Cambodia

In recent years, Cambodia has made good progress in strengthening its macroeconomic management. Although the balance-of-payments deficit remained large in 1995, external assistance and FDI inflows have more than filled the gap. The exchange rate has remained stable and official reserves have increased by more than projected. The fiscal reform framework enacted in 1994 has resulted in increased budgetary control, and preparatory steps have been taken to privatize public enterprise. Financial sector reform, however, has been slow.

Recent Trends and Prospects

Growth, Investment, and Employment. The rate of growth in real GDP in 1995 increased sharply to 7.5 percent from 4 percent in 1994. Agriculture is still the mainstay of the economy, accounting for nearly 50 percent of GDP in nominal terms and providing employment for the bulk of the country's labor force. Agricultural output, which had not risen in 1994, improved by 6.2 percent in 1995, led by an increase in rice production of 25 percent (Figure 2.9). Output of livestock and fisheries also improved relative to the 1994 levels, increasing by 4 percent in both subsectors. Rubber production grew rapidly at 15 percent following outstanding growth of 57 percent in 1994. Forestry output fell by 40 percent after the imposition of a log export ban early in the year.

The industry sector, whose share of GDP is relatively low at 19 percent, grew by nearly 10 percent in 1995 compared with 7.5 percent in 1994. Manufacturing and construction also increased at similar rates. The share of industrial production accounted for by state enterprises was about 50 percent; however, this share is falling, mainly because the vitality of the household and small-scale sectors has increased following economic liberalization.

Services sector output, which accounts for 37 percent of GDP, increased by 8 percent in 1995, somewhat higher than the rate of growth achieved in 1994. Wholesale and retail trade grew even faster at 8 percent, up from nearly 6 percent in 1994. Transport and communications and hotel and restaurant services also expanded rapidly as the economy attracted more foreign visitors and FDI.

Investment continued to accelerate in 1995 to nearly 22 percent of GDP from 14.3 percent in 1993 and 19.5 percent in 1994. Private sector investment, which responded to new incentives and increased political and economic stability, accounted for more than 70 percent of the total. The national savings rate, which had increased steadily from 8.3 percent of GDP in 1992 to 10.2 percent in 1994, mainly due to a reduction in public dissaving, remained at about 10 percent in 1995. Nevertheless, the savings-investment gap widened from 8.6 percent of GDP in 1993 to 11.6 percent in 1994 and 13.2 percent in 1995. Approximately half of the foreign savings inflow in 1995 was associated with the financing of the budget deficit.

Information on unemployment, underemployment, and poverty is incomplete. Although rising incomes and improved economic conditions have had the secondary effect of increasing employment opportunities, Cambodia remains one of the poorest countries in the world.

In 1996 and 1997, the main objectives of public policy will be to increase the rate of real output growth to 7.5 percent; reduce the rate of inflation to 5 percent by 1997; improve the fiscal position by broadening the tax base with the aim of a sustainable increase in the revenue/GDP ratio; and strengthen the external position. The projected increase in output growth is based on agriculture sector growth of 5.2 percent in both 1996 and 1997 as a result of the expected return of normal weather patterns.

These projections assume strong expansion in the industry sector by 11.8 percent in 1996 and 9.8 percent in 1997, facilitated by the implementation of the Government's First Socio-economic Development Plan and improvements in the country's infrastructure. Thus, investment as a share of GDP is projected to rise gradually to 23 percent by 1997, mostly from an increase in private investment. To achieve this growth target, further progress in privatization will be important. Policies will continue to encourage the growth of the services sector, which has the potential to absorb surplus labor and to earn foreign exchange. The sector is forecast to grow by 8.2 percent in 1996 and 9 percent in 1997 as the economy continues to modernize and the demand for commercial and support services increases.

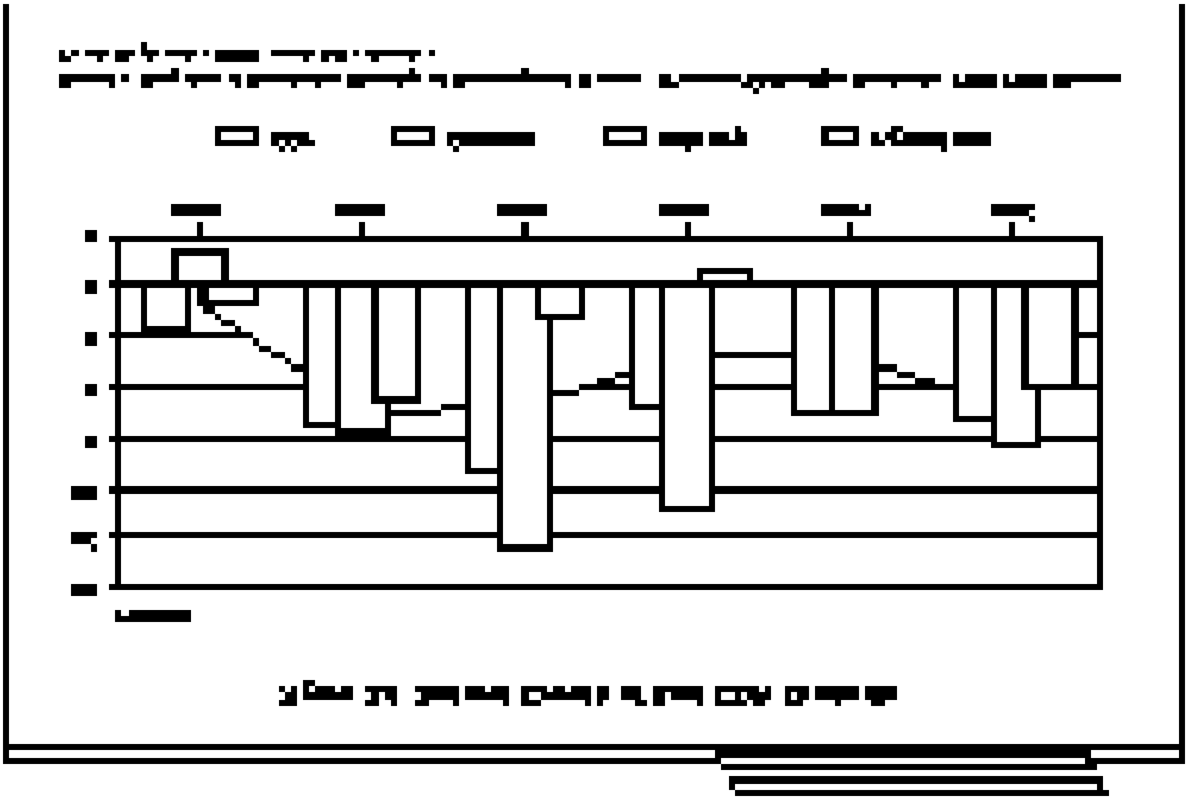
Budget, Money, and Prices. Government revenue in 1995 is expected to be lower than projected in the revised budget as a result of a shortfall in customs collections, partly coming from institutional weaknesses and the limited experience of customs agents. Expenditure control was tightened in 1995, notably with respect to operating expenditure and transfers to state-owned enterprises. Spending on defense and security, although significantly higher than envisaged in the initial budget for 1995, is projected to remain in line with the revised budget. The deficit in the recurrent budget for 1995 was 0.8 percent of GDP, somewhat lower than the revised budget target.

Table 2.7 Major Economic Indicators: Cambodia

		1993	1994	1995	1996	1997
Gross Domestic Product	% change	4.1	4.0	7.5	7.5	7.5
Agriculture	% change	-1.0	0.0	6.2	5.2	5.2
Industry	% change	13.1	7.5	9.5	11.8	9.8
Services	% change	7.2	7.5	8.0	8.2	9.0
Gross Domestic Investment	% of GDP	14.3	19.5	21.5	22.6	23.0
Gross Domestic Saving	% of GDP	5.7	7.9	8.3	10.1	11.5
Inflation Rate	% change in CPI	31.0	26.1	3.5	5.0	5.0
Money Supply Growth	% change	40.0	29.4	38.0	20.0	30.0
Merchandise Exports	$ million	283.6	472.0	735.0	657.8	649.9
	% change	7.2	66.4	55.7	-10.5	-1.2
Merchandise Imports	$ million	-471.0	-692.0	-1,052.0	-1,090.9	-1,125.8
	% change	6.2	46.9	52.0	3.7	3.2
Current Account Balance[a]	$ million	-251.0	-280.0	-378.0	-241.0	-272.0
	% of GDP	-8.6	-11.6	-13.2	-7.5	-7.5
External Debt Outstanding[b]	$ million	383.3	475.0	621.1	712.7	833.7

[a] Excluding official transfers. Data may differ from the series contained in the Statistical Appendix (see Statistical Notes).
[b] Refers to debt to the convertible area only.

Sources: Data collected from the Kingdom of Cambodia, Ministry of Planning and National Bank of Cambodia by EDRC for the Asian Development Bank *Annual Report 1995*; Ministry of Economy and Finance, *Economic Outlook for Cambodia, 1995–2000* (Phnom Penh, September 1995); and staff estimates.



Capital expenditure exceeded expectations, in large part as a result of more rapid disbursements of project-related external assistance. The overall deficit, which is all externally financed, is estimated at 7.1 percent of GDP, also below the budget target for 1995.

In 1995, liquidity growth accelerated to an annual rate of 38 percent compared with 30 percent targeted under the Economic Structural Adjustment Facility (ESAF). The substantially higher rate of expansion was reflected in a higher-than-anticipated increase in the net foreign asset position in the banking system. Net credit to the Government remained virtually unchanged; growth in credit to the private sector subsided after a large increase in the first quarter of the year, related in part to the prefinancing of log exports prior to the reimposition of the export ban. While some of the recent increase in liquidity could reflect a shift away from foreign cash in circulation to foreign currency deposits as confidence in the banking system increases, the majority of the increase in measured liquidity is more likely because of capital inflows. These flows represent a net addition to total liquidity and could, therefore, lead to intensified inflationary pressures.

Following a substantial decline during the first quarter of 1995, the CPI increased at an average monthly rate of nearly 2 percent until the autumn harvest again exerted downward pressure on prices. This resulted in an overall CPI increase for the year of about 3.5 percent.

The Government's fiscal position is expected to improve over the next two years as the tax/GDP ratio rises as a result of improved tax administration under the new tax system, reduced spending on defense and security, and reforms in the civil service system. The main objectives of fiscal policy in 1996 include a reduction in the reliance on external borrowing for current expenditure; a shift away from trade-related receipts toward domestic revenue sources; greater attention to the social sectors; and a broadening of the coverage of fiscal operations to reduce off-budget spending and improve transparency of budgetary transactions. The overall budget deficit is projected to be 7.4 percent of GDP in 1996 and 5.5 percent of GDP in 1997.

Inflation is projected to be maintained at about 5 percent in 1996 and 1997. This will require greater monetary control through blunt measures such as credit ceilings as well as progress in financial sector reforms, which will increase the instruments of monetary control at the disposal of the Central Bank.

External Trade and Payments. The bulk of Cambodia's exports are primary products. Growth in total exports of 55.7 percent in 1995 was lower than in the previous year, mainly because of a rapid increase in reexports, which rose from $242 million in 1994 to $524 million in 1995.

While petroleum products, cement, and machinery continue to dominate imports, there has been a shift in the composition of total imports toward some consumer goods, notably motorcycles and automobiles. As a result, the trade deficit rose to 11.3 percent of GDP in 1995, and the current account deficit, including official transfers, to 5.4 percent of GDP.

The capital account balance was bolstered by a large increase in private capital inflows. FDI increased from $10 million in 1994 to $100 million in 1995, reflecting the international community's increasing confidence in the country's growth potential and market opportunities as well as recent streamlining of bureaucratic procedures under the new Investment Law. Official loan disbursements also rose in 1995 to $80 million from $61 million in 1994, reflecting continued dependence on large-scale financial assistance from official sources. The capital account recorded a net position of $159 million in 1995, largely offsetting the current account deficit (including official transfers) of $153 million. The overall balance registered a surplus of $6 million.

At the end of 1995, Cambodia's total debt stock in convertible currencies was estimated at $621 million or 22 percent of GDP, of which $427 million was long-term debt. Most long-term debt is owed to multilateral and bilateral creditors and is concessional.

Exports are projected to fall by 10.5 percent in 1996 and by a more moderate 1.2 percent in 1997. There are currently export restrictions on logs, sawn timber, gems, gold, silver, and antiquities; however, these restrictions will be reviewed during 1996. A ban on rice exports was lifted in March 1995. Imports are projected to grow gradually by 3.7 percent in 1996 and 3.2 percent in 1997. The Government intends to avoid rapid increases in imports through an aggregate demand management policy while further reducing import tariffs consistent with revenue objectives. The trade and current account deficits are projected to remain high as a percentage of GDP in 1996. The current account deficit, excluding official transfers, will be below 10 percent in 1996 and 1997. These deficits will be offset by capital inflows as official investment and FDI increase.

External debt outstanding is forecast to rise to around $713 million in 1996 and $834 million in 1997, of which long-term debt will be $476 million and $575 million, respectively. All long-term debt will be owed to multilateral and bilateral creditors and be concessional.

Policy and Development Issues

The Government's commitment to market-oriented policies has substantially improved the investment climate in recent years; therefore, continued growth of the economy can be expected over the medium term. However, to meet the growth targets of the Government's First Socio-economic Development Plan, Cambodia's economic performance will rely heavily on the availability of external financing. Economic performance will also depend on political and economic stability and on progress in overcoming bottlenecks in certain infrastructure services. Further progress in structural reforms, including public sector and financial sector reforms, will be crucial.

Given the current fiscal performance, diversification of tax sources and improvements in tax administration are necessary. It is critical that prudent fiscal policy be maintained to reduce the inflationary effect of government deficits financed through the banking system. Effective macroeconomic management over the longer term will require the further development of monetary control mechanisms such as reserve requirements, open market operations, and interest rate adjustments. The lack of banking networks in the rural areas must be addressed to increase savings mobilization. Most provincial branches have not been able to mobilize sufficient deposits to meet the demand for loans and have, therefore, continued to depend on borrowing from the Central Bank. The persistence of high balance-of-payments current account deficits points to the need for policies to improve the rate of domestic saving and thus reduce reliance on foreign saving, the flow of which can be adversely affected by external events.