ASIAN DEVELOPMENT BANK **CER: CAM 2000-14**

COUNTRY ECONOMIC REVIEW

CAMBODIA

December 2000

CURRENCY EQUIVALENTS
(as of 14 November 2000)

Currency Unit	–	Riel (KR)
riel 1.00	=	0.0002607
$1.00	=	KR3,835

ABBREVIATIONS

ASEAN	–	Association of Southeast Asian Nations
CPI	–	consumer price index
CSES	–	Cambodia Socioeconomic Survey
FDI	–	foreign direct investment
GDP	–	gross domestic product
Lao PDR	–	Lao People's Democratic Republic
MHD	–	medium human development
NBC	–	National Bank of Cambodia
ODA	–	official development assistance
US	–	United States
VAT	–	value-added tax

NOTE

In this report, "$" refers to US dollars

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EXECUTIVE SUMMARY

Unusually prolonged and severe seasonal flooding is expected to curb otherwise robust economic growth in 2000. As a result, real gross domestic product (GDP) expansion is projected to slow from 5.0 percent in 1999 to about 4.5 percent in 2000, which equals average real GDP growth performance during 1995-1999. Given the population growth rate of 2.5 percent, this growth performance is not significantly impacting incomes. Real per capita GDP rose less than 10.0 percent during the period. In addition, growth was uneven, with industry growing at an average annual rate of about 15.0 percent, agriculture at 4.0 percent, and services at 1.0 percent. This relatively low, urban-biased growth contributed only modestly to poverty reduction. The incidence of poverty declined only marginally from 39.0 percent of the population in 1994 to 36.0 percent in 1997 and then remained stable from 1997 to 1999, despite aid flows averaging about $20 per capita during 1995-1999.

Economic performance continues to have an urban bias in 2000. A contraction in agriculture is anticipated because of the impact of flooding on crop production and because of an ongoing slump in forestry. The expected reduction in crop production is a sharp reversal from the record harvest of 1999, which resulted in a 9.1 percent increase in crop value added as compared with 1998. The decline of forestry since 1997 is a result of a combination of factors including low world timber prices following the regional financial crisis, higher timber royalties since 1999, and stricter enforcement, since 1999, of laws governing the felling and export of logs. Further expansion of fisheries, which has grown rapidly in the past several years, is expected to partially mitigate the negative impact of poor performance in crops and forestry.

Rapid expansion of the textile industry, based primarily on exports to the United States, should contribute to double-digit growth for industrial value added in 2000. Manufacturing increasingly dominates the industrial sector, accounting for 75.0 percent of industrial value added and nearly 15.0 percent of GDP in 1999. Construction, which accounted for 4.2 percent of GDP in 1999, should continue to expand in 2000 under the influence of a steadily improving political climate. The strong 1999 recoveries in tourism and domestic demand should persist in 2000, supporting moderate service sector expansion, despite the mitigating effects of the floods on economic activity.

The impact of flooding on the economy is likely to slow investment somewhat in 2000 from a high of over 18.0 percent of GDP in 1999, which followed a low of 12.0 percent of GDP in 1998. Reflecting the economic recovery, the substantial increase in investment in 1999 was primarily an expansion of private investment, although public investment reached a high of 6.2 percent of GDP. Local financing became more important as a source of private investment in 1999 as foreign direct investment continued to stagnate, falling from 5.5 percent of GDP in 1997 to 4.3 percent in 1998, and to 4.0 percent in 1999. The main sectors attracting investment projects in the first nine months of 2000 were garments and tourism. Overall, domestic investment is still low as compared with a Southeast Asian average of about 25.0 percent of GDP.

Achieving higher rates of investment, rapid economic growth, and job creation is critical because the labor force is expanding rapidly. Over 25.0 percent of the population is currently aged from 10 to 19 years and labor force participation rates for this group are expected to increase rapidly during the next several years. Because past economic growth has not been adequate to productively absorb new entrants to the labor force, there are indications that underemployment is increasing. Between 1997 and 1999, the proportion of the labor force classified as unpaid family labor increased from 30.0 to 45.0 percent, and the real wages of unskilled labor fell by 5.0 to 10.0 percent. Moreover, large income disparities exist. In 1999 per capita income in Phnom Penh was $691, over three and a half times greater than rural per capita income of $197.

To promote long-run economic growth, Government is increasing expenditures on socioeconomic development by enhancing fiscal revenues, attracting more foreign financing for public investment, and reducing expenditures on defense and security. Fiscal revenues are projected to fall short of the 2000 budget target by about $14 million, but still increase by more than 7.0 percent to 11.8 percent of GDP as compared with 11.5 percent in 1999. Together with an increase of more than 25.0 percent in expenditures, this should increase the fiscal deficit, excluding transfers, from 4.1 percent of GDP in 1999 to nearly 7.0 percent in 2000. However, foreign financing is expected to more than cover this deficit, increasing from 4.5 percent of GDP in 1999 to an expected 7.0 percent in 2000, so that domestic Government debt will fall. The composition of expenditures continues to improve. Defense and security spending is projected to fall from 4.2 percent of GDP in 1999 to 3.8 percent in 2000, while expenditures on health, education, and rural development should rise from 2.0 percent of GDP in 1999 to 2.6 percent in 2000.

Positive developments in money and banking accompany improvements in fiscal performance in 2000. First, the average annual inflation rate should fall from 4.0 percent in 1999 to about zero in 2000. Despite the impact of flooding on agricultural production, food prices were about 7.5 percent lower in September 2000 than in September 1999, in part because of low world rice prices. Since food accounts for about half of the basket of goods used in the consumer price index, falling food prices offset the impact of rising housing and transportation costs. Second, the value of the local currency, the riel, has been stable. It is projected to depreciate by only about 1.0 percent against the dollar in 2000. Third, expansion through September 2000 of foreign currency deposits (by about 39.0 percent) and private sector credit (by about 22.0 percent) reflects increased confidence as political and economic conditions continue to improve. Total liquidity increased by over 24.0 percent through September 2000 yet did not fuel inflation as the velocity of money fell.

Cambodia’s external position is expected to continue improving as well in 2000. An increase in gross official reserves from $422 million in 1999 to about $500 million in 2000 is anticipated as strong growth in exports (projected at 28.0 percent in 2000) and tourist arrivals (projected at 35.0 percent) are providing strong foreign currency earnings. The current account deficit, excluding grants, widened from 8.2 percent of GDP in 1998 to 11.5 percent in 1999, and is expected to be of similar magnitude in 2000 as the recovery generates strong import growth. However, official transfers, 7.3 percent of GDP in 1999, reduced the current account deficit to 4.2 percent of GDP in 1999, and a similar outcome is expected in 2000.

Weather conditions permitting, the economy should achieve growth of 5.0 to 6.0 percent in 2001, high oil prices and a slowing United States economy notwithstanding. Over the short term, the garment sector should continue to lead the industrial expansion. However, in the long run, the competitive edge that Cambodia enjoys because of preferential access to markets in the United States and Europe may be eroded by the liberalization of world textile trade. Tourism should continue to be a source of employment and income growth, foreign currency earnings, and revenues. As the area cultivated to annual crops expands and investment in rural development increases, modest agricultural growth can be expected in the short term, barring severe weather conditions.

The prospects for achieving Government's long-term goal of moving out of the ranks of least developed countries by 2020 hinge upon the country's ability to substantially increase agricultural productivity, to maintain high levels of private investment, to increase and improve the efficiency of public investment, and to increase national savings. In the medium term, with increased investment, improved natural resource management, and stronger protection of land-ownership rights, agricultural productivity should begin to grow. If Government continues to improve macroeconomic management and proceeds with trade-liberalizing reforms, new and diversified investment should materialize to continue the export-led industrial expansion. Planned banking reforms should begin to improve access to credit for small- and medium-sized enterprises, relieving a major constraint to service sector expansion.

The outlook for continued improvement in macroeconomic management is reasonably good. With planned reforms, fiscal revenues should reach 14.0 percent of GDP in the next few years, public expenditure management should improve, and the proportion of expenditures devoted to socioeconomic development should continue to rise. In money and banking, maintaining a stable exchange rate, building international reserves, and strengthening the banking sector, are the reform focus. In the external sector, a key Government objective is to liberalize trade in conjunction with requirements under membership in the Association of Southeast Asian Nations.

Achieving sustained economic development and poverty reduction is subject to several risks. The risk of renewed political instability, although still present, is falling since the political settlement of late 1998. Economic risks include a slowing of progress on reform, a US economic slowdown, a sustained slump in foreign direct investment, and a continuation of high oil prices. Of these, the risk of stagnating foreign investment is the most serious, in part because of the continued regional slump in investment opportunities. Environmental risks are evident as flooding and overexploitation of natural resources jeopardize sustained increases in agricultural productivity. The population growth rate, although high, may be beginning to fall. However, the risk of a debilitating HIVAIDS (human immunodeficiency virus/acquired immunodeficiency syndrome) epidemic that could undermine the beneficial effects of economic growth on poverty reduction is serious.

I. RECENT ECONOMIC DEVELOPMENTS

A. Growth, Employment, Savings, and Investment

1. Aggregate Growth

1. A supply shock—severe seasonal flooding—struck Cambodia in mid-2000, weakening the economic recovery that began in 1999, following the turbulent years of 1997 and 1998. As a result, expansion of real gross domestic product (GDP) is expected to slow in 2000 from the 5.0 percent growth rate achieved in 1999 (Table 1). In addition to slowing economic growth, the flooding adversely affected the lives of one quarter of the population and caused over $100 million in damage to crops, livestock, and infrastructure. In contrast, and despite weakness in foreign direct investment (FDI), strong aggregate demand boosted the service and industry sectors, ensuring a real GDP growth rate higher than the 2.5 percent population growth rate, and thus some improvement from 1999's real GDP per capita of $236 (Appendix, Table A1).

Table 1: Gross Domestic Product by Economic Activity (1995- 2000)
Growth Rates
(constant 1993 prices, percent)

Economic Activity	1995	1996	1997	1998	1999
Agriculture	7.5	2.2	5.8	2.5	1.5
Crops	28.2	4.4	(2.7)	0.6	9.1
Livestock and Poultry	2.8	2.5	1.2	5.6	(4.9)
Fisheries	1.4	8.3	7.8	5.4	16.0
Forestry and Logging	(22.5)	(14.7)	44.3	(0.1)	(33.2)
Industry	20.2	11.7	20.4	8.6	11.4
Mining	2.8	(4.6)	0.1	1.4	8.0
Manufacturing	10.8	18.7	35.1	16.4	9.1
Electricity, Gas, and Water	37.0	0.9	1.6	3.7	3.8
Construction	39.8	1.3	(6.4)	(13.2)	21.6
Services	(0.2)	4.8	(3.7)	(1.3)	5.8
Trade	(2.9)	(0.2)	(2.4)	(5.3)	1.7
Hotel and Restaurants	24.5	6.2	(3.3)	(4.1)	18.3
Transport and Communications	10.0	8.8	(14.4)	(2.6)	13.2
Finance	21.2	6.7	3.6	(9.5)	1.9
Pubic Administration	49.9	17.3	3.5	(0.5)	3.7
Real Estate and Business	(23.1)	0.9	2.7	3.9	3.3
Other Services	1.7	10.1	(9.9)	7.2	3.9
Gross Domestic Product	6.7	5.5	3.7	1.8	5.0

( ) = negative value.
Source: National Institute of Statistics. 1998 and 1999. *National Accounts of Cambodia*. Phnom Penh.

2. Because of the high rate of population growth, real GDP per capita improved by only about 2.0 percent per annum from $215 in 1994 to $236 in 1999 (in constant 1993 dollars), even with an average of 4.5 percent real GDP growth achieved for 1995-1999. This was relatively strong economic performance compared with the 3.0 percent average real GDP growth rate for Southeast Asia over 1995-1999. Yet, average real GDP per capita growth of about 2.0 percent for these years was insufficient to significantly reduce poverty. The percentage of the population living below the absolute poverty line in 1994 was estimated at about 39.0 percent, falling to 36.0 percent in 1997 and remaining at about 36.0 percent in 1999. An important reason for this outcome was that economic growth was not sustained at a sufficiently high level, reaching the Government's target range of 6.0 to 7.0 percent only in 1995. Indeed, real GDP growth dropped below the population growth rate in 1998.

3. The unbalanced nature of economic growth contributed to its inability to significantly impact poverty. Industrial value added growth contributed most to rising real GDP in Cambodia, averaging 14.5 percent over 1995-1999 as compared with 11.2 percent for Viet Nam and 11.5 percent for Lao People's Democratic Republic (PDR). Agriculture, averaging 3.9 percent growth of value added for 1995-1999, was comparable in performance to the 4.3 percent growth achieved by Viet Nam and 4.0 percent growth for the Lao PDR. However, in services value-added growth lagged noticeably at about 1.0 percent as compared with 6.0 percent for Viet Nam and 7.8 percent for the Lao PDR. [1] In an economy at such an early stage of development, rapid industrial growth from a small base is to be expected. However, improved performance in agriculture and services would boost overall growth and increase its impact on poverty.

2. Sectoral Growth

a. Agriculture

4. After two years of anemic growth, the agriculture sector may experience a decline in 2000 because of the impact of flooding on crop production and despite expectations of moderate growth in fisheries. Flooding began as early as July 2000 and the Mekong River rose above emergency levels in September 2000, flooding key rice producing lands. Real value added for crops is projected to fall by about 1.0 percent, as compared with growth of 9.1 percent in 1999 and averaging about 8.0 percent over 1995-1999.[2] Crops accounted for about 18.0 percent of 1999 GDP (Appendix, Table A2) so the projected impact of flooding was to cut the expected contribution of crops to real GDP growth by about 1.5 percentage points relative to its average contribution.

5. The inability to mitigate flood damage is a major contributing factor to the failure to achieve sustained growth of the crop subsector. Rice, Cambodia's most important crop, accounting for about 60.0 percent of 1999 crop value added, is generally produced through low-input, low-output, rain-fed, single-crop subsistence farming. This results in high crop losses from

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[1] For an overview of development issues in Cambodia, including a poverty profile and assessment of economic growth performance, see Asian Development Bank. 2000. *Cambodia: Enabling a Socioeconomic Renaissance, a Country Operational Strategy*. Manila, Philippines.

[2] There is considerable uncertainty about the extent of crop damage. The various estimates give rise to a range of minus 5.0 percent to plus 2.0 percent for growth in real value added for crops. Staff projections for 2000 are made relative to preliminary 1999 national account estimates provided by the National Institute of Statistics, which use an early estimate of paddy production of 3,793 million tons for cropping year 1999/2000 (July 1999 through June 2000). Comparison with reported national account figures is done for consistency. However, using the final paddy production estimate of 4,041 million tons provided by the Ministry of Agriculture, Forestry, and Fisheries would change the staff projection for 2000 real growth in crops value added to about minus 5.0 percent but would also increase real growth in 1999.

flooding, drought, and pest damage. On average during 1996-2000, 92.3 percent of the area cultivated to rice was harvested (Table 2). Heavy seasonal flooding in 1996 contributed to the loss of 15.0 percent of the cultivated area in the 1996 wet season; 10.0 percent to 20.0 percent was destroyed in the 2000 wet season. Changes in environmental factors (such as upstream deforestation and damming) may be increasing the frequency of severe seasonal floods.

Table 2: 1996-2000 Cropping Year Rice Production [a]
('000)

	1996/97			1997/98			1998/99			1999/2000		
Item	**Wet**	**Dry**	**Total**	**Wet**	**Dry**	**Total**	**Wet**	**Dry**	**Total**	**Wet**	**Dry**	**Total**
Hectares												
Cultivated	1,937	234	2,171	1,827	249	2,076	1,873	231	2,104	1,916	242	2,158
Harvested	1,649	233	1,882	1,685	244	1,929	1,745	217	1,962	1,846	233	2,079
Tons												
Produced	2,759	699	3,458	2,673	742	3,415	2,874	636	3,510	3,333	708	4,041
Yield	1.67	3.00	1.84	1.60	3.00	1.77	1.65	2.93	1.79	1.81	3.04	1.94

[a] The 1996/97 wet season crop was transplanted in July-August 1996 and harvested in November 1996-January 1997. The dry or early wet season crop was transplanted in February 1997 and harvested in June 1997. Thus, the 1996/97 cropping year runs from July 1996 through June 1997.
Source: Ministry of Agriculture, Forestry, and Fisheries. Agriculture Statistics, various issues.

6. In contrast to its impact on crops, extensive flooding tends to boost production in the large fisheries industry, so moderate growth in fisheries value added is expected in 2000. Fisheries value added accounted for 10.5 percent of GDP in 1999, making it the fourth largest subsector, behind crops, manufacturing, and wholesale and retail trade. Recorded value added for fisheries has been increasing rapidly over the last several years, growing by 45.0 percent since 1994 and by 16.0 percent in 1999 alone. Yet, Government statistics are believed to underreport the extent of activities in this subsector. Private estimates put the annual catch at 300,000 to 400,000 tons, as compared with official statistics of 100,000 tons or less.[3]

7. Fisheries are a vital industry in Cambodia, providing the principal source of protein for the population and providing significant employment. Although individual fish catch rates have reportedly been falling, overall catches are growing because more people are fishing. Fishing activities are divided into large-scale operations involving exclusive concessions on fishing lots in the Tonle Sap and floodplains, licensed medium-scale activities, or small-scale family fishing. A rapid increase in medium- and small-scale fishing and mismanagement of fishing lots in recent years is leading to overexploitation of some fish species although others are still plentiful. However, in the longer term, increased use of flood control and loss of the fish-spawning habitat, particularly in the inundated forest area of the Tonle Sap, could significantly reduce fish productivity. The new Fishery Conservation, Management, and Development Law to address concerns over the health of the industry is being finalized in late 2000 in preparation for stakeholder consultations.

8. Value added in livestock and poultry, accounting for about 7.0 percent of 1999 GDP, is expected to post modest growth in 2000. Although some livestock were lost to the floods, some recovery is expected from the contraction in livestock production recorded in 1999. The

[3] For more information about Cambodian fisheries, see Degen, Peter, et. al. 2000. *Taken for Granted: Conflicts over Cambodia's Freshwater Fish Resources*, Department of Fisheries, Phnom Penh.

recorded contraction in constant price value added may have involved larger than normal unrecorded livestock trade in regional markets due to large price increases in 1999. Livestock prices have been falling slightly this year, and the Government is taking steps to tighten control of unrecorded trade.

9. Forestry value added, which fell from 6.5 percent of GDP in 1997 to 4.0 percent in 1999, is expected to continue its decline in 2000 based on a drop in recorded exports in the first quarter of 2000 relative to the first quarter of 1999. This follows the 33.0 percent contraction in 1999, resulting from low world prices, past overexploitation, and a crackdown on illegal logging that began in 1999. Conditions that limit production and profitability, such as Government reforms and slow recovery in world prices, are expected to continue in the medium term.

10. A review of commercial concession management in 2000 indicated extensive violations of agreed sustainable forestry management practices. Concessionaires recently agreed to reductions of 50.0 to 75.0 percent of allowable production while these violations are addressed. Other key Government reforms include the 1999 increase in timber royalties from $14 per cubic meter to $54 per cubic meter, the creation of the Forest Crime Monitoring Unit, and the drafting of a new forestry law (expected to be passed by the legislature in 2000). Charging that the new royalty rate was set arbitrarily, is excessive, and does not reflect actual costs, concessionaires are asking the Government to consider setting rates based on site-specific criteria.

b. Industry

11. Industrial expansion, the cornerstone of economic performance for the past several years, is expected to accelerate in 2000 as rapid growth in textile exports to the United States (US) continues, leading to expectations of double-digit growth in manufacturing value added. In 1999, strong growth in textile production was partially offset by a sharp 63.0 percent drop in value added for manufactured wood, paper, and publishing products. This decline was attributed to the steep drop in timber available for local production arising from the crackdown on illegal logging, which led to rapid price increases in 1999 for house furnishings. However, the supply constraint for local wood appears to have eased, as evidenced by declining prices for house furnishings in late 2000. Manufacturing of food and beverages is expected to continue to expand in 2000 due to strong growth in tourism and domestic demand.

12. Through August 2000, US trade statistics show manufactured imports from Cambodia valued at $586.9 million, as compared with $385.1 million through August 1999, an increase of 52.4 percent.[4] Thus, textile value added is expected to increase by about 35.0 percent in 2000, in spite of a January 1999 trade agreement with the US, which set import quotas for 12 categories of Cambodian textile products. Rapid garment export growth was possible because quotas were initially set above actual 1998 production levels, and by August 2000, quotas had increased by more than 20 percent on average in ten of the twelve categories. Moreover, in several of the categories (particularly sweaters, coats, and underwear), the quotas are not yet binding. Under the terms of the 1999 agreement (which lasts through 2001), quotas will increase automatically by 6.0 percent each year, with an additional increase of as much as 14.0 percent possible, based on evidence that Cambodian authorities are enforcing the labor laws.[5]

13. Real industrial value added grew from 14.0 percent of GDP in 1995 to 19.6 percent in 1999, based predominantly on growth in manufacturing value added, primarily for textiles. Value

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[4] US Census Bureau. 2000. *Foreign Trade Statistics.* (On-line) Available: http://www.census.gov/foreign trade.
[5] US Customs Service. 2000. *Textile Status Report.* (On-line) Available: http://www.customs.ustreas.gov/quotas.

added for mining, electricity, gas, and water, accounts for less than 1.0 percent of GDP. In 2000, offshore oil and gas exploration, begun in 1997, yielded prospects of a small gas deposit. If commercial development is feasible, this could provide a valuable source of energy for a country that depends on fuel imports for electricity, which is expensively produced and delivered only in urban areas. Construction, accounting for 4.2 percent of GDP in 1999, rebounded strongly in 1999 after two years of negative growth. Robust growth is expected to continue in 2000, despite flood-related disruptions.

c. Services

14. The service sector, hit hard by the disturbances of 1997 and 1998, recovered in 1999 as a return of consumer confidence fueled an expansion of domestic and foreign demand for services. Tourist arrivals increased by 41 percent (Table 3) and aggregate consumption grew by 3.9 percent in real terms in 1999 (Appendix, Table A3). This trend was expected to continue in 2000 with a 34.1 percent increase in tourist arrivals through September 2000, relative to the same period of 1999. In addition, strong growth in manufacturing and tourism was expected to increase formal sector incomes, stimulating domestic demand for services.

Table 3: Arrivals via Air in Cambodia

Category	1993	1994	1995	1996	1997	1998	1999	2000[a]
Holiday	70,183	133,341	162,317	194,419	163,005	141,926	199,644	207,273
Business	27,659	34,076	43,909	58,431	48,557	37,610	55,384	34,243
Others	20,341	9,200	13,454	7,639	7,281	6,797	7,879	5,692
Total	118,183	176,617	219,680	260,489	218,843	186,333	262,907	247,208
% Change		49.4	24.4	18.6	(16.0)	(14.9)	41.1	34.1

( ) = negative value.
[a] January through September, % change is relative to same period in 1999.
Source: Ministry of Tourism.

15. Tourism is a major industry, generating $82 million in foreign currency receipts in 1996 prior to the steep drop in tourist arrivals in 1997 and 1998. These receipts were estimated at $63 million in 1999 for about the same number of visitors, implying less expenditure per visitor. A second trend is the increasing importance of direct flights to Siem Reap from regional destinations. These began in 1998 from Bangkok, accounting for 5.6 percent of total arrivals by air that year, rising to 10.8 percent in 1999 and 22.1 percent through September 2000. Direct flights from Ho Chi Minh City began in 2000 and additional direct flights are planned from Singapore. These direct flights are expected to increase marketability, especially for multicountry package tours, which accounted for one third of all tourists in 1999.

16. The service sector, accounting for 36.0 percent of GDP in 1999, seemed poised to enter a sustained period of expansion after several years of stagnation. The dominant trade sector, at 10.9 percent of GDP in 1999, contracted for five consecutive years, by 11.0 percent in real terms from 1993 to 1998, before posting a 1.7 percent expansion in 1999. The poor performance over 1995-1999 was, in part, a result of the 1997/1998 political disturbances, but may also have involved an element of structural adjustment in the years after the involvement of the United Nations, which may have provided strong stimulation for service sector growth. In addition to the turnaround in trade in 1999, the hotel and restaurant subsector and the transport and communications subsector experienced dramatic recoveries.

3. Employment and Wages

17. Economic growth will need to be high, sustained, and balanced to absorb a rapidly growing labor force. The *Cambodia Socioeconomic Survey 1999* (CSES 1999) estimates the total labor force at about 5.5 million or 66.0 percent of the population aged 10 years and above, an increase of more than 8.0 over the estimate of 5.1 million provided in the 1998 population census.[6] Although the two measures may not be strictly comparable, the labor force is certainly growing more rapidly than the estimated population growth rate of 2.5 percent, perhaps as much or more than 200,000 per annum. Because of a postconflict baby boom, 26.3 percent of the population is aged 10 to 19 years, for which labor force participation rates can be expected to increase significantly over the next five years, while the cohort over 50 years of age is less than 10.0 percent of the population.

18. With this rapid increase in the labor force, evidence of extensive underemployment is not surprising, despite negligible open unemployment of 0.6 percent in 1999. About 656,000 people, or 11.8 percent of the labor force, were unemployed for 18 or more weeks during 1999. Furthermore, CSES 1999 suggests that low labor force participation rates for some age cohorts (e.g., about 86.0 percent for those aged 20 to 24 years) may indicate that a significant number of workers are discouraged rather than voluntarily out of the labor force. Finally, about 46.0 percent of employed persons were unpaid family laborers in 1999, as compared with just over 30.0 percent in 1997, as reported in CSES 1997.[7] Apparently, many additional workers are being absorbed into family businesses, which may often be a farm given that about 83.0 percent of the labor force is classified as rural with about 85.0 percent of those primarily employed in agriculture.

19. Nevertheless, the overall share of the labor force employed in agriculture fell from about 79.0 percent in 1997 to 76.5 percent in 1999 (Table 4). This is not surprising given the relatively rapid recent growth of industry and tourism. Yet, the large share of the population employed in agriculture indicates Cambodia's early stage of development. Typical of such economies, agriculture employs 76.5 percent of the employed population but generates only about 40.0 percent of GDP. In contrast, industry generates about 20.0 percent of GDP while absorbing 6.4 percent of the employed population.

Table 4: Employed Population (aged 10 and above) by Industry Group, 1997, 1999
(percent)

	Cambodia		**Phnom Penh**		**Other Urban**		**Rural**	
Group	**1997**	**1999**	**1997**	**1999**	**1997**	**1999**	**1997**	**1999**
Agriculture	78.9	76.5	8.1	8.3	50.5	54.3	88.9	84.7
Industry	4.8	6.4	15.7	21.4	8.0	9.2	3.4	4.7
Services	16.3	17.1	76.2	70.3	41.5	36.5	7.7	10.6
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: National Institute of Statistics. 2000. 1998. *Report on the Cambodia Socioeconomic Survey, 1997, 1999.* Phnom Penh.

[6] CSES 1999 defines the working age population as the population aged 10 years and above. National Institute of Statistics. 2000. *Report on the Cambodia Socioeconomic Survey 1999,* and *General Population Census of Cambodia 1998: Final Census Results*. Phnom Penh.

[7] National Institute of Statistics. 1998. *Report on the Cambodia Socioeconomic Survey 1997*. Phnom Penh.

20. An analysis of income patterns indicates a population predominantly reliant on subsistence activities, especially outside of Phnom Penh. CSES 1999 reports an annual per capita income of $250, which compares closely with 1999 per capita GDP of $257. Yet the rural annual per capita income, $197, is less than one third that of Phnom Penh, $691, and less than two thirds that of other urban areas, $310. Moreover, self-employment generates as much as 60.0 percent of per capita income, while income from other sources such as transfers is about 20.0 percent and wage employment contributes about 20.0 percent.

21. Nevertheless, wage employment is slowly becoming more important both as a source of employment and income. About 15.0 percent of those employed in 1999 were classified as paid employees as compared with about 10.0 percent in 1997. The average annual earnings of wage employees was $520 in 1999, about twice the per capita income. On average, wage employees in Phnom Penh (about 53.0 percent of Phnom Penh employed) earned $939, with top Government officials, professionals, and machinists as top earners. In contrast, wage employees in rural areas (11.0 percent of rural employed) earned $353 per annum, with Government officials, clerks, market workers, and soldiers among the lowest paid.

22. Comparison of data collected at the village level in CSES 1997 and CSES 1999 indicate that daily wages for unskilled labor are low and falling in real terms, that Phnom Penh wages are significantly higher than rural wages, and that gender differences in wages are relatively low (Table 5). The 1999 daily wages for unskilled labor range from $2.31 for men plowing in the Phnom Penh area (down from $2.62 in 1997) to $0.95 for women planting in rural areas (down from $1.02 in 1997).[8] Daily wages for unskilled men in 1999 were about 33.0 percent higher on average in Phnom Penh than in rural areas. Gender gaps in wages appear to be most pronounced in Phnom Penh for plowing and least pronounced in rural and other urban areas for planting.

Table 5: Selected Average Daily Wages for Unskilled Men and Women, 1997, 1999
($)[a]

	Plowing			Planting			Construction		
Item	**1997**	**1999**	**Ratio**	**1997**	**1999**	**Ratio**	**1997**	**1999**	**Ratio**
Phnom Penh									
Men	2.62	2.31	0.88	1.48	1.33	0.90	2.12	1.77	0.83
Women	1.46	1.31	0.90	1.38	1.70	0.87	1.73	1.47	0.85
Ratio	1.80	1.77		1.07	1.11		1.22	1.20	
Other Urban									
Men	2.28	2.12	0.93	1.24	1.04	0.84	1.71	1.48	0.87
Women	2.21	1.86	0.84	1.20	1.03	0.86	1.50	1.28	0.85
Ratio	1.03	1.14		1.04	1.01		1.14	1.15	
Rural									
Men	1.88	1.76	0.94	1.07	0.96	0.90	1.58	1.36	0.86
Women	1.39	1.61	1.16	1.02	0.95	0.93	1.39	1.21	0.87
Ratio	1.36	1.10		1.05	1.02		1.14	1.13	

[a] Data were converted to $ using the annual average of the end-of-month midpoint of the official exchange rate.

Source: National Institute of Statistics. 2000. 1998. *Report on the Cambodia Socioeconomic Survey, 1997, 1999.* Phnom Penh.

[8] Wages, as quoted in CSES 1997 and CSES 1999, in riel, rose in nominal terms by about 10.0–15.0 percent but fell in real terms as average prices increased by about 20 percent between 1997 and 1999.

4. Savings and Investment

23. To generate employment, Cambodia must achieve and maintain high rates of balanced growth; this requires sufficient levels of investment and savings. Cambodia's average level of investment of 14.6 percent of GDP during 1995-1999 is nearly the lowest in Southeast Asia, for which the average level of gross domestic investment over the five years is about 24.0 percent (Table 6). Similarly, Cambodia's five-year average gross national savings rate of 11.1 percent is the lowest in Southeast Asia, although about the same as those of the Lao PDR and Myanmar. Finally, Cambodia's average savings-investment gap of minus 3.5 percent of GDP is somewhat higher than the average of about minus 2.6 percent for Southeast Asian countries, implying a higher level of dependence on foreign savings.

Table 6: Average Growth Rate and Savings-Investment Gap, 1995-1999
Southeast Asia Developing Member Countries

Item	CAM	INO	LAO	MAL	MYA	PHI	THA	VIE
Real GDP Growth Rate	4.5	1.5	5.8	5.0	5.7	3.7	1.3	7.2
Gross National Savings[a]	11.1	24.3	12.4	39.4	11.9	19.5	35.0	19.8
Gross Domestic Investment [a]	14.3	25.0	25.9	35.7	12.6	21.7	33.8	25.7
Savings-Investment Gap [a]	(3.2)	(0.7)	(13.5)	3.7	(0.7)	(2.2)	1.2	(5.9)

( ) = negative value
[a] Given as a percent of GDP, current prices.
CAM = Cambodia, GDP = gross domestic product, INO = Indonesia, LAO = Lao PDR, MAL = Malaysia, MYA = Myanmar, PHI = Philippines, THA = Thailand, VIE = Viet Nam
Source: Asian Development Bank. 2000. *Asian Development Outlook 2000*. Manila: Oxford University Press.

24. Although low by regional standards, Cambodia's gross domestic investment rose from 11.7 percent of GDP in 1995 to 18.4 percent in 1999 (Table 7). Public investment fell from 5.9 percent in 1996 to 4.8 percent in 1997 as official assistance dropped with the political disruption, before recovering in 1998 and reaching 6.2 percent of GDP in 1999. Public savings, negative in three of the last five years, reached 1.8 percent of GDP in 1999. Official loan disbursements declined from a high of 2.4 percent of GDP in 1996 to 1.7 percent in 1999. Combining public savings and official loan disbursements leaves a public savings-investment gap that averages 3.7 percent of GDP over the five years.

25. Official transfers, averaging 8.4 percent of GDP over the five years, are more than sufficient to cover the public savings-investment gap. In fact, although official transfers are poorly and incompletely measured and not always channeled through the Government, if at least 50.0 percent of official transfers are devoted to capital spending, then public investment may be underestimated by as much as 0.5 percentage points of GDP on average.[9] However, official transfers fell from 11.3 percent of GDP in 1995 to 7.3 percent in 1999, increasing the importance of public savings and official loans as sources of public investment.

9 Official transfers are considered as income in the national accounts and so are reflected in gross national savings. However, because public savings are defined as domestic current fiscal revenues less current fiscal spending, official transfers are completely reflected in gross private national savings in Table 7.

26. Private domestic investment rose from 6.3 percent of GDP in 1998 to 12.2 percent in 1999. In part, this resulted from the reduction in inventories in 1998 of about 1.0 percent of GDP and a subsequent increase in stocks in 1999 of about 2.5 percent. In addition, political stability is stimulating locally-financed investment, which is increasing as a percentage of investment projects approved by the Government for favorable tax treatment. FDI, in contrast, dropped slightly as a percentage of GDP from 4.3 percent in 1998 to 4.0 percent in 1999. Although FDI is crudely estimated, based in part, on investment approval statistics, a substantial decline since 1996 is apparent. FDI, reached a high of KR776 billion in 1996, then fell to KR458 billion in 1999, and may decline in 2000.

Table 7: Saving and Investment

Item	1995	1996	1997	1998	1999
	KR billion				
Gross National Savings	658	759	1,182	1,126	1,625
Public	(59)	(103)	52	(32)	205
Private	717	862	1130	1158	1420
Domestic Investment	974	1,269	1,314	1,262	2,106
Public[a]	399	491	439	600	711
Private[b]	575	778	875	662	1,395
Savings-Investment Gap	(316)	(510)	(132)	(136)	(481)
Foreign Savings					
Foreign Direct Investment	373	776	502	453	458
Official Loan Disbursements	175	198	105	174	198
	percent of gross domestic product (current prices)				
Gross National Savings	8.7	9.1	12.9	10.7	14.2
Public	(0.8)	(1.2)	0.6	(0.3)	1.8
Private	9.5	10.4	12.4	11.0	12.4
Domestic Investment	12.9	15.2	14.4	12.0	18.4
Public[a]	5.3	5.9	4.8	5.7	6.2
Private[b]	7.6	9.3	9.6	6.3	12.2
Savings-Investment Gap	(4.2)	(6.1)	(1.4)	(1.3)	(4.2)
Foreign Savings					
Foreign Direct Investment	4.9	9.3	5.5	4.3	4.0
Official Loan Disbursements	2.3	2.4	1.1	1.7	1.7

( ) = negative value.
[a] Includes externally financed technical assistance for implementation of capital projects.
[b] Includes changes in stock.
Sources: National Institute of Statistics. 1998. 1999. *National Accounts of Cambodia.* Phnom Penh, International Monetary Fund, and staff estimates.

27. Statistics compiled by the Council for the Development of Cambodia for 836 approved projects from August 1994 through December 1999, indicate total commitments of $5.8 billion in fixed assets. Of this amount, 39.0 percent was in industry (led by wood processing, cement, and garments), 56.0 percent was in services (led by tourism and construction), and 5.0 percent was

in agriculture. The local share of these investment commitments was about 27.0 percent. Malaysia was the primary foreign source of committed funds, with about 32.0 percent, about 8.0 percent came from other members of the Association of Southeast Asian Nations (ASEAN)[10], 20.0 percent from the other Asia-Pacific countries, 8.0 percent from the Americas, and 6.0 from Europe. However, in 1999 alone, Cambodian investors committed $274 million of fixed assets in investment projects, up from $167 million in 1997 and $248 million in 1998. This accounted for about 58.0 percent of total investment projects approved in 1999.

28. Although local investment rose, overall investment commitments dropped to $470 million of fixed assets in 1999 from $855 million in 1998, with the biggest drops occurring in wood processing (down $175 million), tourism (down $100 million), and garments (down $50 million). Through the first nine months of 2000, investment commitments amounted to $213 million in fixed assets, predominantly in garment factories ($71.1 million) and tourism ($62.1 million). This compares with $235 million in fixed assets through the first nine months of 1999.

B. Fiscal Developments

29. The Government's fiscal strategy is to avoid inflationary bank financing of the fiscal deficit, while taking steps to enhance revenues and attract foreign financing for public investment. In the recovery year of 1999, the Government followed a conservative fiscal policy, reducing the fiscal deficit to 4.1 percent of GDP (1.5 percent, including grants) from 5.9 percent (2.7 percent, including grants) in 1998, and beginning to repay credit extended by the National Bank of Cambodia (NBC) in 1998. Although the 2000 budget incorporated an increase in the deficit to 6.1 percent of GDP (1.7 percent, including grants), a further reduction in net credit from NBC was planned because foreign financing was expected to increase from 4.5 percent of GDP in 1999 to 6.7 percent in 2000.[11]

30. Improved fiscal performance in 1999 was based on progress in revenue mobilization. In 1999, revenues increased by 40.0 percent from 8.9 percent of GDP in 1998 to 11.5 percent in 1999 (Table 8). The boost in revenue came predominantly from the new value-added tax (VAT)—KR181 billion—and exceptional revenues from the sale of US textile import quotas—KR87 billion. The 2000 budget envisioned a 12.0 percent increase in total revenues to KR1,475 billion but recent Government projections indicate an increase of about 7.6 percent to about KR1,416. Because of low inflation, this should still be greater than nominal GDP growth, so that revenues will likely increase as a percent of GDP.

31. Tax revenues were 11.0 percent above the budget target in 1999 because of unexpectedly strong VAT collections on imports. This trend continued in 2000. Tax revenues were about 72.0 percent of total revenues in 1999. The share of direct taxes was 6.3 percent of total revenues, while that of indirect and trade taxes were each about 33.0 percent (Appendix, Table A4). Compared with Viet Nam and Thailand, Cambodia relies relatively less on direct taxes (which are over 20.0 percent of revenues in Viet Nam and over 30.0 percent in Thailand), and more on trade taxes (which are about 25.0 percent in Viet Nam and about 12.0 percent in Thailand).

[10] Members are Brunei, Cambodia, Indonesia, Lao PDR, Malaysia, Myanmar, Philippines, Singapore, Thailand, and Viet Nam.

[11] Net banking sector claims on the Government increased by KR125 billion to KR179 billion in 1998, but then dropped to KR105 billion in 1999 and to KR6 billion through September 2000. The sharp reduction as of September 2000 reflects a buildup of deposited revenues. Net claims should rise in the last quarter of 2000 as Government spending increases.

Table 8: Government Budget Operations

Item	1996	1997	1998	1999	Budget 2000
	KR billion				
Total Revenue	749	881	942	1,316	1,475
Tax Revenue	534	597	679	948	1035
Nontax Revenue	176	271	230	354	420
Capital Revenue	39	12	33	14	20
Total Expenditure (cash basis)	1,346	1,269	1,565	1,787	2,242
Current Expenditure	813	817	935	1,059	1,285
Capital Expenditure	533	452	630	728	957
Current Balance (excluding grants)	(103)	52	(26)	243	170
Overall Fiscal Balance (excluding grants)	(591)	(388)	(623)	(471)	(767)
Financing	591	388	623	471	767
Foreign Financing (net)	573	447	506	515	843
Project Aid	423	351	504	511	693
Budget Support (grant)	150	96	2	4	150
Domestic Financing	18	(59)	117	(44)	(76)
Central Bank	(19)	(75)	120	(70)	(76)
Nonbank	37	16	(3)	26	0
	percent of gross domestic product (current prices)				
Total Revenue	9.0	9.6	8.9	11.5	11.8
Tax Revenue	6.4	6.5	6.4	8.3	8.3
Nontax Revenue	2.1	3.0	2.2	3.1	3.4
Capital Revenue	0.5	0.1	0.3	0.1	0.2
Total Expenditure (cash basis)	16.1	13.9	14.9	15.6	17.9
Current Expenditure	9.8	8.9	8.9	9.2	10.3
Capital Expenditure	6.4	4.9	6.0	6.3	7.7
Current Balance (excluding grants)	(1.2)	0.6	(0.2)	2.1	1.4
Overall Fiscal Balance (excluding grants)	(7.1)	(4.2)	(5.9)	(4.1)	(6.1)
Financing	8.3	4.2	5.9	4.1	6.1
Foreign Financing (net)	8.1	4.9	4.8	4.5	6.7
Project Aid	6.3	3.8	4.8	4.5	5.5
Budget Support (grant)	1.8	1.0	0.0	0.0	1.2
Domestic Financing	0.2	-0.6	1.1	(0.4)	(0.6)
Central Bank	(0.2)	(0.8)	1.1	(0.6)	(0.6)
Nonbank	0.4	0.2	0.0	0.2	0.0

( ) = negative value.
Note: The budget plan uses a gross domestic product projection for 2000 of KR12,489.
Sources: Ministry of Economy and Finance, International Monetary Fund.

32. In addition to increasing revenue mobilization, the Government is taking steps to improve revenue composition. Introduction of the VAT reduced dependence on trade taxes, which fell from about 40.0 percent of revenues in 1998 to about 33.0 percent in 1999. This progress will help Cambodia, as the newest member of ASEAN, to meet its commitment (in principle) to eliminate all import duties by 2015. However, trade taxes increased from 3.6 percent of GDP (KR376 billion) in 1998 to 3.8 percent in 1999 (KR433 billion), and about 87.0 percent of VAT revenues were imposed on imported goods. Thus, the dependence on taxes collected at the border is apparent and improvements in revenue composition would facilitate revenue mobilization while minimizing market distortions.

33. Nontax revenue collections increased by over 50.0 percent from 1998 to 1999, mainly because of the sale of US textile import quota rights. Nontax revenues are expected to fall well short of the targeted 18.3 percent increase in 2000. The main two areas in which expectations exceeded performance were forestry exploitation and post and telecommunications. For the former, market conditions appear to partially explain the shortfall, whereas for the latter, collection of arrears is inadequate. Post and telecommunications is the largest component of nontax revenues at about 36.0 percent of the 2000 budget target for nontax revenues.

34. In light of the expected revenue shortfall of KR54 billion (about $14 million) in 2000, total spending limits were not increased despite KR19 billion in emergency spending on flood relief. Total expenditures grew from 14.9 percent of GDP in 1998 to 15.6 percent in 1999, with expansion to 17.9 percent budgeted for 2000. Expenditures on defense and security, which fell from 4.3 percent of GDP in 1998 to 4.2 percent in 1999, were budgeted to fall to 3.6 percent in 2000. At the same time, spending on the priority areas of health, education, and rural development, increased from 1.4 percent of GDP in 1998 to 2.0 percent in 1999, and was budgeted to reach 2.5 percent in 2000. This represents significant progress in budget execution. For several years, budget allocations reducing defense and security spending and increasing social spending have been unrealized, as actual spending would exceed allocations for defense and security while falling short for social sectors.

35. Yet significant weaknesses remain in budget planning and execution. Although social sectors received their full budgets in 1999, most spending occurred in the last quarter. Through nine months, only 43.0 percent of the nonwage current expenditure budget was implemented. About 80.0 percent of 1999 budgeted current spending in the Ministry of Public Health, for example, occurred in the final quarter. Indeed, about 58.0 percent of 1999 spending by the Ministry occurred in November 1999 when the Government made a large purchase of drugs and medical supplies. The same pattern of low implementation of priority sector budgets occurred through the first nine months of 2000, but the Government explained that in many cases, open bidding processes initiated at the beginning of the year would be completed in the fourth quarter. Thus, the Government expects all priority sector budgets to be implemented fully in 2000.

36. A related issue is low budget allocations for recurrent expenditures in economic and social sectors. Revenues are relatively low and defense and security spending relatively high—although falling (35.0 percent of the 2000 current expenditure budget, down from 42.6 percent in 1999). In addition, the Government is committed to providing counterpart funds for aid-financed public investment projects. Thus, limited funds remain to devote to low civil service wages or operating costs (16.6 percent and 28.6 percent of 2000 current expenditure budget, respectively). A particularly difficult issue is inadequate funding for road maintenance, despite large planned investments by aid agencies, particularly the Asian Development Bank, for road rehabilitation.

C. Monetary Developments and Prices

37. Phnom Penh experienced offsetting inflationary and deflationary pressures, as measured by the consumer price index (CPI), through the first nine months of 2000 after average inflation decelerated in 1999 to 4.0 percent from 14.8 percent in 1998 (Table 9, Appendix Table A5).[12] Three sets of factors influenced this outcome including relative price movements, exchange rate behavior, and monetary developments.

1. Relative Price Movements

38. The decrease in food prices, rise in housing costs, and rise in world oil prices were significant relative price movements that affected the price level in Phnom Penh in 2000. World rice prices, which strongly influence rice prices in Phnom Penh, are currently low because of large world surpluses. Thus, despite flooding, local rice prices were 7.5 percent lower in September 2000 than in September 1999. Indeed, prices fell for most major categories in the food subgroup, which carries a 46.3 percent weight in the CPI, including cereals, meat and poultry, and fish.

Table 9: Average Annual Inflation Rate
(Consumer Price Index, percent)

Year/Month	All Items	Food, Beverage, and Tobacco (49.8 %)[a]	Clothing and Footwear (3.6%)	Housing and Utilities (24.0%)	House Furnishing and Household Operation (2.0%)	Medical Care (5.8%)	Transport and Communi-cation (8.9%)	Recreation and Education (3.3%)	Personal Care and Effects (2.6%)
1996	7.2	7.6	4.1	8.0	8.4	1.0	11.1	2.1	1.6
1997	8.0	6.7	0.5	8.7	1.6	9.5	19.5	2.3	1.7
1998	14.8	14.1	13.0	15.0	19.7	24.1	15.1	7.7	11.0
1999	4.0	7.6	1.7	0.3	13.0	(7.3)	3.5	(0.9)	0.4
2000									
January	0.4	(0.3)	(3.4)	3.1	4.4	(6.4)	4.5	(6.0)	(2.0)
February	(0.3)	(2.5)	(4.1)	3.1	5.6	(5.2)	7.8	(6.1)	(1.9)
March	0.2	(2.0)	(3.2)	3.1	7.6	(5.6)	10.3	(8.1)	(2.4)
April	(0.9)	(2.8)	0.3	2.6	7.0	(5.9)	3.8	(7.3)	0.4
May	(2.7)	(6.1)	0.6	3.1	6.4	(6.1)	2.3	(7.3)	(0.6)
June	(3.3)	(7.6)	(4.7)	2.7	6.2	(5.3)	4.8	(5.4)	1.7
July	(2.7)	(7.2)	(3.3)	2.1	(1.5)	(2.5)	6.9	(5.8)	2.1
August	(1.8)	(5.3)	(3.4)	1.9	(1.8)	(2.4)	8.7	(5.9)	3.0
September	0.2	(3.1)	(3.2)	3.0	(2.0)	2.8	10.8	(2.8)	2.5
Average[b]	(1.2)	(4.1)	(2.7)	2.7	3.5	(4.1)	6.7	(6.1)	0.3

( ) = negative value.
[a] Numbers in parentheses in the headings are weights for each group in the consumer price index
[b] Average inflation rate for January through September 2000.
Note: Annual inflation rates for each month are calculated as the percentage change in the consumer price index from the same month in the previous year. These rates are then averaged to obtain the average annual inflation rate.
Source: National Institute of Statistics, The consumer price index measures price changes in Phnom Penh only.

[12] Although the National Institute of Statistics has plans to extend its coverage, the consumer price index currently measures price movements only in Phnom Penh.

39. Housing costs, which carry a 19.5 percent CPI weight, rose because of strong demand in Phnom Penh. This is thought to be a result of political stability. The rise in world oil prices contributed to increasing costs for transport, although this effect was mitigated by the introduction of new port services in Sihanoukville, which significantly reduced the cost of fuel delivery. Initially, falling food prices together with falling prices in clothing and footwear, medical care, and recreation and education, dominated until September 2000, when food prices began to rise and fuel price increases began to accelerate.[13] Thus, in September, the price level was virtually the same as a year earlier, although food was relatively cheaper with transportation and housing relatively more expensive. These trends, particularly the effects of world prices and increased political stability, are likely to be similar in other areas of Cambodia, except in isolated communities, which may be more of a problem than usual in 2000 because of the prolonged flooding.

2. Exchange Rate Movements

40. Very low inflation through the first nine months of 2000 is related to very low depreciation. Heavy dollarization of the Cambodian economy means that many prices are quoted in dollars and must be converted to riel prior to CPI calculation. The riel depreciated against the dollar by 6.6 percent in 1996, 11.7 percent in 1997, 20.7 percent in 1998, 1.2 percent in 1999, and 1.0 percent in the first nine months of 2000 (Appendix, Table A6).[14] Thus, changes in the inflation rate track changes in the exchange rate. The exchange rate depreciated relatively rapidly in the second half of 1997 and in 1998 as a consequence of political instability and the regional financial crisis. However, in 1999 and 2000, with improvements in political and regional economic conditions, exchange rate depreciation slowed significantly. Moreover, to a certain extent, the depreciation against the dollar reflects regional trends. The riel depreciated by about 30.0 percent against the dollar from end-1996 through end-July 2000, but appreciated by about 7.0 percent against the Thai baht, and depreciated by only about 13.0 percent against the Singapore dollar during the same period.

3. Monetary Developments

41. In Cambodia, the link between price movements and monetary developments is relatively weak because of low levels of monetization (the extent to which money is used in economic activity, as measured, for example, by the ratio of liquidity or broad money to nominal GDP) and high levels of dollarization. The main monetary policy tool of NBC is to avoid financing fiscal deficits, which it has done since 1998. After three years of relatively modest growth, total liquidity is expanding more rapidly in 2000, having grown by over 24.0 percent through September 2000 (Table 10, Appendix, Table A7). This was the combined result of a recovery of currency in circulation from the contraction in 1999, and accelerated expansion of foreign currency deposits as confidence in the economy strengthened. However, falling velocity—the ratio of nominal GDP to average stock of broad money—limited the inflationary impact of increased money supply growth.

42. Foreign currency deposits continue to dominate total liquidity increasing from 61.0 percent of total liquidity in 1995 to 68.0 percent in August 2000. Riel deposits (demand, time, and savings) account for less than 4.0 percent of total liquidity, while currency in circulation

[13] There is some concern that, because of outdated CPI weights, inflation is being underestimated. In particular, the share of food is thought by some to be too large and the share of transport to be too small. The National Institute of Statistics plans to revise these weights by December 2000 or January 2001.

[14] These depreciation rates are calculated for the average annual midpoint of the official buying and selling rates. Using end-of-period exchange rates for each month, an average annual exchange rate is calculated for the year.

accounts for 27.7 percent. The liquidity to nominal GDP ratio was 12.5 percent in 1999 as compared with about 30.0 percent for Viet Nam and about 90.0 percent for Thailand, indicating a fairly low level of monetization of the economy. However, this measure of liquidity does not include the value of dollars in circulation, which is probably much larger than the value of riels in circulation.

Table 10: Monetary Survey

Item	1995	1996	1997	1998	1999	Sep 2000
	KR billion					
Net Foreign Assets	550	881	1,172	1,726	2,019	2,448
Net Domestic Assets	99	31	(109)	(494)	(577)	(656)
Domestic Credit	446	567	697	841	876	942
Net Claims on Government	148	128	54	179	103	6
State Enterprises	5	5	6	6	10	4
Private Sector	293	435	637	656	763	932
Other Items	(347)	(536)	(805)	(1,335)	(1,453)	(1,599)
Total Liquidity	649	912	1,063	1,230	1,443	1,792
Money Supply (M1)	278	329	385	543	532	540
Currency in Circulation	251	300	356	509	490	497
Demand Deposits	28	29	29	34	42	44
Quasi Money	371	583	678	687	911	1,252
Time and Savings Deposits	5	8	13	20	32	34
Foreign Currency Deposits	366	575	665	667	879	1,218
	annual percentage change					
Net Foreign Assets	40.7	60.1	33.0	47.3	17.0	21.3
Net Domestic Assets	67.6	(68.7)	(450.5)	(354.4)	(16.8)	(13.9)
Domestic Credit	15.6	27.1	22.8	20.7	4.2	7.5
Net Claims on Government	3.3	(13.7)	(57.8)	232.5	(42.5)	(93.8)
State Enterprises	(14.9)	2.3	13.5	1.2	66.7	(62.1)
Private Sector	23.8	48.1	46.5	3.0	16.3	22.1
Other Items	(6.2)	(54.5)	(50.1)	(65.8)	(8.8)	(10.0)
Total Liquidity	44.3	40.4	16.6	15.7	17.3	24.2
Money Supply (M1)	39.6	18.1	17.0	41.1	(2.0)	1.5
Currency in Circulation	42.3	19.5	18.8	43.0	(3.7)	1.3
Demand Deposits	18.5	5.5	(1.3)	18.5	23.5	3.9
Quasi Money	48.0	57.2	16.4	1.3	32.6	37.5
Time and Savings Deposits	(71.5)	55.0	68.2	51.4	60.0	7.1
Foreign Currency Deposits	57.2	57.3	15.7	0.3	31.8	38.5

( ) = negative value
Source: National Bank of Cambodia.

43. The rapid increase in foreign currency deposits in 1999 and 2000 reflects both strong export growth and improved confidence in macroeconomic management and political stability.

On the asset side, net foreign assets are increasing at a similar rate. Surprisingly, even as domestic credit edges up, net domestic assets continue to become more negative as capital and reserves of commercial banks continue to build rapidly. These are counted as negative assets since they are, in effect, liabilities to shareholders.

44. A healthy sign of economic recovery is the accelerated growth of credit to the private sector, which grew by 22.1 percent through September 2000, at the same time that net credit to the Government continued to fall after the buildup in 1998. Thus, the composition of domestic credit shifted between December 1998 and September 2000, with the share of net claims on the Government and state enterprises falling from 22.0 percent to 1.1 percent while the private sector share rose from 78.0 percent to 98.9 percent. As the Government disburses accumulated deposited revenues while implementing the last quarter of the 2000 budget, net claims on the Government are expected to rise. Yet, the trend to a reduced public sector presence in domestic credit markets is clear.

45. By sector, the largest share of the KR857 billion credit extended by commercial banks through June 2000 was for services and personal consumption (27.1 percent), followed by wholesale and retail trade (24.6 percent), and manufacturing (19.4 percent). All sectors experienced an increase in credit except agriculture, which accounted for only 3.5 percent of credit extended by commercial banks through June 2000.[15]

46. The expansion of deposits and credit is accompanied by increases in real interest rates. The interest rate on 12-month dollar deposits fell from 6.48 percent in January 1999 to 5.90 percent in July 2000. Over the same period, the annual inflation rate fell from plus 9.0 percent to minus 2.7 percent, indicating that the real interest rate shifted from being negative to substantially positive. The interest rate on 12-month dollar loans rose from 17.11 percent in January 1999 to 18.49 percent in July 2000. Thus the spread between deposit and lending rates rose from 10.63 percent to 12.59 percent, perhaps reflecting an increase in demand for credit. However, this spread was still below the 14.5 percent spread prevailing in August 1998, possibly because increased political stability has reduced perceived risk. Although credit and lending activities in riels are relatively small as compared with banking in dollars, real interest rates on riel deposits and loans have been rising as well.

D. External Trade and Balance of Payments

47. Gross official reserves rose to $422 million in 1999 despite a widening of the current account deficit, including official transfers, to 4.2 percent of GDP (Table 11). The reduction of short-term outflows increased the capital account surplus, more than offsetting the current account deficit. Thus, as in previous years, there was a balance of payments surplus. Yet rapid growth in imports reduced gross official reserves from 3.6 months of total imports of goods and services in 1998 to 3.3 in 1999. Net international reserves were $349 million in 1999 or 2.7 months of total imports of goods and services.[16] Gross official reserves are projected to rise again in 2000, perhaps as much as $80 million to about 4.0 months of total imports of goods and services.

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[15] These statistics are provided in National Bank of Cambodia. 2000. *Economic & Monetary Statistics Review*. June. Phnom Penh.

[16] Many of the balance of payments statistics cited in this section (and elsewhere in the report) are taken from International Monetary Fund. August 2000. Staff Report for the 2000 Article IV Consultation and First Review under the Poverty Reduction and Growth Facility. (On-line). Available: http://www.imf.org.

Table 11: Balance of Payments

Item	1996	1997	1998	1999
	$ million			
Trade Balance	(476)	(264)	(193)	(294)
Exports	617	786	855	933
of which: Domestic	295	534	610	695
Reexports[a]	322	252	245	238
Imports	(1,093)	(1,050)	(1,048)	(1,227)
of which: Retained[a]	(771)	(798)	(803)	(989)
Services (net)	(63)	(49)	(97)	(122)
Private transfers	46	60	60	70
Current Account Balance	(493)	(253)	(230)	(346)
Official Transfers	300	209	194	220
Current Account Balance Including Transfers	(193)	(44)	(36)	(126)
Official Loans (net)	68	35	39	45
Disbursements	75	35	46	52
Amortization	(7)	0	(7)	(7)
Foreign Direct Investment (net)	294	168	120	120
Short-Term Flows, Errors, and Omissions	(117)	(131)	(111)	(15)
Capital Account Balance	245	72	48	141
Overall Balance of Payments	52	24	12	24
Financing	(52)	(28)	(12)	(24)
Change in Gross Official Reserves	(52)	(28)	(11)	(32)
Other	0	0	(1)	8
	annual percentage change			
Domestic Exports	10.1	81.0	14.2	13.9
Retained Imports	28.3	3.5	0.6	23.2
Foreign Direct Investments	94.9	(42.9)	(28.6)	0.0
	percent of gross domestic product (current prices)			
Domestic Exports	9.4	17.5	21.9	23.1
Retained Imports	(24.5)	(26.1)	(28.8)	(32.9)
Current Account Balance	(15.6)	(8.3)	(8.2)	(11.5)
Memorandum Items:				
Gross Official Reserves ($ million)[b]	234	262	390	422
(months of goods and services imports)	2.1	2.4	3.6	3.3

( ) = negative value.
[a] Some imported goods are reexported to neighbors such as Viet Nam to exploit differences in duties.
[b] Includes $117 million returned to Cambodia by the Bank of International Settlements in 1998.
Sources: National Bank of Cambodia, International Monetary Fund, and staff estimates.

48. Economic recovery increased the current account deficit, excluding official transfers, by $116 million from 1998 to 1999. Retained imports of goods grew by over 23.0 percent in 1999, widening the trade balance to $294 million or 9.8 percent of GDP from $193 million or 6.9 percent of GDP in 1998.[17] The deficit on the service balance also expanded in 1999, despite an increase in tourism receipts. Although official transfers also increased to $220 million in 1999, the current deficit including transfers was $126 million or about 4.2 percent of GDP, increasing from about 1.3 percent of GDP in 1998.

49. Increased economic activity and rising world oil prices expanded the value of petroleum imports from $111 million or 13.8 percent of retained imports in 1998 to $153 million or 15.5 percent in 1999. Petroleum imports are projected to reach $194 million or over 16.0 percent in 2000. Although not yet of serious concern with rising international asset reserves and sustained growth in industry and services, petroleum products are the second largest import by value after intermediate garment sector imports.

50. Domestic exports (total exports less reexports) grew at a slower pace than imports but still at a strong 13.9 percent in 1999 as garment exports continued to surge, expanding by nearly 37.0 percent to $536 million. However, forestry exports contracted by 41.0 percent from $178 million in 1998 to $105 million in 1999 because of the crackdown on illegal log exports. Rubber exports, although recovering slightly in 1999 to $28 million, are still significantly below historical levels ($41 million in 1995) as a result of aging rubber trees and inefficient operations. Exports of fish products rose from $2.5 million to $3.4 million in 1999. However, unrecorded exports of rubber and fish products (as well as forestry products) might be significant.

51. Garment exports have been expanding rapidly, and are projected to reach $746 million in 2000, a 731 percent increase since 1996. At the same time, forestry exports have been declining, and are projected to fall to $80 million in 2000, about a 46.0 percent decline since 1996. Thus, as domestic exports increased from $295 million in 1996 to a projected $890 million in 2000, or by over 300 percent, garment exports grew from about 35.0 percent of exports in 1996 to a projected 84.0 percent in 2000. A significant portion of garment exports is for the US market although some are destined for European markets as well. Thus, the US is now the major export destination for Cambodian goods, followed distantly by Singapore. Primary sources of import goods are, in order of importance, Thailand; Hong Kong; China; Taipei,China; Singapore; and People's Republic of China.

52. The capital account surplus increased by $93 million from 1998 to 1999 because of a significant reduction in short-term outflows in 1999, accompanied by a slight rise in net official loans. The level of FDI did not change. FDI is expected to remain at about the same level in 2000, while net official loan disbursements will rise to about $86 million so that the capital account surplus rises to perhaps $200 million, assuming negligible short-term flows. Overall, FDI, falling by nearly 60.0 percent from a high of $294 million in 1996, has become less important as a source of financing.

53. Most bilateral assistance is currently through grants. Thus, low-interest debt from multilateral institutions is rising in importance as a percentage of Cambodia's external debt, from 14.4 percent in 1997 to 18.1 percent in 1999 (Table 12). Cambodia's two largest creditors in

[17] Retained imports are those not reexported to neighboring countries, primarily Viet Nam. Many goods (estimated at over $200 million in 1999) are imported into Cambodia and then transferred across the border to Viet Nam. This trade occurs because of lower duties in Cambodia on several consumer goods such as cigarettes.

1999 were the Russian Federation (63.8 percent) and the US (14.1 percent). In part because the exact amounts are in dispute, Cambodia is not servicing either set of debts and a significant portion of each is in arrears.[18] Both are eligible for rescheduling under the Paris Club's Naples terms.[19] This could reduce debt by roughly 50.0 percent to about 35.0 percent of GDP in 2000 from 69.0 percent in 1999. Debt would be expected to stay below 40.0 percent of GDP over the next several years. Debt service is currently relatively low at 1.8 percent of exports and 4.2 percent of Government revenues in 1999. Assuming debt rescheduling occurs in 2001, and with current obligations, debt service would rise to perhaps 4.3 percent of exports by 2004. Thus, debt can currently be considered manageable.

Table 12: External Debt and Debt Service

($ million)

Item	**1997**	**1998**	**1999**
Total External Debt Outstanding	1,985	2,039	2,083
Multilateral	286	331	376
World Bank	126	148	170
Asian Development Bank	95	119	140
International Monetary Fund	65	64	76
Bilateral	1,699	1,708	1,707
Russian Federation[a]	1,328	1,328	1,328
United States	306	300	294
Other	65	80	85
Debt Service	8.2	15.1	14.5
Amortization	0.4	6.6	6.5
Interest Payments	7.8	8.5	8.0
Memorandum Items:			
Debt Service (percent of domestic exports)	1.2	2.1	1.8
Debt Service (percent of Government revenue)	2.8	6.0	4.2
Domestic Exports of Goods and Services ($ million)	684	719	826
Total Government Revenue ($ million)	295	250	345
External Debt (percent of gross domestic product)	65	73	69
GDP (current price, $ million)	3,059	2,793	3,008

[a] Debt to the Russian Federation is converted at a rate of 0.6 rubles = $1.

Source: Ministry of Economy and Finance, International Monetary Fund.

[18] For further details, see International Monetary Fund. 1998. *Cambodia: Recent Economic Developments.* (On-line) Available: http://www. imf.org.

[19] The Paris Club is a group of creditor Governments, formed in 1956, that arranges debt-rescheduling agreements with countries that have excessive debt burdens. In 1994, the Paris Club agreed on a set of guidelines (called Naples terms) for concessional debt-rescheduling terms for low-income countries, which provides for a reduction of debt of about 67.0 percent in net present value terms. In addition, debt to the Russian Federation, which joined the Paris Club in 1997, is eligible for an additional up-front 70.0 percent discount.

II. SHORT- AND MEDIUM-TERM ECONOMIC PROSPECTS AND POLICY ISSUES

A. Growth and Investment

54. Achieving and sustaining a higher rate of economic growth is essential if Cambodia is to make significant progress in reducing pervasive poverty. The rapidly growing labor force must be absorbed in the context of rising labor productivity and real wages. The Government has set a long-term, real GDP growth target of 6.0 to 7.0 percent. If this target is achieved, implying real GDP per capita growth at or above 4.0 percent, then the incidence of poverty should begin to fall. If a greater portion of that growth comes from increased agricultural productivity and the expansion of service provision, particularly by small- and medium-size enterprises, then poverty reduction should proceed more rapidly.

55. The Government's development goal is to move the country out of the ranks of least developed countries by 2020. The United Nation's *Human Development Report 2000,* using 1998 statistics, ranks Cambodia near the bottom of the group of countries considered to have achieved medium human development (MHD).[20] Comparing Cambodia's performance with that of the average MHD country is instructive. The average MHD citizen can expect to live about 16.0 years longer than the average Cambodian's 53.5 years, to have nearly three times the Cambodian's per capita income of $1,257 measured at purchasing power parity, and to be literate, as are about 77.0 percent of the citizens of MHD countries, compared with 37.0 percent of Cambodians.[21]

56. The typical MHD country's 1998 GDP is distributed by value added as about 15.0 percent in agriculture (Cambodia, 43.0 percent), 35.0 percent in industry (Cambodia, 20.0 percent), and 50.0 percent in services (Cambodia, 37.0 percent). To achieve this structural transformation, Cambodia will need to boost its gross domestic investment rate from about 15.0 percent of GDP closer to the MHD average of 25.0 percent, and its gross national savings rate from about 11.0 percent to the MHD average of about 25.0 percent. Boosting investment rates, currently low and overly dependent on foreign savings, is critical to achieving the Government's goal of sustained real economic growth of 7.0 percent per annum.

57. In the short term, Cambodia can expect to achieve about 4.5 percent growth of real GDP in 2000, despite a flood-related contraction in agriculture (Table 13). This projection is based on rapid export growth, primarily in the garment sector, and the continued expansion of the tourist industry. These two factors should combine with an agricultural recovery in 2001 to return growth to the 5.0 percent range. Unfavorable factors that might limit growth in the short run are a slowing US economy, which could curb the growth of tourism and garment exports, and a continuation of high world oil prices. A decline in investment activity in 2000, in part because of the inhibiting effects of the flood on economic activity, should be followed by a modest rebound in investment in 2001 as private investors continue to be attracted to the garment and tourism sectors, while foreign aid agencies boost investment to accommodate emergency relief.

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[20] This is defined as scoring between 0.5 and 0.799 on the human development index. This is a composite index (computed annually with 0.0 being the lowest score and 1.0 the highest possible score) that measures progress in achieving long life, literacy, education, and income. Cambodia's score is 0.512. United Nations Development Programme. 2000. *Human Development Report 2000: Human Rights and Human Development.* (On-line). Available: http://www.undp.org.

[21] A new study implies that only about 37.0 percent of the population are literate as compared with the previous estimate of 65.0 percent used in the Human Development Report. See Ministry of Education, Youth, and Sports. 2000. *Report on the Assessment of the Functional Literacy Level of the Adult Population in Cambodia*. Phnom Penh.

58. In the long term, agricultural productivity must rise above subsistence levels and the proportion of the population engaged primarily in agriculture must fall. The most important medium-term constraints to reaching that goal appear to be (i) the inability to mitigate the damage caused by flooding and drought, (ii) inadequate natural resource management (particularly forest and fisheries), and (iii) insecure land rights.

Table 13: Key Economic Indicators: Short-Term Projections

Item	1999	2000	2001
Output Growth			
GDP Growth (constant 1993 prices, percent)	5.0	4.5	5.0
Agriculture	1.5	(1.0)	3.7
Industry	11.4	16.0	11.0
Services	5.8	4.0	3.0
Savings and Investment (current prices)			
Gross National Savings (percent of GDP)	14.2	11.3	13.0
Gross Domestic Investment (percent of GDP)	18.4	14.9	17.0
Money and Inflation (annual percent change)			
Money Supply (M2)	17.3	27.5	20.0
Consumer Prices (final quarter basis)	0.0	1.5	5.0
Government Finance (percent of GDP)			
Revenue	11.5	11.8	12.0
Expenditure	15.5	18.7	18.0
Overall Fiscal Deficit (excluding grants)	(4.0)	(6.9)	(6.0)
Balance of Payments			
Trade Balance (percent of GDP)	(9.8)	(9.5)	(10.0)
Current Account Deficit (percent of GDP)[a]	(11.5)	(11.4)	(12.2)
Domestic Exports (growth rate, percent)[b]	13.9	28.0	15.0
Retained Imports (growth rate, percent)[b]	23.2	19.7	14.5
External Payments Indicators			
Gross Official Reserves ($ million)	422	502	550
(months of imports of goods & services)	3.3	3.9	4.3
External Debt Service[c]	1.8	1.8	2.0
External Debt (percent of GDP)	69	70	65
Memorandum Items:			
GDP (current prices, KR billion)	11,471	11,987	13,126
GDP (current prices, $ million)	3,008	3,108	3,366
Official Exchange Rate (KR per $, midpoint average)	3,814	3,857	3,900

( ) = negative value.
GDP = gross domestic product.
[a] Excluding official transfers.
[b] Some imports are reexported to neighboring countries, e.g., Viet Nam.
[c] As percent of domestic exports of goods and services.
Sources: National Institute of Statistics, Ministry of Economy and Finance, National Bank of Cambodia, International Monetary Fund, and staff estimates.

59. First, the annual uncertainty about weather conditions imposes huge risks on agricultural activities, reducing returns to private investment, particularly in annual crop production. Second,

mismanagement of the nation's forest and fisheries resources in the medium-term could seriously reduce long-term potential in these two sectors, which have a combined contribution to value added of about 15.0 percent of GDP. Moreover, these activities act as supplemental sources of income as well as sources of fuel and protein for the rural population. Finally, lack of clear land title erodes incentives for farmers to invest in land improvements as well as limits their ability to borrow for investment purposes. Thus, in the medium term, without sustained efforts to relieve these constraints, significant improvements in agricultural productivity are unlikely to be obtained.

60. In industry, past performance has been overly reliant on expansion of the garment sector in conjunction with preferential access to US markets. In the short term, this expansion is likely to continue. However, world trade in textiles is to be liberalized by 2005, so the long-term prospects for the Cambodian textile industry are less certain. Moreover, as countries such as the People's Republic of China and Viet Nam move to regularize trade relations with the US and join the World Trade Organization, Cambodia's medium-term advantages are likely to be eroded. Thus, diversification into other industries based on an overall strategy of liberalizing trade to achieve export-led growth would seem to be important. The most immediate policy implications for Cambodia are to maintain macroeconomic stability while working to improve legal and regulatory conditions, and enhance physical, human, and financial infrastructure.

61. In services, performance should improve over the medium term, as the tourism industry continues to expand. If agricultural and industrial growth can be sustained, domestic demand for services should continue to improve. The service sector, currently accounting for 37.0 percent of GDP and 17.0 percent of employment, has tremendous potential for growth in value added and employment, particularly when compared with the experience of average growth rates of this sector in other countries, such as the 6.0 percent average growth rate achieved by Viet Nam during 1995-1999. The most immediate constraint to service sector expansion is probably the lack of financial services for the expansion of small- and medium-sized enterprises.

B. Macroeconomic Management

1. Public Finance

62. To achieve long-term growth of 7.0 percent per annum, Cambodia must increase public investment from current levels of about 5.5 percent of GDP, and improve its efficiency. Revenue enhancement from the current level of about 12.0 percent in 2000 is vital. This is a major goal of the current reform effort being assisted under the 1999 International Monetary Fund Poverty Reduction and Growth Facility. Planned reforms during 2001 and 2002 include (i) broadening of the revenue base by extending VAT coverage; and (ii) strengthening revenue administration, particularly in customs, non-tax revenues, and arrears collection. In the context of continued reform of the forestry concession system, the Government is reviewing the royalty system to ensure its fairness and consistency with sustainable forestry management.

63. With planned reforms, revenues are projected to approach 14.0 percent of GDP over the next few years as compared with the average of about 18.0 percent for MHD countries. Thus, Cambodia will need to attract large amounts of official development assistance (ODA) to significantly boost public investment in the medium term. Cambodia already receives large amounts of ODA—averaging about 10.0 percent of GDP over the last five years and over $20 per capita—in comparison with MHD countries for which the average level of ODA is 3.4 percent of GDP and just over $6 per capita. A large portion of ODA to Cambodia, over 80.0

percent in 1999, is through official transfers. The Government does not manage some of these transfers, and a portion is devoted to current expenditures rather than investment.

64. External debt service is relatively minor, currently under 2.0 percent of exports of goods and services, and likely to remain under 5.0 percent after rescheduling of debt to the US and the Russian Federation, as compared with an average of about 19.0 percent for MHD countries. This implies that judicious expansion of the use of official loans, on concessional terms, to expand public investment is possible provided that (i) efforts to enhance revenue mobilization continue, and (ii) the Government's ability to efficiently absorb and manage additional loan-financed projects improves.

65. Public expenditure management is still very weak. With a development goal of reducing poverty, the Government is working to redirect funds away from defense and security to socioeconomic development. A demobilization program, to reduce the size of the military by over 30,000 soldiers by the end of 2002, is currently under way. In a pilot project, the Government demobilized 1,500 soldiers in May 2000. Lessons learned from that exercise will be used to improve the efficiency of full-scale demobilization once external funding for the $45 million program is secured.

66. In addition to increasing the proportion of expenditures devoted to socioeconomic development, Government is working to improve budget planning, execution, and transparency. Among planned reforms for 2001-2002 is the development and use of a medium-term expenditure framework to improve the linkage of recurrent expenditures to the Public Investment Program. Priority action plans are being implemented to improve budget execution in health, education, and rural development, which has traditionally been difficult, in part because of the decentralized nature of spending in these areas. These budget reforms will eventually be introduced in all sectors. Finally, the Government is moving to increase the transparency of public finance through the establishment of an independent national auditor general.

67. Public investment is dominated by aid financing. Many aid activities are carried out by aid agencies independently of the Government, and the Government has very little control over these flows. To identify priority areas for public investment, the Government is preparing a five-year plan, covering 2001-2005, to guide socioeconomic development and poverty reduction. This plan will attempt to balance the needs for continued infrastructure investments with those for increased social service provision.

2. Money and Banking

68. NBC's primary goals are to maintain macroeconomic stability, reduce reliance on the dollar as a medium of exchange, and facilitate expanded domestic saving and investment through improved banking supervision. To contain inflation and maintain exchange rate stability, NBC has a managed but flexible exchange rate policy. The spread or premium between the official exchange rate and the unofficial parallel market exchange rate is kept to 1.0 percent by adjusting the official exchange rate each morning according to the movements in the previous day's closing parallel market rate. Moreover, to accumulate and conserve official reserves, NBC intervenes in the exchange rate market only to avoid rapid appreciation by buying excess dollars when conditions warrant this intervention. Although the Government has been able to keep inflation low and exchange rate depreciation relatively modest over the last two years, dedollarization (the gradual elimination of the dollar as a medium of exchange) remains a long-term goal.

69. Foreign currency deposits continue to dominate broad money supply. While dollarization inhibits the use of monetary policy to stabilize the economy, it does not prevent the expansion of banking services, a critical need in a country that suffers from such a low level of monetization. Banking reform is a major effort under the Poverty Reduction and Growth Facility program. In late 2000, NBC was in the process of reviewing the relicensing applications of all banks as required under the 1999 Financial Institutions Law and classifying them as (i) viable and eligible for immediate relicensing, (ii) potentially viable but requiring a restructuring plan, and (iii) nonviable requiring liquidation. The classification process should be completed by end-2000. Once the relicensing process is complete, banks should significantly improve their performance. In 2000, total commercial bank loans are projected at only about 7.0 percent of GDP, although credit extension to the private sector appears to be growing.

3. External Sector

70. Key Government policy objectives in the external sector are (i) to liberalize trade in conjunction with requirements under current ASEAN membership (particularly the ASEAN Free Trade Agreement) and proposed World Trade Organization membership; (ii) to negotiate rescheduling agreements on bilateral debt with the Russian Federation and the US; and (iii) to increase the level, broaden the base, and enhance the quality of FDI projects. By 2002, the Government plans to reduce the maximum tariff rate from 120.0 percent to 30.0 percent, reduce the number of tariff bands from 12 to 4, and reduce the unweighted average tariff from about 17.0 to about 13.0 percent. Cambodia’s average common effective preferential trading tariff on goods included under the ASEAN Free Trade Agreement will fall from 10.4 percent in 2000 to 8.93 percent in 2002. The Government is working to gain approval of membership in the World Trade Organization in 2001. Debt rescheduling negotiations are ongoing and may be completed in 2001.

71. Attracting sufficient levels of FDI is critical to achieving the high rates of growth and employment generation needed to significantly reduce absolute poverty from the current level of over 35.0 percent. Cambodia’s investment regime is open and liberal, with no significant legal barriers to FDI except in certain areas such as printing, radio, and television, and the prohibition against owning land. However, corruption, inadequate physical and financial infrastructure, low labor productivity, and weak legal institutions tend to offset investment incentives such as tax exemptions for up to eight years and import duty exemptions on investment goods and materials. Nevertheless, where significant opportunities exist, such as in tourism and garments, Cambodia is able to attract foreign investors. The ability to continue attracting foreign and domestic private investment in a sustained way is ultimately a matter of expectations about future opportunities. With real reform progress and macroeconomic stability, investors should be able to find and exploit sufficient opportunities in Cambodia to sustain high levels of growth.

C. Risks and Uncertainties

72. Four types of risks could jeopardize economic performance over the short, medium, or long term. The first is political risk. In the short term, renewed political disturbances could rapidly decelerate economic performance. However, this risk is much lower than a year ago, with political conditions continuing to stabilize over the two years since the political settlement that resolved the election-year crisis. Political events that might have some impact on political stability are the proposed international tribunal to determine whether former Khmer Rouge leaders committed human rights violations and the upcoming 2001 commune elections.

73. The second type of risk is economic risk. A stalled reform program could impact economic development. However, the Government has made good progress on reforms, particularly in the areas of macroeconomic management: public finance, money and banking, and the external sector. Reform programs are continuing, albeit slowly, on the difficult issues of forestry reform and demobilization. By early 2001, the Government plans to complete formulation of a strategy for comprehensive civil service reform. Overall, the Government appears to be firmly committed to undertaking economic reforms vital to ensuring rapid economic development. Additional economic risks include an extended period of high world oil prices, and the possibility that the world economy may be slowing. In addition, the inability of Cambodia to attract additional investment in the short-term could slow economic growth.

74. The third type of risk is environmental. If, perhaps because of upstream deforestation, the frequency of severe seasonal floods increases, the impact on the agriculture sector and the vulnerable portions of the rural economy, including transportation, could be quite serious. Furthermore, the risk of irreparable environmental degradation, particularly for forestry and fisheries, is significant despite the Government's efforts to improve management of these natural resources. Although significant progress in halting illegal logging has been made in 1999 and 2000, reform of the equally mismanaged fisheries concessions has barely begun.

75. The final type of risk is demographic. The rate of population growth, at 2.5 percent is well above the average for MHD countries of 1.1 percent per annum. Indications that the birth rate is falling, presented in CSES 1999, are inconclusive and could reflect underreporting of newborns. If the growth rate is not brought down, efforts to translate rapid economic growth into significant poverty reduction could be hampered. A potentially devastating health risk is the rapid spread of HIV/AIDS.[22] Cambodia's HIV/AIDS epidemic is the worst in Asia, with an estimated 3.7 percent of the adult population HIV infected. This could eventually debilitate the population and significantly reduce the pace of economic development.

[22] human immunodeficiency virus/acquired immunodeficiency syndrome.

APPENDIX

Tables **Pages**

Table A1: Key Economic Indicators

Item	1995	1996	1997	1998	1999
Output Growth					
GDP Growth (constant 1993 prices, percent)	6.7	5.5	3.7	1.8	5.0
Agriculture	7.5	2.2	5.8	2.5	1.5
Industry	20.2	11.7	20.4	8.6	11.4
Services	(0.2)	4.8	(3.7)	(1.3)	5.8
Savings and Investment (current prices)					
Gross National Savings (percent of GDP)	8.7	9.1	12.9	10.7	14.2
Gross Domestic Investment (percent of GDP)	12.9	15.2	14.4	12.0	18.4
Money and Inflation (annual percent change)					
Money Supply (M2)	44.3	40.4	16.6	15.7	17.3
Consumer Prices (final quarter basis)	—	9.0	9.1	12.6	(0.0)
Government Finance (percent of GDP)					
Revenue	8.5	9.0	9.6	8.9	11.5
Expenditure	16.5	16.1	13.9	14.9	15.6
Overall Fiscal Balance (excluding grants)	(7.5)	(7.1)	(4.2)	(5.9)	(4.1)
Overall Fiscal Balance (including grants)	—	(0.3)	(0.5)	(2.7)	(1.5)
Balance of Payments					
Trade Balance (percent of GDP)	—	(15.1)	(8.6)	(6.9)	(9.8)
Current Account Balance (percent of GDP)[a]	—	(15.6)	(8.3)	(8.2)	(11.5)
Domestic Exports (growth rate, percent)[b]	—	10.1	81.0	14.2	13.9
Retained Imports (growth rate, percent)[b]	—	28.3	3.5	0.6	23.2
External Payments Indicators					
Gross Official Reserves ($ million)	182	234	262	390	422
(months of imports of goods and services)	1.6	2.1	2.4	3.6	3.3
External Debt Service[c]	—	—	1.2	2.1	1.8
External Debt (percent of GDP)	—	—	65	73	69
Memorandum Items					
GDP (current prices, KR billion)	7,543	8,325	9,149	10,531	11,471
Official Exchange Rate (KR per $, midpoint average)	2,467	2,640	2,991	3,770	3,814
GDP (current prices, $ million)	3,058	3,153	3,059	2,793	3,008
Per capita GDP (current prices, $)	288	290	274	244	257
Per capita GDP (constant prices, $)[d]	223	230	232	231	236
Population (million)	10.6	10.9	11.2	11.4	11.7

( ) = negative value.

GDP = gross domestic product, — = not available

[a] Excluding official transfers.

[b] Some imports are reexported to neighboring countries, e.g., Viet Nam.

[c] As percent of domestic exports of goods and services, convertible currencies only.

[d] GDP in constant 1993 prices is converted to dollars using the 1993 official exchange rate and then divided by the population estimate to obtain real GDP per capita. It is not directly comparable to real GDP per capita in other countries.

Sources: National Institute of Statistics, Ministry of Economy and Finance, National Bank of Cambodia, International Monetary Fund.

Table A2: Gross Domestic Product by Economic Activity
constant (1993 prices)

Economic Activity	1995	1996	1997	1998	1999
	KR billion				
Agriculture	2.812	2,874	3,039	3,115	3,162
Crops	1,301	1,358	1,321	1,329	1,450
Livestock and Poultry	542	555	561	593	564
Fisheries	582	630	679	716	830
Forestry and Logging	388	331	478	477	319
Industry	947	1,058	1,274	1,383	1,541
Mining	12	12	12	12	13
Manufacturing	569	675	912	1,061	1,158
Electricity, Gas, and Water	35	36	36	38	39
Construction	331	335	314	272	331
Services	2,695	2,825	2,721	2,685	2,840
Trade	919	917	895	848	862
Hotel and Restaurants	287	305	295	283	334
Transport and Communications	405	440	377	367	415
Finance	69	74	76	69	70
Pubic Administration	215	252	261	259	269
Real Estate and Business	493	497	511	531	548
Other Services	309	340	307	329	342
Product Taxes less Subsidies and Imputed Bank Charges	289	359	344	329	341
Gross Domestic Product	6,744	7,115	7,378	7,512	7,885
	percent of gross domestic product				
Agriculture	41.7	40.4	41.2	41.5	40.1
Crops	19.3	19.1	17.9	17.7	18.4
Livestock and Poultry	8	7.8	7.6	7.9	7.2
Fisheries	8.6	8.9	9.2	9.5	10.5
Forestry and Logging	5.8	4.7	6.5	6.4	4.0
Industry	14.0	14.9	17.3	18.4	19.6
Mining	0.2	0.2	0.2	0.2	0.2
Manufacturing	8.4	9.5	12.4	14.1	14.7
Electricity, Gas, and Water	0.5	0.5	0.5	0.5	0.5
Construction	4.9	4.7	4.3	3.6	4.2
Services	40.0	39.7	36.9	35.7	36.0
Trade	13.6	12.9	12.1	11.3	10.9
Hotel and Restaurants	4.3	4.3	4.0	3.8	4.2
Transport and Communications	6	6.2	5.1	4.9	5.3
Finance	1.0	1.0	1.0	0.9	0.9
Pubic Administration	3.2	3.5	3.5	3.5	3.4
Real Estate and Business	7.3	7.0	6.9	7.1	7.0
Other Services	4.6	4.8	4.2	4.4	4.3
Product Taxes less Subsidies and Imputed Bank Charges	4.3	5.0	4.7	4.4	4.3
Gross Domestic Product	100.0	100.0	100.0	100.0	100.0

Source: National Accounts of Cambodia, Ministry of Planning, National Institute of Statistics.

Table A3: Expenditure on Gross Domestic Product
(current prices)

Expenditure Item	1995	1996	1997	1998	1999
	KR billion				
Final Consumption Expenditure	7,213	7,883	8,594	9,967	10,636
Household Consumption	6,800	7,354	8,041	9,377	9,916
Government Consumption	413	529	553	590	720
Domestic Investment	974	1,269	1,314	1,262	2,106
Public[a]	399	491	439	600	711
Private[b]	575	778	875	662	1,395
Net Exports of Goods and Services	(1,182)	(1,460)	(1,019)	(1,079)	(1,368)
Statistical Discrepancy	538	633	260	380	96
Gross Domestic Expenditure	8	8,325	9,149	10,530	11,470
	percent of gross domestic product				
Final Consumption Expenditure	95.6	94.7	93.9	94.6	92.7
Household Final Consumption	90.1	88.3	87.9	89.0	86.5
Government Consumption	5.5	6.4	6.0	5.6	6.3
Domestic Investment	12.9	15.2	14.4	12.0	18.4
Public[a]	5.3	5.9	4.8	5.7	6.2
Private[b]	7.6	9.3	9.6	6.3	12.2
Net Exports of Goods and Services	(15.7)	(17.5)	(11.1)	(10.2)	(11.9)
Statistical Discrepancy	7.1	7.6	2.8	3.6	0.8
Gross Domestic Expenditure	100.0	100.0	100.0	100.0	100.0

( ) = negative value.

a Includes externally financed technical assistance for implementation of captial projects.

b Includes changes in stock.

Sources: Ministry of Planning, National Accounts, International Monetary Fund, staff estimates.

Table A4: Composition of Government Revenues and Current Expenditures

Item	1995	1996	1997	1998	1999
	KR billion				
Revenues	643	749	881	943	1316
Tax Revenues	445	543	597	679	948
Direct Taxes	21	27	44	56	83
Indirect Taxes	104	164	206	248	432
of which: Turnover Tax	77	98	122	156	22
Excise Tax	9	57	74	76	92
Value-Added Tax	—	—	—	—	315
Trade Taxes	321	344	347	376	433
of which: Import Duties	301	335	336	372	397
Nontax Revenue	190	176	271	230	355
Current Expenditures	737	813	817	935	1059
General Administration	108	121	136	194	208
Defense and Security	431	430	420	458	444
Social Administration	149	180	190	204	297
of which: Education	74	81	83	102	147
Health	26	43	45	44	75
Economic Administration	48	69	61	63	91
of which: Public Works	8	7	7	6	9
Agriculture	13	16	15	15	21
Rural Development	2	2	2	2	3
Interest	2	13	10	15	22
	percent of total revenue				
Tax Revenues	69.3	72.5	67.8	72.0	72.0
Direct Taxes	3.3	3.5	4.9	5.9	6.3
Indirect Taxes	16.1	21.8	23.4	26.3	32.8
of which: Turnover Tax	12.0	13.1	13.8	16.6	1.7
Excise Tax	1.4	7.6	8.4	8.1	7.0
Value-Added Tax	—	—	—	—	23.9
Trade Taxes	49.9	45.9	39.4	39.9	32.9
of which: Import Duties	46.8	44.7	38.1	39.5	30.2
Nontax Revenue	29.5	23.4	30.8	24.4	27.0
	percent of current expenditure				
General Administration	14.7	14.9	16.6	20.7	19.6
Defense and Security	58.5	52.9	51.4	49.0	41.9
Social Administration	20.2	22.1	23.3	21.8	28.0
of which: Education	10.0	10.0	10.2	10.9	13.9
Health	3.5	5.3	5.5	4.7	7.1
Economic Administration	6.5	8.5	7.5	6.7	8.6
of which: Public Works	1.1	0.9	0.9	0.6	0.8
Agriculture	1.8	2.0	1.8	1.6	2.0
Rural Development	0.3	0.2	0.2	0.2	0.3
Interest	0.3	1.6	1.2	1.6	2.1

— = not available.

Source: Ministry of Economy and Finance.

Table A5: Consumer Price Index and Inflation Rate

Month	1995	1996	1997	1998	1999	2000
Consumer Price Index[a]						
January	101.9	105.1	111.9	128.9	140.5	141.0
February	101.8	107.3	112.3	129.9	141.1	140.6
March	100.3	105.7	111.7	130.3	140.7	140.9
April	98.8	107.3	114.1	131.2	141.5	140.2
May	99.0	107.8	114.9	134.7	143.3	139.5
June	101.1	107.7	115.6	137.5	144.2	139.4
July	104.2	112.1	123.5	141.8	144.4	140.4
August	105.3	112.7	122.4	139.5	143.6	141.1
September	107.0	113.3	126.6	143.0	144.0	144.3
October	108.5	117.5	127.9	143.7	143.7	
November	107.4	116.7	127.5	143.1	143.8	
December	105.3	115.9	126.6	143.4	142.6	
Average	103.4	110.8	119.6	137.3	142.8	140.8
Final Quarter	107.1	116.7	127.3	143.4	143.4	
Annual Inflation Rate						
January		3.1	6.5	15.2	9.0	0.4
February		5.4	4.7	15.7	8.6	(0.3)
March		5.4	5.7	16.7	8.0	0.2
April		8.6	6.3	15.0	7.9	(0.9)
May		8.9	6.6	17.2	6.4	(2.7)
June		6.5	7.3	18.9	4.9	(3.3)
July		7.6	10.2	14.8	1.8	(2.7)
August		7.0	8.6	14.0	2.9	(1.7)
September		5.9	11.7	13.0	0.7	0.2
October		8.3	8.9	12.4	(0.0)	
November		8.7	9.3	12.2	0.5	
December		10.1	9.2	13.3	(0.5)	
Average		7.2	7.9	14.8	4.0	(1.4)
Final Quarter		9.0	9.1	12.6	(0.0)	

( ) = negative value.
[a] Index, July-September 1994 = 100
Source: National Institute of Statistics.

Table A6: Exchange Rates

(Official, KR/$, Midpoint of End-of-Period Buying and Selling Rates)

Year/Month	End-of-Year/Month		Annual Average	
	Level	% Change[a]	Level	% Change[a]
1993	2,429		2,846	
1994	2,588	(6.1)	2,569	10.8
1995	2,539	1.9	2,467	4.1
1996	2,720	(6.7)	2,640	(6.6)
1997	3,460	(21.4)	2,991	(11.7)
1998	3,780	(8.5)	3,770	(20.7)
1999	3,775	0.1	3,814	(1.2)
2000				
January	3,800	(0.7)		
February	3,825	(0.7)		
March	3,820	0.1		
April	3,830	(0.3)		
May	3,860	(0.8)		
June	3,865	(0.1)		
July	3,880	(0.4)		
August	3,900	(0.5)		
September	3,880	0.5		
Average over January - September			3,851.1	(1.0)

( ) = negative value.

[a] This measures the percent appreciation of the riel against the dollar. Negative changes represent depreciation.

Source: National Bank of Cambodia.

Table A7: Factors Affecting Domestic Liquidity

Item	1995	1996	1997	1998	1999	September 2000
Changes in Total Liquidity (KR billion)						
Net Foreign Assets	159	331	291	554	293	429
Foreign Assets	266	333	366	607	304	419
Foreign Liabilities	107	2	75	53	11	(10)
Net Domestic Assets	40	(68)	(140)	(387)	(81)	(80)
Domestic Credit	60	121	129	142	37	66
Net Claims on Government	5	(20)	(74)	125	(76)	(97)
State Enterprises	(1)	0	1	(0)	4	(6)
Private Sector	56	141	202	18	109	169
Other Items	(20)	(189)	(269)	(529)	(118)	(146)
Total Liquidity	199	263	151	167	213	349
Currency in Circulation	75	49	56	153	(19)	7
Demand Deposits	4	2	(0)	6	8	2
Time and Saving Deposits	(13)	3	5	7	12	2
Foreign Currency Deposits	133	209	90	2	212	339
Changes as Percent of Previous Year Total Liquidity						
Net Foreign Assets	35.4	50.9	31.9	52.1	23.8	29.8
Foreign Assets	59.1	51.3	40.2	57.1	24.7	29.0
Foreign Liabilities	23.7	0.4	8.3	5.0	0.9	(0.7)
Net Domestic Assets	8.9	(10.5)	(15.3)	(36.4)	(6.6)	(5.6)
Domestic Credit	13.4	18.6	14.2	13.4	3.0	4.6
Net Claims on Government	1.1	(3.1)	(8.1)	11.7	(6.1)	(6.7)
State Enterprises	(0.2)	0.0	0.1	(0.0)	0.3	(0.4)
Private Sector	12.5	21.7	22.2	1.7	8.8	11.7
Other Items	(4.5)	(29.1)	(29.5)	(49.8)	(9.6)	(10.1)
Total Liquidity	44.3	40.4	16.6	15.7	17.3	24.2
Currency in Circulation	16.6	7.5	6.2	14.4	(1.6)	0.5
Demand Deposits	1.0	0.2	(0.0)	0.5	0.6	0.1
Time and Saving Deposits	(2.8)	0.4	0.6	0.6	1.0	0.2
Foreign Currency Deposits	29.6	32.2	9.9	0.2	17.2	23.5

( ) = negative value.

Source: National Bank of Cambodia.