



Cambodia

Benefiting from favorable weather conditions and an improved political climate, Cambodia experienced higher economic growth in 1999 than in the previous year. Lower inflation, a lower fiscal deficit, and a slightly increased capital account deficit accompanied the improved growth. If the government can maintain the political stability and reform progress achieved in 1999, economic growth of 6-7 percent per year can be expected over the medium term.

RECENT TRENDS AND PROSPECTS

In 1999, real GDP grew by 5 percent. This resulted from a good wet-season crop harvest, continued garment export growth, and recovery in tourism. After two years of contraction, agriculture grew in 1999 because of expansion of value added in crops, livestock, and fisheries. Strong growth in manufacturing, particularly textiles, and a rebound in construction activity contributed to double-digit growth in industrial production. A 33 percent increase in tourist arrivals led to moderate growth in services. Both public investment and foreign direct investment declined in 1999 because of the lagged effects of the 1997 political and regional economic crises.

Domestic revenues jumped from 9.2 percent of GDP in 1998 to 11.6 percent in 1999 because a value-added tax was introduced. Current expenditures increased modestly from 9.1 percent of GDP in 1998 to 9.6 percent in 1999. As a result, government savings—current revenues less current expenses—improved from -0.4 percent of GDP in 1998 to 1.7 percent, while capital spending fell from 6.1 percent of GDP in 1998

to 5.5 percent in 1999. This narrowed the overall fiscal deficit from 6.1 percent of GDP in 1998 to 3.7 percent. The National Bank of Cambodia's net claims on the government decreased in 1999, in contrast to the previous year when credit was extended to finance part of the budget deficit.

Average annual inflation fell to 4 percent in 1999 from 14.8 percent in 1998. Broad money (M2) increased by 17.3 percent in 1999. Foreign currency deposits, the main component of quasi-money, rose 31.8 percent in 1999, up from a 0.3 percent hike the previous year. Enhanced political stability also contributed to the growth of deposits. Independent audits of nine commercial banks in 1999, however, indicated that a weak banking sector, characterized by limited credit activity and high cash liquidity, continued to hamper economic development.

Improved 1999 exports of garments, as well as timber, fish products, and rubber, led to strong domestic export growth of about 22 percent. However, because of rapid import growth, the trade deficit widened from 6.8 percent in 1998 to 7.3 percent in 1999, while the current account deficit grew from 8 percent of GDP

in 1998 to 8.4 percent. The riel, which had depreciated against the dollar in 1997 and 1998, appreciated by 0.1 percent in 1999.

A return to real GDP growth rates of 6-7 percent is possible in the medium term if political stability and progress in structural reforms are maintained. A critical determinant of long-run agricultural growth will be greater public investment, particularly in rural infrastructure and water resource management. If labor conditions improve, annual increases in US quotas on textile imports from Cambodia will allow moderate growth in garment assembly. However, diversification to other markets and perhaps to other types of basic manufacturing will be necessary to sustain rapid manufacturing growth. Finally, long-term tourism potential, if successfully developed, would stimulate activities in agriculture, industry, and services.

ISSUES IN ECONOMIC MANAGEMENT

On 22 October 1999, the International Monetary Fund approved a three-year, \$81.6 million Enhanced

Structural Adjustment Facility. The agreement particularly emphasized fiscal reform, because Cambodia's 1998 revenues as a percent of GDP were the lowest of all reporting developing member countries, and spending on social sectors as a percent of GDP was less than both the Lao People's Democratic Republic and Viet Nam. With a goal of raising government revenues to 13 percent of GDP by 2002, the government implemented several revenue-generating measures in 1999, including a value-added tax. Continuing efforts are under way to reduce ad hoc tax exemptions, expand onsite tax audits of large taxpayers, and increase efforts to collect tax arrears. The government is working to increase the capacity and efficiency of the tax and customs departments.

Public expenditure on defense regularly exceeds that on the social sectors. For example, in the 1999 budget, 22 percent was allocated to defense and less than 20 percent for the social sectors. The latter included 8 percent budgeted for education and 5 percent for health. Actual outlays for education—and even more so for health—generally fall short of budgeted levels. This trend to spend less than the

Table 2.7 Major Economic Indicators, Cambodia, 1997-2001
(percent)

Item	1997	1998	1999	2000	2001
GDP growth	2.6	1.3	5.0	6.0	7.0
Gross domestic investment/GDP	14.7	13.4	13.1	13.0	14.0
Gross savings/GDP	5.9	5.4	4.7	4.0	4.0
Inflation rate (consumer price index)	8.0	14.8	4.0	6.0	5.0
Money supply (M2) growth	16.6	15.7	17.3	12.0	12.0
Fiscal balance/GDP ^a	-4.2	-6.1	-3.7	-4.5	-4.0
Merchandise exports growth ^b	81.0	8.3	21.8	11.0	10.0
Merchandise imports growth ^c	5.8	-0.1	20.4	12.0	10.0
Current account balance/GDP ^d	-8.8	-8.0	-8.4	-9.0	-10.0
Debt service/exports	2.5	2.9	2.5	3.0	3.0

a. Cash basis.

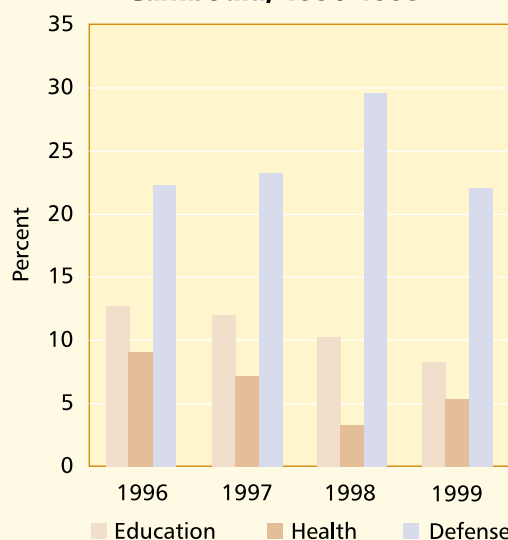
b. Domestic exports.

c. Retained imports.

d. Excludes official transfers.

Sources: Ministry of Economy and Finance; National Institute of Statistics; National Bank of Cambodia; staff estimates.

Figure 2.7 Education, Health, and Defense Spending, as Percentage of Total Expenditures Cambodia, 1996-1999



Note: Figures for 1999 are budgeted expenditures.
Source: Ministry of Economy and Finance.

allocated budget seems to have reversed only in the last quarter of 1999.

Defense spending has remained a priority in the past several years. Its share in total expenditure increased while spending on the social sectors declined (figure 2.7). However, defense spending as a percent of GDP fell from 5.7 percent in 1995 to about 4 percent in 1999. The government is further reducing defense spending by demobilizing about 30,000 soldiers during 2000-2003. In addition, various efforts are under way to improve spending on the social sectors, such as decentralizing budget responsibility. These steps should improve the capability to develop human resources.

POLICY AND DEVELOPMENT ISSUES

Insufficient public spending on education and health exacerbates the underdevelopment of human resources. This inhibits economic development and contributes to poverty. The government share of total educational expenditures is about 25 percent. As a

result, about 40 percent of the population have never attended school, 32 percent are illiterate, and less than 1 percent has had any training beyond high school. The skills needed to improve administrative, legal, educational, and medical institutions are therefore in short supply, often forcing Cambodia to rely on international experts. The labor force—which has high dependency ratios because of high fertility and an unusually large population with disabilities—also is characterized by low productivity.

Improving the level of education will not be simple, however. Access to basic education varies by geographical region, socioeconomic status, and gender. Distance and an inadequate transportation system are major constraints to school attendance for the rural poor. The high opportunity costs of sending children to school is another major obstacle, because about 80 percent of the population reside in farm households that depend largely on their own child labor. This is particularly true of female labor, resulting in lower enrollments for females than males. The proportion of girls enrolled is about 45 percent in primary school, 40 percent in lower secondary school, and 25 percent in upper secondary school. Basic education suffers from extremely low quality, in part because most instructional materials and many qualified teachers were lost during the Khmer Rouge years. All too often, unqualified, low-paid, and demoralized teachers are confronted with overcrowded and ill-equipped classrooms.

In addition to low levels of education, a poorly functioning health care system results in one of the lowest rates of health service utilization in the world. This, combined with poor water and sanitation coverage, leaves the population debilitated, contributing to low productivity. Stunting is common among children, permanently robbing them of their physical potential. Adults frequently lose days of work because of illnesses for which treatment by a health provider is usually expensive and often unreliable. Self-medication is common. Leading causes of death include malaria, acute respiratory infections, tuberculosis, road accidents, and accidental mine detonations. An HIV/AIDS epidemic looms on the horizon as a threat to future development. Ultimately, to ensure sustainable long-run growth, Cambodia must devote more financial resources to educating its people, and safeguarding their health.