CAMBODIA DEVELOPMENT FINANCE ASSESSMENT

DRAFT FOR DISCUSSION

Cambodian Rehabilitation & Development Board (CRDB)
Council for the Development of Cambodia (CDC)

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List of Abbreviations

ACRA	Association of Cambodian Recruitment Agencies
AEC	ASEAN Economic Community
AF	Adaptation Fund
AIIB	Asian Infrastructure Investment Bank
APTA	Asia pacific Trade Agreement
ASEAN	Association of Southeast Asian Nations
BSP	Budget Strategic Plan
CAMFEBA	Cambodian Federation of Employers and Business Associations
CAP	Consolidated Action Plan
CBC	Credit Bureau of Cambodia
CCAPS	Climate Change Action Plans
CCFF	Climate Change Financing Framework
CCSP	Climate Change Strategic Plan (2014-2023)
CDC	Council for the Development of Cambodia
CDM	Clean Development Mechanism
CDP	The UN Committee for Development Policy
CIB	Cambodian Investment Board
CMA	Cambodia Microfinance Association
CMDGs	Cambodia Millennium Development Goals
COFOG	Classification of the Functions of Government
CPEIR	Climate Finance Public Expenditure Reviews
CPIA	Country Policy & Institutional Assessment (WB)
CRI	Climate Relevance Index
CRDB	Cambodian Rehabilitation and Development Board
CSEZB	Cambodian Special Economic Zone Board
CSR	Corporate Social Responsibility
DCC	Department of Climate Change
DCPS	Development Cooperation & Partnerships Strategy 2014 - 2018
DFA	Development Finance Assessment
EBA	Everything but Arms initiative
EDC	Electricité du Cambodge
FDI	Foreign Direct Investment
FMIS	Financial Management Information System
FRC	Final Registration Certificate
GAVI	Global Alliance for Vaccine & Immunization
GCF	Green Climate Fund
GDCE	General Department of Customs and Excise
GDFI	General Department of Financial Industry
GDP	Gross Domestic Product
GDSPNTR	General Department of State Property and Non-Tax Revenue
GEF	Global Environment Facility
GFATM	Global Fund for Aids, Tuberculosis and Malaria
GSP	Generalised System of Preferences
IBRD	International Bank for Reconstruction and Development (WB)
IDA	International Development Association (WB)
IDP	Industrial Development Policy 2015 – 2025
IFC	International Finance Corporation
ILO	International Labour Organisation
IMF	International Monetary Fund
INDCS	Intended Nationally Determined Contributions

INFFs	Integrated National Financing Frameworks
JMI	Joint Monitoring Indicators
LDC	Least Developed Countries
LMIC	Lower Middle Income Country
LMP	Labour Migration Policy
MDG	Millennium Development Goal
MEF	Ministry of Economy and Finance
MIGA	Multilateral Investment Guarantee Agency
MAFF	Ministry of Agriculture, Forestry and Fisheries
MEF	Ministry of Economy and Finance
MIC	Middle Income Country
MFIS	Micro-finance Institutions
MoE	Ministry of Environment
MOLVT	Ministry of Labour and Vocational Training
MOFAIC	Ministry of Foreign Affairs and International Cooperation
MoP	Ministry of Planning
MOWRAM	Ministry of Water Resources and Meteorology
MTFF	Medium-Term Fiscal Framework
NBFI	Non-Bank Financial Institutions
NCD	Negotiable Certificates of Deposit
NCFF	National Climate Funding Facility
NPRS	National Poverty Reduction Strategy
NSDP	National Strategic Development Plan
ODA	Official Development Assistance
OOFs	Other Official Flows
PBA	Programme-Based Approaches
PEFA	Public Expenditure and Financial Accountability Assessment
PER	Public Expenditure Review
PIP	Public Investment Programmes
PFM(RP)	Public Financial Management (Reform Programme)
PPP	Public Private Partnership
PSD	Private Sector Development
QIP	Qualified Investment Projects
R&D	Research & Development
RGC	Royal Government of Cambodia
RMS	Revenue Mobilisation Strategy 2014-2018
ROE	Return on Equity
RS	Rectangular Strategy
SAFTA	South Asian Free Trade Area
SDG	Sustainable Development Goals
SEDP	Socio-Economic Development Plans
SEZ	Special Economic Zone
SNEC	Supreme National Economic Council
SOEs	State-Owned Enterprises
SOPs	Standard Operating Procedures
SRDP	Socio-Economic Rehabilitation and Development Programs
SWAp	Sector Wide Approach
TPP	Trans Pacific Partnership
UNEP	United Nations Environment Programme
UNFCCC	United Nations Framework Convention on Climate Change
VAT	Value Added Tax
WHO	World Health Organization
WB	The World Bank Group

Executive Summary

Introduction and Objectives of the Development Finance Assessment

As a newly classified Lower-Middle Income Country, Cambodia is seeking to consolidate and maintain its impressive track record of socio-economic progress. But realising Cambodia's aspiration to reach upper-middle income country status by 2030, together with the implementation of the 2030 sustainable development agenda, demands a vision that is broader, more holistic and more ambitious**.** Achieving national development objectives and the SDGs will demand the mobilisation of a significantly increased level of resourcing and will require more complex and comprehensive financial management structures for both private and public sources.

To address these challenges, the Royal Government of Cambodia has established a wide range of policy initiatives and reforms. Drawing from these policies, and reviewing institutional arrangements and implementation, this Development Finance Assessment (DFA) provides an overview of resources potentially available for financing Cambodia's development over the medium-term. It emphasises the important role of domestic resource mobilisation and the private sector as well as the continued but evolving role of external cooperation.

Specific objectives of this DFA include examining current resource flows and their management, providing projections for medium-term financing (to 2025), and making recommendations for strengthening capacity for the longer-term management of development finance.

Context

Cambodia has made significant progress in implementing its socio-economic development agenda: economic growth has averaged 7.7% per year over two decades and poverty has declined from 53.2% in 2004 to 13.5% in 2014. MDG performance has been amongst the best in the world as the country's socio-economic performance has been internationally acclaimed and the IFIs have referenced Cambodia as an Olympian of Growth and Asia's New Tiger Economy.

In spite of these achievements, Cambodia still faces a number of development challenges. To finance and support its next stage of national development, the Royal Government will need to mobilise and manage a broader and more diverse range of development resources. To do this it will be advantageous to adopt a holistic planning system that extends beyond traditional public sector budgeting to include the resources mobilised by all development actors*.*

The quality of the links between the national plan and the budget is a key area that is currently be strengthened through the introduction of Program Based Budgeting and Budget Strategic Plans. Specific issues to address include: (i) most sectors have strategic plans but no costing (except education and to a large extent health); (ii) recurrent and (externally-funded) capital expenditures are prepared separately and are not linked; and (iii) links between aid-funded investment and sector strategies remain weak and supply-driven.

Current institutional arrangements also support medium and long-term planning. The Rectangular Strategy, complemented by the NSDP and individual sector strategies, provides a strategic and effective orientation over a five-year period. There is also evidence that cross-sector issues are also being addressed in long-term policies and plans such as the IDP, the Climate Change Strategic Plan, a Financial Sector Development Strategy and a PPP Policy.

An additional challenge is the limited capacity to address cross-sector prioritisation and operational coordination. Factors to consider in promoting implementation capacity include: (i) Focus on clearly defined and measurable goals; (ii) establishing targets and responsibilities to motivate and guide stakeholders; (iii) developing a clear implementation plan to link resources, actions and goals; and (iv) ownership, leadership and coordination arrangements.

As Cambodia moves to address these issues, it's re-classification as a Lower-Middle Income Country affects the availability of external support. Grant-funding may be replaced by concessional loans while net ODA may fall as new disbursements are reduced or off-set by loan amortization. By the time of Cambodia's graduation from LDC status - perhaps in another decade - the expected progress in many indicators of human development will likely be additional factors influencing sharp reductions in ODA. Cambodia needs to: (i) ensure a close link between priorities and development finance; and (ii) engage with existing and new external partners to maintain the resource flow.

Cambodia also needs to be mindful of avoiding the Middle Income Trap, which occurs as current drivers of growth are gradually eroded but are not replaced by a new growth dynamic. Specifically, policies are required to address: (i) the structural change trap (moving from an economy characterised by low-cost labour and abundant natural resources towards attracting higher quality FDI based on higher skills, productivity and competitiveness); (ii) the governance trap (strengthening capacity to implement cross-sector policies and to manage and regulate economic activity); and (iii) the financial trap (increasing domestic revenue performance and establishing complementary ties with private sector finance).

Assessing Public Development Finance Flows

The availability and quality of public finance will be a decisive element to support the implementation of national development priorities and the sustainable development agenda. The RGC has succeeded in mobilising resources to support its national development effort and has ensured macroeconomic stability. Financing the next phase of national development places an emphasis on social and physical infrastructure. Increased investments are required in education together with improvements in the business environment and the promotion of competitiveness and diversification.

However, Cambodia remains dependent on external resources to finance capital investments: 71% of capital expenditure in 2015 was externally funded. This is of medium-term concern as availability and alignment with national priorities remain challenging. It will therefore be critical to implement budgetary reforms to develop the necessary fiscal space and reallocate resources.

Public Revenue

Consistent reforms to both tax policy and administration over more than two decades yielded positive results. The tax base remains small, however, mainly due to the narrow economic structure. Current levels of revenue/GDP are comparable to a number of its neighbors and to those of other ASEAN countries. The Revenue Mobilisation Strategy (2014-2018) sets an ambitious goal to raise domestic revenue by 0.5 percentage points of GDP annually, from 15.18% in 2014 to 17.35% in 2018.

Implementation of the RMS will demand higher levels of coordination and commitment from ministries and other institutions while significant capacity development is still needed to raise customs and non-tax revenues. Options for widening the tax base include: i) income tax, ii) expansion of property tax base, iii) including more individuals and SMEs and, iv) the Large Taxpayers Department.

External development cooperation (ODA providers)

ODA increased rapidly in the decade to 2011 then peaked in 2012 before beginning to decline from 2013 (in volume and as a % of GDP). The decline in ODA flows is expected to continue. Alignment with national priorities is assessed positively, however analysis based on NSDP requirements shows that there is scope for improvement both across and within sectors.

The Development Cooperation and Partnerships Strategy 2014-2018 (DCPS) sets out objectives, principles and policy tools for maximizing the impact of all external cooperation as well as for promoting partnerships and impact with all development actors (NGOs, South-South, private). Improved budget integration - through the BSPs and/or the SOPs for Donor Funded projects - should be emphasized while the DCPS results framework can be more strategically linked to that of the NSDP to ensure that external resources are aligned with priorities and contributing to development impact.

Public Climate Change Finance

External finance is the largest source of funding: only one-quarter of total public climate expenditure was funded by the national budget in 2014. External climate finance for the public sector has been volatile but the trend is positive and significant growth is possible if RGC can strengthen capacities for mobilising and accessing these funds.

The RGC has taken bold and consistent steps to organize the RGC climate change response. Policy and monitoring are now strong and resource tracking is at the forefront of international best practice. The introduction of the Climate Change Action Plans (CCAPs) has enabled RGC to estimate demand-supply alignment for climate finance and forms the basis for further mobilisation and programming work. Effort is now needed to ensure that PFM and ODA management address key climate finance issues in line with the CCSP 2014-2023. To sustain climate financing the establishment of a National Climate Funding Facility (NCFF) with a strengthened role for the NCSD is recommended.

South-South and Triangular Cooperation (SSC)

Cambodia has well-established SSC partnerships with China, Malaysia, Thailand, Indonesia and Singapore. China is the major source, mainly through loans that are ODA-like in concessionality but further improvements in volume could be achieved by broadening the base of SSC partners. There is also potential for accessing increased technical cooperation support (as opposed to capital finance), especially in issues specific to MICs (remittances, industrialization, skills upgrading).

Overall policy guidance for managing South-South Cooperation is set out in the Development Cooperation and Partnerships Strategy. A more strategic use of SSC could be achieved by identifying current needs and matching them with potential providers of SSC support, especially from the Asia-Pacific region. Ownership and alignment can be promoted via existing policy, planning and review processes so that common principles and practices are applied to all providers of external cooperation. Information on provision and results needs to be more systematically collected and analysed in order to ensure impact and inform further SSC mobilisation efforts.

Assessing Private Development Finance Flows

Future provision of development finance is expected to draw increasingly from the private sector. From an economic development perspective, the private sector has been the key driver of Cambodia's GDP growth in the last decade, accounting for approximately 21.5% of GDP in 2015. A marked process of structural change and modernisation has occurred: until the mid-90s agriculture accounted for almost one-half of Cambodia's GDP but by 2013, its share fell to only 31.6 while the contribution of Industry rose from 16.7% to 24.1% and that of services from 34.8% to 38.5%.

However, Cambodia's levels of domestic investment are low if compared to other countries in the region. Challenges to improving competitiveness include: i) institutional/policy capacity; ii) infrastructure (power and transportation); iii) education, training and entrepreneurship; (iv) access to bank financing; and (v) industrial relations.

Bank and Micro-finance lending

Cambodia's GDP growth has been credit-intensive yet not accompanied by an increase in private investment. Financial inclusion has been growing: micro Finance Institutions (MFIs) are well developed and account for 25% of new lending and 20% of outstanding loans. Risks relate to rising financial sector vulnerabilities (high loan to deposit ratios and exposure to real estate speculation). The successful introduction of the Credit Bureau of Cambodia or (CBC) has resulted in substantial improvements in credit quality. Strengthening overall monitoring, coordination and supervision by the NBC is needed.

Foreign Direct Investment (FDI)

FDI has increased in volume as well as in its share of GDP: USD 1.73 billion in 2015, equivalent to 9.6% of GDP. FDI investments in Cambodia are mainly concentrated in garments, tourism, construction and agriculture. Competitiveness through low wages and LDC-related preferential access to EU markets has helped to mobilise FDI but these conditions may change as wage increases diminish competitiveness and competitors secure favorable access to export markets.

The government has succeeded in attracting FDI to the Special Economic Zones (SEZs) that create favourable conditions for export-oriented manufacturing. Laws and regulations are favorable but key challenges - infrastructure, energy, skills - must be addressed.

Public-Private Partnerships

Most PPPs are located in the electricity sector with some in the telecommunications, airports and roads. PPPs are not standardized, and previously they were issued on an ad hoc, reactive, unsolicited, and negotiated basis, rather than through proactive preparation and competitive tendering.

A Policy Paper on Public-Private Partnerships for Public Investment Project Management was approved in June 2016 and focuses on improving the legal, regulatory and institutional frameworks. The government has also embarked on a substantial capacity building programme for utilizing PPPs. An Infrastructure Investment Plan with prioritized PPPs should be developed as a key element of the IDP.

NGO, Impact investing and local philanthropy

NGO finance in 2015 (USD 227.5 million) was equivalent to 1.25% of GDP (16.9% of total external cooperation). The focus of NGO support is on community and social welfare, education and health. Local and international NGO subsectors are highly concentrated: 15 local NGOs account for 75% of local NGO expenditure and 15 international NGOs for over 50% of all international NGO funding. There is good potential for consolidating and expanding access to NGO funds as well as to promote increased alignment with national priorities.

Remittances

MoLVT reported 700,000 migrants remitting over USD 1 billion inflows in 2015. The volume of internal migration is even larger, with more than two million migrant laborers. Recent studies show that households receiving remittance income have higher school participation and education expenditure, emphasising the developmental impact of remittances. The Labour Migration Policy (2015-2018), provides the framework to govern labour migration, protect migrants' rights and improve the development impact of remittances, however, significant inter-ministerial coordination is required to achieve its goals.

Private sector climate finance

The role of private sector in climate finance is still limited, mainly in the Clean Development Mechanism (CDM), but is expected to increase. The absence of reliable and comprehensive data on private climate-related investments is a challenge for government's capacity to monitor, influence and improve this flow. Major changes in volume are possible, however this is an area where policy needs strengthening. Oversight must be improved to focus on facilitating alignment with national priorities, Cambodian bank lending is under-utilized and the climate risk insurance system is under-developed. The strategic integration of the CCSP and the IDP would help to identify a priority agenda for mitigation investments that can form the basis for public policy and private sector investment.

Corporate Social Responsibility

Cambodia's CSR sector is in its infancy but it represents an untapped opportunity to support the development effort of the Government. CSR is a fast-growing practice: international companies replicate models developed elsewhere while local companies also have well-established and highly-regarded CSR programmes. There is potential to expand CSR models to complement Government-led development.

Projections of medium-term development finance

The DFA models resource availability to 2025 while recognising that respective flows are more/less under Government control and there are varying degrees of difficulty in aligning them with national priorities. The DFA projection model took into account three main factors:

- ***Cambodia-specific factors*** - the relative attractiveness of Cambodia as an investment destination (endowment of infrastructure and skilled labour, the costs of doing business, the relationships between government and donors, the ability to turn policies such as the IDP into viable projects).

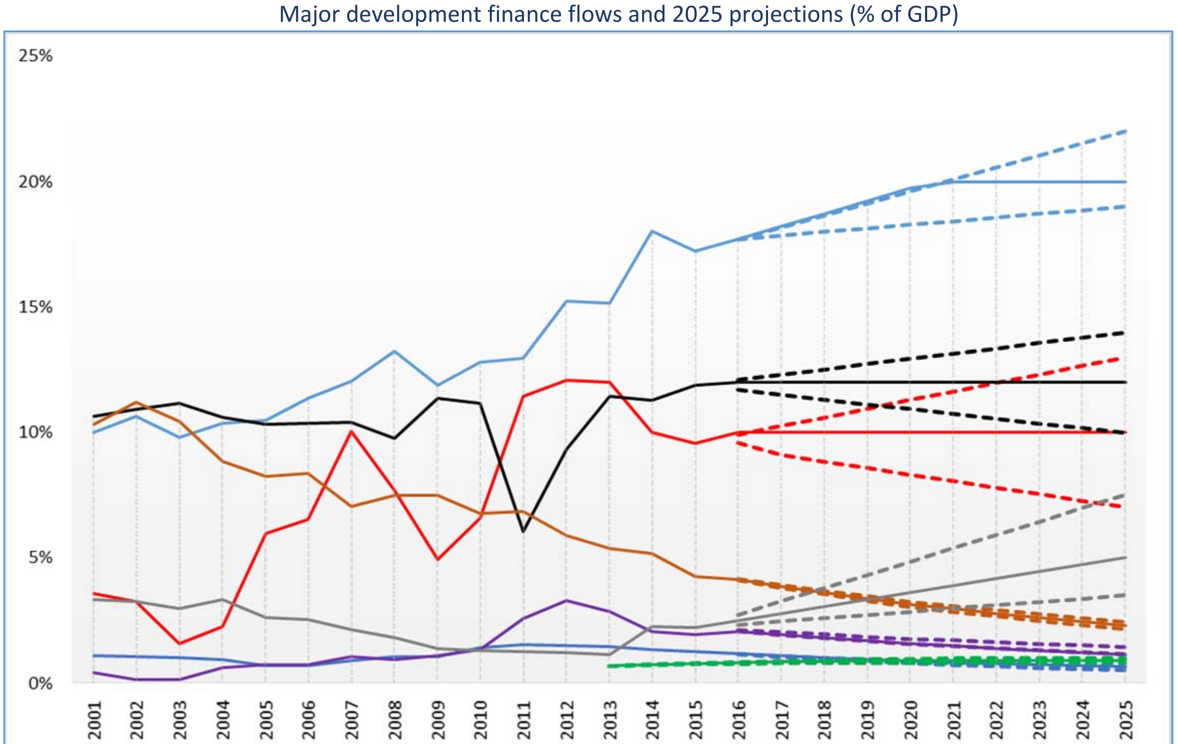
- ***Interaction between flows*** - good performance in mobilising and managing a particular resource flow, domestic revenue or ODA for example, will likely have positive "crowding in" effects on other flows, e.g. FDI and private investment.
- ***Global economic factors*** - FDI, private investment, remittances (via the demand for labour) will all be driven by external factors, most obviously the global economic business cycle. Cambodia will also be affected by the relative attractiveness of competitors (e.g. Bangladesh and Myanmar for light manufacturing as well as Vietnam's relative attractiveness to FDI in light of its EU trade agreement).

Summary of DFA Economic Projections

	2015		2020		2025	
	USD m	% GDP	USD m	% GDP	USD m	% GDP
Domestic Revenue	3,114	17,2	5,011	19.7	6,961	20.0
Domestic Private Investment	2,147	11.9	3.048	12.0	4,176	12.0
FDI	1,732	9.6	2.540	10.0	3,480	10.0
Remittances	397	2.2	914	3.6	1,740	5.0
ODA	767	4.2	800	3.1	800	2.3
South-South Cooperation	349	1.9	400	1.6	400	1.1
Climate Finance	140	0.8	226	0.9	312	0.9
NGOs	226	1.3	225	0.9	225	0.6
Total Development Finance	**8,873**	**49.1%**	**13,164**	**51.8%**	**18,094**	**52.0%**

The total financing that would be potentially available for supporting national development more than doubles (to USD 18 billion) in nominal terms, but as a share of GDP, it rises by only by 3 percentage points to 52%. This seems to be insufficient to sustain Cambodia's future finance needs and therefore, reinforces the need to intervene with a more strategic approach to development finance.

Major development finance flows and 2025 projections (% of GDP)



Domestic revenue	South-South Cooperation
Private investment	Remittances
FDI	NGO
ODA	Climate finance

Main Conclusions

There are a number of new financing opportunities that can be usefully explored even as LMIC and LDC graduation may significantly affect access to finance and trade. A smooth transition requires dedicated government leadership and significant institutional reforms. These could be articulated in a dedicated *Economic Transition Plan* or managed as part of the routine national planning exercise.

Transition will require a more strategic allocation of scarce resources to catalyse investment as well as to secure necessary reforms and capacity development. First, the government will need to coordinate policies to ensure that the current growth and resourcing model can be maximised for the longest possible period. Second, complementary actions should establish the foundations for the new economic development model, the wider finance flows that should sustain it and the respective institutional arrangements.

In order to move forward, the Royal Government should continue to explore policy and institutional solutions to address complex, cross-sector priorities. This mainly relates to the implementation of the major reform programmes but should be extended to include the strengthening of research capacity and the development of monitoring systems to inform decision-making across program areas. Institutionalising DFA work to ensure development finance is diversified and maximised, balancing investment and capacity development priorities, will also require adopting *whole of Government approaches*, especially for the IDP and SDG agendas.

Further research into the key flows and their inter-linkages is also desirable to ensure their maximum developmental impact as well as to identify policy solutions and institutional actions on a timely basis. This may include more in-depth economic modelling linked to the LDC graduation process and the use of resources to further accelerate national development.

1. Introduction

1. In July 2016, Cambodia's re-classification as a Lower-Middle Income Country (LMIC) was confirmed. As a newly classified LMIC, Cambodia is seeking to consolidate and maintain its impressive track record of socio-economic progress. Cambodia aspires to reach the status of an Upper-Middle Income Country by 2030 and a High-Income Country by 2050.

1. The emerging post-2015 development agenda demands a vision that is broader, more holistic and more ambitious than that of the MDGs**.** Cambodia's development challenges will become more complex while, at the global level, the Sustainable Development Goals (SDGs) aim to complete the unfinished business of the MDGs and seek progress across all three dimensions of sustainable development: social, economic and environmental. Achieving national development objectives and the SDGs will demand the mobilisation of a significantly increased level of resourcing and will require more holistic financial management structures for both private and public sources.

2. At the global level, the SDGs will require the best possible use of domestic and external resources, including to utilise private sector partnerships on a much increased scale. Domestic tax revenues must be combined with effective management of other finance flows including ODA, south-south cooperation, international philanthropy, remittances, and foreign direct investment. Together this potential financing from all global sources could amount to nearly USD 1 trillion: Cambodia will have to compete for its share of existing funds as well as for new funding opportunities such as in climate change. A more strategic and coordinated use of domestic and external resources will also be needed, especially to support the development of government capacities to manage key finance flows as well as to establish and strengthen a wide range of partnerships among development actors. The Royal Government will need to increase the mobilisation of public resources substantially, and boost private sector development, finance and investment.

3. To strengthen its response to these challenges, the Royal Government of Cambodia has established a wide range of policy initiatives and reforms. These are managed within the framework of the Rectangular Strategy Phase III, which prioritizes five main policy areas: i) Good governance; ii) Infrastructure; iii) Agriculture; iv) Private sector development; and (v) Capacity and human resources. At the national and sector level, specific policies and strategies have been formulated, oriented by the National Strategic Development Plan (NSDP). A wide-range of public sector reforms is being implemented to improve Public Administration, Public Financial Management, Subnational Democratic Development and the Legal & Judicial system.

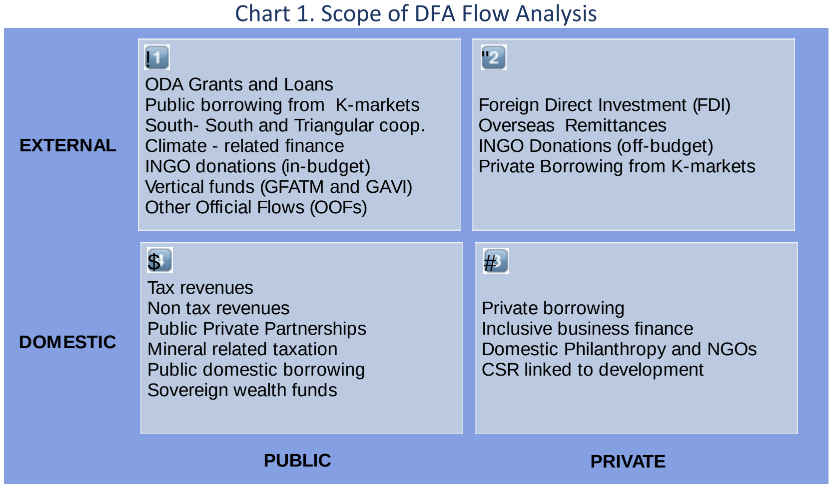
4. Long-term guidelines to further develop the economy and address the three dimensions of sustainable development (social, economic and environmental) were recently developed. Cambodia's first Industrial Development Policy (2015 – 2025) was launched in 2015. Recognizing challenges and opportunities at the regional and global level, the IDP's objective is to maintain a high level of sustainable and inclusive economic growth. This is to be achieved through economic diversification while strengthening competitiveness and promoting productivity. The Climate Change Strategic Plan (2014-2023) represents a further part of the policy response and aims to address economic development and poverty alleviation in a transition towards a green economy as the basis for low-carbon, climate-resilient development. The Climate Change Strategic Plan also takes note of strategies in other key sectors to ensure overall consistency and a cross-Government approach to addressing the adaptation to the potential effects of climate change.

2. Purpose and Objectives of the Development Finance Assessment (DFA)

5. The primary purpose of the Development Finance Assessment (DFA) is to present a comprehensive view of resources potentially available for financing Cambodia's development needs over the medium-term, i.e. the next decade including findings and recommendations to inform discussion and decision making. It emphasises the important role of domestic resource mobilisation and the private sector as well as the continued but evolving role of aid and partnerships with development partners. By using national data as well as regional and global cross-country comparisons, this report will identify opportunities to manage a wide range of development finance sources in a coherent manner, which is necessary if the country is to take full advantage of funding opportunities to address the achievement of Cambodia's long-term development goals and the SDGs.

6. The Development Finance Assessment will be used further to develop an *Integrated National Financing Frameworks* that records government resources and all other funding sources relevant to the achievement of their development priorities and results. The DFA therefore serves as a comprehensive tool to map past, current and potential future sources of development finance, reviewing a broad range of development finance flows from domestic and external, public and private sources as shown in Chart 1 below (some are not relevant in Cambodia's context and therefore are not included in the analysis).

Chart 1. Scope of DFA Flow Analysis



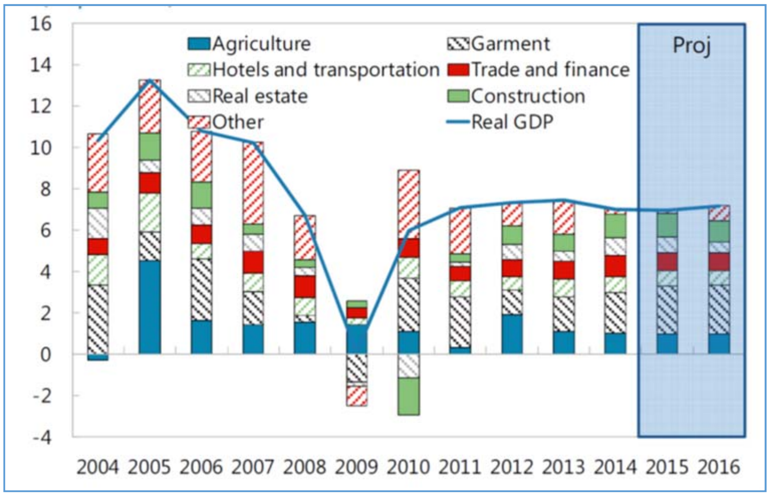
7. Specific objectives of this assessment include:
   - To understand the context in which development finance is currently mobilised and managed.
   - Provide an overview of the evolution, use and impact of the main flows of development finance.
   - Assess the links between finance and results and national planning-budgeting processes.
   - Assess the roles of national institutions in managing each of the individual financial flows.
   - Analyse the complementarities between the different sources of development finance.
   - Provide projections - and underlying assumptions - for medium-term financing (to 2025).
   - Make recommendations for strengthening capacity for the management of development finance.

8. The DFA is organised in the following sections:
   - Section 3 outlines Cambodia's socio-economic context, key development challenges and arrangements for planning and programming development activities.
   - Section 4 analyses the quantitative and qualitative aspects of public finance management and the main sources of public finance available in the medium term.
   - Section 5 examines the extent to which current efforts to strengthen private sector development are aligned with national priorities and the main sources of private finance
   - Section 6 proposes a prospective framework to analyse the future development of finance flows, models financing assumptions and produces projections of major development finance flows to 2025.
   - Section 7 outlines the initial conclusions and the main actions emerging from the DFA.

3. Context: Linking Policy to Resources and Results

9. Cambodia has made significant progress in implementing its socio-economic development agenda. Economic growth averaging 7.7% per year over two decades has resulted in the poverty rate declining from 53.2% in 2004 to 13.5% in 2014. Chart 2 illustrates the main drivers of growth: the garment sector (employing 650,000; 73.7% of total exports), construction and real estate, and hotels and tourism.

Chart 2. Contributors to economic growth in Cambodia (% of GDP)



Source. IMF Article IV 2015 pp 22

3.1 Recalling Cambodia's impressive record of socio-economic development

10. The country's socio-economic performance has been internationally acclaimed:

- ***Consistent economic growth*** - the IFIs have noted Cambodia's remarkable growth over 20 years, an Olympian of Growth and Asia's New Tiger Economy.
- ***Rapid and sustained poverty reduction*** - there has been a significant decline in poverty from 53.2 % in 2004 to 13.5% of the population in 2014.
- ***MDG performance amongst the best in the world*** - Cambodia is one of very few countries that have outperformed the MDG targets on poverty reduction and other social indicators.
- ***Strong external sector*** - Cambodia is also one of the largest recipients of foreign direct investment (FDI) and a top exporter of textiles.

11. In addition to halving the poverty rate and meeting CMDG 1, Cambodia has achieved its goals in primary school enrolment (CMDG 2), reducing infant and child mortality (CMDG 4), reduction of maternal mortality (CMDG 5), and excellent progress in prevention of HIV/AIDS (CMDG 6). CMDG 9, which focuses on de-mining, has also made recorded significant achievements.

12. Other CMDGs, for example in accessing water and sanitation and in advancing gender equality, are also approaching their 2015 targets. Advances in human development are consistent with the experience of the CMDGs. Over the 20-year period 1990-2010, the UNDP Human Development Index (HDI) increased at 1.8% per year, placing Cambodia amongst the world's fastest-developing countries.

13. In spite of these achievements, Cambodia still faces a number of development challenges: the 'near poor', living just above the poverty line, remain vulnerable to shocks and access to social services, particularly to health and education requires further efforts. Cambodia is also highly vulnerable to climate change.

14. To finance and support its next stage of national development, the Royal Government will need to mobilise and manage a broader and more diverse range of development resources, looking beyond development cooperation as a principal financer of investment and social service delivery. To do this it will

be advantageous to adopt a holistic planning system that extends beyond traditional public sector budgeting.

3.2 Cambodia's long and medium-term planning and public finance management

15. Cambodia impressive economic performance was to some extent based on the country's capacity to build quality national development plans and to integrate them with available national and external financing. Two decades of PFM reform have been complemented by quality of national planning and aid management.

The National Planning System

16. Since 2008, the RGC has synchronised the planning process with the political mandate and the *NSDP Update 2009-2013* emerged to implement the *'Rectangular Strategy'*, which lays out the 5-year priorities for the socio-economic development agenda of the Royal Government of Cambodia. This brought about significant improvements in planning, including the introduction of results frameworks and indicators. The *NSDP Update 2009-2013* was the first to introduce costing estimates that link finance and actions. The *NSDP 2014-2018* provides medium-term financial estimates for capital investment from private and public sources.

Public Finance Management Reform

17. The RGC embarked on a long-term *Public Financial Management Reform Programme (PFMRP)* to strengthen PFM systems in line with international standards. The PFMRP was designed as a comprehensive long-term undertaking with four phases: i) budget credibility, ii) financial accountability, iii) linking budget to policy; and, iv) accountability for results. A notable aspect of PFM reform concerns the introduction of *Program Based Budgeting (PBB)* to align the budget with policy, establish main program activities in the budget, and introduce performance indicators and monitoring. By these measures, there has been significant progress that also makes it possible to conceive of a wider system that can record and coordinate a broad range of development finance sources.

Building a Robust ODA Management System

18. The Royal Government has succeeded in mobilizing significant development cooperation resources to support socio-economic development, reaching levels over USD 1 billion annually since 2008 and accounting for approximately 10% of GDP. The RGC *Development Cooperation & Partnerships Strategy 2014–2018* identifies the main principles and tools, including results frameworks, use of PBAs and resource transparency that will serve as the basis for further strengthening development cooperation.

3.3 The government budget as a strategic finance tool

19. The national budget provides a strategic tool for implementing public policy priorities. The budget process has been gradually strengthened to integrate domestic and external resources. Overall medium-term financing coherence is promoted by an initial alignment of the financial estimates provided in the NSDP with a general Macroeconomic Framework for the five-year period prepared by the MEF. This top-down methodology provides general ceilings but generally excludes resources required for strengthening the capacities of the government institutions.

20. **Public Investment Programmes (PIP). The** Ministry of Planning facilitates a bottom-up three-year rolling investment plan for identifying and listing specific and priority projects with the aim to achieve sector and NSDP targets. The PIP is updated annually and includes both funded and pipeline projects.

21. **Medium-Term Fiscal Framework (MTFF).** The MTFF provides annual projections of the revenue and indicative recurrent expenditures for the next 3 years. It is prepared by the MEF and is based on top down projections derived from the Macroeconomic Framework. The MTFF also lists capital expenditure priorities.

22. **Budget Strategic Plan (BSP).** The BSP is a 3-year plan that follows a bottom-up approach. It is developed by line ministries to reflect required resources for capital and recurrent expenditures at national and sub-national levels. The BSP was introduced by MEF to link policy to budgeting, moving away from incremental line-item budgeting towards a more programmatic and results-based approach. External cooperation is embedded in the system using information provided by CDC's ODA Database.

Assessing performance of the planning and budget system

23. The quality of the links between the national plan and the budget is measured by different international assessments. The World Bank's CPIA indicator has improved slightly from 2.5 in 2005 to 3.0 in 2015. Overall, values for macroeconomic management and fiscal policy have remained stable while the overall CPIA Rating moved up from 3.1 in 2005 to 3.4 in 2015. This progress compares favourably when benchmarked with other developing countries in the region, LDCs and the Low-Income Countries group. The Public Expenditure and Financial Accountability Assessment (PEFA) conducted in 2015 shows continued challenges in linking policy and budget (a 'C' for this indicator since 2010). The assessment attributed this rating to: (i) most sectors have strategic plans but no costing (except education and to a large extent health); (ii) recurrent and (externally-funded) capital expenditure plans are prepared separately and are not linked; and (iii) links between aid-funded investment and sector strategies remain weak and supply-driven.

24. Solutions identified by MEF include additional innovations to the PFM reform including the consolidation of program budgeting and its gradual extension towards performance budgeting. The expected progress for development cooperation management is in line with these goals, based on using development effectiveness principles to promote a results-based approach, strengthen alignment and resource transparency, and promote a catalytic role for ODA (e.g. in supporting the IDP).

3.4 Developing the system to address sustainable development challenges

25. As Cambodia's reforms move forward and the economy becomes more sophisticated, the development challenges confronting the country become more complex and cross-sector in nature. The localisation of the SDGs, which are highly inter-dependent, also demands an integrated vision of sustainable development. Longer-term approaches emphasise coherence between long-term planning and resourcing. Table 1 shows some of the main priority issues addressed, which will require the strategic mobilisation of resources and coordination of efforts across a range of public and private actors.

Table 1. Key PFM issues and proposed improvements

Area	Key Improvements in process or forecasted
MTFF	• Coverage of budget estimates for all sectors to improve the basis for budget allocations • 3-year fiscal forecasts to include sector, function and administrative classifications
PIP	• A system of project prioritisation is needed • PIP quality to improve by promoting Government-led project formulation (not supply-driven) • Difficulties to formulate and implement long-term projects to address cross-sector priorities • Recurrent expenditure requirements are not captured • Off-budget and NGO projects funded directly by donors are excluded • Capacity of line ministries is limited and not linked to BSP work
BSP	• More accuracy and improved costing is required (with links to sources of funding) • Program-based budgeting linking inputs & outputs is still weak • Major elements of the budget are missing from program budgeting (capital items) • Budget integration and recurrent/capital coherence requires further strengthening • Levels of understanding and capability in LMs is inconsistent and needs support • PB is not fully supported by FMIS and audit systems; further integration is needed • Budget negotiations are still based mainly on line items and BSPs have limited use • Annual reporting of program results is not well established
ODA Management	• ODA for investment remains a large budget share but requires improved alignment with PIP & budget • Coherence between CDC, MoP and MEF data to be improved • The information about NGO assisted projects must be reflected in planning & budget • ODA Database information is provided by donors and needs reconciliation with LM systems • The DCPS results framework must be fully implemented to ensure real progress • ODA funds projects supported by EDPs that are not part of the PIP • Implementation of the SOPs for Donor Funded projects is not fully applied • Most EDPs are not using Government PFM systems (loans use the system automatically)

Developing and financing integrated and consistent long-term strategies

26. The Rectangular Strategy, complemented by the NSDP and individual sector strategies provide a strategic and effective orientation over a five-year period. There is also evidence that cross-sector issues are also being addressed in long-term policies and plans such as the IDP, the Climate Change Strategic Plan, a Financial Sector Development Strategy and a PPP Policy. To ensure consistency and coherence across national policies and strategies, the Cambodia Vision 2050 which is being finalized and is expected to be

completed before the end of 2017 will inform the formulation of the socio-economic development agenda of the next government.

Financing and implementing complex, cross-sector strategies

27. Several government reports point out that a major challenge is the limited capacity to address cross-sector prioritisation and operational coordination. This concern is already expressed in the Cambodia Industrial Development Policy.

28. The current implementation arrangement is not capable of delivering a systematic solution for these major issues. This problem is not caused by the fact that the solution requires a long-term vision, which the *PFMRP* demonstrates Government capability for; rather there are challenges related to high-level and technical-level inter-ministerial coordination for implementation. As a result, the implementation of many long-term strategies has been slower than predicted.

29. A notable exception of cross-sector strategy implementation stands out: the Policy on the Promotion of Paddy Production and Rice Exports, which was approved by the RGC in 2010. This Policy seems to have triggered impressive and unprecedented levels of coordination and of quality government interventions. It provides a good reference for possible replication: the Policy set in motion a number of processes that moved the country forward and produced impressive results: Cambodia is now the world's 8th largest rice exporter. The Rice Policy is now being reviewed and finalised with the aim to achieve rice exports of 1 million tonnes per year by 2018.

30. Factors that may be relevant in promoting implementation capacity elsewhere include:

- **Focus:** the government focused on a particular commodity instead of the whole agriculture sector
- **Targets:** Clear and ambitious policy targets were spelled out to motivate and guide stakeholders
- **Implementation Plan:** the policy provided a well-defined action plan that defined goals and actions
- **Ownership, Leadership and Coordination:** since its inception, this policy has been under the direct supervision of Samdech Techo, Prime Minister of the Kingdom of Cambodia.

3.5 Managing middle-income country status

31. Cambodia's re-classification as a Lower-Middle Income Country affects the type of financial support available from the World Bank and, potentially, other sources. Currently, Cambodia may continue to access funds from the highly-concessional IDA window but is nearing the 'blend finance' point and IDA graduation. Other donors, such as the ADB, and several OECD/DAC bilaterals, also take note of LMIC status when considering their own support. Grant-funding may be replaced by concessional loans while net ODA may fall as new disbursements are reduced or off-set by loan amortization. Many other factors affect funding decisions, not least status as an LDC but Cambodia needs to: (i) ensure a close link between priorities and development finance; and (ii) engage with existing and new external partners to maintain the resource flow.

3.6. Preparing for graduation from Least Developed Country (LDC) status

32. The LDC classification is administered by the UN based on GNI per capita, human assets and economic vulnerability. Graduation requires meeting two of the three main criteria: Cambodia has already met the Human Assets criteria and may meet the Economic Vulnerability criteria in the near future. Graduation is then reviewed and confirmed over a period lasting at least six years and will impact mainly on ODA receipts and trade access.

33. Cambodia's present and future development is highly dependent on the expansion of trade and foreign investment and actions within the context of LDC support arrangements should be targeted at strengthening trade capacity and institutions. Cambodia should therefore maximise access to LDC support: there are more than 100 trade-focused mechanisms and initiatives available to support LDCs and a dedicated Programme of Action. By the time of Cambodia's graduation from LDC status - perhaps in another decade - the expected progress in many indicators of human development will likely be additional factors influencing sharp reductions in ODA.

3.7 Preventing Middle Income Country Traps

34. Middle Income Countries face challenges as drivers of growth at low income levels may gradually disappear and are not replaced by a new growth dynamic.

Addressing the Structural Change Trap

35. Factors that have hitherto generated high growth (low-cost labour, abundant natural resources and credit) will be less pertinent as the country reaches higher levels of per capita income. Issues to consider are:

- **Quality of Foreign Direct Investment.** Rising wage costs deter FDI in low-skill sectors while capacity to attract alternative, higher value-added FDI is limited by the short supply of skilled labour.
- **Changing Trade Factors**. Cambodia's favorable access to key markets (EU, USA and Japan) has also been a determinant for attracting FDI but further market diversification is needed.
- **Skills Gaps**. Shortages of skills are a significant constraint to meeting Cambodia's aspirations for sustained rapid growth and a diversified and higher-value-added economy while strengthening competiveness and increasing productivity.
- **Research and Development (R&D)**. R&D aims to address issues related to low productivity, skills shortages, diversifying agricultural products and responding to climate change.

36. The challenges are well captured in the Industrial Development Policy that identifies need to *move from a growth model based on low-skill, low value-added industries to one based on high technology and knowledge-based industries that are better integrated into global value chains.* The policy calls for improvements in the level and quality of infrastructure, a better educated workforce and continuing improvements to the business environment. It is important to start developing the new sources of growth during this decade, based on the reallocation of productive factors in higher productivity activities, with more skilled labour and technological capacities.

Addressing the Governance Trap.

37. Effective institutions will help Cambodia to compete in a more complex and demanding global marketplace while also providing key economic and social services at home.

- **Coordination of the implementation of key strategies**. Government capacity to coordinate implementation of key policies must be strengthened.
- **Capacity and new tools for debt management.** Capacity of the MEF to manage debt is in place but must also adapt to a new development finance environment (non-concessional loans, PPPs, bonds).
- **Development of the Financial System.** Banking sector reforms will enable the NBC to manage monetary policy to provide additional fiscal and monetary flexibility.
- **New capacities to manage PPPs**. During the next five years the government will improve the legal framework and build the MEF capacity to develop and manage PPPs.

Addressing the Financial Trap

38. MICs sometimes confront difficulties in integrating into international financial markets while maintaining scope for counter-cyclical macroeconomic intervention. Increased foreign currency indebtedness, for example, may lead to fiscal and monetary challenges. The current level of financial manoeuvrability is very limited as fiscal space is highly dependent on access to grants and concessional loans. The gradual loss of grants would require public revenue to rise by 27% from existing levels, i.e. an increase of the Total Revenue/GDP ratio (FY 2013) from 15% to 18.27%. The margin for implementing counter-cyclical macroeconomic policies to develop the new financial paradigm is therefore currently very limited and highly dependent on concessional external finance.

4. Public Finance flows

39. The availability and quality of public finance will be a decisive element to support the implementation of the national development priorities and the sustainable development agenda in Cambodia. This section therefore considers two issues: (i) public finance opportunities and challenges; and (ii) the main public finance flows.

4.1 Overall analysis of public finance

40. The RGC succeeded in mobilising resources to support its national development effort and ensured macroeconomic stability maintaining the resource mobilisation effort. The Government has sought to maintain a prudent fiscal stance based on an increased revenue effort and rationalised expenditures. In addition to realising sustained high rates of growth over the last decade, domestic revenue mobilisation has steadily increased (rising from 10.3% to 17.8% between 2005 and 2016). However, Government expenditure has almost doubled (from 12.8% to 21.4% of GDP in the same period); the deficit has been modest and sufficiently financed by external cooperation resources, and inflation has been subdued.

Table 2. Economic Indicators, 2005-2015 (% of GDP)

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
GDP growth (constant prices)	13.3	10.8	10.2	6.7	0.1	6.1	7.1	7.3	7.4	7.0	7.0
Inflation (Annual average)	6.3	6.1	7.7	25.0	-0.7	4.0	5.5	2.9	3.0	3.9	1.2
Domestic revenue mobilisation	10.3	11.5	11.9	12.7	12.0	13.1	13.1	15.2	15.0	17.4	18.0
Government expenditure	12.8	14.2	14.7	16.1	20.4	20.6	20.6	21.5	21.4	21.6	20.8
Private investment (incl. FDI)	9.9	10.8	10.5	13.2	7.2	7.7	13.3	14.5	14.7	15.1	15.0
Private sector credit	31.8	51.6	76.0	55.0	6.5	23.4	31.2	28.0	26.7	31.3	30.2
External debt	35.0	31.0	29.4	24.9	28.5	28.7	29.7	31.5	32.5	33.4	34.2
External cooperation (incl. NGO)	9.5	9.8	9.0	9.5	9.6	9.8	11.1	10.7	9.7	8.6	7.4

Source. MEF

41. Overall, the economy is stable and macroeconomic performance has been sound. Growth remains strong and continues to be robust at 7% in 2015-16 and is projected to rise modestly over the medium term. This outlook is subject to substantial downside risks from a stronger U.S. dollar and/or a protracted growth slowdown in Europe constraining garments export and tourism growth. Weaker-than-expected growth in China would also have spill-overs through FDI, banking and tourism. Domestic risks include financial sector vulnerabilities from rapid credit growth, fiscal pressures and erosion of competitiveness from wage increases.

42. While Cambodia's growth performance has been impressive, the economy still has a somewhat narrow base but the focus on diversification and resilience to shocks is already embedded in Cambodia's development plans such as the IDP.

43. Financing the next phase of national development places an emphasis on social and physical infrastructure. Increased targeted investments are required in education together with improvements in the business environment and the promotion of competitiveness and diversification. However, the country is mainly dependent on external resources, mainly ODA, to finance capital investments: 71% of capital expenditure in 2015 was externally funded. This is of medium-term concern as the availability and alignment of external finance does not fully correspond to national priorities so it will be critical to implement budgetary reforms to develop the necessary fiscal space and reallocate resources.

44. Potential medium-term finance-related risks acknowledged by RGC include: i) the finance of deficits with donor funds and concessional loans that may decrease in the medium term; ii) the growing exposure of the real estate and construction sectors to private flows from abroad; iii) the limited capacity for banking supervision and of the regulatory framework; iv) the need for rebuilding stocks of government deposits to pre-crisis levels and on narrowing budget deficits over the medium term.

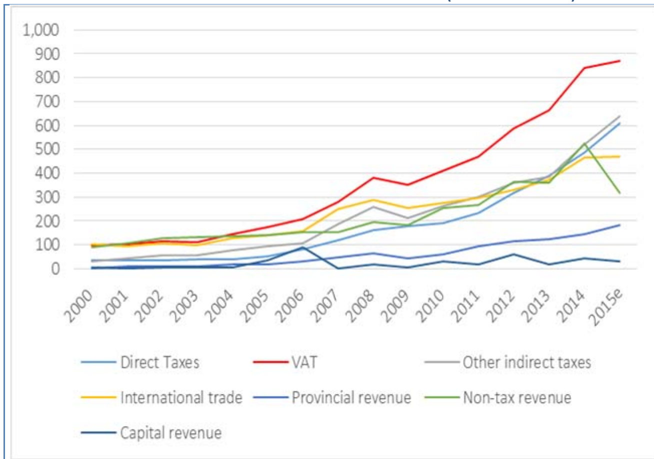
4.2 Assessment of Public Finance Flows

4.2.1 Public Revenue

Situation Analysis

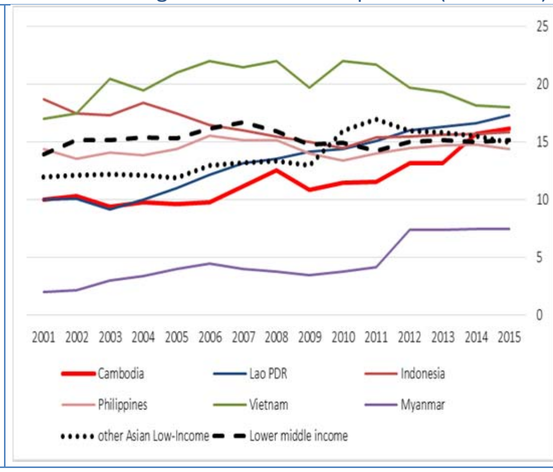
- Consistent reforms to both tax policy and administration over more than two decades yielded positive results: domestic revenue increased from 10.3% of GDP in 2005, to 17.98% in 2015.
- The tax base is small, mainly due to the narrow economic structure. Current levels of revenue/GDP are comparable to a number of its neighbours and to those of other ASEAN countries.

Chart 3. Total domestic revenue (USD million)



Source. MEF Macroeconomic framework

Chart 4. Regional revenue comparison (% of GDP)



Source. WDI/IMF

- Indirect taxes dominate tax revenue and accounted for 54.5% of total tax revenue in 2015. Domestic and import VAT and Excise Duties generated the majority of indirect tax revenue
- Direct taxes progressed from 16% of total tax revenue in 2010 to 22% in 2015 and are mainly concentrated in profit taxes (74% of direct taxes), payroll taxes (19%) and land and property tax (7%)
- Customs revenue is stationary at around 6% of GDP per year and is generated by a relatively narrow tax base comprising a few imported goods
- Non Tax Revenue contributed to 14-16.5% of total revenue in each of the last 5 years

Policy and Institutional Setup

- The Revenue Mobilisation Strategy (RMS) 2014-2018 sets an ambitious goal of raising domestic revenue by 0.5 percentage points of GDP annually (reaching 17.8% in 2016 from 15.18% in 2014).
- The General Department of Customs and Excise has a 5-year strategy aligned with the RMS.

Recommended Approach

- Implementation of the RMS will demand higher levels of coordination, and commitment from ministries and other institutions, especially in the area of non-tax revenue collection.
- Reaching the desired revenue goals of the RMS will change the mind-set and behaviours through strengthening the culture of tax compliance.
- Significant capacity development is still needed to raise non-tax revenues
- Options for widening the tax base include: i) income tax and other personal taxes, ii) expansion of property tax base, and iii) further strengthening of tax administration.
- New and higher taxes may also be needed as well as higher rates for excise taxes on alcohol, tobacco and luxury goods.
- Tax holidays should be gradually replaced with other incentives such as investment allowances, tax credits, and accelerated depreciation mechanisms.
- Incentives provided to qualified investment projects (QIPs) were estimated at 3% of GDP and their contribution for attracting investment may be marginal. The cost-benefit of QIP incentives requires evaluation.
- Potential use of capital markets for issuing bonds may be explored as a medium-term financing option to augment domestic revenues.

4.2.2 External development cooperation (ODA providers)

Situation Analysis

- ODA increased rapidly in the decade to 2011 then peaked in 2012 before beginning to decline from 2013 (in volume and as a % of GDP). The decline in ODA sources is expected to continue.
- Modalities of support have also evolved over the past decade. Investment projects rose sharply to around USD 1 billion annually, almost 3 times larger than technical cooperation.
- Alignment with national priorities is assessed positively, however CDC analysis shows that there is scope for improvement both across and within sectors based on NSDP requirements.

Chart 5. Development cooperation (USD million)

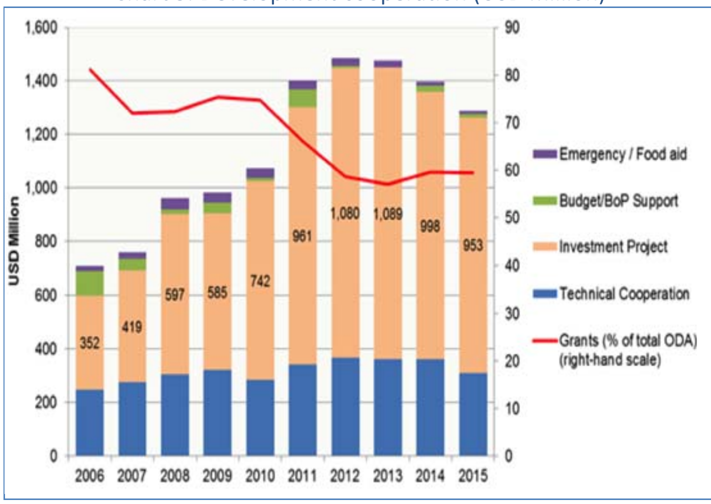
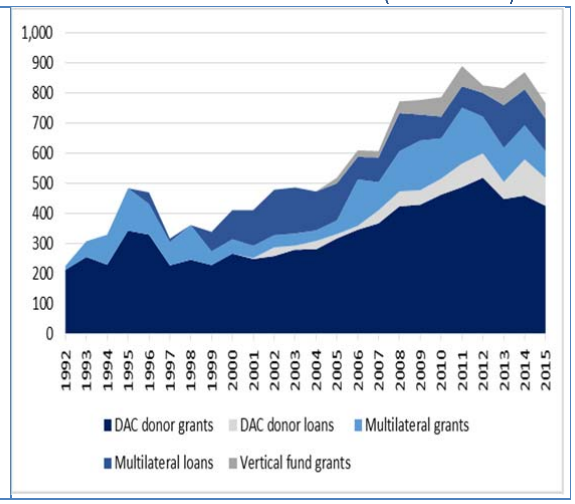


Chart 6. ODA disbursements (USD million)



Source. CRDB/CDC ODA Database

Policy and Institutional Setup

- The RGC's Development Cooperation and Partnerships Strategy 2014-2018 (DCPS) sets out objectives, principles and policy tools for maximising the impact of all external cooperation as well as for promoting partnerships and impact with all development actors (NGOs, South-South, private).
- All ODA grant mobilisation and coordination is managed by the CRDB/CDC while the Ministry of Economy and Finance (MEF) manages all development cooperation loans.
- A set of 20 Joint Monitoring Indicators (JMIs) based on NSDP and sector goals is used to guide dialogue across Technical Working Groups that are chaired by senior RGC officials.
- Other Official Flows (OOFs), mainly directed to the private sector including micro-finance institutions, are also likely to increase and they offer a potential source of finance once ODA potential is exhausted.

Recommended Approach

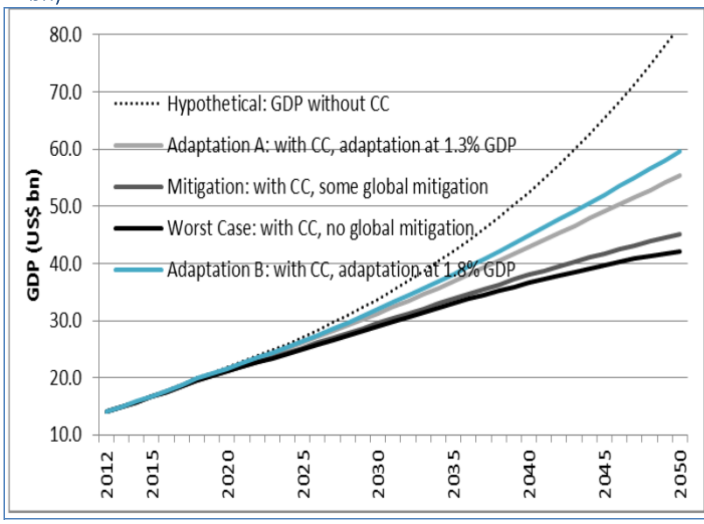
- Improved budget integration - through the BSPs and/or the SOPs for Donor Funded projects - should be emphasised in PFM reform and the Development Cooperation and Partnerships Strategy.
- ODA for investment remains an important part of the budget capital expenditures but alignment must be further improved through PFM reforms and leadership of key strategies (IDP, climate change etc).
- A more comprehensive Data Management System may be needed to record non-ODA flows and those resources from non-aid providers.
- The DCPS results framework can be more strategically linked to that of the NSDP in order to ensure that external resources are aligned with priorities and contributing to development impact.
- ODA should be directed more assertively towards projects included in an improved PIP that includes pre-appraised projects that have been approved by RGC.
- Ultimate success in securing ODA alignment and impact will be highly dependent on key PFM reforms (especially programme budgeting) that promote a more systematic integration of aid into the budget processes at both central and line ministry levels.

4.2.3 Public Climate Change Finance

Situation Analysis

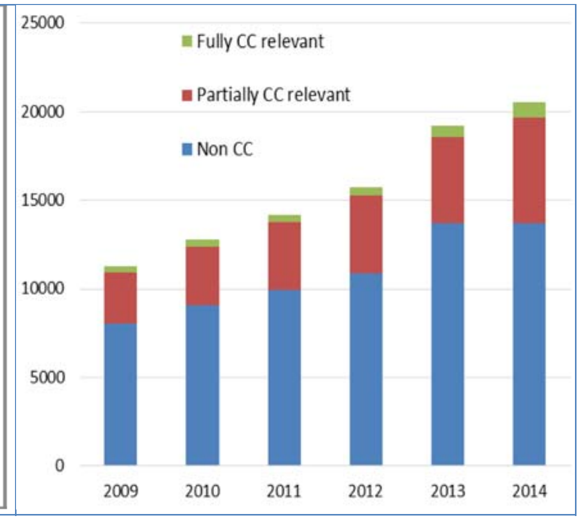
- Cambodia is considered amongst the countries most vulnerable to climate change and its damage to GDP has been estimated to be at least of 1.5% per annum by 2030, and 3.5% by 2050.
- External finance is the largest source of funding. Only one-quarter (24.8%) of total public climate expenditure was funded by the national budget in 2014.
- External climate finance for the public sector has been volatile but the trend is positive. Significant growth is possible if RGC can strengthen capacities for mobilising and accessing these funds.
- Information about external and domestic CC funding needs further improvement to ensure it is accurate and reliable (including to reconcile across different sources).

Chart 7. Impact of climate change on GDP, 2012-2015 (USD billion)



Source. CCFF 2015

Chart 8. Climate change public expenditure (Riels bn)



Source CPER 2013/14

Policy and Institutional Setup

- The RGC took bold and consistent steps to organise the RGC climate change response. RGC's policy, strategy and monitoring is strong. Resource tracking is at the forefront of international best practice.
- The majority of externally funded climate expenditures (67% of the total) are flowing through MEF systems, mostly for large infrastructure and agriculture projects.
- The introduction of the Climate Change Action Plans (CCAPs) enabled RGC to estimate demand-supply alignment for climate finance and forms the basis for further mobilisation and programming work.

Recommended Approach

- The effects of the IDA and LDC graduation processes should be strategized and incorporated to the implementation of the CCSP 2014-2023 and further developments of the CCFF
- A clear agenda to ensure that PFM and ODA planned developments address key climate finance issues is needed and it should fit with the implementation of the CCSP 2014-2023
- The strategic integration of the CCSP and the IDP would maximise mitigation efforts in a manner that is consistent with transformation and growth of the economy.
- Further institutional solutions are needed to sustain climate financing. This includes the establishment of a National Climate Funding Facility (NCFF) with a strengthened role for the NCSD
- Whole of Government capacity development and intra-institutional coordination strengthening is needed to address known problems that could significantly delay the implementation of the CCSP.
- Higher quality formulation and costing of the CCAAs is also needed to keep momentum and ensure that cross-sector actions can be adequately planned and implemented
- The development of the government's capacity and other institutional solutions forecasted in the CCFF should be integrated with top priority to the short-term prioritisation of ODA and other public sector investment allocations.

4.2.4 South-South and Triangular Cooperation (SSC)

Situation Analysis

- Cambodia has well-established SSC partnerships with China, Malaysia, Thailand, Indonesia and Singapore.
- China is the dominant source of SSC in Cambodia, mainly through loans that are ODA-like in concessionality. Their terms and conditions are comparable to other development partners.
- Further improvements in volume could be achieved by broadening the base of SSC partners and developing more consistent relations with existing ones.
- There is potential for accessing increased technical cooperation support (as opposed to capital finance), especially in issues specific to MICs (remittances, industrialisation, skills upgrading).

Chart 9. South-South flows 2000-2015 (USD million

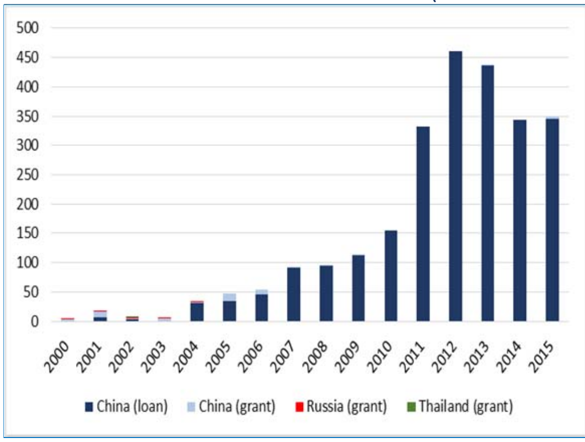
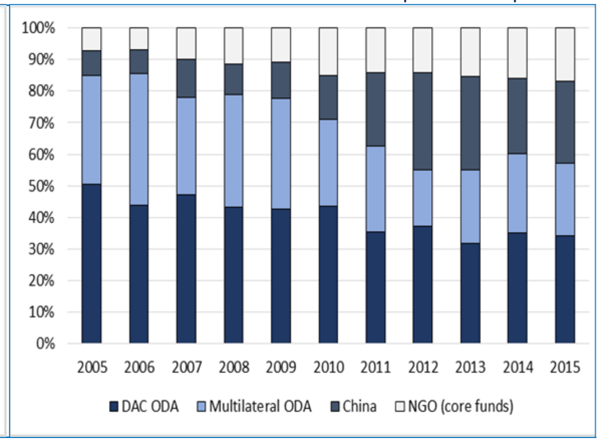


Chart 10. China's share of total development cooperation



Source. CRDB/CDC ODA Database

Policy and Institutional Setup

- Overall policy guidance for managing South-South Cooperation is set out in the Development Cooperation and Partnerships Strategy.
- Most non-China SSC is negotiated and managed either by the MOFAIC or is negotiated and mobilised directly by line ministries. Learning and scaling is limited while sustainability is usually overlooked.
- Line ministries and agencies often identify and manage their own SSC initiatives; for this reason there is very little data and impact on evidence on South-South support beyond assistance from China.

Recommended Approach

- Information on provision and results needs to be more systematically collected and analysed in order to ensure impact and inform future SSC mobilisation efforts.
- A significant proportion of SSC are tied non-concessional loans. RGC should seek to broaden SSC opportunities and sources to ensure cost-benefits are maximised in Cambodia's favour.
- Ownership and alignment can be promoted via existing policy, planning and review processes so that common principles and practices are applied to all providers of external cooperation.
- Effectiveness and impact of SSC can be improved by ensuring effective programming and implementation arrangements and by linking to a sector results and monitoring framework.
- SSC initiatives should be included as part of sector programming or programme-based approaches to the fullest extent possible so that their contribution can be complemented and secured.
- The impact of SSC support can be improved by creating better information systems to record, disseminate, scale-up and replicate the results of South-South initiatives.
- A more strategic use of SSC could be achieved by identifying current needs and matching them with potential providers of SSC support, especially from the Asia-Pacific region.

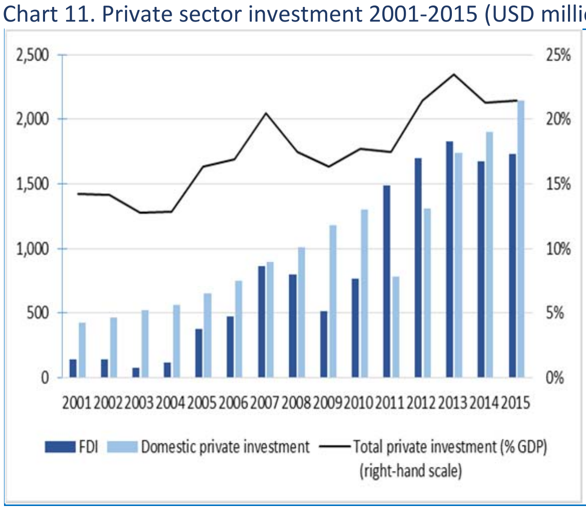
5. Private finance flows

45. Future provision of development finance is expected to draw increasingly from the private sector. This section of the DFA therefore reviews the principal flows of private finance and examines current policy with a view to identifying options for expanding access to development finance over the next decade and beyond.

5.1 Private Sector Contributions to Sustainable Development

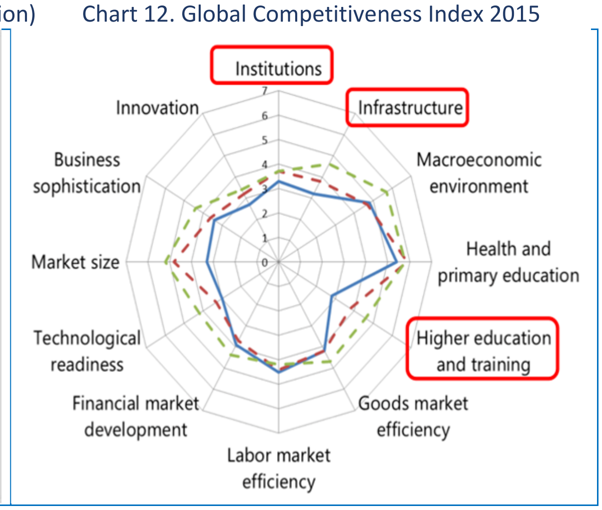
46. From an economic development perspective, the private sector has been the key driver of Cambodia's GDP growth, exports and fiscal revenue in the last decade. Private investment has recovered from a downturn during the global crisis and in 2015 accounted for approximately 21.5% of GDP.

Chart 11. Private sector investment 2001-2015 (USD million)



Source. MEF Macroeconomic Framework

Chart 12. Global Competitiveness Index 2015



World Economic Forum (Cambodia = blue; VN=red; Thai=green)

47. The steady growth of both FDI and private domestic investment is a key feature of the trend. A marked process of structural change and modernisation has accompanied the steady growth of the private sector. Until the mid-90s agriculture accounted for almost one-half of Cambodia's GDP but by 2013, its share fell to only 31.6%. In the meantime, the relative contribution of Industry rose from 16.7% to 24.1% and that of services from 34.8% to 38.5%. However, Cambodia's levels of domestic investment are low if compared to other countries in the region. The most successful Asian economies showed much higher levels during their high-growth periods. In the 1980s and 1990s; Korea's domestic investment averaged 30%, Malaysia 32% and Thailand 34%. More recently, China registered an average of 43% for 2000-2003.

5.2 Opportunities and Challenges for Private Sector Development

48. The Industrial Development Policy 2015-2025 provides the most recent and comprehensive assessment, portraying the industrial sector as: "*weak as reflected by its simple structure, narrow base and low level of sophistication, while its growth is mostly concentrated in a few industries. Most of the production activities are family-based with lack of entrepreneurship and inadequate use of technology, thus limiting their ability to compete in international markets*." Other factors relate to access to bank financing and the negative incidence of the labour market and industrial relations to maintain the competitiveness of the economy.

49. The World Bank's Ease of Doing Business Report 2016 ranks Cambodia 127 of 189 economies with its lowest scores are related to access to power and cross-border trade. The Global Competitiveness Index produced by the World Economic Forum ranks Cambodia 90th out of 140 countries. The most challenging areas are related to: i) institutional/policy capacity, including the legal framework and governance; ii) infrastructure (power and transportation); and, iii) education and training.

5.3 Analysis of the Main Private Finance Flows

5.3.1 Bank and Micro-finance lending

Situation Analysis

- Cambodia's GDP growth has been credit-intensive yet not accompanied by an increase in private investment. The credit-to-GDP ratio has almost doubled since 2011.
- Micro Finance Institutions (MFIs) are well developed and account for 25% of new lending and 20% of outstanding loans. MFIs are principally financed by loans from foreign lenders.
- Financial inclusion has been growing and the percentage of people having a bank account increased from 3.7% (2011) to 22.2% (2014).
- Risks relate to rising financial sector vulnerabilities (high loan to deposit ratios and exposure to speculative real estate)
- A relatively new and fast growing source of funding is from small-scale investors via crowd-funding with initiatives such as CamboFund, established in 2015, and TosFund, which started in 2016.

Chart 13. Credit growth in Cambodia, 2009-2015 (%)

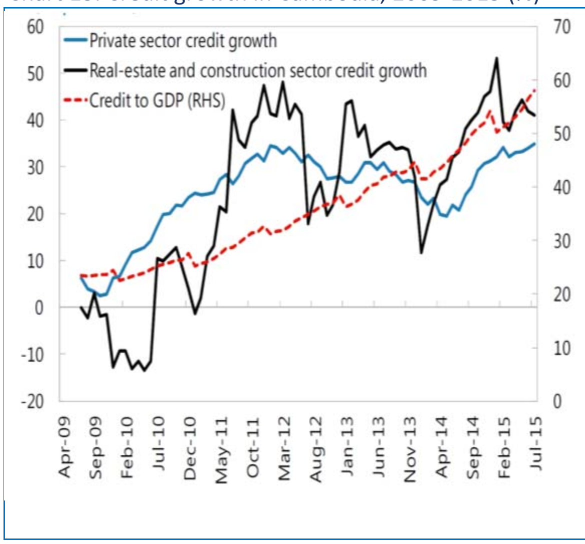
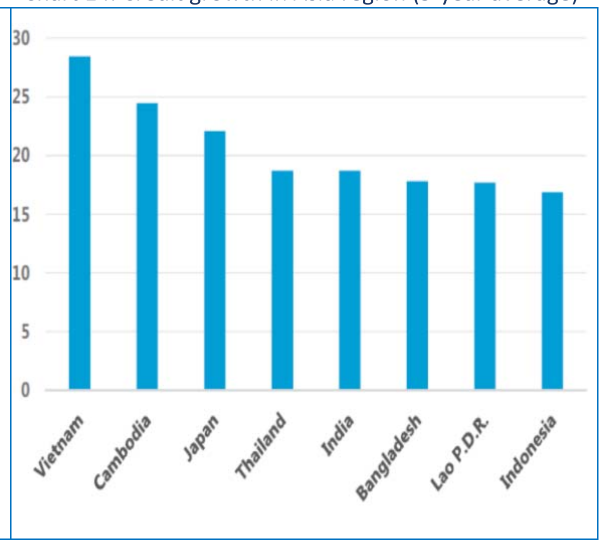


Chart 14. Credit growth in Asia region (5-year average)



Source. IMF Article IV 2015 p4

Recommended Approach

- The banking system remains concentrated. The top five banks account for more than half of all banking sector assets. A stronger concentration is visible in micro finance funding.
- Foreign banks are small and mid-sized; have limited ability to mobilise domestic savings and largely depend on injections of foreign funds raising liquidity risks. The RGC introduced Negotiable Certificates of Deposit (NCDs) in 2013 to mitigate this problem, but this inter-bank market is still in its infancy. Extending existing measures as NCDs and the introduction of bond financing may address liquidity concerns.
- A result of the successful introduction of the Credit Bureau of Cambodia (CBC) is that banks and MFIs have reported substantial improvements in credit quality since participating in the CBC, for example by reducing their exposure to borrowers with multiple loans. Strengthening overall monitoring, coordination and supervision by the NBC is needed. Further development of the CBC may contribute to this.
- The recent expansion of the MFI sector has contributed partly to the trend towards multiple loan taking and non-repayment among borrowers. This emphases the importance of extending the reach of the CBC and oversight of the NBC.
- The RGC will consider establishing a crisis management framework to anticipate potential shocks.
- Innovative sources of finance such as crowd-funding should be further analysed and incentivised.

5.3.2 Foreign Direct Investment (FDI)

Situation Analysis

- FDI has increased in volume as well as in its share of GDP. Although the trend has not been smooth, the amount in 2015 is estimated as USD 1.73 billion, equivalent to 9.6% of GDP.
- FDI investments in Cambodia are mainly concentrated on a few sub-sectors: garments, tourism, construction and agriculture.
- Most of FDI is regional investment. The list of top ten investor countries in Cambodia includes China, Vietnam, Korea, Hong Kong, Malaysia, Taiwan, Japan and Singapore.
- Competitiveness through low wages and LDC-related preferential access to EU markets, has helped to mobilise FDI from investors incentivised by tariff-free access to ASEAN and the EU.
- These trends are due to change in the near future as recent wage increases are diminishing overall competitiveness in low-cost manufacturing.
- The government succeeded in attracting FDI to the Special Economic Zones (SEZs) that create favourable conditions to attract export-oriented manufacturing investment.
- Since their creation in 2005, SEZs drew USD 1.89 billion of FDI and generated 143,302 jobs.

Chart 15. Foreign Direct Investment, 2005-2015 (USD million)

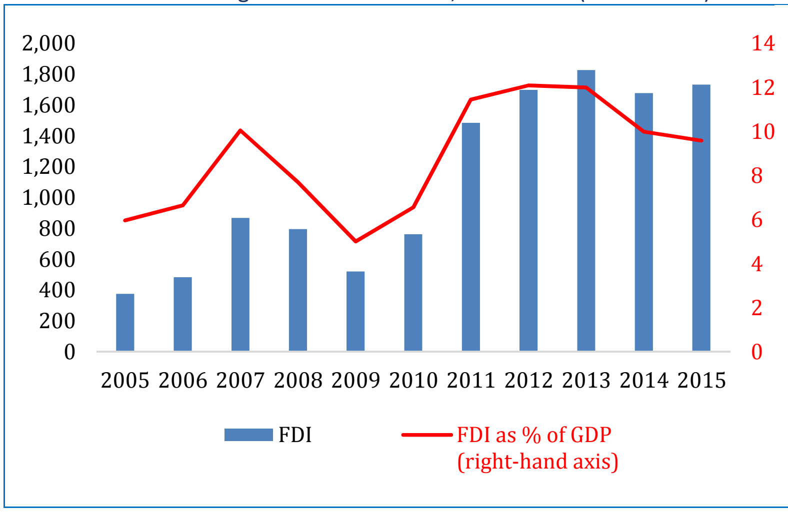
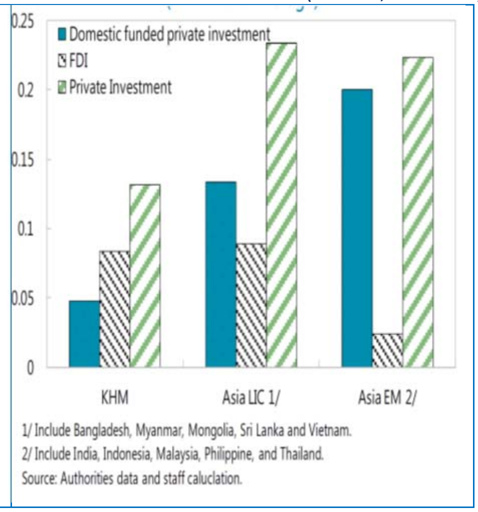


Chart 16. Private investment (% GDP, 2011-13)



Source. IMF Article IV 2015

Policy and Institutional Setup

- Laws and regulations to encourage FDI applied in Cambodia are non-discriminatory and very favourable. Only investments that qualify as QIPs can have access to the incentives available.
- QIPs are entitled to several incentives, which include the partial or total exemption of custom duties and corporate taxes.
- To operate in a SEZ a project must first be eligible as a QIP. SEZ investments receive the same benefits of other QIPs and have only a few additional tax arrangements, intended to facilitate the import of key components and re-export-them.

Recommended Approach

- The country will need to address the key challenges that affect medium-term competitiveness (infrastructure, energy, skills) within a decade.
- Particular attention should be paid to the issue of skill shortages that are already limiting the quantity and quality of FDI and take long to produce results.
- FDI short-term expansion should be mainly linked to the expansion of SEZs. It would be beneficial to focus efforts to attract more quantity and quality of FDI using the SEZ system.
- The tax exemption system may need to be reviewed to ensure benefits are maximised.
- Streamlining IDP Implementation can promote FDI prioritisation.

5.3.3 Public-Private Partnerships

Situation Analysis

- The overall level of PPP outside the power sector is low. PPP projects being proposed are generally small-to-medium size and emerge on an ad hoc basis.
- PPPs are not standardized, and they tend to be issued on a reactive, unsolicited, and negotiated basis, rather than through proactive preparation and competitive tendering.
- The amount of funds being raised through PPPs is below potential, and it is unlikely the services provided accurately reflect potential or market needs.
- Official data shows that the majority of PPPs are located in the electricity sector with some in the telecommunications, airports and roads.

Chart 17. Numbers and Value of PPP Projects by Subsector

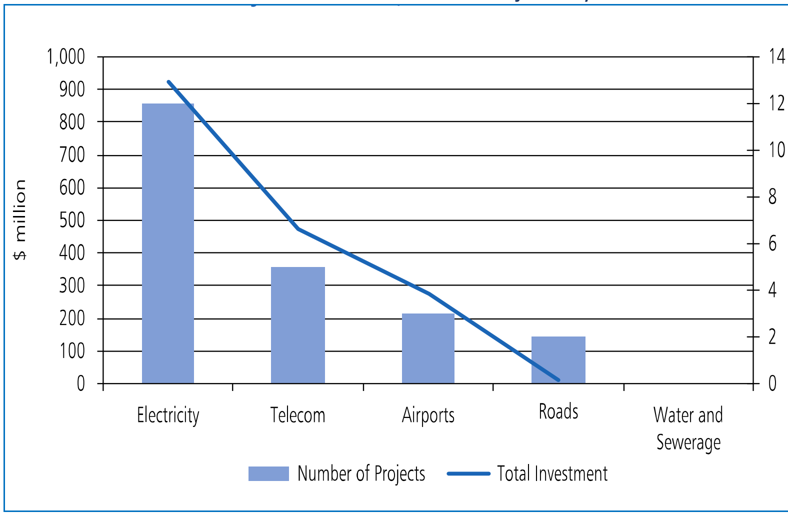


Chart 18. Major PPP projects in Cambodia

Number and Form of PPP
6 hydropower generation BOT projects 3 coal-powered generation BOT projects 2 transmission leases/BOT projects Various licenses issued to small REEs for generation and distribution
3 airport concessions Air navigation services concession
National Route 4, concession Various rural concessions
Operation and maintenance contract
Oil terminal and dry port concession
16 small rural distribution concessions 1 bulk water project
2 concessions

Source. ADB 2012

Policy and Institutional Setup

- A Policy Paper on Public-Private Partnerships for Public Investment Project Management, 2016-2020 was approved in June 2016 and launched at a Cabinet meeting in September 2016.
- PPP policy will build on the 2007 Law on Concessions and set out the vision and objectives of the Government, focusing on improving the legal, regulatory and institutional frameworks.

Recommended Approach

- The government embarked on a substantial capacity building programme for improving the processing capacity for PPPs.
- The development of the PPP policy will benefit from a higher-level strategic discussion to provide coherence for the medium-term direction and prioritisation of PPPs.
- An Infrastructure Investment Plan should be developed to estimate the costs of implementing the IDP and this plan should then be prioritised to guide future PPP development.
- The participation of Cambodian firms in PPPs is going to be very limited by the unavailability (on competitive terms) of long-term private sector finance.
- A strategic integration between the planned development of PPPs and private banking development is needed.
- There are opportunities to expand the market for small and medium scale PPP development in services such as urban waste collection, water supply, energy provision and infrastructure.
- There are also opportunities to engage the private sector in climate change related PPPs (energy, water) adaptation and mitigation areas forecasted in the CCSP.
- The integration of quality data and evidence is a priority to inform future decision-making.

5.3.4 Non-Government Organisations, Impact investing and local philanthropy

Situation Analysis

- Total NGO finance in 2015 (USD 227.5 million) was equivalent to 1.25% of GDP and represented 16.9% of total external cooperation.
- International NGOs fund their own programmes and also provide support to local NGOs. The focus of their support was on community and social welfare as well as education and health.
- Local NGOs disbursed USD 30 million of their own funds in 2015, (0.17% of GDP). Their focus is on Health & HIV/AIDS, Community & Social Welfare, Rural Development and Education.
- Local and international NGO subsectors are highly concentrated: 15 local NGOs account for 75% of local NGO expenditure and 15 international NGOs for over 50% of all international NGO funding.
- Innovative mechanisms (Development Impact Bonds) were successfully tested and may significantly grow where partnerships with Government, donors and the private for-profit sector are established.

Chart 19. Total NGO sector support 2015 (USD million)

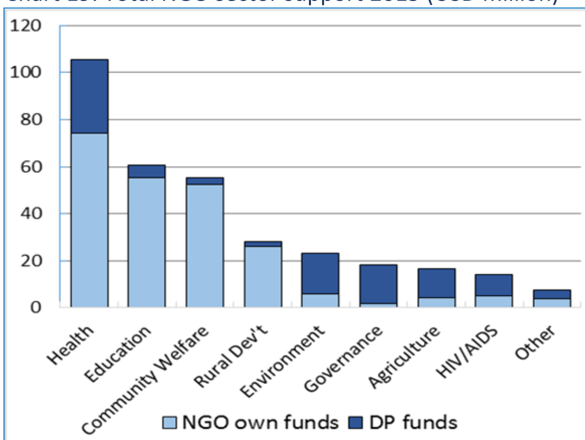
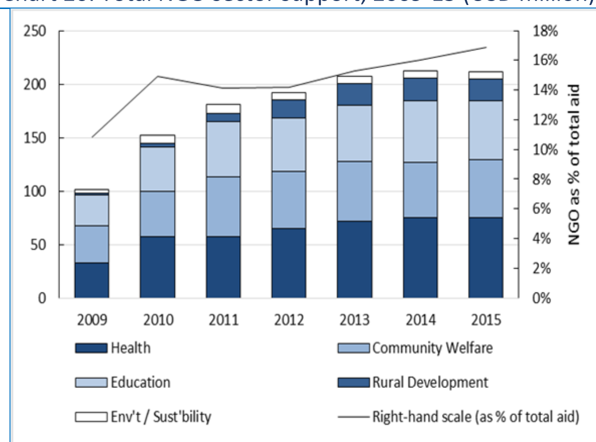


Chart 20. Total NGO sector support, 2009-15 (USD million)



Source. CRDB/CDC NGO Database (June 2016)

Policy and Institutional Setup

- The Law on Associations and Non-Governmental Organisations, (2015), regulates NGOs and other non-for profit associations. All NGOs, (local and foreign), must register and sign a MoU.
- There are 264 NGOs registered as active by the CDC, but only 122 reported on their activities to the CDC. This information is publicly accessible through the CDC website.

Recommended Approach

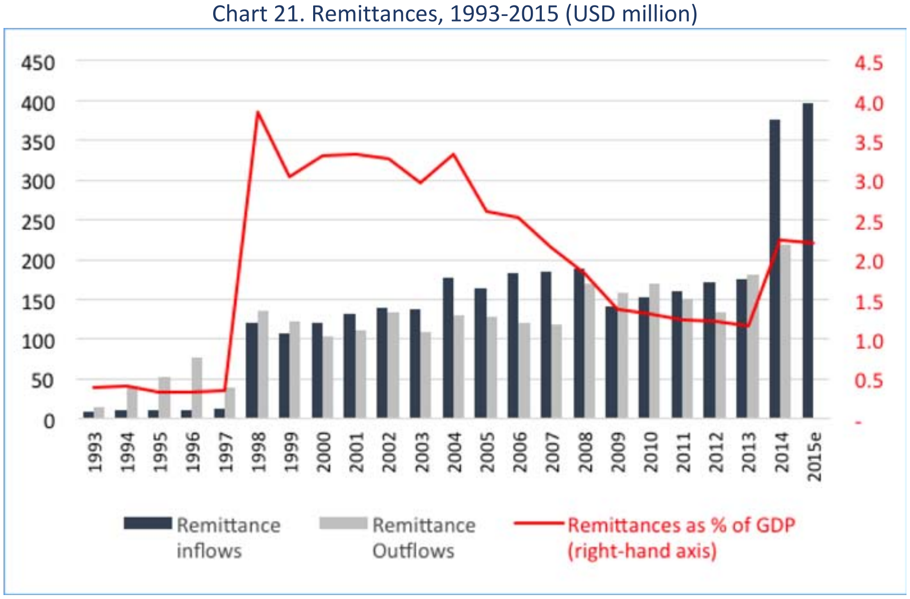
- There is good potential for consolidating and expanding access to NGO funds as well as to promote increased alignment with national priorities.
- Greater results could be obtained with a more consistent and coordinated support between NGOs and RGC, building on the NSDP, DCPS and the TWG mechanism, as well as sub-national coordination.
- Building partnership through strategic dialogue and exploring the development of more comprehensive partnerships (social PPPs) is an opportunity to be explored.
- The implementation of programme budgeting by the MEF will enable a more informed use of NGO information during the budget formulation process and avoid current duplications.
- To guide the mobilisation and allocation of NGO resources, and assess their development impact, it is perhaps sufficient to focus on the largest 50 NGOs.
- Access to innovative external finance such as Impact Investment should be further explored and could also be boosted with a strategic allocation of government support and underwriting of risk.
- Substantial untapped NGO resources might be available for the particular niche of Climate Finance. This is unexplored terrain where the government may usefully support further research, knowledge and capacity development to identify, mobilise and secure these funds.

5.3.5 Remittances

Situation Analysis

- Data from MLVT reported over USD 1 billion inflows in 2015 and USD 1.7 billion in 2016. However, international sources (World Bank) estimate only USD 400 million in 2015.
- According to MLVT, 620,000 migrants were working outside national borders in 2015, increasing to 1,150,000 migrants in 2016.
- MLVT estimates that in 2015 only 200,000 (including 86,500 women) are working legally: Thailand (111,300), South Korea (44,300), Malaysia (38,600), Japan (2,290) and Singapore (400).
- The number of licensed recruitment agencies increased from 18 to 31 (2008 -2010).
- The volume of internal migration is even larger, with more than two million Cambodians living away from their original homes
- Recent studies show that households receiving remittance income have higher school participation, education expenditure and skills, emphasising the developmental impact of remittances.

Chart 21. Remittances, 1993-2015 (USD million)



Source. World Bank

Policy and Institutional Setup

- The Labour Migration Policy (2015-2018), provides an excellent framework to govern labour migration, protect the migrants rights and improve the development impact of remittances
- MOLVT was given the institutional leadership role in implementing the policy, however, significant inter-ministerial coordination is required to achieve its goals
- Credible evidence to inform policy and decision-making is not available and data collection (especially sex-disaggregated data) remains a challenge to be addressed.
- The establishment of Migrant Support Centres (MRCs) can be instrumental in the application of this Policy locally. Three pilot MRCs have been tested with very limited resources

Recommended Approach

- Whole-of-government capacities and approaches are needed to provide an accelerated implementation of the Labour Migration Policy at the national and local levels
- Engagement of stakeholders outside the MOLVT has been limited: the importance of this flow perhaps deserves increased dialogue, possibly the creation of a specific TWG and JMIs.
- The expansion of the MRCs and their services is essential to boost the development impact of remittances at the local level and to ensure migrant's rights.
- There are ample opportunities for benefitting from available South-South Cooperation to learn from other country's experiences in the region.

5.3.6 Private sector climate finance

Situation Analysis

- The role of private sector in climate finance is still limited, mainly in the Clean Development Mechanism (CDM), but is expected to increase (e.g. Japan's bilateral Joint Crediting Mechanism).
- The absence of reliable and comprehensive data on private climate-related investments is a challenge for government's capacity to monitor, influence and improve this flow.
- A first mapping of private sector contributions in 2015 produced a good baseline of opportunities in several sectors (agriculture, forestry, fisheries, energy, water, construction, transport and tourism).

Recommended Approach

- Major changes in volume can be projected if further research is applied to better understand the external resource availability and country access procedures.
- International climate finance will be more accessible as Cambodia starts graduation from MIC. However, this is an area where government policy needs significant strengthening.
- Oversight must be improved to focus on facilitating alignment with national priorities and influence the development of this flow.
- Cambodian bank lenders should become better acquainted with the economic potential for low carbon and climate-resilient development.
- The climate risk insurance system should be further promoted in Cambodia.
- For better mobilisation of finance for climate projects, increased engagement of SMEs and the informal sector is essential and should play an important future role.
- Microfinance institutions offer examples of climate-related financing (e.g. support to solar home system distribution) and there is scope for mobilising bank sector engagement.
- The absence of clear carbon market guidelines means that voluntary carbon project developers are hesitant in taking further risks. A clear legal framework is required to incentivize their investments.
- The strategic integration of the CCSP and the IDP would help to identify a priority agenda for mitigation investments that can form the basis for public policy and private sector investment.

5.3.7 Corporate Social Responsibility

50. This concept extends to private companies operations beyond their profit-related objectives and legal responsibilities towards a concerted effort to provide some social benefit and to promote public welfare. Common CSR activities at the global level include supporting community-based activities and promoting 'green business' and environmental sustainability. Cambodia's CSR sector is in its infancy but it represents an important and untapped opportunity to mobilise resources that can support the development effort of the Government and its other partners.

51. CSR is a fast-growing practice among private sector companies in Phnom Penh. International companies replicate models developed in their operations elsewhere, for example Unilever (supporting water management), Manulife (supporting hospitals). Maybank, the Malaysian Bank, was named the "Best CSR Bank Cambodia 2015" by the Global Banking & Finance Review. Local companies, including EZECOM (supporting IT in schools) and the Royal Group also have well-established and highly-regarded CSR programmes that bring resources and expertise to the development effort. Smart-Axiata, the Cambodian telecoms company, was awarded the Best Corporate Social Responsibility program in 2015 by the Global Banking and Finance Review. The company made important contributions to supporting literacy, working with UNESCO and the Ministry of Education, Youth and Sports, to assist 92,000 young people around the country. Smart-Axiata also sponsors the Cambodian delegation to the Homeless World Cup.

52. There is therefore an opportunity for companies, and for the Government, to learn and adapt CSR models so they can complement and reinforce Government-led development efforts in order to scale-up CSR in Cambodia so that it can be more than a marketing opportunity.

6. Analysis of Future Development Finance Flows

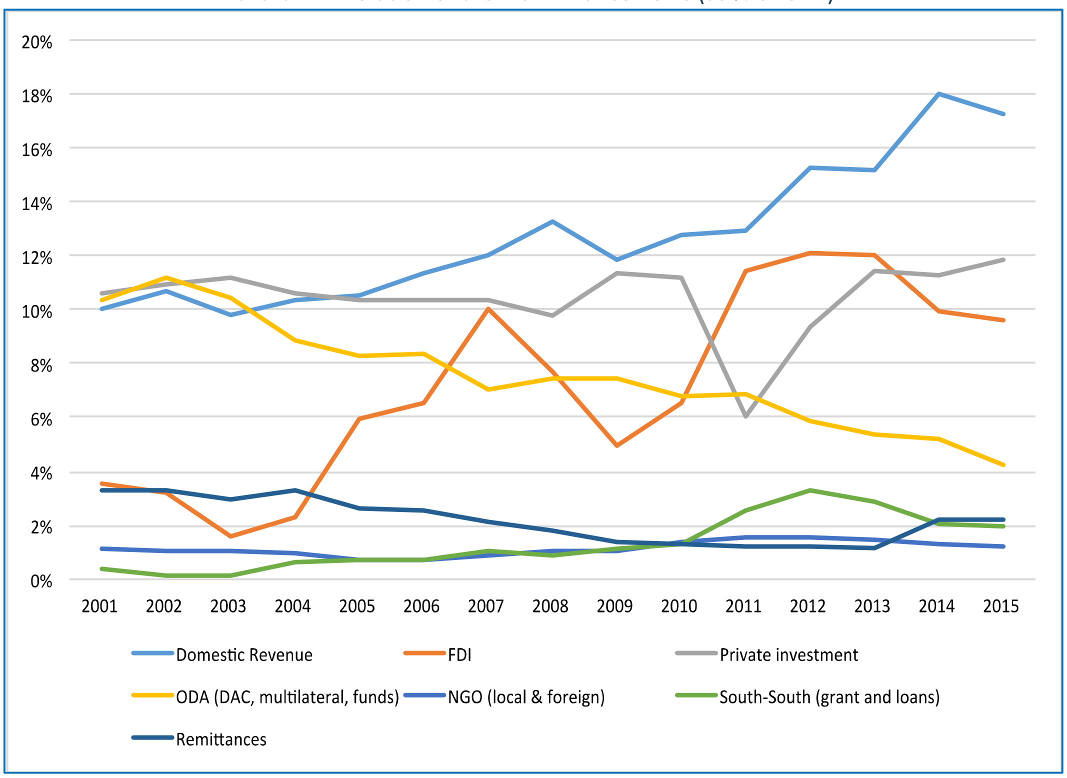
54. The Rectangular Strategy-Phase III 2014-2018, intends Cambodia *"to move resolutely and confidently forward on a journey of reform and development, aimed at graduating from a low-income country to a lower- middle income status in the very near future and further to become an upper-middle income country by 2030 and high income country by 2050." Accordingly,* this section assesses potential development financing options and associated actions to maximise impact on medium and long-term development goals.

55. Recent policy initiatives such as the IDP recognise that the current socio-economic development paradigm is nearing its outer limitations and moving to a new growth model is necessary. The analysis proposed in this section outlines how such a transformation may be financed while: (i) maintaining and consolidating the current growth model and its gains for the longest possible time; and (ii) identifying reforms and investments that will establish the foundations of the new growth model.

6.1 Priority Issues in Managing Major Flows

56. The evolution of the main flows is summarised in the Chart 22 below. It includes flows that can be directly programmed by the government (domestic revenue, ODA, and debt) as well as those outside of the public sector that are harder to manage (FDI, remittances, domestic private investment).

Chart 22. Evolution of the main finance flows (as % of GDP)



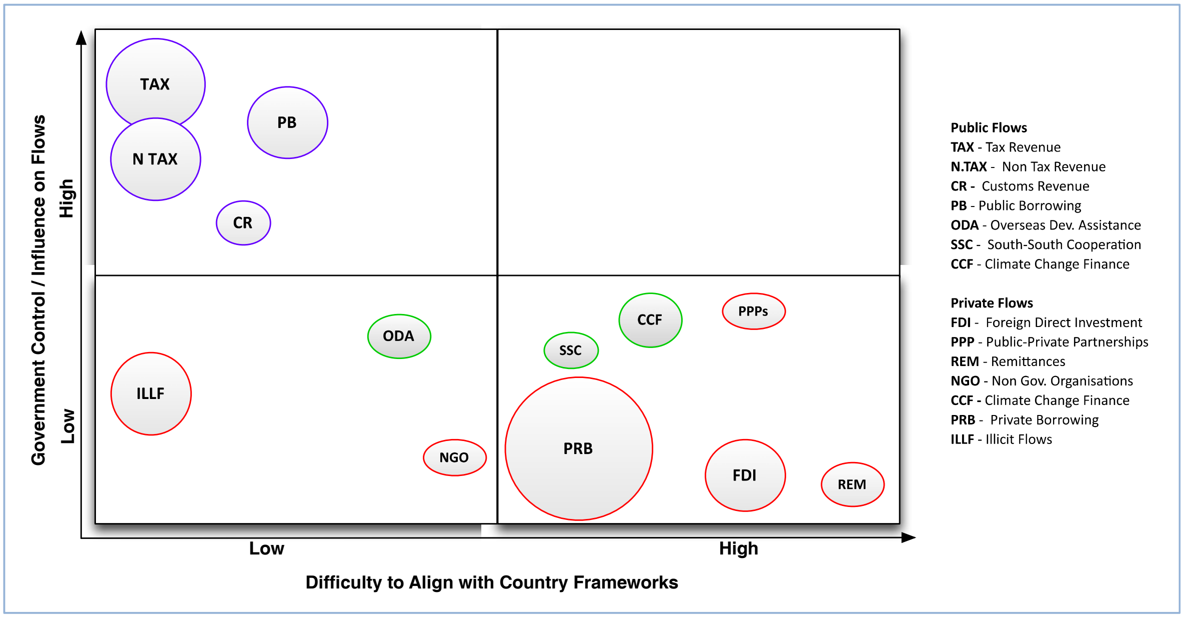
57. It can be seen that, except ODA, all of these resources have been increasing over time as a share of GDP. Domestic revenue, supplemented with borrowing, is the biggest source of financing for Government. Few financial flows are under direct government control, but public policy can be used to coordinate or leverage the development impact while results can also be monitored. The analysis of the previous two chapters on public and private flows provides insights and proposals for strengthening management of each flow as well as for coordinating public and private flows to ensure that resource mobilisation is maximised and the best possible development results are secured.

Chart 23. Priorities for the development of Major Flows of Development Finance

Making good progress	***Requiring increased effort***	***New approaches required***
♦ Public Financial Management	♦ Customs revenue	♦ Private sector development
♦ Tax revenue	♦ Non-Tax Revenue	♦ Private climate finance
♦ ODA	♦ PPPs	♦ Access capital markets
♦ Bank & Microfinance	♦ Public climate finance	♦ Remittances
	♦ FDI & domestic private investment	♦ Trade and taxation of trade
	♦ South-South Cooperation	
	♦ Public sector efficiency	
	♦ NGO and impact investment	

58. The proposed orientations for the future development of these flows have been grouped into three broad categories: i) managing changes in volume; ii) improving oversight, alignment and size; and iii) improvements on oversight and alignment only.

Chart 24. Mobilisation, Alignment and Control of the major development finance flows



Managing changes in volume

59. ***Public Revenue (17.2% of GDP).*** Implementation of the Revenue Mobilisation Strategy focuses on enforcement and key capacity improvements, especially in non-tax and customs revenue. There is also some potential for widening and deepening the tax base over the longer term through: i) income tax, ii) expansion of the property tax base, iii) including more individuals and small firm taxpayers; and iv) strengthening the Large Taxpayers Department.

60. **Foreign Direct Investment (9.6%).** FDI increases depend on the success of the SEZs and wider improvements in logistics, power and infrastructure while mitigating any negative impact of rising wages and low skills/productivity. Even in the best-case scenario, no significant upward trends (as % of GDP) may be expected from this flow.

61. **Public Borrowing**. There is room for increasing the current levels of borrowing/GDP, but this should be carefully planned as part of a debt strategy, ensuring that an adequate usage of PPPs avoids unnecessary additional borrowing and also that new loans are allocated to key priorities. As the country accesses blend financing, it may be prudent to prepare the introduction of other mechanisms, such as bonds and other domestic debt instruments.

Improving oversight, alignment and volume

62. ***Official Development Assistance (4.2% of GDP).*** Alignment is broadly in line with national plans but within sectors there may be scope for ensuring both government and donor funds work in a more complementary way through improved budgeting processes. It is expected that the relative share of ODA as a percentage of GDP will continue to decrease making it necessary to use ODA to leverage other flows while ensuring that current support is tailored to preparing for the next phase of the country's development.

63. ***South-South Cooperation (1.9%).*** Except support from China, current levels of alignment are difficult to gauge as South-South support is often ad hoc and its results are unreported. Controlling the quality of the activities can be challenging and value for money may not always be assured. Given government's positive stance on SSC, volume, sources and modality (especially technical cooperation) could be increased, as SSC is currently sourced from very few countries.

64. ***Public-Private Partnerships (n/a)***. The strategic focus for PPPs should be to support the implementation of high-priority areas of infrastructure development while ensuring that risks and contingent liabilities are well managed from a public sector perspective. Current reforms carried out by the MEF are focused on strengthening the process management of PPPs are pointing in the right direction but it may be some time before PPPs account for any significant share of development finance.

65. ***Non-Government Organisations (1.3%).*** There is some scope for increasing and diversifying volume by exploring philanthropic sources of funding and innovative instruments such as impact investing and Development Impact Bonds. Alignment can be further strengthened by encouraging more NGOS participation in national and sector consultations and by emphasising the particular contributions that NGOs can make to complement government and ODA spending.

66. ***Public and Private Climate Finance (n/a).*** External climate finance for the public sector has been more volatile than domestic funds, but the overall trend is positive. Major increases in volume can be projected if further research is applied to better understand external resource availability and country access procedures. The establishment of a National Climate Funding Facility (NCFF) is an important step while oversight can be further improved through institutional strengthening to track and monitor public flows, especially through integration with improved budgeting systems. Promoting and monitoring private climate finance is an important medium-term objective that has already taken its first encouraging steps. Capacity of the RGC for implementing the Climate Change Strategic Plan (2014-2023) needs substantial strengthening both within and outside of the Ministry of Environment.

Improving oversight and alignment only

67. ***Private Bank Lending and Microfinance (30% of GDP).*** Growth is already at or above levels considered prudent. Further efforts to improve financial depth may still be needed, especially for improving access and participation of SME productive investments from agricultural, industrial or services sectors. A risk management strategy is needed to prepare for: i) a potential slowdown in real estate development; ii) a reduction in available international credit and other private inflows; and iii) delays to implement key government measures to improve and safeguard bank's liquidity.

68. ***Remittances (2.2%)***. The Labour Migration Policy (2015-2018) is a comprehensive basis for strengthening government's oversight and alignment of this flow. Implementation should be the main focus including to safeguard labour migrants before and during their employment abroad and the strengthening of mechanisms to ensure access to secure and cost-effective remittance flows via their use of the formal banking system.

6.2 Flow Projections: Underlying Assumptions and Scenario Modelling

69. DFA analysis of each flow can inform assumptions on future trends that then, in turn, permits a medium-term financing scenario to be produced. The initial estimates presented here are intended to begin a more robust and substantial investigation into the likely funding profile of key flows and measures that can be taken to mobilise and manage them to best effect. The DFA projection model took into account three main factors:

- ***Cambodia-specific factors*** - the relative attractiveness of Cambodia as an investment destination (endowment of infrastructure and skilled labour, the costs of doing business, the relationships between government and donors, the ability to turn policies such as the IDP into viable projects).
- ***Interaction between flows*** - good performance in mobilising and managing a particular resource flow, domestic revenue or ODA for example, will likely have positive "crowding in" effects on other flows, e.g. FDI and private investment.
- ***Global economic factors*** - FDI, private investment, remittances (via the demand for labour) will all be driven by external factors, most obviously the global economic business cycle. Cambodia will also be affected by the relative attractiveness of competitors (e.g. Bangladesh and Myanmar for light manufacturing as well as Vietnam's relative attractiveness to FDI in light of its EU trade agreement).

70. Finally, and in general terms, economic growth trends are unlikely to be linear. But estimating them at a prudent constant rate allows for shortfalls to be balanced out by expansionary periods over the full economic cycle. Growth remains strong and is projected to remain steady at 7% up to 2020 and 6.5% for 2021-25. High- and low-case scenarios complement a baseline scenario underpinned by 6-7% annual GDP growth.

71. ***Domestic revenue considerations:*** Recent Cambodia performance has been strong and there is catch-up with neighbors towards a regional ceiling at around 20% of GDP. There is potential for strengthening tax administration as well as, in the longer-term, exploring additional revenue sources. Given the spending pressures from higher wages, a sustainable and systematic implementation of the Revenue Mobilisation Strategy is also important to achieving the government target of incrementally raising domestic revenue by 0.5 per cent of GDP annually.

- ***Scenario assumptions:*** Revenues follow MEF projections in the early years then increase by 0.5 percentage points per annum as a share of GDP up to a ceiling of 20%. Upper- and lower-case scenarios are based on the success in implementing the Revenue Mobilisation Strategy with variation of +2 and -1 percentage points of GDP above/below the baseline scenario by 2025, i.e. 22% and 19% of GDP.

72. ***FDI considerations:*** FDI is highly cyclical with all countries riding peaks and troughs (modelling FDI as a linear trend is problematic as it is influenced by the global economic cycle). Cambodia already performs well in comparison to its neighbors and other reference countries. For the period that Cambodia remains an LDC it will be an attractive FDI location due to the preferential market access but a potential slowdown in China's economy, combined with competition from elsewhere, may moderate FDI.

- ***Scenario assumptions:*** Maintain FDI at 10% of GDP (i.e. a nominal annual growth rate of 6-7%). Upper- and lower-case scenarios depend on global economic factors, especially in China (supply-side) and the EU (demand side) as well as the relative competitiveness of countries such as Bangladesh, Vietnam and Myanmar. Domestic factors are also important in terms of promoting Cambodia as an attractive FDI location. Variation of +/- 3 percentage points of GDP by 2025 is included in the model.

73. ***External development cooperation considerations:*** Reference countries that have attained Cambodia's level of development and LMIC status have seen their aid/GDP ratios decline. As global aid budgets tighten and bilaterals move their grant finance elsewhere in support of the SDGs, it is likely that: (i) aid levels (net of Chinese bilateral support) will decline; and (ii) grants will be replaced by concessional loans. Continued LDC status over the next decade offers an opportunity to maintain aid at a higher rate but will depend on the Government's ability to convince donors to continue investing in the SDGs and national priority programmes. If NGOs - currently providing USD 225 million annually - are included in aid estimates then there is additional

reason to expect that this finance source will not decline too rapidly. AIIB, a new multilateral, funds may off-set exiting bilaterals in volume terms (AIIB aid may not be a like-for-like substitute, however, as it may replace grant-funded social sector programmes with infrastructure loans; domestic revenues will need to cover this gap).

- ***Scenario assumptions:*** Aid (including NGOs and expected AIIB support) levels are unlikely to grow in line with GDP. Aid (excluding Chinese bilateral aid) is therefore expected to remain at the nominal 2015 level of USD 800 million per year with NGOs contributing a further USD 225 million. Upper- and lower-case scenarios depend on global economic factors, principally donor policies on ODA budgets and country preferences. Domestic factors considered relevant include advocacy and commitment to donor partnerships in the context of the SDGs, as well as to demonstrate that Cambodia's transition towards LDC graduation (still a decade away) requires support. Variation of +/- USD 50 million by 2025 is included in the model for donor aid. For NGOs, the level of USD 225 million is considered to be a maximum given the on-going reflections of foreign NGOs regarding their long-term engagement in Cambodia, so the lower case scenario results in a fall of USD 50 million by 2025.

74. ***Remittances:*** There is significant variation in the remittance/GDP ratio of regional countries. Cambodia has made important strides in recent years to promote safe and economically rewarding migrant labour. Recent agreements have been signed with Qatar and Saudi Arabia so that these countries can join others such as Thailand, Malaysia and South Korea as import destinations for Cambodians working abroad. To positively impact the demand side, Cambodian labour can also become more attractive by: (a) being productive relative to wage levels; and (b) increasing their skills (and internationally-recognized qualifications). Remittance levels can also be increased by establishing safe and economical banking arrangements while their developmental impact can be further promoted by encouraging these funds to remain in the banking system rather than be used to finance consumption.

- ***Scenario assumptions:*** Given RGC commitment to enabling migrant labour and to expected increases in wage rates (as well as improved recording of flows), remittances are expected to grow and reach 5% of GDP by 2025. Upper- and lower-case scenarios depend also on global economic factors, principally receiving country demand for labour. Domestic factors that can increase the numbers of workers going abroad as well as the remittance per capita include investments in vocational training and an adequate banking system linked to countries where most Cambodian labour is located. Favoring the up-side, variation of + 2.5 percentage points of GDP by 2025 (i.e. growing to 7.5% of GDP) is included in the model with a downside estimate of remittances falling relative to the baseline by 1.5 percentage points by the end of the period (i.e. reaching 3.5% of GDP).

75. ***Domestic private investment***: is expected to maintain its GDP share (12% in 2015). The RGC has noted that GDP growth has been highly credit-intensive and it needs to be accompanied by an increase in private investment. There is therefore an expected upside if credit is increasingly directed to investment in the future. The upper/lower case scenario is to increase/decrease by 2 percentage points of GDP relative to the baseline scenario by 2025.

76. ***South-South Cooperation***: currently this flow comprises almost exclusively of China's bilateral aid, currently around USD 400 million annually (averaging USD 384 over the last 5 years). These flows are projected to continue at the current nominal rate and therefore decline in GDP share. Upper and lower-case scenarios may depend on the willingness of RGC to formalize and strengthen SSC mobilisation and management and to engage SSC as a more strategic resource. By promoting and more closely managing all SSC flows, they can potentially be increased (an upside estimate of USD 100 million by 2025) as well as directed to priority areas (with opportunities increased learning and sustainability).

77. ***Climate finance*** - the Cambodia Climate Change Financing Framework baselines and projections have been developed by MoE. From external sources dedicated to climate finance (i.e. excluding integrated funding), the 2013 baseline was USD 105 million. This rises by 2023 to between USD 250 million (lower-case scenario) and USD 305 million (upper-case). The mid-range is therefore USD 278 million, which can be extended outwards to 2025. The upper-case scenario results in climate finance rising to 1% of GDP by 2025.

6.3 Results of the DFA scenarios for development finance availability to 2025

78. Total financing potentially available for supporting national development more than doubles in the period to USD 18 billion by 2025. As a share of GDP, however, it rises by only 3 percentage points to 52%, driven principally by domestic resource mobilisation and remittances. To provide a better perspective, in 2005 total development cooperation funding (ODA, NGO and China) was approximately equal to domestic revenue. In 2025 it is estimated that domestic revenue will be almost 5 times larger than aid receipts. Assuming the broad validity of the assumptions made for all finance flows, this emphasises: (i) the likely critical importance of domestic revenue mobilisation; and (ii) the need to maximise and better manage key flows.

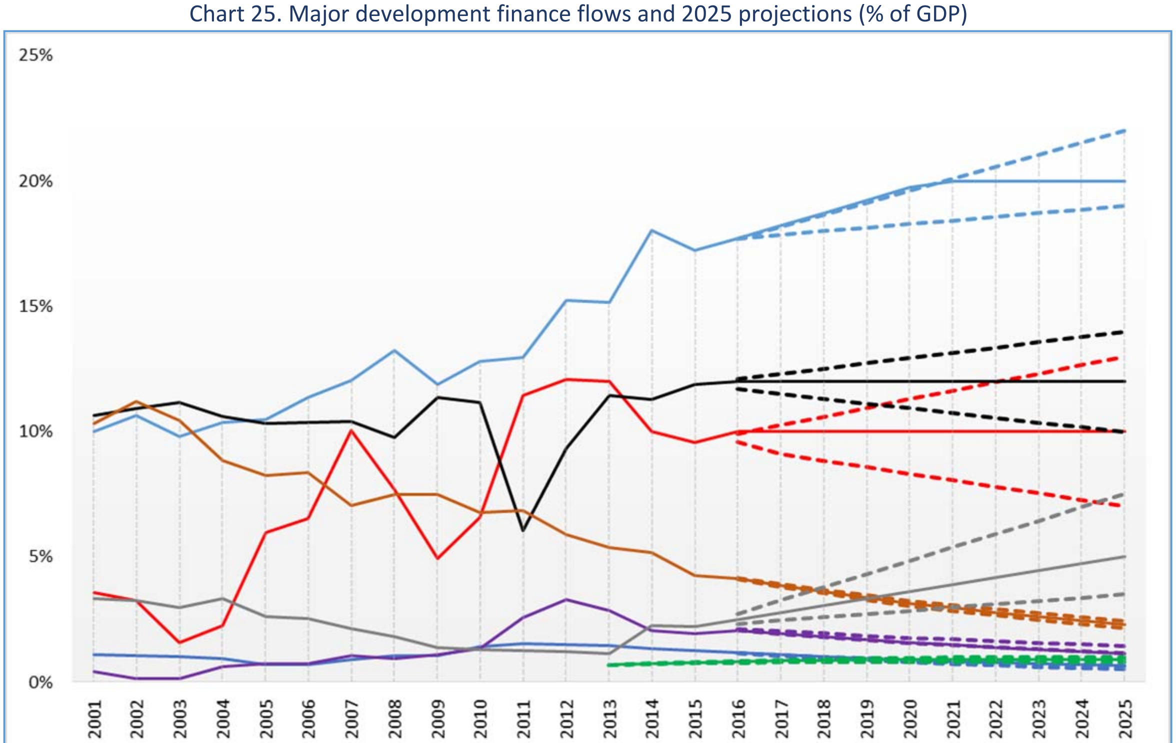
Table 3. Development finance projections

	2015		2020		2025	
	USD m	% GDP	USD m	% GDP	USD m	% GDP
Domestic Revenue	3,114	17,2	5,011	19.7	6,961	20.0
Domestic Private Investment	2,147	11.9	3.048	12.0	4,176	12.0
FDI	1,732	9.6	2.540	10.0	3,480	10.0
Remittances	397	2.2	914	3.6	1,740	5.0
ODA	767	4.2	800	3.1	800	2.3
South-South Cooperation	349	1.9	400	1.6	400	1.1
Climate Finance	140	0.8	226	0.9	312	0.9
NGOs	226	1.3	225	0.9	225	0.6
Total Development Finance	**8,873**	**49.1%**	**13,164**	**51.8%**	**18,094**	**52.0%**

Source CDC / DFA Team projections

79. An additional challenge is to incorporate the financial implications of implementing the SDGs into planning and modelling. Further research is needed to model how the main changes expected during the next decade, especially the MIC and LDC graduation process (such as the gradual reduction of grants, and the gradual increase of non-concessional loans as well as trading arrangements with partners), will impact on growth and the major flows. Modelling should also incorporate the inter-linkages between critical flows.

Chart 25. Major development finance flows and 2025 projections (% of GDP)



Domestic revenue	South-South Cooperation
Domestic Private investment	Remittances
FDI	NGO
ODA	Climate finance

7. Main Conclusions and Emerging Actions

80. Impressive progress over the last two decades demonstrates leadership, commitment and capacity. This is the foundation to look to build towards becoming an Upper Middle Income Country by 2030 and to realise the Sustainable Development Goals. The NSDP, the Industrial Development Policy and the Climate Change Strategic Plan, together with sectoral plans for implementing the SDGs, lie at the heart of future development programming and resource mobilisation.

81. The conclusions in this section summarise the DFA main findings and propose a pathway for a medium-term approach to secure further social, economic and environmental progress.

7.1 Main Conclusions

82. One of the major findings of this study is to emphasise the need to consider and monitor the social and economic consequences of the changes over the next decade related to Cambodia's new status as an LMIC, prospective LDC graduation, SDG funding and implementation, vulnerabilities resulting from these changes and, looking beyond ODA and development cooperation, the next steps in securing resources to finance national development.

Developing an Economic Transition Plan

83. LMIC and LDC graduation will significantly affect access to finance and trade. A smooth transition requires dedicated government leadership and significant institutional reforms that could be set out in an *Economic Transition Plan* or managed as part of the routine national planning exercise. Transition will require a more strategic allocation of scarce resources, such as ODA to catalyse investment as well as to secure necessary reforms and capacity development.

84. The Economic Transition Plan should visualise action along twin tracks. First, the government will need to coordinate policies to ensure that the current growth and resourcing model can be maximised for the longest possible period. Second, complementary actions should be carefully designed and implemented to develop the foundations for the new economic development model, the wider array of finance flows that should sustain it and the necessary institutional architecture and capacities.

Potential Contributions of Public and Private Finance and the Main Flows Analysed

85. The Economic Transition Plan should set out a framework to monitor and manage private and public flows and to inform the key reforms necessary to broaden and increase sources of development finance as well as to ensure that activities are implemented in a coordinated manner to maximise impact. The analysis in the earlier chapters of this DFA is intended to orient the design of this plan.

7.2 The Way ahead: Next Steps and Further Action

86. The following recommendations aim to inform and strengthen capacity to access potential sources of development finance. The way ahead suggests two parallel work streams: i) a whole of government discussion of an *Economic Transition Plan* to consolidate the strategic approach suggested in this DFA and provide the basis for decision-making; and ii) develop further research and analytical work to extend initial DFA findings and to put in place the capacity for updating and revising the analysis.

Explore policy and institutional solutions to address complex, cross-sector priorities

- Strengthen leadership and capacity to implement complex, cross-sector reforms.
- Establish improved monitoring systems, essentially through strengthening and improving data generating mechanisms to inform decision-making across program and reform areas.
- Expand capacity for policy research and long-term planning (e.g. SNEC).
- Develop a DFA roadmap in the form of an *Economic Transition Plan* (or via the NSDP process)

Exploring ways to reach whole of government approaches

- Institutionalise DFA work to ensure development finance is diversified and maximised.
- Promote a coherent/holistic approach to managing public and private flows.

- Review mandates of Government bodies to ensure comprehensiveness and complementarity.
- Use the IDP and SDG agenda to inform a wider resource mobilisation effort.
- Balance investment and capacity development priorities.

Further research the key flows and their inter-linkages

- Research: i) policy solutions / consensus; (ii) institutional reforms; and (iii) SDG costings and phasing.
- Linking PSD, FDI and PPP promotion through planning and budget integration.
- Maximising the development impact of remittances
- Micro-finance and SME development and financial inclusion.

Economic Modelling and Flow Projections

- Formulate a new economic development model towards and beyond LDC graduation.
- Establish institutional arrangements for holistic oversight of all development finance flows.
- Use comprehensives development finance model to inform policy making.

87. The DFA is a tool that sets in motion or supports an already on-going process of institutional change towards improved country development financing. Achieving institutional reforms will require effective change management. Three conditions for change include: (i) capacities for implementing complex programmes, including through performance-based budgeting approaches and improved use of data to support monitoring and results-based programming; (ii) performance incentives and reward structures; and (iii) laws and policies (e.g. investment laws, PPP).

88. A post-DFA roadmap could also provide intermediate milestones to guide the implementation of DFA findings that are subsequently incorporated into RGC policy. Further work - both research-related and institutional reform - could also be undertaken to strengthen the link between medium-term investment planning, resource mobilisation and the management of both public and private flows. All DFA recommendations must therefore be reviewed fully prior to their inclusion in future policy and planning frameworks so that they complement and advance the current programme of reforms and the implementation of priority policies.

Table 4. Key Action Areas Emerging from the Flow Analysis

Area/Flow	Key Action Areas	
1. Public Finance	1.1	MTFF to be augmented to accommodate wider development finance analysis
	1.2	Improved quality and prioritisation of the PIPs
	1.3	Accelerated accuracy and improved costing of BSP as part of programme budgeting
	1.4	A more strategic use of ODA to strengthen program budgeting & partnering
	1.5	Further integration of ODA & budget to support reforms and resource mobilisation
	1.6	Approaches to support financing and implementation of cross-sector reforms/plans
2. Public Revenues	2.1	RMS implementation requires cross-sector coordination
	2.2	Changes of mind-set and behaviours on mobilising and managing public finances
	2.3	Widen the tax base and re-prioritise current taxes used (e.g. income & property tax)
	2.4	Rationalising tax exemptions (e.g. on electricity) & reform of excise taxes (e.g. tobacco)
	2.5	Tax holidays replaced with other incentives (depreciation/import allowances, tax credits)
	2.6	Investment in capacity development to raise customs and non-tax revenues
3. Development cooperation	3.1	Improved alignment of assistance with current and future national priorities
	3.2	Further integration of externally-funded programmes with national programme budgets
	3.3	Aid and government monitoring systems need further harmonisation
	3.4	Strategic prioritisation of aid to build capacity to manage development finance/partnership
4. South-South Cooperation	4.1	Improve information and knowledge on SSC options & impact to inform policy making
	4.2	Develop coherent systems to ensure impact, concessionality, value & sustainability
	4.3	Strengthen ownership and alignment by extending policy, planning and review processes
	4.4	Identify and diversify sources of SSC by establishing a more strategic and coherent process

Area/Flow	Key Action Areas	
5. Public Climate Change Finance	5.1	Mainstream PFM for Climate Finance and align annual CCSP planning/programming process
	5.2	Revisit integration of the CCSP and the IDP to promote sustainable investments
	5.3	Establish the National Climate Funding Facility (NCFF) with a strengthened role for NCSD
	5.4	Whole of Government capacity & coordination for CCAA costing & CCSP implementation
	5.5	Improve quality of data, information and evidence on public spending (incl ODA)
6. Bank and micro-finance lending	6.1	Banking and MFI business sectors to become deeper and broader
	6.2	Manage risks of high LTD ratios and promote domestic savings, domestic bonds etc
	6.3	Address and manage real estate and construction sector credit risks
	6.4	Further extension of the Credit Bureau of Cambodia to improve credit management
	6.5	Emerging sources of finance (impact investing, crowd-funding) should be further analysed
7. FDI	7.1	ODA to catalyse promotion of medium term private sector development and FDI
	7.2	Address bottlenecks: infrastructure, energy, skills using re-oriented ODA partnerships
	7.3	Balance positive and negative FDI effects: labour laws, social protection, revised tax incentive
	7.4	Streamlined implementation of the IDP to ensure strategic use of FDI in SEZs
8. PPPs	8.1	Finalise new legal framework and accelerate institutional development
	8.2	Align PPP development with IDP, PSD and CCSP priorities
	8.3	Untapped potential for small-scale PPPs should be explored in parallel.
9. NGOs	9.1	Promote RGC-NGO partnership to promote mobilisation, alignment & impact
	9.2	Programme budgeting to consider major NGO funding in key sectors (health, social welfare)
	9.3	Promote access to innovative sources of finance (Impact Investment/Bonds)
	9.4	Explore untapped NGO support in Climate Finance and other niche areas (e.g. migration)
	9.5	Further engage NGOs in strategic development dialogue
10. Remittances	10.1	MOLVT capacity to implement the Labour Migration Policy (LMP) to be strengthened
	10.2	Whole-of-government (& sub-national) approaches required to support LMP implementation
	10.3	Multi-stakeholder approach required to develop capacities of national and local governments
	10.4	Promote profile and dialogue (consider creation of a specific TWG and JMI)
	10.5	Development of services to be provided by MRCs to be reviewed and extended
	10.6	Access available South-South Cooperation to learn from experiences in the region