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MINISTRY OF ECONOMY AND FINANCE

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Cambodia: Recent Economic and Social Developments

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It is a great pleasure for me to address this distinguished gathering. In my presentation today I would like to share with you some thoughts on the recent economic and social developments of Cambodia. I will focus on Cambodia's recent macroeconomic performance, progress in poverty reduction and in improving key social indicators particularly in health and education sectors. I will also discuss the major development challenges facing Cambodia and some key policies for sustaining economic growth.

I. Recent economic performance

Let me start by briefly reviewing recent economic developments.

Cambodia has traversed a long way since normalization of the political situation in 1993. From below ground zero the country bounced back to normalcy, has rebuilt many destroyed institutions and regained human and institutional capacity in various fields. The resumption of long denied external assistance has helped accelerate our recovery.

Undoubtedly, significant progress has been made in governance and economic management. Positive and progressive changes are clearly manifest in our performance spanning more than a decade. Major highlights are:

- Restoration of, and vast improvements in, internal peace and security
- Democracy taking strong roots, both at the national and sub national levels.
- Major advances in the rule of law and improvements in maintenance of law and social order
- Sustained and steady macroeconomic growth

- Steadily improving fiscal discipline and management
- Stronger integration of Cambodia with the region and the rest, of the world
- Sharp and spatially widespread reduction in poverty levels
- Measurable improvements in key social indicators such as: expansion of primary education; reduction in mortality rates for both infants and under-five year old children; significant reduction in communicable diseases, spectacular in HIV/AIDS; improved urban access to safe water, and rural access to sanitation; and, reduction in gender disparity in many fields.

Economic performance in Cambodia was quite impressive during the last 10 years. A sound macroeconomic policy framework has been put in place to provide a solid foundation for continued economic growth. Since the establishment of the Royal Government of Cambodia in 1993, GDP growth has averaged a healthy 5.9 per cent per annum between 1993 and 1998. During 1999-2005, overall growth averaged 7.3 per cent annually. Thus, during 1994-2005, the growth rate averaged almost 7 percent per annum. In per capita terms average growth was 4½ per cent per annum in this period.

However these achievements mask some important concerns:

- Prevalence of poverty at 34.7 per cent of the population, markedly higher in rural areas.
- Though the Government has played a key role in spurring socioeconomic development through progressive policies, since Cambodia started from Ground Zero it was relatively easy for these policies to yield impressive results. Going forward sustaining growth will require more skilful economic management.
- Economic growth has been sectorally uneven, leaving the economy vulnerable to external shocks; diversification of the sources of growth will be needed to sustain high growth performance in the future.
- Growth has been urban biased, underlining the need for more rural focus in the future.
- Reforms in governance have not progressed at the expected pace.

There has been a sharp reduction in poverty levels (by 11 percentage points from 39 per cent to 28 per cent) in 56 per cent of the country surveyed both in 1993 and 2004. The poverty gap is also not alarming since a large proportion of the poor are found close to the poverty line. Greater and targeted attention to the rural areas would have an immediate and significant impact in reducing poverty levels.

1.1. Recent Macroeconomic performance

GDP growth in 2005 is estimated at about 7 per cent reflecting stronger agricultural growth, continued expansion of exports, tourism and construction activities.

Value added by the agricultural sector rose by 4.5 per cent in real terms, due to good weather conditions, with rice production increasing by 20 per cent. During 2005 the government launched a number of quick yielding irrigation projects, which have contributed to improved rice production.

Agriculture is crucial to improving incomes, particularly of the rural poor. Total crop production, particularly rice, grew steadily in recent years resulting in exportable surpluses. Average paddy yield per hectare has improved, but is still below the levels in neighbouring countries. Several measures are underway to improve and diversify agricultural production. In Forestry, many old concessions were cancelled for non-performance and new concessions granted with a strict condition to comply with Environmental and Social Impact Assessments (ESIAs).

Rural Development is on track with many roads rehabilitated, markets improved, and training provided to a large number of village officials. Rural credit has expanded but interest rates are still very high and the credit demand far outstrips supply.

In the future stronger performance of the agricultural sector resulting from implementation of market-friendly policies and increased investment in infrastructure is expected to boost rural and agricultural growth, pushing up real GDP growth and substantially contributing to poverty reduction. Sustained long-term growth of agriculture will be supported by liberalization policies and improved land and labor productivity generated by intensifying agricultural education and research, adoption of improved technology, agro-industrial development, broadening of extension activities to farmers and increased investments in rural infrastructure as outlined in the National Strategic Development Plan (2006-2010).

The output of the industrial sector rose by 10.7 per cent in 2005. The main factors underlying this performance were: continuous growth of garment manufacturing (10.2 per cent) and an expansion of construction activities (13 per cent).

Oil and gas exploration in the Gulf of Thailand has provided a strong impetus to the future economic development of Cambodia. The Royal Government of Cambodia awarded an offshore concession of 6,278 square kilometres (Cambodia Block A) to a consortium comprising Chevron Overseas Petroleum (Cambodia) Limited (with 55 per cent ownership) as the operator, with equity participation of Moeco Cambodia Co., Ltd, a subsidiary of Mitsui Oil Exploration Co.Ltd (30 per cent) and LG Caltex (15 per cent). In January 2005, the operator announced that oil has been discovered in four exploration wells. Analysis of samples indicates the quality of the crude is 44 degree API. The preliminary results of these exploration wells are promising. Chevron plans to drill 10 more wells in 2006.

Garment manufacturing remains a dynamic sector. Garment exports rose by 12 per cent in US \$ terms in 2005 (from US\$ 1.98 billion in 2004 to US\$ 2.2 billion in 2005). This amounted to almost 80 per cent of total Cambodian exports. Improvements in competitiveness resulting from implementing the

recommendations of the World Bank's *Investment Climate Assessment*, have likely limited the extent of anticipated disruption among and relocation of garments producers in 2005. This situation is expected to further improve in 2006 and thereafter. The Royal Government, with the strong support of the Government of Thailand, has also taken major steps to attract garment factories from Thailand into the Koh Kong Industrial Estate, located close to the Southern Thai-Cambodia border. This could provide encouragement to manufacturing units in the other regional countries also to relocate to Cambodia to benefit from the economies of clustering.

Special mechanisms have been set up to assist the private sector. The share of private sector industry in GDP has continued to rise sharply, pushed by the fast growing garment sector and construction. But private sector has to diversify to other industrial areas if this performance is to be sustained. Tourism has grown robustly and steadily. Measures have been taken to promote the orderly development of Small and Medium Enterprises (SMEs), which constitute 90 per cent of all enterprises and account for half of the employment in the private sector. Policy reforms will also attract foreign investment in labor-intensive manufacturing industries and tourism-related services.

Construction is also a key component of the industrial sector, accounting for about 22 percent of manufacturing activities. Public sector spending for infrastructure projects and private sector expenditure for office and residential construction have provided the impetus to the growth in construction. This development is expected to continue in the near term. However the construction boom is mainly limited to Phnom Penh and Siem Reap province. Construction permits issued by the Phnom Penh municipality increased by 35 per cent in 2005.

Rehabilitation of damaged *physical infrastructure*, particularly roads, is generally proceeding well. Sihanoukville and Phnom Penh ports are now handling increasing volumes of goods. The Phnom Penh airport has been substantially improved with private sector involvement under BOT terms. Electricity supply, particularly in Phnom Penh, and some other major urban centers, has improved with increased generation capacities and enhancement of transmission and distribution systems. New energy sources are being explored. Possibility of exploitation of offshore oil and gas resources which I described a while ago has vastly improved the long term prospects of the energy sector.

The service sector has also performed well, boosted by the robust tourism sector and increases in tourism-related services. The contribution of Services to GDP grew on average by 6.2 per cent per annum in real terms during 1999-2005 with the value added by hotel and restaurants sub sector increasing by 15 per cent.

Table 1: Cambodia - Visitor Arrivals, 1999-2005

Modes of Arrival	1999	2000	2001	2002	2003	2004	2005
By air	262,907	351,661	408,377	522,978	455,972	626,121	856,521
-Phnom Penh	234,382	264,649	274,689	320,187	269,674	316,748	416,396
-Siem Reap	28,525	87,012	133,688	202,791	186,298	309,373	440,125
Land and Boat	104,836	114,704	196,542	263,546	245,042	361,238	476,479
Total	367,743	466,365	604,919	786,524	701,014	987, 359	1,421,615

Source: Ministry of Tourism. 2005.

The number of tourists visiting Cambodia in 2005 increased by 35 percent (1.4 million tourist arrivals), compared with 2004. Among countries the Republic of Korea ranked first in terms of tourist arrivals.

Tele-communications and internet use have also expanded, though their costs have to decline substantially for promoting competitiveness in business and affordable connectivity and access to the people at large.

Sustainable future economic growth in Cambodia is heavily dependent on the success of the strategy of the government and the private sector to diversify the economy and broaden the sources of growth. Greater domestic investment, preferably in industries that utilize domestic resources, such as SMEs should be an important aspect of this strategy. The challenge for Cambodia is to further strengthen governance for attracting more private investments and improving competitiveness compared with neighbouring countries. In particular, the country's physical infrastructure network must be expanded to serve the marketing requirements of the rural economy. Social infrastructure particularly in the health and education sectors needs to be further enhanced. Regional initiatives to further integrate Cambodia into ASEAN should be accelerated, particularly through the Economic Cooperation Strategy (ECS) partnership scheme with neighbouring countries.

Foreign investment approvals in 2005 increased sharply compared with 2004. The proposed investment projects include the US\$2 billion new town project near Phnom Penh, a US\$200 million oil refinery, a US\$180 million cement factory, a US\$34 million hotel and golf club, a US\$30 million office building, a US\$27 million power station, a US\$19 million dry port, a US\$13 million industrial zone, a US\$5 million cigarette factor, and a US\$9 million sea port at Kampot.

1.2. Fiscal Policy and Performance

The objectives of fiscal policy are to maintain fiscal stability with a gradual increase in budget allocation for social and economic sectors through curtailing and rationalizing public expenditure and by broadening the tax base, preventing leakage, and strengthening customs and tax administration to collect additional

revenue. Prudent fiscal policy has been recognized as key to ensuring price stability in Cambodia's highly dollarized economy.

The Royal Government's fiscal policies are designed to ensure a level of public spending consistent with macroeconomic stability. The expenditure program is being reformed as part of ongoing structural adjustment package aimed at promoting domestic saving, productive investment, and efficient resource allocation.

Fiscal performance in 2005 was encouraging, with improved revenue mobilization and expenditure restraint. The 2005 Budget has been implemented with considerable prudence and caution with the view to mobilize additional public sector savings for fully financing the requirements of high priority reform programs, such as the implementation of civil service reform, especially the rationalization of civil services and investments in rehabilitating and strengthening physical infrastructure, particularly roads and bridges. This approach has helped keep inflation under check.

Domestic revenue in 2005 reached 11.7 per cent of GDP, compared with 11.3 per cent in 2004. The ratio of tax revenue to GDP increased from 8.4 per cent in 2004 to 8.7 per cent in 2005. Non-tax revenue in 2005 is expected to be at around 2.5 per cent of GDP.

Improvements to tax and customs administration, zero tolerance for tax evasion, and new tax measures have helped in the additional resource mobilization effort. Tax reform will continue with focus on strengthening tax compliance and expanding the tax base. In this regard, the private sector should also play its part by fully complying with its fiscal obligations.

As regards expenditure management, in implementing civil service reform, RGC increased salaries for civil servants, especially teachers and health workers, commensurately with their responsibilities,. This is considered essential social investment, crucial for institutional capacity building and should have a positive long term impact on economic performance.

The government has channelled considerable resources to the social and economic sectors in the last decade in order to fight poverty and improve key social indicators underpinning the CMDGs. In the 2006 fiscal year, the government has substantially increased allocations for the economic and social sectors. The social sector has received about 37.1 per cent of the total current expenditure (3.7 per cent of GDP) an increase of 17.5 per cent over 2005.¹ The allocation for the economic sectors has also increased by 16.1 per cent over 2005.² These are fully in accordance with the policy directions indicated in NSDP.

¹ The allocations for the Ministry of Health, Ministry of Education, Youth and Sport, Ministry of Social Affairs, Veteran and Rehabilitation and Ministry of Women Affairs increased by 9.3 per cent, 20.5 per cent, 19.2 per cent and 20.6 per cent respectively over 2005 (1.08 per cent, 1.83 per cent, 0.46 per cent and 0.06 per cent of GDP respectively).

² The allocations for the Ministry of Agriculture, Forestry and Fishery, Ministry of Rural Development, Ministry of Land Management, Urbanization and Construction, and Ministry of Water Resource and Meteorology increased by 13.3 per cent, 34.8 per cent, 58.1 per cent and 31.6 per cent respectively over 2005.

Overall, the planned prudence in public sector spending and the increases in revenue collection in the Budget will improve the current balance and release additional public sector savings for investment in high priority projects with the ultimate objective of achieving sustainable and non inflationary growth.

I am sure participants will be keenly interested in the implementation status of the **Public Financial Management Reform Program**. I would now like to summarize the progress achieved so far in the Program.

MEF has fully demonstrated its ownership of the PFMRP, launched by Samdech **Prime Minister Hun Sen** in December at the 2004 Consultative Group meeting.³ MEF has been proactive in the preparation of the PFMRP. However an even greater proactive involvement of MEF will be needed throughout the implementation period of the Program. All Departments involved in Program implementation have actively participated although some are making more substantive progress than others. Overall a solid foundation has been laid on which to build the superstructure.

A monitoring mechanism and framework have been instituted setting out 14 indicators to measure the progress made in the 27 activities of the stage one action plan of the Program.

Good progress is being made in 11 out of the 14 indicators. However some areas of weakness remain. While some progress has been made in reducing the payment arrears, the stock seems to start building up after second quarter. There has been some progress in enabling smooth budget implementation, but inadequate attention paid so far to streamlining the commitment/payment approval process in both MEF and line ministries threatens the longer term progress in this area. The absence of integrated debt management and planning is also affecting the predictability of budget/expenditure release. Slow progress on the development of an overarching resource mobilization strategy could have adverse implications for long term revenue growth and expenditure sustainability. Work on integrating capital expenditures needs to be accelerated.

In the first nine months of implementation 224 actions (88 per cent) out of 254 actions envisaged in stage one are due to commence. Of these 224 planned actions, 35 actions (16 per cent) have been completed while 173 actions (77 per cent) are on-going and 16 actions (7 per cent) have not started yet. Of the 173 actions whose implementation has been initiated on schedule, progress on 25 actions (14 per cent) has been below expectations. The main areas where continuing slippage may affect the achievement of stage one objectives include delay in development of an integrated reporting system for capital investment projects and a reliable framework for analyzing macro-fiscal links and preparing budget forecasts including the improvement of the government's financial report (TOFE-GFS). Institutional arrangements for the consolidation of debt planning and management remain unclear. Work on streamlining the

³ For example, the PFMRP has also been officially launched by MEF's individual departments in small ceremonies with MEF management in attendance; in addition, MEF management has been launching the PFMRP through road shows at the provincial level.

commitment/payment process to facilitate smooth budget implementation has not commenced. Good progress has been made in identifying the numerous bank accounts held by public sector entities but the consolidation work has lagged including for donor accounts.

In addition work on the IFMIS and capacity development measures is proceeding slower than expected due to the limited capacity of the new IT office, line departments and EFI. Notwithstanding this difficulty a Project Plan has been finalized and will be submitted to the management for approval shortly. A critical problem in this area is the lack of a competent consultant.

The Government continues to explore provision of further technical assistance from ADB for improving the macro-fiscal analytical frameworks. The recruitment of a fiscal policy adviser to assist in the exercise is also under consideration. The recruitment of the consultant for assisting in IT development is being expedited. ADB is also recruiting a consultant to prepare an assessment of debt management. Recruitment of a consultant for improving the payments system is under way.

In light of this review, the following remedial actions are appropriate:

- Establish a working group led by the Budget Department to coordinate the activity relating to improving comprehensiveness and integration of the budget and report directly to the Reform Committee.
- Establish a working group led by the Economic and Public Finance Policy Department to coordinate the development of an overarching resource mobilization policy and measures to improve resource mobilization and the activity relating to improving realism and sustainability of the budget including work relating to the macro-fiscal framework and budget resource forecast and report directly to the Reform Committee.
- Establish a working group led by the Investment and Cooperation Department to coordinate the implementation of the activity relating to improving realism and sustainability of the budget and report directly to the Reform Committee.
- Establish a working group led by the Financial Affairs Department to coordinate the implementation of the activity for streamlining commitment/expenditure approval processes and report directly to the Reform Committee.
- National Treasury may examine whether line ministries could report to MEF on the consolidation of all of their accounts by a certain date failing which MEF will work directly with the banks to close down the concerned accounts and transfer the funds to Treasury.

A discussion of PFMRP will not be complete without an evaluation of the **Merit Based Pay Initiative (MBPI)**. Further evidence of the importance of tackling the incentives issue has emerged through the evaluations of the Initiative carried out by UNDP and IMF. Both institutions cite the low levels of pay levels in the MEF and other government ministries as a key constraint to achieving sustained improvements in the standards of public financial management and accountability in Cambodia. Keeping this in view and following several refinements and adjustments, the operations manual for the MBPI and an MOU between Development Partners and RGC have been approved. Under stage 1 action plan of PFMRP the MBPI would cover 300 officials with an average monthly payment of \$275 although higher and lower rates would allow for some decompression.

The size of RGC's financial contribution to the scheme under stage 1 of the program and a commitment to the MBPI to achieve self-financing by the end of the program are key to its success and sustainability. This has been recognized and endorsed by all parties.

Development Partners have agreed that the Multi-Donor Trust Fund (MDTF) would go forward only if RGC agrees to providing at least twenty per cent of the total cost for Stage 1 and RGC endorsement of the MBPI as an official reform initiative. There are several options for channelling RGC's financial contribution to the MBPI including through MEF's PMG allocation and the use of the MEF's counterpart funding for the program.

The Government has undertaken a number of supporting activities based largely on RGC-DP MOU on the MBPI to ensure that the development impact of the MBPI will be maximized. These include:

- MEF working alongside the Council on Administrative Reforms (CAR) in tightening control over establishment matters; this would include piloting an establishment register for MEF to commence 6 months after the start of the MBPI.
- A functional analysis of MEF to be completed within the first 6 months of the operation of the MBPI, to inform the strategy for organizational change to be implemented starting with stage 2 of the PFMRP.
- A fiscal sustainability analysis to be carried out to examine the extension of the MBPI to a wider group of officials in MEF, to other ministries involved in the PFMRP, and the prospects for extending the MBPI pilot to other ministries. This analysis should be set in the context of any other government wide pay adjustments.
- MEF to prepare a report recommending improvements to non-wage/allowance benefits and entitlements by July 2006 for implementation 6 months after the launch of the MBPI.
- MEF to develop a more comprehensive strategy for coping with the potentially negative consequences from large numbers of officials who may not be successful in their applications to join the MBPI.

Going forward during the 5-year lifetime of the initial MDTF a base-case scenario that increased MBPI coverage to 900 participants by 2009 would have a cumulative cost of US \$8.6 million, \$4.9 of which would be covered by donors. For a high case scenario with 1,200 participants the corresponding figures would be \$11.7 million and \$6.6 million. A low case with no increase from the present level of 300 participants would require \$5.1 million and \$3.2 million respectively. Several inputs would feed into the decision on at what pace the MBPI may be extended, including results of the fiscal sustainability analysis, reviews of both the wider reform program and the MBPI itself, and the wider context of pay reform across the Cambodian civil service.

Ongoing reform of the government's organizational structure is key to enhancing the impact of the MBPI. Several new departments have been created such as Internal Audit and Non-Tax Revenue Departments. A new Economic and Public Financial Policy Department has been created by merging the Department of Economic Analysis and Forecasting and the Finance Policy Planning, Management and Monitoring Unit. The Department of Budget and Financial Affairs has been reorganized into the Budget Department and the Financial Affairs Department. The Foreign Currency Unit has been transferred to the Treasury.

Overall, the MBPI has been progressing well. The recruitment process has been completed and payments to the selected candidates has commenced.

1.3. Monetary Policy and Performance

Broad money rose by 20 per cent in 2005, due to the increase in foreign currency deposits and credit to the private sector. Foreign currency deposits, the largest component of broad money, recorded an increase of 20 per cent reflecting public confidence in the banking sector and the economic policies of the Royal Government of Cambodia. Credit to the private sector rose by 40 per cent, driven by the construction of hotels and houses. Capital and reserves of the banking system continued to rise, up by 9.6 per cent from the previous year as banks strengthened their capital base in compliance with the recent requirements of the law regarding capital adequacy. Gross official reserves rose by 12 per cent reflecting continued strong export performance, sustained tourist arrivals, and capital inflows, including FDI.

Despite high oil prices, the government has been successful in keeping inflation under check and ensuring a stable exchange rate. Inflation reached 5.8 per cent at the end of 2005, which is higher than the average of last 5 years mainly due to the impact of higher oil price. The Cambodian riel depreciated marginally to 4,110 nets per US\$ by the end of 2005 from 4035 nets at the end of 2004.

1.4. External sector performance

The external sector performance during 2005 showed signs of resiliency, despite high oil prices. Provisional 2005 data indicated that the overall balance registered an increased surplus of 1.1 per cent of GDP, compared with a surplus

of 0.9 per cent of GDP a year earlier. This improvement resulted mainly from larger inflows into capital and financial accounts. Gross international reserves rose further to cover more than 2.5 months of import of goods and services at the end of 2005.

The current account deficit, excluding official transfers, increased from -9.9 percent of GDP in 2004 to -10.3 per cent of GDP in 2005, reflecting the impact of higher petroleum prices and net income debits. Domestic exports increased by 9.8 per cent, while imports increased by 17.6 per cent. ⁴Exports of textiles, clothing and footwear, which accounted for more than 70 per cent of Cambodia's domestic exports continued to expand. Non-garment exports are estimated to have increased at a faster pace than the garment sector, albeit from a very low level but produced only about 13 per cent of Cambodia's total export earnings. This group includes traditional agricultural commodities such as rubber, wood products, fishery products, and rice. In order to reduce the dependence of the economy on the exports of a single commodity and to utilize the country's rich agricultural potential in a more dynamic way, the government has increasingly encouraged private investment in the agriculture sector and agro-industries.

Agreement on debt rescheduling with the U.S. and Russia may reduce amortization payments, but it could also increase interest obligations. Cambodia's external debt repayment will have a significant impact on budget implementation and consequently on the trajectory of poverty reduction. By 2008, after the rescheduling of pre-1993 obligations, Cambodia's external debt is estimated at about 43 per cent of GDP, with a debt service ratio of about 2.6 per cent. However, the fiscal burden of the debt is heavy, given the low revenue to GDP ratio. Thus Cambodia will continue to pursue a prudent external debt management policy and strictly avoid non-concessionary financing.

1.5. Evaluation of International Financial Institutions

The IMF Executive Board approved in December 2005 debt relief for Cambodia under the Multilateral Debt Relief Initiative. As part of the Initiative, the IMF will provide 100 per cent debt relief on all debt incurred by Cambodia to the IMF before January 1, 2005. The debt relief will amount to US\$82 million. The international community has made these additional resources available to help Cambodia make faster progress toward the Cambodia's Millennium Development Goals (CMDGs).

Cambodia has qualified for IMF debt relief because of its overall satisfactory recent macroeconomic performance, progress in poverty reduction, and improvements in public expenditure management. Since 1999, Cambodia has enjoyed a robust economic expansion, with annual growth rate averaging over 7 per cent and inflation kept under control.

During this period, the Royal Government has shown strong commitment to implementing the National Poverty Reduction Strategy, and improving public administration, in particular public expenditure management. Performance in

⁴ provisional estimates.

these areas provides assurance that resources made available under the Multilateral Debt Relief Initiative will be used effectively.

II. Poverty Reduction and Social Development

Poverty reduction is at the core of the development policies and strategies of the Royal Government. The Rectangular Strategy, initiated by Samdech **Prime Minister Hun Sen**, specifically targets economic growth, full employment for Cambodian workers, and equitable distribution of fruits of growth thus ensuring social justice, and strengthened efficiency of the public sector.

Poverty in Cambodia has fallen by 10-15 per cent during 1994-2004. Based on the recent Cambodia Socio-Economic Survey (CSES), the poverty headcount ratio declined from around 47 per cent in 1994 to 35 per cent in 2004. Per capita household consumption has risen 32 per cent in real terms. 90 per cent of the poor live in rural areas. Poor households have higher dependency burden and lack resources including capital: they tend to be uneducated, unskilled and unhealthy. Critical problems of the urban poor revolve around security of housing and opportunities for gainful income generation.

The education sector is a success story in human development with many indices showing significant improvement and a high level of collaboration among all stakeholders based on a Sector Wide Approach (SWAP). The successes achieved through education sector reform during the past five years have been very significant. In 2001, the Government abolished start-of-the year contributions in grades 1 to 9 which resulted in additional enrolment of around 0.6 million students. Most encouragingly, the number of students from the poorest communities has increased by around 0.5 million in the past four years.

A focus on primary education, backed with rising public spending, has resulted in more schools and trained teachers, lower direct costs to households; and increasing primary enrolment rates. Enrolment has risen particularly fast for girls and for children from poor households. Since 2000, primary school enrolment has increased from 2.2 million to 2.7 million with the major part of the benefits accruing to poor and rural areas. The overall primary net enrolment rate (NER) has increased from 84 per cent to 91 per cent over the same period. The rise (by 8 percentage points) has been even greater for girls, especially in rural and remote areas. In remote areas, NER growth has been more striking rising from 62 per cent to 79 per cent during the same period, due to provision of school facilities closer to home. The number of primary schools in remote areas has increased from 318 to 473 in the past 4 year. An additional contributing factor has been a highly effective public information campaign on benefits from earlier age enrolment and increasing public awareness of the new government policy. Children needing to repeat grades has fallen considerably from 26 per cent of enrolment in 1997 to 10 per cent in 2003. Concerns regarding the quality of education at all levels however continue and have to be addressed.

Lower secondary education performance has also increased significantly since 2000, with grade 7-9 enrolment growing from around 284,000 to 460,000 (62 per cent). The number of lower secondary schools has increased from 508 to 688 mainly in previously un-served rural and remote communities. While the gross enrolment rate (GER) has increased from 27 per cent to 39 per cent, the net enrolment rate has increased more slowly from 17 per cent to 21 per cent. Enrolment growth is showing some signs of levelling off, with only an 11 per cent increase in the past year. The number of girls enrolled has grown from 105,000 to 193,000 (88 per cent). However, primary to low secondary transition rates appear to be stagnating after an initial increase between 2000/01 and 2001/02. The government recognizes the need to further reduce costs for poor families in order to sustain demand. In 2003, the government introduced targeted scholarships for the poor, girls and ethnic students in grade 7 to 9.

Upper secondary enrolment has grown from around 105,000 to 154,000 over the past four years. Net enrolment rate however, has remained relatively steady at around 7-8 per cent. Girls and ethnic minority students are significantly under-represented, with the female share at around 33 per cent. The main constraint is the lack of lower and upper secondary facilities in many rural and ethnic minority districts and communities. For example, 53 out of 185 districts (30 per cent) do not have upper secondary facilities, which is a major reason for the stagnant transition rates in grades 9-10. The government's strategic priorities are therefore to expand high quality upper secondary education in all districts and provinces to ensure more equitable access to post-basic education and paid employment.

The main strategy for improving the quality of post-secondary education is to build on the continuously strengthening public private partnership in expanding higher education opportunities. Before 1999, higher education provision was limited to a small number of Phnom Penh-based public higher education institutes focusing on supplying professional staff for government services. There has been a spectacular growth in higher education in the past five years with much of the growth coming from the private sector. The current enrolment in higher education is around 45,000 with an estimated 25,000 students in public institutions. However, most of the students in higher education come from either Phnom Penh or more urbanized provinces. Women continue to be significantly under-represented due to their low enrolment and consequent low graduation rates from Grade 12.

The quality and efficiency of the teaching service continue to improve. The number of trained primary school teachers has increased from around 42,000 in 1999/00 to 47,000 in 2002/03. The number of trained secondary teachers has increased from 17,800 to over 22,700 during the same period, with an increased share of the teachers having upper secondary education or graduate qualifications. In order to sustain these improvements, the government is implementing additional measures. For example, the allocation for the teacher redeployment and incentives program has increased. Teacher development program allocations increased by 10 per cent in 2003, with increased emphasis on in-service teacher development and school management training.

A number of program indicators show continued progress in education quality improvement. Textbook availability has been maintained at the policy mandated - target ratio of one textbook per pupil per subject in primary and lower secondary schools. Budget allocations for school operations and basic supplies, teacher training, program monitoring and performance based staff allowances, especially for school directors, have been introduced and sustained since 2001/02. In addition, the Government has taken steps to strengthen standards and governance in schools. Standards monitoring will continue to be strengthened to ensure that Government spending on education has maximum effect. A related priority therefore is to strengthen governance systems that make schools and communities mutually accountable for results.

Significant progress has been achieved in the health sector as well. The TB epidemic shows a declining trend. There are also improvements in the provision of health care services, in particular for maternal and child health, increased delivery by trained providers, and delivery of primary, secondary; tertiary health care. All health indices have shown considerable improvement (e.g. vaccination coverage and antenatal contacts and curative care) but they are still inadequate in many cases and do not compare favorably with the nearby countries. Child malnutrition remains serious and incidences of preventive diseases are still at unacceptable levels. High rates of maternal mortality are of particular concern. A survey conducted in 2004 report that the IMR has declined from 93/1000 live births in 1998 to 66/1000 live births in 2003, and the Under 5 Mortality declined from 124 in 1998 to 97 in 2003. The same survey estimates that between 1998 and 2003 average life expectancy at birth increased for men from 52 to 60 years, and for women from 56 to 65 years. These estimates will be verified and the results validated by late 2006.

We are proud that Cambodia is one of the only three developing countries in the world that have successfully arrested the growth of HIV epidemic. A spectacular success story is the rapid decline in prevalence of HIV/AIDS (down to 1.9 per cent among adults aged 15-49 in 2003, from 3 per cent in 1997), brought about RGC's highly focused commitment and excellent collaboration with and among external development partners.

The government understands that developing an adequate and qualified health system to provide quality health care services preferentially to the poor though necessary is not sufficient. Although health care services will have a significant impact on improving health indicators, they are not the only determinant of good health. There are other social, economic, and environmental factors that affect health. A key challenge in improving health is to mobilize multi-sectoral interventions. For example, MoE should play very important role in providing education on Reproductive Health, Sexuality, and HIV/AIDS to youth and adolescents. Improving living standards including nutrition, access to clean drinking water and sanitation, better information and knowledge, and consequent changes in attitudes and behavior with regards to risk factors will have a significant impact on health.

Since only 20 per cent of the population currently uses publicly provided health services, there is a large scope for integrating the private sector in public health

activities. Interventions such as regulation of the private sector, ensuring quality standards of health service delivery by private providers, and promoting public-private partnerships in service delivery are necessary. Contracting NGOs to manage health service at the OD level is an innovative approach to improve the governance and management of public health services.

Other than education and health care, steady advances have been made in ensuring gender equity. Already the share of women in the total labor force has improved, thanks in part due to the large number of women finding employment in the fast growing garment industry.

Achievement of poverty reduction and CMDGs critically depends on significant and steady progress in diverse socio-economic dimensions such as: robust and equitable macroeconomic growth; strong check on inflation; significant increases in agricultural production and productivity; protection and enhancement of environment; strengthening and improvement of infrastructure; robust industrial growth, creation of employment and incomes; reforms in public administration and judiciary; fast growth in private sector investments; unhindered growth in trade; and, growth in the services sector including tourism.

III. Prospects

The Rectangular Strategy adopted in 2004 sets out the Royal Government's development goals and targets. These would be operationalised and implemented through the NSDP (2006-2010). RGC is fully committed to the basic principles for taking the country forward: strict adherence to democracy In governance with openness and guaranteed freedom of expression; political stability, rule of law, equity and social order; a fully responsive, responsible, effective, transparent, accountable and predictable administration; maintenance of macroeconomic stability and infrastructure and a conducive climate for private sector to flourish; and provision of essential social services for human capital formation and enhancement.

With peace and internal stability taking strong hold, sustained improvements in social order, and robust economic growth in the past few years, Cambodia is at a *critical threshold* for faster future progress. The next ten years represent a *decade of opportunity* to realise the ambitious CMDGs and uplift the poor and vulnerable. The overarching policy directions to govern the implementation of NSDP include

- Factoring in poverty reduction and gender sensitivity in all activities.
- Pursuing reforms in all sectors, however painful they may be in the short-term.
- Fostering and facilitating robust, equitable, and spatially and sectorally balanced macroeconomic growth.
- Significantly increasing investment in productive sectors and in human development.
- Targeting the most needy and the least served people and areas.

- Focusing on well-tried, low cost alternatives with quick and high returns at the grassroots to have a profound and positive effect on the poverty situation.
- Optimising factor productivity.
- Relying on labor intensive techniques in activities such as construction to maximize employment and household incomes, particularly in rural areas.
- Stressing capacity building in all sectors.

Diversification within the garment industry as well as the development of new industries is essential for reducing Cambodia's vulnerability to external shocks. On 15 May 2002, in a meeting with investors, **Samdech Prime Minister Hun Sen** unveiled RGC's strategy to diversify the Cambodian economy. He emphasized that apart from assisting in the adjustment and further development of the garment industry, RGC will give priority to the development of other labor-intensive manufacturing enterprises, such as toys, footwear and assembly of electrical and electronics appliances for domestic and industrial uses. It is also important to promote the development of ancillary industries in order to reduce Cambodia's dependence on imported inputs. However the development of high quality products will require investments in technology, training, and quality control.

Although there is an apparent abundance of labor in Cambodia, it is relatively unskilled in the use of sophisticated industrial machinery and equipment. Far too little has been spent on training of staff with skills that are transferable across industries. Better skilled staff will lead to contended and more productive work environment, which in turn will lead to an increase in production.

A crucial element in the development strategy is enhancement of Cambodia's international competitiveness through provision of adequate physical infrastructure to effectively respond to the increasing needs for basic services, such as low-cost water and power supply, financial information and management and telecommunications. Priorities in rehabilitation of physical infrastructure include: primary and secondary roads, railways, airports, ports, irrigation facilities, telecommunications, electricity generation and distribution networks etc., with maximum attention being paid to attracting private sector to undertake work on a BOT basis wherever possible. Taking the cue from the positive experience of neighbouring countries Cambodia will set up Special Economic Zones to encourage investments particularly for exports (see **Annex 1**).

Prospects of exploitation of offshore oil and gas resources are bright. RGC will undertake special studies and put in place necessary infrastructure to optimise the use of these valuable resources and the revenues to flow from them.

Attracting private sector, both domestic and foreign, is of utmost importance to accelerate the pace of economic development. RGC will remove the major obstacles to investment including delays in approvals and high transaction costs and improve the overall climate through various governance reforms. SMES will receive special attention, including better and easier access to long and medium term finance.

Opportunities for trade with neighbouring countries and others have improved but are not being adequately availed to exploit fully Cambodia's comparative and competitive advantages. Reforms to enhance private sector participation will address issues relating to trade as well.

The government is aware that rapid population growth could derail Cambodia's prospects. The National Population policy designed to improve the quality of life of all Cambodians will be implemented to provide information and knowledge to all couples and enable them to make the appropriate choice about the size and spacing of children and provide them with the needed services and supplies to attain their goals.

Annex 1

Special Economic Zones and Growth Corridor

In December 2005 RGC adopted a Sub-decree on the Establishment and Management of Special Economic Zone (SEZ), which aims to provide investors with adequate infrastructure and supportive facilities. Under this policy the Royal Government of Cambodia identified the following growth poles for industrial development: Poipet (near Cambodian-Thai border), Bavet (at the Cambodian-Vietnamese border) and Sihanoukville.

The SEZs aim to develop areas along the borders with neighbouring countries and turn them into agricultural, industrial, trade and investment development zones. Resources such as telecommunications, water supply and electricity, as well as other ancillary facilities and social and legal infrastructure will be mobilized for boosting economic activities in these areas.

The main rationale of establishing the SEZs is to effectively respond to the challenge of diversifying the Cambodian economy and to promote demand-driven development, such as food processing and export promotion.

Potential Manufacturing Industries for Sihanoukville

The Sihanoukville SEZ has been operational for a few years. A key objective of the Sihanoukville SEZ is to attract FDI. Improvement of port facilities is key to enhance the competitive edge of Sihanoukville as an international commercial gateway. The improvement of connecting roads, particularly of National Route No. 48, is essential in providing Sihanoukville with relative cost advantage, strengthening the linkage with Thailand and giving impetus to future coastal zone development. The SEZ could then be effective to induce FDI in enterprises in which linkages to local resources could be secured, such as in the processing of locally available fruits and seafood. The SEZ at Sihanoukville will serve as a prototype for inducing FDI in a variety of industries in other SEZs.

The SEZ in Sihanoukville will be a strategic zone for Cambodia to diversify export industries and related services and thereby facilitate various economic activities and create new jobs for Cambodian nationals. Emphasis will be given to promoting categories of industries and services not available in Cambodia presently. Export processing will be an essential feature of the SEZ. Concurrently the SEZ will also promote recapturing of the domestic market with made-in-Cambodia products. The Table below describes the potential for locating different types of industries in the SEZ.

Types of industries/services to be attracted to SEZ

Zone Division	Category of prospective industry	Specific types of industry
Free Zone (FZ)	None-traditional, export oriented and labor intensive industry	Garment/fabrics (high to medium notch), sportswear Wooden, stuffed and plastic toys Electric appliances/ Components Machinery components Automobile parts and components such as Wire harness/accessories Ceramic products - Ceramic tiles, roof tiles etc. Rubber products - surgical and medical rubber gloves, condoms Paper products - packing and cushioning materials, paper containers Others (Jewellery, etc.)
	High value-added, recycle oriented and labor Intensive industry	Used car/motor cycles and used tire — for resemble, retreat and recycle
	International Wholesaler	Temporal duty — free storage of goods for transshipment
Promotion Zone (PZ)	Export - oriented (traditional) and labor-intensive type	Garment — outerwear, shirts, pants, Infant wear and uniforms Footwear — leather shoes and chemical shoes Process agricultural products — processed vegetables, fruits and nuts
	Export - oriented, import-substituting domestic resource based Industry Export-oriented, partly import-substitute and labor intensive Industry	Electric appliance assemble — washing machine, refrigerators, electric fan Machinery assemble — small pumps, generators and engines Metal processing — galvanized iron sheet, steel cutlery, building materials

In the long run, growth of urban centres particularly the SEZs will induce higher demand for local products and widen linkages to secondary industry. The preservation of environment will be a top priority even as industrial development and urbanization accelerates in the SEZs. In particular, efforts will be made to ensure sustainability of use of local resources such as forests and marine resources.

Strategies for the development of SEZ

Enhancing Competitiveness of Garment Industry

The target of the garment industry is to achieve a substantial foothold in export markets. It will be necessary to boost the value-added of products to make them competitive in the medium-priced market. For this purpose, development of relevant industries for the manufacturing of ancillary materials, such as ribbon, button and collar stay and other accessories of garments, will be important. Support for business development with Cambodian initiatives will be essential to widen the Cambodian garment industry base and start anew a process of domestically motivated industrial accumulation. It is imperative to

move away from the present contract-based manufacturing to direct access to export markets, for which the strengthening of marketing capability will be necessary.

Recycling of Used Machinery, Automobiles, Electric Appliances and Computers

A large quantity of used machinery, particularly automobiles, electric appliances and computers, is disposed of or discarded in Japan and other developed countries. Used machinery would have a substantial value if usable units are selected and repaired or disassembled to extract the useful parts. Recycled machinery or parts could then be marketed in Cambodia or exported to neighbouring nations. Cambodia can host such activities and serve as a gateway to the Indochina market as a whole. SEZs could provide an excellent site for displaying and sales of refurbished equipment. However in promoting this activity in Cambodia appropriate safety examination systems and environmentally safe and friendly methods in dealing with used machinery would need to be adopted.

Promotion of Agro-industry

The processing of agricultural outputs into industrial or semi industrial goods is accomplished by agro-industries. The introduction of agro-industries will increase the value added of agriculture and fishery products. The potential areas of agro-industry development include seafood and fruits and vegetables.

Promotion of Assembly Industry

Assembling is a labor intensive industry, requiring inexpensive but well-trained labor force. Without much industrial knowledge and capital accumulation in Cambodia, it may not be possible to manufacture sophisticated goods from the scratch. However production on knockdown or semi-knockdown basis could be undertaken even as industrial experience is accumulated. Possibilities include electric appliances, transport vehicle and machinery assembly, wire harness for automobiles etc.

Recapturing Domestic Markets

Mineral and Agro-based Products

Cambodia imports various commodities including products whose raw materials are locally available. Agro-based commodities, such as processed foods account for 3 per cent of the total import, and mineral products including cement account for 4 per cent. With ample local resources in agro-fishery, some components of the imported processed foods could be locally manufactured and the import requirements correspondingly reduced. Processed meat, fish, canned or dried fruits and vegetable oil are typical examples. With regard to mineral resources, a comprehensive assessment of the endowment of resources needs to be made.

Recapturing of the domestic market by made-in-Cambodia products will help improve industrial capacity and reduce imbalances in trade.

Improvement of the technology and quality control will be key for the growth of agro-based industries. Stringent control of smuggling would be an absolutely necessary condition for promoting local industries.

Construction Materials

Construction is a sizable industry in Cambodia, accounting for 5 per cent of the total output of the economy. Only a small proportion of construction materials is manufactured locally, such as simple bricks. As the expansion of urban centers and industrial estates continues, there will be a sizable demand for construction materials. In order to utilize this opportunity for domestic industry development, capabilities need to be boosted for the production of construction materials including concrete secondary products, such as concrete pipes, slabs and panels, galvanized iron steel sheets and more sophisticated bricks and tiles. Construction materials are bulky and heavy, and are generally deemed suitable for import substitution.

Promotion of Footwear Industry

The clear comparative advantage of Cambodia lies in labor intensive industries. Footwear manufacturing is a well developed export industry with the annual export value of US\$ 8 million. Prevalence of a liberalized environment for raw material imports and product exports will be essential for the development of this industry. Alongside improvement of technology including design technology and quality control will be important for supporting the growth of the footwear industry. Public private partnerships could be usefully forged in these activities.

Upgrading Small and Micro Industry

Small and micro (handicraft) enterprises (SME) are indigenous to Cambodia's industrial base. Although the output value of SMEs is not yet very high, they are advantageous from the point of view of providing a quick response to changing market demand, low intensity of capital use and high employment potential. Utilized technologies are often conventional or traditional, where ample room for improvement exists. Managerial skills are often primitive resulting in inefficiency. Financing of SMEs by the formal financial sector is also weak. These market failures may need to be corrected with government intervention.

Competitive Infrastructure facilities

While the neighbouring nations, such as Thailand and Vietnam, have been active for more than a decade in providing industrial estates with competitive infrastructure facilities, Cambodia has lagged behind and has much less to offer to potential investors by way of incentives in its SEZs. Utilities are expensive, particularly electricity. Transportation costs are substantially higher compared

with most of the neighbouring nations, particularly in Phnom Penh. Unless this situation in turned around Cambodia will lose its competitive edge (see Table below).

Table Comparison of Cost for FDI in Asian Nations

Country City		Cambodia Phnom Penh	Shihanouk- Ville	Thailand BKK	China Shenzhen	Shanghai	Vietnam Hanoi	HCMN
Monthly Salary (\$/month)	Worker (incl. of fringe benefit)	60-70	601-70	140	40-110	190-280	75-115	95-140
	Engineer /Supervisor	100-500	100-300	300	120-250	280-460	190-310	155-290
	Manager	500-2,500	n.a.	620	340-720	430-910	470-540	470-620
	Minimum wage by law	45	45	3.71/day	69.35	59.2	41.6	41.6
Land/Office price	Factory lot sale in IE (\$/m ²)	20-40 (outside IE)	n.a.	30-70	14 (50 years)	25 (50 years)	80 (30 years)	100 (40-50 years)
	Factory lot lease in IE (\$/m ² /month)	0.1-0.2	n.a.	unknown	0.24	Unavailable	0.22	0.23
	Office floor (\$/m ² /month)	10-20	10-20	10	12-14.5	30	22	16
	Apartment (\$/month)	1,000-2,000	800-1,500	1,350-1,460	360-970	2,150-4,000	1,700	1,800
	Electricity (\$/kWh)	0.21	0.21	0.04	0.09-0.12	0.07	0.07	0.07
	Water (\$/m ³)	0.22	0.25	0.21-0.36	0.23-0.29	0.15	0.23	0.23
	Telephone (3 min. in Japan)	4.8	4.8	2.3	2.9	2.9	6.9	6.9
	Transport (40 ft container to Yokohama port Japan)	1,800	1,600	1,450	1,250	700	1,500	1,500

Source; Data for Cambodia by Study Team's factory interview survey, all other data from JETRO. All data are as of November

Development Image of Growth Corridor

The Growth Corridor Area is composed of three distinctive sub-areas, with different characteristics. The following table describes the present and future scenarios of industrial development in the Growth Corridor Area.

Matrix of Industrial Development Directions

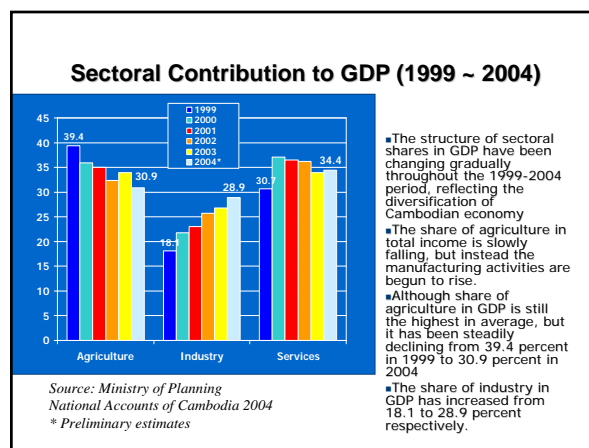
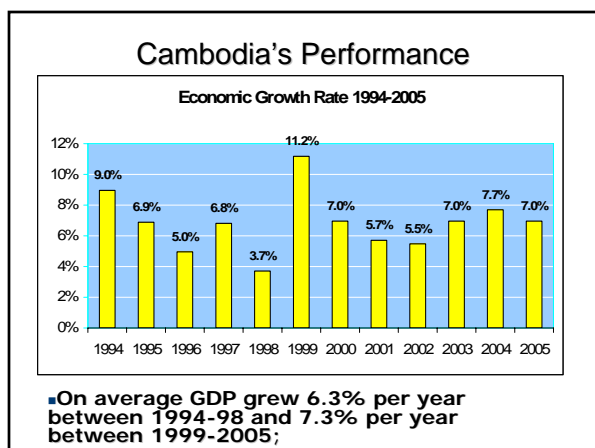
Sub-Area	Present (2002)	Short-term (Up to 2008)	Med to long term (Up to 2015)
Greater Capital Area	<ul style="list-style-type: none"> • Garment and footwear (Labor intensive industries) • Supply of agriculture product to urban consumption 	<ul style="list-style-type: none"> • Development of agro-processing industry • Airport based industry (high value added, labor intensive industry) • Electric appliance/transportation machinery assembly 	<ul style="list-style-type: none"> • Enlargement of agro-processing industry • Development of import substitution industries • Electric appliance/transportation machinery assembly and production • Development of IT industry • Logistic center
Shihanouk-ville Area	<ul style="list-style-type: none"> • Garment and footwear (labor intensive industries) • Beverage production • Marine products processing • Improvement of port facility • Beach resort for domestic visitors 	<ul style="list-style-type: none"> • Development of agro-fishery processing industry • Port based industry (Garment; light manufacturing) • Enlargement of beverage • Port-oriented industry (ship repair; boat building) • Coastal tourism for domestic visitors 	<ul style="list-style-type: none"> • Development of agro-fishery processing industry • Development of import substitution industries • Electric furnace semi assembly/production • Enlargement of used machinery reuse and recycling • Export of beverage products • Coastal tourism for international visitors
Intermediate Area	<ul style="list-style-type: none"> • Cottage and handicraft industry • Vegetable and fruit production • Cattle farming • Fishery 	<ul style="list-style-type: none"> • Enlargement of suburban agriculture for import substitution • Modernization of cottage industry • Promotion of village tourism • Agro-fishery processing 	<ul style="list-style-type: none"> • Further improvement of agro-fishery processing for export



Outline	
I. Macroeconomic Performance	
II. Fiscal Developments	
III. Development of a robust financial sector	
IV. External sector performance	
V. Social development and poverty reduction.	
VI. The way forward	

I. Macroeconomic Performance

- ## 1. Macroeconomic Performance
- Positive and progressive changes over the past decade:
 - Sustained and steady economic growth;
 - Stronger integration with the region and the rest of the world;
 - Sharp and spatially widespread reduction in poverty levels;
 - Steadily improvement in fiscal discipline and management;
 - Measurable improvements in various social indicators: expansion of primary education; reduction in MMR and IMR; reduction in communicable diseases; improved access to safe water and sanitation.



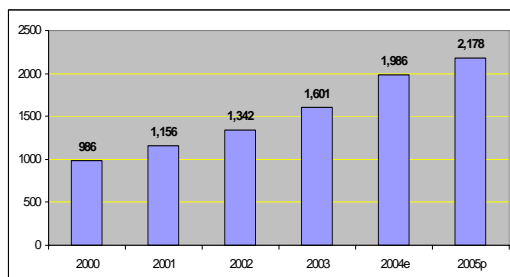
1. Developments in 2005

- The economic growth in 2005 is estimated to be 7 percent, reflecting:
 - Stronger agricultural growth, 4.5% (benefiting from irrigation systems);
 - Continued growth of manufacturing (10.2%) and expansion of exports (12%);
 - Increased in construction activities (13%), fuelled by housing and infrastructure projects;
 - Tourist arrivals increased by 35% to 1.4 million visitors, bringing foreign exchange;
 - Inflation is high, at 5.8%.

1. Fiscal incentives for garment sector

- Particularly for garment exports, the Royal Government has provided financial incentives to support this sub-sector after the end of Multi-Fibre Agreement in early 2005.
- The RGC exempted payment of profit tax for 2 more years, resulting in loss to budget revenue of approximately CR71.5 Billion in 2006 and CR106.2 Billion in 2007. This does not include custom duties exemption of approximately CR1,211.8 billion a year.

Cambodia's Garment Exports (million US\$)



■ Increase in Exports mainly attributed to the Garment Exports which represent over 80% of the Total export in 2005

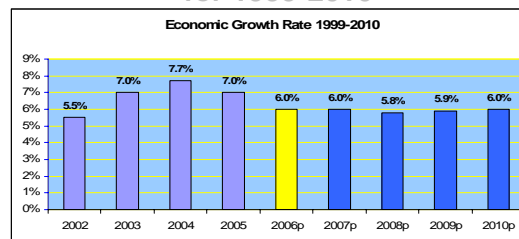
1. Macroeconomic performance (cont...)

- Medium term outlook is good;
- The prospect of the robust economic growth will remain valid as *Cambodia's off-shore oil and gas exploration* provides strong impetus to economic development of Cambodia.
- The government approved a number of infrastructure and real estate projects, which would imply that construction activities will drive GDP growth in the next 5-10 years;

1. Building foundation for sustainable development

- A wide range of reforms will sustain growth over the long term:
 - Public Financial Management Reform;
 - Financial Sector Development;
 - Private Sector Development particularly through improved trade facilitation such as single window, single administrative document, risk management, SME development and establishment of Special Economic Zones (SEZ);
 - Governance reform, including land management reform, administrative reform, as well as legal and judicial reform.

Overall Economic Growth Outlook for 1999-2010



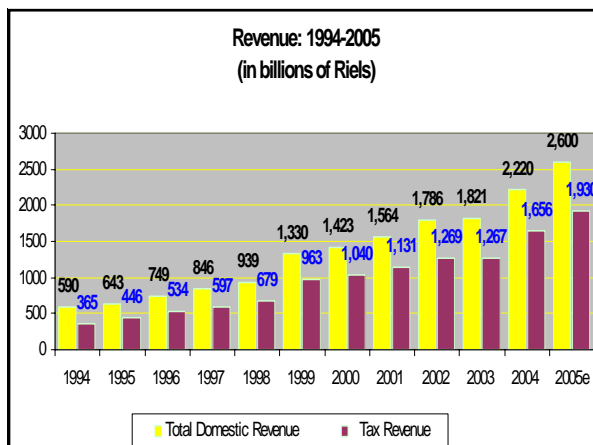
■ Growth in 2006 is expected to increase to around 6 percent, driven by tourism and garment exports continue to increase - but at a slower rate

II. Fiscal Developments

2. Public Financial Management Reform

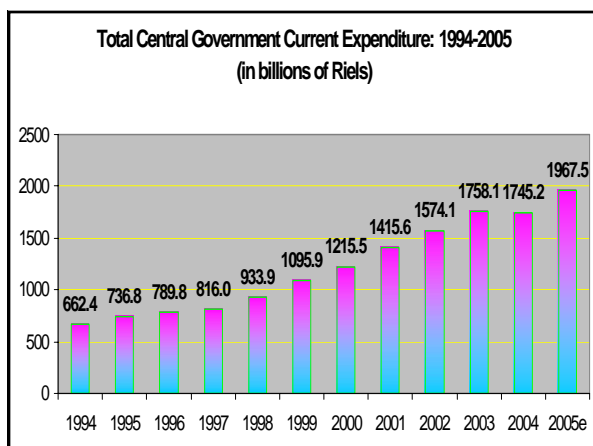
■ The Public Financial Management Reform has produced early results:

- Budget discipline;
- Increase in revenue collection;
- Improved expenditure management;
- Drastic reduction in arrears;
- Better incentives for government officials through Merit-Based Pay Initiative (MBPI);



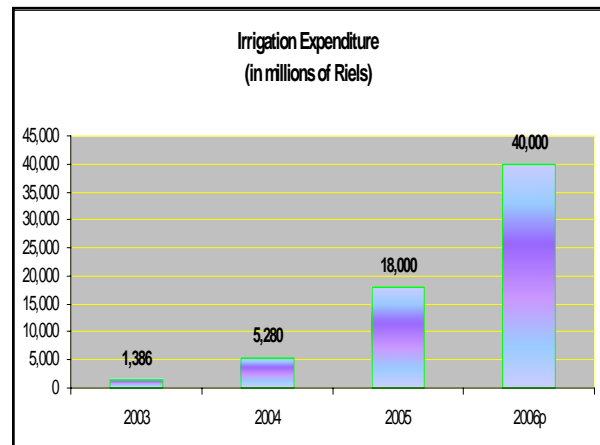
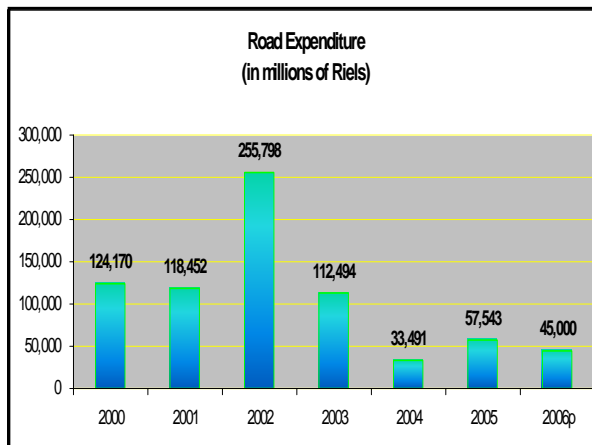
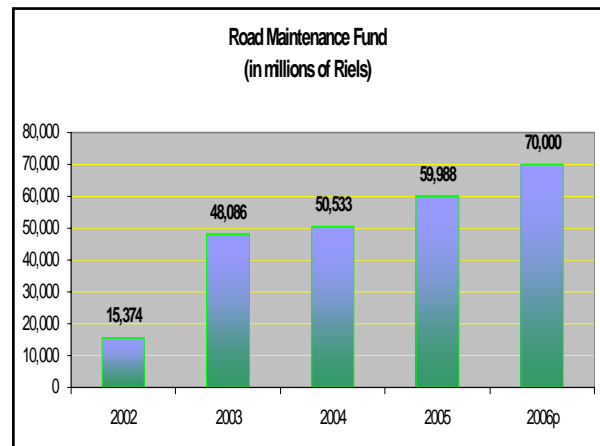
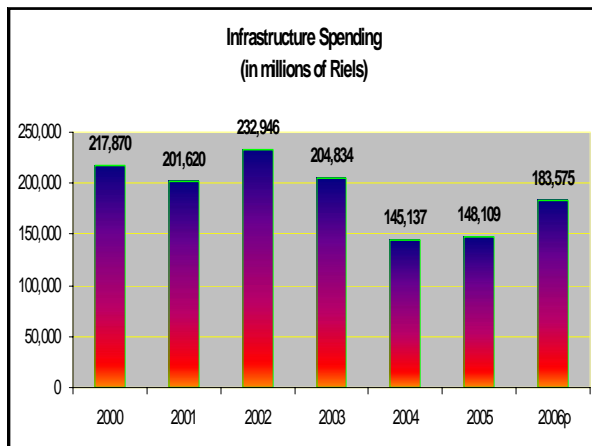
2. Fiscal Developments

- The fiscal performance in 2005 has been good, with improved revenue mobilization and expenditure rationalization.
- On nominal term, revenue increased by 22% in 2004 and 17% in 2005;
- On real terms, domestic revenue in 2005 reached 11.7 percent of GDP, compared to 7.6 percent of GDP in 1995 and 11.3 percent of GDP in 2004.
- On real terms, tax revenue increased from 5.3 percent of GDP in 1995 to 8.7 percent of GDP in 2005, an increase of 3.4% of GDP.



2. Spending on Infrastructure

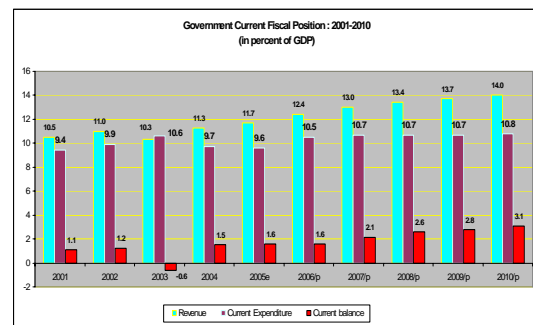
- RG attaches great importance to infrastructure development;
- Studies indicate that decreasing the distance from the village due to good road by one kilometer will enhance productivity by about 30 thousand Riel per hectare;
- Land with access to irrigation facilities during the dry season has 15 percent greater rental value and 10 percent higher sale value than land without irrigation;
- From 2000-2005 the disbursement for infrastructure and its maintenance amounted to about 1,324 billion riels.



2. Spending on Infrastructure (cont...)

- For the period 2004-2005, the Royal Government disbursed 270 billion riels for road-bridge infrastructure and 23 billion riels for irrigations;
- In 2006, the Government has allocated 115 billion riels for road-bridge infrastructure and 40 billion riels for irrigations

2. Medium Term Fiscal Plan

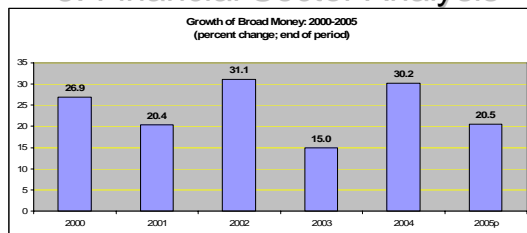


III. Development of a robust financial sector

3. Monetary Policy and Performance

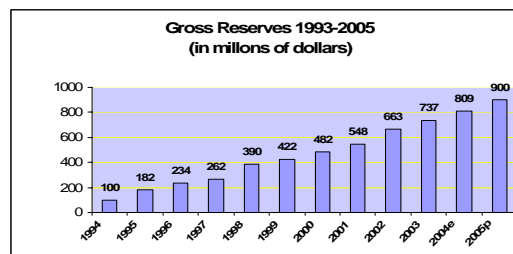
- Banking reform will continue;
- Greater confidence in the banking system leads to broad money recording a robust growth of 20 percent in 2005, due to the increase in foreign currency deposits and credit to the private sector.
- Credit to private sector rose by 40%, driven by the construction of hotels and real estate.

3. Financial Sector Analysis



■ In 2005, M2 grew 20%, foreign currency deposits of residents remained the most important counterpart to monetary expansion, accounting for more than half of the annual increase in broad money.

3. International Reserves



■ During 1994 to 2005, the international reserves on average annually increased by 27%; by IMF definition US\$900 million; if included gold more than US\$1 billion;

■ Gross international reserve maintained at 2.5 months of import.

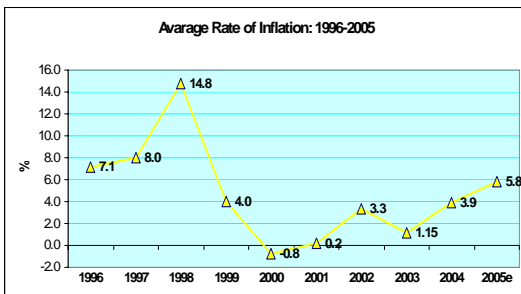
3. Foreign Investment

- The proposed investment projects include:
- US\$2 billion new town project near Phnom Penh,
- US\$200 million oil refinery,
- US\$180 million cement factory,
- US\$34 million hotel and golf club,
- US\$30 million office building,
- US\$27 million power station,
- US\$19 million dry port,
- US\$13 million industrial zone,
- US\$3 million tobacco factory,
- US\$5 million cigarette factor,
- US\$9 million sea port at Kampot and others.

4. Inflation

- Despite high oil prices, the Royal Government has been successful in maintaining inflation under check and ensuring stable exchange rate in general.
- Inflation reached 5.8 percent at the end of 2005. This is in the range that can be managed.

4. Trends in inflation



■ During 1999-2005, the average rate of inflation has been 2.5%;

4. Development of Microfinance, insurance and capital markets

- Microfinance has transformed former Khmer strongholds into prosperous farms;
- The government will introduced life insurance;
- Draft laws and regulations are being prepared for the development of bond markets and stock exchange;
- Accounting and auditing standards were introduced and training is underway to improve corporate governance.

V. External sector performance

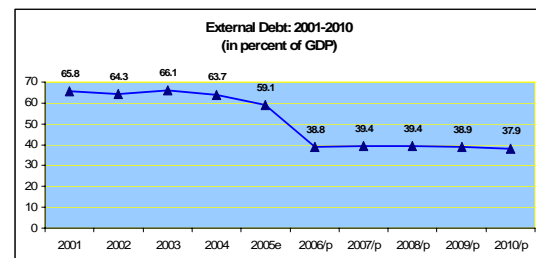
4. External sector performance

- There were signs of improvements, despite high oil prices;
- Provisional 2005 data indicated that the overall balance registered an increased surplus of 1.1 percent of GDP, compared with a surplus of 0.9 percent of GDP a year earlier;
- This improvement resulted mainly from a larger inflow into capital and financial accounts as against last year's performance, which was more than offset by the increase in the current account deficit.

4. External sector performance (cont...)

- Domestic exports are expected to increase by 9.8 percent, while import will increase by 17.6 percent.
- Exports of textile, clothing and footwear, which accounted for 80 percent of Cambodia's domestic exports, continue to expand.
- Non-garment exports were estimated to have increased at a faster pace than the garment sector, albeit from a very low level, and produced only about 13 percent of Cambodia's total export earnings.
- This group includes traditional agricultural commodities such as rubber, wood products, fishery products, and paddy rice.

Cambodia's Performance



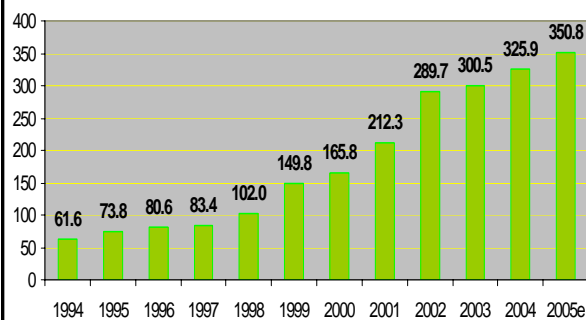
■ The above figures include bilateral debt with the Russian Federation and the US and the decline in 2006 reflects the impact of completing rescheduling agreements on Naples terms with these creditors

V. Social Development and Poverty Reduction

5. Social Development: Education

- Cambodia has made impressive progress in financing and reforming the education sector, with the support of the development partners;
- A focus on primary education, backed with rising public spending, has resulted in more schools and trained teachers, lower direct costs to households;
- From 1994 to 2005, spending on education has increased more than four times in nominal terms, from 61.6 billion to 350.8 billion CRs respectively;
- The government spending has benefited to the poor;

Spending for the Ministry of Education: 1994-2005
(in billions of Riels)



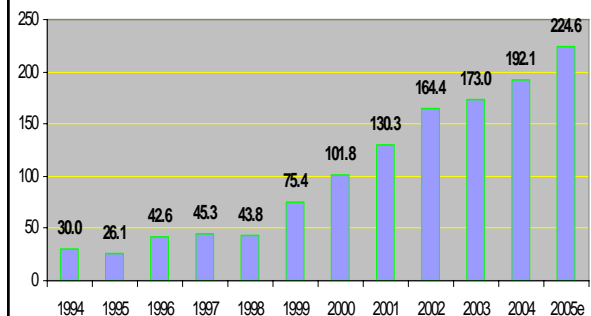
5. Social Development: Education (cont...)

- Increasing net primary enrolment rates from 84% in 2000 to 91% in 2004 (particularly for girls and poor children).
- The percentage of children needing to repeat grades has fallen considerably from 26 percent in 1997 to 10 percent in 2003.
- Concerns for improving quality at all levels however continue and have to be addressed.

5. Social Development: Health

- Significant progress has been achieved in the Health sector as well.
- Health spending has also risen significantly from 30 billion CRs in 1994 to 224.5 billion CRs in 2005 (an increase more than six times).
- All health indices have shown considerable improvement but they are still high;
- IMR has declined from 93 per 1,000 live births in 1998 to 66 per 1,000 live births in 2003;
- Under 5 Mortality Rate declined from 124 to 97 for the same period;
- Life expectancy at birth increased for men from 52 to 60, and for women from 56 to 65 years.

Spending for the Ministry of Health: 1994-2005
(in billions of Riels)



5. Social Development: Health (cont...)

- A spectacular success story is the rapid decline in prevalence of HIV/AIDS (down to 1.9 percent among adults aged 15-49 in 2003, from 3 percent in 1997), brought about RGC's highly focused commitment and excellent collaboration with and among external development partners.
- TB and Malaria prevalence is on the decline.

5. Poverty Reduction

- Poverty in Cambodia has fallen by 10-15 percent between 1994-2004. Poverty headcount reduced from around 47 percent in 1994 to 35 percent in 2004.
- If based on geographic samples of surveys in 56% of total territories, the poverty headcount reduced from around 39 percent in 1994 to 29 percent in 2004.
- Per capita household consumption has risen 32 percent in real terms.
- Critical problems for the urban poor revolve around security of housing rights and opportunities for gainful income generation.

The Way Forward

- PFM Reform is crucial for Cambodia's development;
 - Mainstreaming the Priority Action Program (PAP);
 - Program budgeting linking policies to financing;
 - Public accounting reform;
 - State enterprise reform – performance;
 - Performance based management;
 - Mainstreaming Meritocracy to improve government bureaucracy;
- Ensuring sustained growth;
- Agricultural development for poverty reduction.



Thank you for attention!