ensure an equitable distribution of spin-offs from the economic growth between rich and poor, urban and rural communities, men and women, and
- Promote sustainable management of the environment and natural resources.

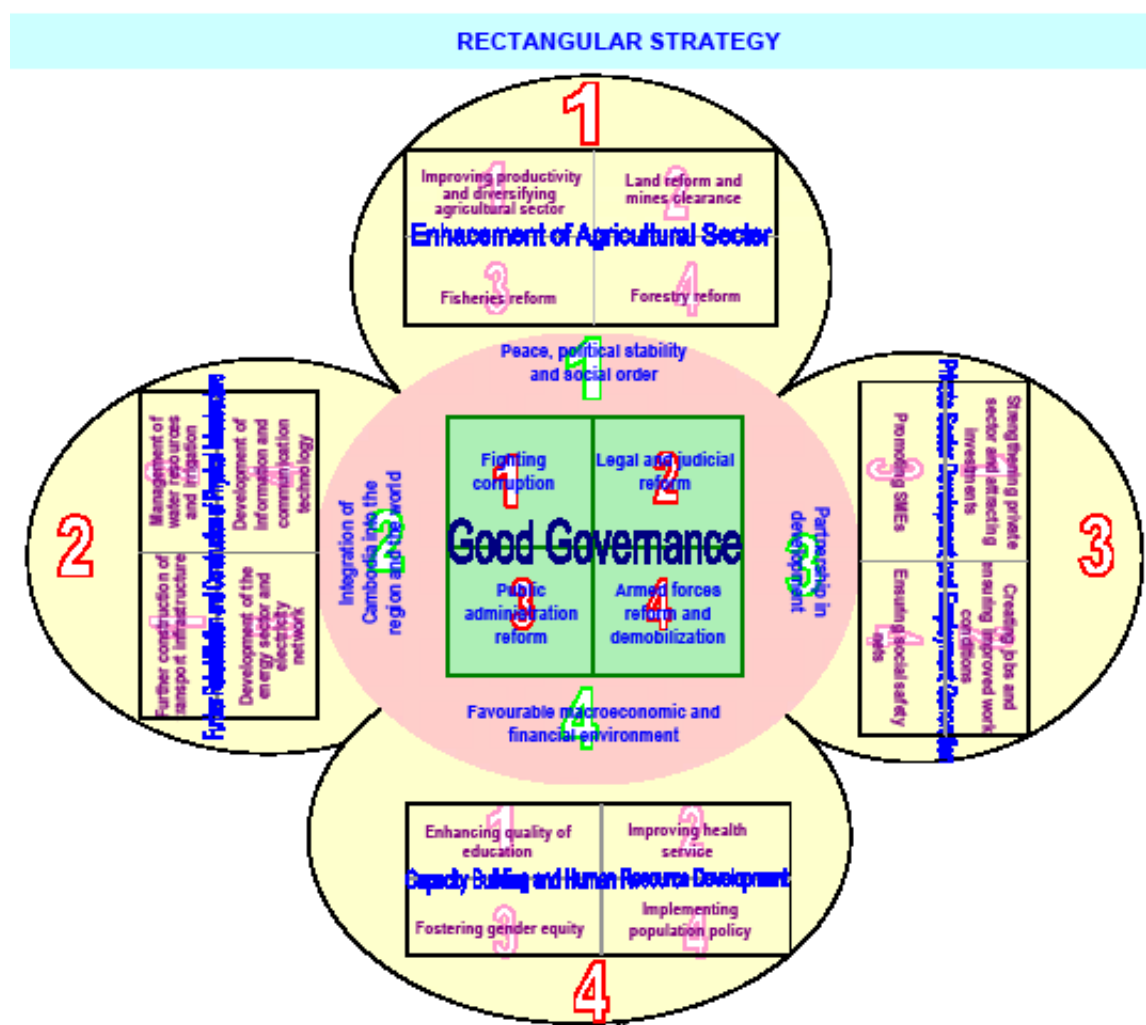
The RGC's agenda is not limited to fighting poverty. Its vision for development is one of social cohesion, with a state-of-the-art educational system and abundant cultural wealth. Making the vision into reality will require unfailing respect for the values of social justice, the interests of the people and their development, and the formulation and implementation

of enhanced poverty reduction policies based on sustainable economic growth and improved governance.

To realize this vision Prime Minister Samdech Hun Sen launched, in July 2004, the “Rectangular Strategy for Growth, Employment, Equity and Efficiency,” as an economic platform of the Royal Government’s third legislature of the National Assembly. This strategy captures the key elements of the Millennium Development Goals, the National Socio-economic Development Plan of 2001-2005 (SEDP2), of the National Poverty Reduction Program of 2003-2005 (NPRP), and other reform policies, strategies, plans, and programs. Its objective is to encourage economic growth, generate employment for the Cambodian work force, guarantee equity and social justice, and improve the efficiency of the public sector through implementation of the Governance Action Plan for in-depth, coordinated, and consistent reforms at all levels and in all sectors.

The Rectangular Strategy is an integrated structure of interlocking rectangles, as seen in the Figure 25.1:

Figure 25.1. The Rectangular Strategy



The positive results obtained in implementing the Rectangular Strategy have strengthened the overall confidence in a bright future for Cambodia. The foundations have been laid for development of the private sector, trade, investment, and tourism sectors, all generators of employment and income for Cambodians. Progress has been made in reforming agriculture and strengthening social and physical infrastructure. In recognition of the overall success in implementing the Rectangular Strategy it has been decided to continue with the same socio-economic agenda with minor modifications in the fourth mandate of the government.

However the battle for securing Cambodia's future is not yet won. Cambodia succeeded in achieving the targeted growth and reducing poverty appreciably during 1998-2008 but many challenges remain. The RGC is aware that there are numerous obstacles to overcome before achieving sustained progress and assuring lasting prosperity for the country and its people. The quality of institutions plays a crucial role in assuring sustained development and achieving a quick victory in the fight against poverty. Therefore, the government will pay special attention to accelerating institutional reforms in the following areas: (i) public administration reform; (ii) decentralization and local development; and (iii) legal and judicial reform.

25.2. Public Administration Reform

Civil service reform has a broad aim: “the creation of a government workforce of the size and with the skills, incentives, ethos, and accountability needed to provide quality public services and carry out the functions assigned to the state.” The experience of global development shows that there is a strong correlation between the caliber of the government workforce of a country and its level of economic and social development. It is seen that certain countries in Southeast Asia, such as Singapore and Malaysia, have an efficient, motivated civil service with the required professional qualities. Moreover, it is indispensable that the administration manages public affairs well, produces and delivers public services, defines and applies sound economic policy, and efficiently manages public expenditures.

Capacity building in the public sector for improving the efficiency of the civil service can be achieved through organizational, administrative, and strategic reforms. Good governance addresses a number of factors that are essential for economic growth and sustainable development. It reduces the costs of services rendered and increases the assurance of effective government policy implementation and predictability in law enforcement. It also ensures merit based selection and equality of opportunity for all. It is for these reasons that RGC has placed good governance at the core of the Rectangular Strategy.

Institutional efficiency reduces uncertainties and costs, and encourages capital and technological inflows, which in turn feed economic growth. Cambodia has begun the implementation of a strategy intended to remodel the structure and size of the civil service and improve the quality of public services. The building of capacity and technical expertise within the administration is essential for success of the reforms.

Cambodia has also launched initiatives for increasing the use of electronic technologies and methods in the administration. E-government helps install an efficient administration that can respond and adapt to rapid changes in the regional and international environment, as well as to the demands of an increasingly dynamic private sector.

In order to determine the ‘needed size’ of the civil service, each country’s case must be considered on its own merits, taking into account the history and ground reality of the country, the functions assigned to the State, the degree of centralization, professional qualifications of government staff, and budgetary constraints. Downsizing may not be a solution if to start with, the services are understaffed. Even if the staff downsizing could provide means of improving motivation, it could result in a heavy short-term financial burden to pay off the retrenched staff; it carries a certain political cost for Cambodia, which has only experienced peace in the last decade.

However, the salary and wage policy must be at the center of the civil service reform. Underpaid civil servants find it hard to resist temptation, pressed as they are by influential private interest groups and incapable of properly discharging their duties. This results not only in the deterioration of public goods and services, but in a worsening of the context of private activity and a rise in transaction costs in all facets of the economy.

The concept of salary linked to results is worthy of consideration. But careful attention must be paid to both the effectiveness and risks of such an approach.. Non-monetary incentives could be effective and can take various forms—more stimulating work, possibility of promotion to positions of influence, recognition of merit, and professional rewards, among others. But an incentives based system of wage management must include an honest, documented assessment of results.

Civil service reform must include diagnostics and structural measurements, the purpose of which would be to modify the salary scale (in particular to reestablish competitiveness in the upper levels), give more importance to merit, increase internal mobility, better manage personnel, offer skills development, and heighten the need to be accountable to the public.

A civil service based on meritocracy recognizes the principle of appointment according to individual merit (qualifications, skills, integrity, etc.) in order to ensure equality of opportunity and gives considerable importance to giving the individual freedom of action

subject to prescribed rules. The competitive process is a procedure that supposedly guarantees the awarding of socially prestigious positions in the hierarchy according to applicant's merit. The fundamental idea of meritocracy is that each person is appraised for what he or she does, not for who he or she is. This rule applies first and foremost to procedures regulating access to coveted positions. In such a system of selection, only the individual and his or her talents count. Thus, it corresponds perfectly to the maxim that each person will be appraised for individual achievement, regardless of who he or she is. But this practice can also result in a society divided into two widely separate categories: excellent at the top and mediocre at the bottom.

In the area of diagnostics several initiatives have been taken including a civil service census, a functional study of the ministries, several surveys, and the preparation of a corpus of rules and regulations. The census not only led to the exposure of "ghost" civil servants and illegal payment of salaries, but also prepared the way for setting up a human resources database and improving personnel management, all necessary measures for avoiding the recurrence of irregularities.

Experience shows that even at low salary levels, young people who are better trained can be encouraged to work for the government if they are attracted by the responsibilities and training they will receive. The National Program for Administrative Reform (NPAR) approved by the RGC in early 1999 is based on this approach. The Council for Administrative Reform (CAR) was mandated to speed up civil service reforms and strengthen the civil service management through:

- Improvement in public service delivery.
- Definition of benchmark criteria for the job market.
- Evaluation of operations.
- Increasing wages to improve performance.
- Developing the hiring process in order to supply adequate service.
- Improvement of civil service personnel management.

During the first phase of implementation of the NPAR, efforts were concentrated on following five major activities: document and supervise the composition and distribution of civil service employees; develop the instruments needed to direct and motivate personnel; evaluate the needs of the ministry central services (administration); complete the

preliminary work needed to make the administration more accessible to the public at large; and build capacity for reform planning and management. The following has already been achieved within the framework of the NPAR:

- Data on the composition and characteristics of the civil service have been collected and analyzed. As a result, there is now a clear vision of the composition and characteristics of civil service employees, at the national and local level.
- The legal and supervisory framework of the civil service is now in place.
- Human resources management systems, including the human resources management information system (HRMIS), are operational for the planning and management of public service personnel.
- A new system of hiring and salaries, more conducive to performance evaluation and promotion, has been drawn up and is now in place.
- Innovative policies have been designed in order to bring together available resources and increase performance in the priority sectors, including constituting Priority Mission Groups (PMGs), targeted allowances, and one-window service offices for employees at the local level.

With regard to the civil service salary policy, the RGC is emphasizing two fundamental approaches. First, any changes must respect the principle of relativity between the different categories of employees (political, civil service, military, and security officers). Second, these changes must be financially viable over the long term, in keeping with the fiscal framework. As a result, salary increases remain subject to available funds, and thus to public revenue. The RGC pledges a salary increase of 10% to 15% per year. Available funds will be allocated to priority needs by means of instruments such as the PMG program, and through a system of compensation that complements the base salary. The CAR secretariat is working out systematic simulations to evaluate the various options. The findings of wage policy study will be superimposed on the evaluation of operations, which was scheduled to begin in early 2005.

25.3. Decentralization and Local Development

Under the decentralization process, the law on commune administration and the law on commune council elections have both been enacted. Implementation of decentralization at the commune level addresses decentralization of authority, duties and responsibilities of

commune officers, terms of reference for commune administration, and democratic decentralization.

Decentralization of powers, duties, and terms of reference means the delegation of powers, duties, services, and jurisdictions from the central level to the commune, so that the commune may make decisions and manage them on its own, while enjoying own-source resources. The commune administration has the following terms of reference:

- Ensure public safety, order and organization.
- Stimulate economic and social development and raise the standard of living of the people.
- Promote the health and well-being of the people living in the commune.
- Protect the environment and natural resources and ensure their management.
- Coordinate the differing views within groups and communities to promote a climate of tolerance and mutual respect.
- Accomplish missions in response to the needs of the citizens.

The commune is to have its own-source resources, a budget, and assets. The income of the commune may include:

- Income from taxes, non-tax revenue, and the proceeds from services.
- Subsidies from the national budget allocated to the commune.
- Revenue from the application of its role as an agent of the State.

In Cambodia, the process of decentralization has progressed through several stages. The above terms of reference were carefully drafted taking into account the capacity of the local governments but in implementation some difficulties have been encountered. Various evaluations have emphasized: (i) the lack of resources available to the local authorities to implement the terms of reference transferred to them; (ii) the lack of cooperation of supporting agencies, and (iii) misunderstanding of what decentralization means. In the mid- and long term, the State is aiming to forge a comprehensive framework designed to improve local development, financial and administrative management of the local authorities, while developing human resources, programming, and financing of

infrastructure and facilities, and assuring grassroots participation in order to deepen democracy. The need to match accountability of local administration with their enhanced role in administration is however not always clearly understood.

The government gives priority to providing support for institutional development with a view to promoting genuine local administration. Local tax system will be reformed so as to allow the local authorities to free up sufficient resources to finance local public investments. The jurisdictions of local authorities will be strengthened and broadened, and, at the same time, more rational territory boundaries will be drawn up, in order to constitute entities that are more administratively and financially viable.

25.4. Legal and Judicial Reform

The RGC is aware that the institutionalization of codes of conduct and of laws and regulations determining human interaction in society is of great importance for the realization of sustainable development. The major legal and judicial reform undertaken by the RGC, along with the active support of donors, has as its goal the full restoration of the legal and judicial framework country which was destroyed during the years of tragedy and turbulence that Cambodia went through. The international community is supporting the government in these efforts. . This reform aims at building one of the major pillars of democracy—the equality of citizens before the law. It also aims to create conditions conducive to strengthening the legal security of investments, a necessary condition for the economic and social development of the country.

This legal and judicial reform aims to use the opportunity to bring the judicial system in the country to international standards. The CLJR has prepared both the short-term action plan organized around 33 priorities and a medium term action plan covering 27 priorities. These two action plans are based on the phased achievement of the 7 objectives of the Strategy for Legal and Judicial Reform, viz. :

- Improve the protection of fundamental rights and freedoms.
- Improve the legislative framework.
- Provide better access to legal and judicial information.
- Enhance quality of legal services.
- Strengthen legal and judicial services.

- Introduce alternate dispute resolution methods.
- Strengthen legal and judicial institutions to allow them to carry out their terms of reference.

The main elements of the action plans are:

- Reconstitution of a comprehensive, consistent Cambodian legal corpus. The painstaking work of drafting the civil and penal codes and code of civil procedure is now nearly completed; it is imperative to assure as wide a participation and consultation as possible in the legislative process at the level of preparation, revision, and enactment of these legal texts.
- The creation, in February 2002, of a Royal School of Magistracy focusing on the genuine professionalization of magistrates. International aid is anticipated to allow other functions to be included in this training effort: court clerks, notaries, bailiffs, liquidators, and other stakeholders in the court system. The Lawyer Training Center is now operational.
- A model court has been established in Kandal province, the purpose of which is to identify best professional practices in the handling of cases. New facilities were to be completed in 2006. The establishment of specialized courts is also in process, in order to better handle juvenile, commercial, and administrative cases.
- Finally, inclusion of magistrates among the categories of civil servants whose will receive the highest salary raises, as a complement to the long-term training efforts. Justice must be allowed to function by providing it with the human, technical, and political means, including in terms of budget and salary. This is an important measure, and the independence of the judiciary depends upon it.

Several issues in judicial reform need to be addressed:

- Guaranteeing the separation of powers and the independence of the magistracy, including restructuring the Supreme Council of the Magistracy (SCM) and elevating the status of judges. Amendments to the Law on the Organization and Functioning of the Supreme Council of the Magistracy have been drawn up and approved by Council of Ministers; they await ratification by Parliament. The restructuring of the SCM is now well advanced; a Secretariat is in place, and the needs for assuring the proper functioning of the SCM are being evaluated.

- The bill on the status of magistrates and the organic law on the organization and functioning of the courts were drawn up, and were slated to be submitted to Parliament in 2005, but the legislative process has slowed..
- Drafting of legislation on work jurisdiction is pending.
- Courts of commerce and trade are yet to be established.
- Allocation of human and financial resources needed by the Ministry of Justice is inadequate in such critical areas as creating an ad hoc public information service on jurisprudence so that citizens can be properly informed.

A crucial test of the success of legal and judicial reform is the ease of access by the poorest of the poor to justice and judicial services in order to assuage feelings of social injustice and vulnerability, strengthen the confidence of communities in the rule of law, improve the quality of life, and reduce poverty. Three decades of war, turbulence, and internal conflicts have caused deep psychological trauma and underlying tensions. A young and growing population and abrupt social changes fostered by the development of technologies and deeper regional and global integration are challenging traditional values. Society is changing rapidly.

A sound court system for adjudicating the rights and responsibilities of the investor is also a basic requirement for inspiring investor confidence and sparking private investment. The legal reform has to ensure the protection of intellectual property rights and smooth business openings and closures. Sound legal systems in banking, taxation, and accounting, insurance, secured transactions, business transactions, bankruptcy procedures, contracts, commercial credit, and instruments of transfer and payment transactions are necessary for an efficient financial sector .

Legal and judicial reforms are made even more difficult because of Cambodia's social context. The lack of qualified Cambodian jurists has meant that international experts have had a strong influence on the existing court system and shaping its future. This gives rise to inconsistencies that make law enforcement difficult. Law enforcement remains a challenge for a number of reasons, in particular the abysmally low salaries. It is difficult to enforce the law transparently, courageously, and impartially when the salaries of the officers in charge of enforcing it are not in tune with the onerous responsibilities they discharge.

25.5. Good Governance and Modernization of the Administration

Improved governance of the economic reforms will make it possible to institute more credible programs and actions against corruption. It is also needed for modernizing the administration, strengthening democracy and decentralization, and protecting and promoting human rights.

Anticorruption strategy must be accompanied by efforts to improve the quality of public services with full accountability of public officials for timely delivery of services. A specific program to promote greater justice and social equity, greater involvement by the people in the decisions of the State, and increased transparency in decision making are hallmarks of a system of good governance responsive to the public, which it must serve.

To reach these goals, the strategy adopted will give special consideration to: (i) improvement of the living and working conditions of magistrates, court clerks, and public prosecutors; (ii) overhaul of legal documents regulating public procurement; (iii) strengthening the efficiency of the market performance and eliminate repressive control mechanisms; and (iv) continuation of the civil service reform in the direction of greater professionalization and efficiency, with accompanying improved motivation of government employees.

In modernizing administration the major challenges to be met involve: (i) respect for the principles of transparency; (ii) making public information on the laws governing the budget, settlement, and timely submission of the Government's Table of Financial Transactions (tableau des opérations financiers de l'État - TOFE); (iii) improvement of public financial management through increasing effectiveness and efficiency of public expenditures, pursuit of fiscal system reform, notably through enlargement of the tax base and increasing the share of taxes in total revenue; and (iv) strengthening of justice. At the core of the modernization program should be the establishment of an information system based on state-of-the-art technologies for providing real time information covering the main sectors of public interest (taxation and public spending, statistics, economic and social data, administrative information, etc.).

The anti corruption legal framework is being established. The RGC recognizes, as its development partners suggest, the need for an integrated approach to combating corruption. Enactment of the anticorruption law will be a big step forward, but it should be followed up by its strict enforcement. Rationalizing administrative procedures, streamlining and modernizing the taxation system, elimination of red tape and improving motivation of

officials and employees by means of an economic wage can all contribute to reducing corruption.



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