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Cambodia: Ex Post Assessment of Longer-Term Program Engagement

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CAMBODIA

Ex Post Assessment of Longer-Term Program Engagement

Prepared by a Staff Team from the Asia and Pacific, Fiscal Affairs, and Policy Development and Review Departments[1]

Authorized for Distribution by the Asia and Pacific and Policy Development and Review Departments

August 6, 2004

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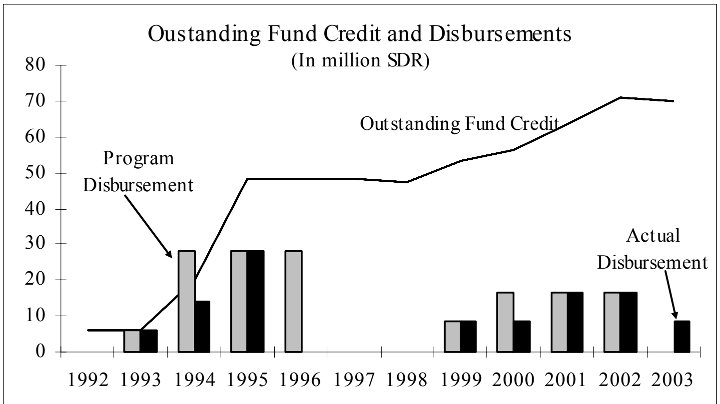
I. INTRODUCTION

1. **This paper assesses Cambodia's progress in implementing its economic stabilization, reconstruction, and reform programs supported by the Fund during 1993–2003 and draws lessons for future Fund involvement.** Cambodia has had three Fund arrangements since 1993. A Systemic Transformation Facility (STF) arrangement was approved in mid-1993 in support of a program for 1993–94. The STF built upon a stabilization program supported by an informal monitoring arrangement adopted in October 1992, which provided a framework for the clearance of arrears to the Fund. Cambodia drew only the first of the two STF tranches and immediately formulated a medium-term adjustment program that was supported by a three-year Enhanced Structural Adjustment Facility arrangement (ESAF-I) in early 1994. The mid-term review of the second annual program under ESAF-I could not be completed due to governance problems in forestry management and revenue collection. Despite repeated efforts to bring the program back on track amidst a progressively deteriorating political situation, ESAF-I expired. With the return of political stability after the 1998 general elections and a renewed impetus for reform, Cambodia entered into a three-year ESAF/Poverty Reduction and Growth Facility arrangement (ESAF-II/PRGF) in 1999, and completed all six reviews with only some delays in the structural reforms area (Box 1).



Source: IMF Finance Department.

2. **The Fund-supported programs were aimed at addressing two very different problems.** The programs under STF and ESAF-I were geared to address problems typical of a postconflict-cum-transition to a market economy. Policies focused on rehabilitation, reconstruction, restoring price stability, and basic institutional development. ESAF-I was expected to initiate several structural reforms mainly supportive of growth, governance, and institutional development, but they stalled somewhat as the program went off-track. The program under ESAF-II/PRGF arrangement aimed at consolidating stability and developing a solid basis for high and sustained growth to address deeply rooted poverty, including by adopting the PRSP framework. However, it was not until the last part of ESAF-II/PRGF that a comprehensive *National Poverty Reduction Strategy* (NPRS) was developed, and the process of making it operational is still in its initial stages (Box 2).

II. BACKGROUND AND INITIAL CONDITIONS

3. **Cambodia's needs for reconstruction and development resulted from several years of civil strife.** During the Khmer Rouge regime of 1975–79, the population was decimated, its economy was reverted to an agrarian barter system, the industrial base and

infrastructure were destroyed, social services ceased, and the banking system and domestic currency were abolished.[2] Rebuilding began after 1979, initially within the framework of a centrally planned economy and a monobank system, supported by Soviet Union and CMEA assistance. Market-oriented reforms were introduced starting in 1985–86, including liberalization of prices, privatization of certain state enterprises, and the formal adoption of a two-tier banking system. However, the economic situation remained difficult given the withdrawal of external assistance and continued civil conflict. The Paris Peace Accord of 1991 and the subsequent establishment of the United Nations Transitional Authority of Cambodia (UNTAC) finally paved the way for Cambodia's renewed access to international financial assistance, including from the Fund.

4. **Prior to the normalization of relations with the Fund, Cambodia faced waves of rapid inflation and exchange rate depreciation,** reflecting the government's recurrent resort to money creation to finance the fiscal deficit as external assistance withered. With monetary instability and negative real interest rates, financial intermediation levels and confidence remained very low.

5. **The informal monitoring arrangement covering the period 1992–93 anchored the restoration of monetary stability on the strict control of the domestic deficit financing.** It also called for the establishment of positive real interest rates for domestic currency bank deposits, and a limit on the spread between the official exchange rate and the parallel market rate, as a step prior to the adoption of a unified flexible exchange rate regime. As fiscal performance improved, money growth dropped sharply, inflation plummeted, and the depreciation of the riel slowed. Temporary setbacks in early 1993 were mainly due to heightened uncertainty surrounding elections and rumors that a new government would again de-monetize the economy.

III. Experience Under the STF, ESAF-I, and ESAF-II/PRGF

A. Macroeconomic Performance

6. **Macroeconomic performance was characterized by a quick return to price stability, while growth remained volatile and narrowly based, and poverty pervasive.**

- Inflation dropped to single digit levels in the mid-1990s and remained moderate throughout the period under review, peaking at 13¼ percent in 1998 in the wake of the Asian financial crisis (Figure 1).

- Following massive devaluations of the riel up to mid-1993, the exchange rate was unified under a market-based regime and remained relatively stable thereafter; official reserves grew steadily reflecting an increased demand for domestic currency

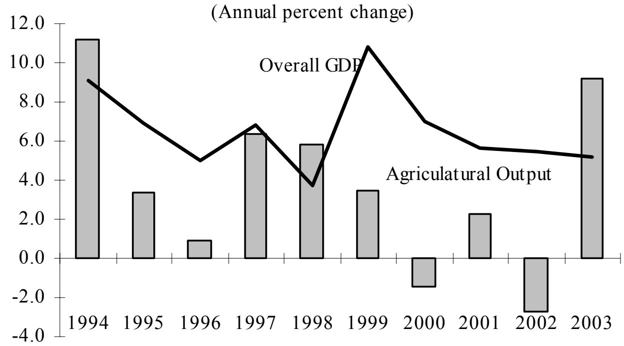
[2] For a chronology of key political and economic developments see Annex I.

(Figure 2). However, significant foreign currency inflows and lingering fears of de-monetization boosted dollarization, particularly in urban areas.

- Real GDP growth was on average robust, but it was narrowly based and volatile reflecting the vagaries of the political cycle. Growth in the urban areas was driven mainly by the garment sector. This sector gained preferential access to the quota-protected EU and US markets in the mid-1990s.[3] It immediately attracted sizable inflows of foreign direct investment, which eventually led to a surge in garment exports. However, the sector's backward linkages to the rest of the economy remained minimal, as most nonlabor inputs were imported and profits remitted abroad.

- Growth in rural areas, home to more than 80 percent of the population, remained dependent on agricultural output which continued to suffer from a lack of investment in technology, infrastructure and diversified crops, a shortage of land amid a rapidly growing population, and natural disasters such as the repeated floods in 2000–02.

Overall GDP and Agricultural Output
(Annual percent change)



Source: National Institute of Statistics; and Fund staff estimates.

- Against this background, poverty remained high and pervasive, particularly in rural areas where the majority of the poor are located (Annex II).

7. **Important progress was made in building central institutions of macroeconomic management, restructuring the financial sector, and integrating Cambodia into the world economy, but there was slow progress in other critical structural areas.**

- Fiscal management and control at the central government level was improved through a number of legal and administrative reforms, and the role of the central bank was strengthened as part of the efforts to build a two-tier banking system.

[3] Under these schemes, garment exports increased from near-zero in 1994 to almost 40 percent of GDP in 2003, and now account for about 85 percent of total exports. The phasing out of Phase IV garment quotas among WTO members in 2005 could create significant competitive pressures, especially from China, and the net trade impact could be between 2 to 4 percentage points of GDP, according to recent staff estimates.

- Privatization of state-owned enterprises (SOEs), which had begun under the market-oriented reforms in the late 1980s, was largely completed by 1996.

- The trade regime was liberalized as Cambodia joined ASEAN and prepared for WTO membership. Accession preparations also provided impetus to legal reforms, in particular the commercial law, civil and criminal codes, intellectual property rights, customs laws, and trade-related investment measures.

- However, the civil service remained weak and ineffective, and corruption pervasive, impeding basic functioning of the public administration, highlighting the need for further institution-building and reform.

B. Main Factors Contributing to Macroeconomic Performance

Fiscal policy

8. **Fiscal policy played a key role in achieving stability, but recurrent pressures on revenues made it difficult to attend in full priority needs** (Figure 3). In line with the various programs' targets, the current fiscal deficit shifted gradually from a deficit into a moderate surplus starting in 1998, before it declined to near balance in 2003 owing to a contraction in tourism-related receipts and increased smuggling. Overall fiscal deficits before grants, which were just indicative targets under all programs, were broadly consistent with available foreign financing and zero recourse to domestic bank credit.[4]

9. **Fiscal revenues rose sharply in the early 1990s but have since increased only moderately and usually below target,[5] despite continued efforts to reform the tax system and strengthen revenue administration** (Box 3). While the resulting tax structure was more efficient, equitable, and elastic than the one in the early 1990s, the recurrent revenue shortfalls resulted from the interplay of several factors, including lack of ownership, frail political will, corruption, and fundamental weaknesses in revenue administration. In particular:

- Tax revenue mobilization was seriously undermined by delays in the implementation and enforcement of measures owing mostly to political pressures, and a serious

[4] With the exception of 1998 when a sharp decline in revenues, in the face of already constrained expenditures, forced the government to access domestic bank credit for the first time since 1994.

[5] After rising from 4½ percent of GDP in 1992 to 8½ percent in 1994, total revenues only rose by 2 percentage points of GDP between 1994 and 2003, roughly half of the targeted increase under the Fund-supported programs.

erosion of the tax base due to ad-hoc extensions of tax and customs exemptions and holidays.

- Nontax revenue collections were adversely affected by the lack of transparency, control and accountability of government contracts for the provision of services (including telecommunications and civil aviation),[6] and the income foregone from the forestry sector owing to a lack of an effective forestry management system and substantial illegal logging.

- The problems affecting revenue administration, which were no different from the rest of the administration, ranged from low wages, acute shortage of qualified personnel, widespread absenteeism, and corruption, to inadequate resources and facilities. The customs administration had to confront, in addition, porous borders and smuggling, and outdated legislation.

10. **To meet the current balance and domestic financing targets given the recurrent shortfall in revenues, expenditures were compressed below target, usually without clearly defined criteria, and payments arrears arose**.

- In general, current expenditures, the wage bill, and operating expenditures had to be kept below target during the review period.[7] However, starting in 1998, the government was in a position to counter the compression of priority expenditures, mainly using the space created by declining defense and security expenses and, to a lesser extent, by the continued nonpayment of debt service on the portion of external debt with the United States and Russia.[8] The level of social expenditures which was only 1½ percent of GDP in 1998 (a third of the average level for low-income countries), rose steadily to nearly 3 percent of GDP by 2001.[9]

- Expenditure arrears problems have arisen on several occasions during the review period but adequate information was seldom available. With recent improvements in public accounting, partial information became available and the issue became central

[6] For a detailed discussion of the revenue implications of government contracts see Box 4 in the Staff Report for the Sixth Review under the PRGF, IMF Country Report No. 03/58.

[7] For example, in 2002 current expenditures and operating expenditures were about 1½ and ½ percentage point of GDP lower than envisaged in the program under ESAF-II/PRGF.

[8] The shift in expenditure composition was also subject to conditionality under the World Bank SAC loan approved in 2000 which called for assurances that the budget would provide for increasing allocations to priority expenditures.

[9] For further analysis see Cambodia: Selected Issues and Statistical Appendix, IMF Country Report No. 03/59.

to program discussions in 2001. Since then, recorded arrears have risen rapidly to about 4¾ percent at end 2003,[10] reflecting spending pressures associated to the pre-2003 election period. Until 2003, budgets did not contain special allocations to pay for arrears and, as a result, the government resorted to partial and not too transparent solutions, such as offsetting arrears against the suppliers' tax liabilities. This in turn contributed to reduce revenue collections, forcing a new cycle of expenditure compression and further arrears build-up.

11. **Capital expenditures—mostly financed from donor funds—remained high over the review period.** While justified on grounds that there was great need for reconstruction and rehabilitation, it is not clear whether the mostly aid-funded development program was aligned with the government's priorities, what were the selection process or criteria applied in choosing investment projects, and what efforts were being done to enhance the government's project implementation capacity (see below). Moreover, none of the programs contained an explicit analysis of: (i) the medium-term implications of development expenditures on the current budget, or (ii) the quasi-fiscal development expenditures financed outside the budget that would eventually become a responsibility of the budget.

Deficit Financing, External Financial Assistance and Debt Management

12. **Deficits were financed primarily from external sources during the review period, although only about half of all external financing was channeled through the budget.** Between 1993 and 2003, Cambodia received about US$5 billion in external assistance, equivalent to an average of about 13 percent of GDP annually.[11] Of this, budgetary assistance averaged about 6 percent of GDP annually, with an average of 1 percent of GDP annually for budgetary support and the rest for project support. As the current balance improved, general budgetary support declined steadily to negligible magnitudes by 2000–03, while project support rose to absorb virtually all assistance. Although Fund financial support was relatively small, large increases in external financial assistance were generally preceded by the approval of Fund programs.

[10] Most of these arrears are owed to private sector suppliers, the road maintenance credit and on wages. The definition of what constitutes an arrear—in terms of an outstanding obligation due for payment over which the government has failed to pay after a certain period of time—is also not clear. In view of the above, figures quoted should be treated as indicative only.

[11] The data shown here was provided by the Cambodia Development Council. It is larger than the BOP external financing estimates of about $4 billion, or 10 percent of GDP per annum, which are currently undergoing review.

13. **External financial assistance to Cambodia was significantly higher than to other low income countries,[12] but available information does not allow for a comprehensive analysis of its effectiveness and alignment with the development priorities of the country.**

- Based on a functional classification, about 40 percent of total financial assistance ($2 billion) was spent on free-standing technical cooperation (reportedly mostly to pay foreign experts), and another 40 percent was allocated to investment projects. Despite this distribution, Cambodia's administrative capacity remained weak and infrastructure rehabilitation and development limited, particularly in rural areas, giving rise to questions about effective knowledge transfer and project selection procedures.

- Based on an economic classification of aid flows, most of the aid was channeled to education, health, institution building and infrastructure. However, only about 8 percent of total financial assistance was directly allocated to agriculture and rural development, even though 80 percent of Cambodia's poor live in rural areas.

14. **About 80 percent of total external financial support was in the form of grants, although the composition changed toward loans in recent years.** It is estimated that between 1999 and 2003 Cambodia borrowed about $600 million on concessional terms mainly from the World Bank and AsDB. This brought Cambodia's external public debt to about 70 percent of GDP at end-2003, two-thirds of which is in arrears mainly to Russia, but also to the United States, and the rest mostly to multilaterals.

15. **Rising debt levels and the overall slow progress in ensuring fiscal sustainability highlight the need for a debt management strategy.** Although all programs called for an orderly resolution of the public debt with the United States and Russia, concerns on debt sustainability were given more prominence during ESAF-II/PRGF when it was concluded that debt would be manageable only if Cambodia were granted rescheduling terms similar to those obtained under the Paris Club Agreement of 1995 (i.e., Naples terms). However, the difficulties encountered in raising revenues and the various priority expenditures competing for any additional revenues have limited further Cambodia's ability to repay debt. In this context, the rescheduling terms required to achieving debt sustainability will need to be defined as part of a comprehensive medium-term plan for fiscal sustainability (Box 4).

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[12] Per capita aid averaged of about US$350 since 1993, more than 50 percent above the average for Sub-Saharan countries in Africa.

Monetary and exchange rate policy

16. **Encouraged by the initial success in restoring stability, the programs under review continued to prescribe monetary restraint and exchange rate flexibility.**[13]

- With tight limits on bank financing of the deficit and zero net credit to state-owned enterprises, private sector credit and a build-up in official reserves became the major sources of liquidity expansion. Monetary policy had to rely on bank-specific credit targets in the absence of indirect policy instruments. Reserve requirements and refinancing facilities for commercial banks were adopted at the outset of ESAF-I, but they remained largely ineffective. Moreover, the absence of government securities limited the use of the refinancing facility.[14]

- Following the effective unification of the official and parallel market rates from the mid-1990s, official intervention, in particular under the second ESAF-II/PRGF, was geared toward building-up international reserves.[15] During this period, the NBC also intervened occasionally to resist disruptive downward pressures to avoid adverse inflationary pressures.

- The tight domestic credit stance and official intervention contributed to stabilize the riel and lower inflation

17. **Notwithstanding, the low inflation and stable riel exchange rate, dollarization rose significantly, limiting the role of the exchange rate as a shock absorber in the short-term and of monetary policy as a countercyclical tool.** Dollarization was particularly acute in urban areas,[16] while demand for riel continued to rise steadily mainly in the rural areas and for transaction purposes.[17]

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[13] A currency board arrangement (CBA) was considered by staff in 1998 but judged premature in light of continued weaknesses in the banking system and the persistent low level of budgetary revenues.

[14] The first issuance of treasury bills only took place in April 2003, following the issuance of a promissory note amounting to CR 40 billion that took place in 2002 in connection with the recapitalization of the Foreign Trade Bank (FTB).

[15] In line with staff's recommendations, Cambodia accepted the obligations of Article VIII, Sections 2, 3, and 4 on January 1, 2002.

[16] Dollarization, as measured by the ratio of foreign currency deposits to broad money, soared from under 1 percent in 1991 to 26 percent in 1992 reflecting Cambodia's renewed access to aid and remittances. Dollarization continued to rise rapidly to over 60 percent in 1996 and has plateaued around 70 percent since the Asian financial crisis. In addition, there are significant, but largely unrecorded, amounts of foreign currency cash in circulation.

[17] Riels in circulation grew from almost 2½ percent of GDP in 1994 to over 5 percent in 2003.

Institutional development and structural reform

18. **Efforts were devoted early on to building the central institutions of macroeconomic management, in particular the central bank and the ministry of finance.** Strengthening the role and building the capacity of the central bank was at the center of the financial sector reform (see below). The key fiscal institutional measures included the introduction of an organic budget law (1993); and steps to increase fiscal transparency, including by assigning financial controllers to each ministry, defining procurement procedures, and implementing a cash budget management system. Notwithstanding these measures, fiscal management continued to suffer from fundamental shortcomings, in particular a fragmented budget department, a proliferation of government accounts in the NBC, and poor budget execution.

19. **Progress in structural reform has been mixed.**

- In the fiscal area, some progress was made in privatizing the state owned enterprises (SOEs) and reforming the management of the forestry sector. However, divestiture of seven major rubber plantations and the Foreign Trade Bank were delayed, and there was little progress in privatizing small enterprises. Despite important progress, the management of forestry resources did not reach the desired efficiency level, illegal logging continued, and the sector's contribution to the budget was well below its notional fiscal incidence.[18]

- In the financial area, reforms were successful in setting up the basis for a two-tier banking system, strengthening the soundness of the banking sector, and subjecting banks to a comprehensive regulatory and supervisory regime. Key bank soundness indicators improved visibly.[19] However, financial intermediation remained very limited by international standards, particularly in rural areas, where the absence of credit has been considered a key constraint in raising farm output and incomes.[20]

- In contrast, only limited progress was achieved in improving governance, civil service reform, and demobilization.

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[18] During 1995–98, government revenues from forestry averaged less than ½ percent of GDP, compared with estimated revenue losses of about 4 percent of GDP due to inadequate resource pricing. A sustainable forestry policy was estimated to generate government revenues of about 1–1½ percent of GDP by 2002.

[19] Following the closure of 15 banks and recapitalization of FTB, the only remaining state-owned bank, capital adequacy reached 50 percent in 2002.

[20] Private sector credit in percent of GDP rose from 3½ percent in 1994 to 8 percent at end 2003, but it was mostly in foreign currency and related to trade.

- Governance problems and corruption have been pervasive throughout the period under review, with mixed progress in certain areas (see Annex III). Evidence of weak governance ranged from ad-hoc exemptions of tax and customs laws to ineffective forestry management. Since the adoption of a more systematic Governance Action Plan in 2001, progress was made by: (1) improving forestry management; (2) introducing competitive bidding for government contracts at line ministries; and (3) establishing a National Audit Authority (NAA). Further progress depends on measures in a number of other critical areas, in particular civil service reform and legal reform (including the adoption of civil and penal codes, and an anti-corruption law).

- On civil service reform, new rules for recruitment were implemented, a census carried out, and ghost workers eliminated. However, Cambodia's civil service remunerations remained low compared with other sectors; there was an acute shortage of qualified personnel, and widespread absenteeism. In 2002, the government committed to develop a pay and employment program.[21] The World Bank provided full funding for the program but so far progress has been minimal.

- The postconflict demobilization program was beset by problems, including a large number of ghost soldiers and dependents. As these problems were addressed, related budgetary expenditures started to decline, although they remained high by international standards.[22] A renewed effort started beginning in 2000. However, it has been suspended since early 2003, partly because of the elections, and partly because of evidence of misprocurement on a contract.

C. Collaboration with the World Bank and Technical Assistance

20. **Fund-Bank collaboration regarding policy advice was generally close.** The Bank took the lead in the areas of public sector reform (civil service reform and military demobilization), forestry management, legal reform, governance, and since 2002 on public expenditure management. Specific recommendations in each of these areas deemed to be critical for macro-stability became structural performance criteria or benchmarks. Bank structural conditionality was complementary to that in Fund-supported programs. In general,

[21] The program aimed at increasing and decompressing wages, rationalizing and redeveloping staff in line with the highest priorities, and improving human resource management.

[22] By 2001 Cambodia's military expenditure was estimated at 3 percent of GDP, about twice as high as in Western Hemisphere countries and slightly above the average for Africa and Asia. However, in percent of total government expenditure, Cambodia spent nearly twice as much as the Asian average and about three times as much as countries in Africa and the Western Hemisphere (WEO country database).

the division of responsibilities between the Fund and the Bank was broadly clear and the policy advice consistent, except for some contradictory advice in the fiscal institutional area that arose as a result of Integrated Fiduciary Assessment and Public Expenditure Review (IPAFER) findings. The issue was resolved by further enhancing communication through sharing of work plans and terms of reference, and agreeing to work together to provide support in this area.

21. **Coordination of the wide-ranging technical assistance provided during the review period was complex as it involved several key multilateral agencies** (Annex IV). Under the STF and ESAF-I, the UNDP, AsDB, World Bank, and IMF jointly provided technical assistance to build the central institutions of macroeconomic management. During ESAF-II/PRGF, the technical assistance and cooperation action plan (TCAP) coordinated TA activities of the Fund, UNDP and AsDB, regarding fiscal management and financial sector reform. The World Bank did not participate directly in TCAP but continued to provide complementary TA on public expenditure management, civil service reform, governance, and poverty reduction. Following some complaints by the authorities that they were becoming overwhelmed by the amount (and occasional duplication) of TA being offered to them, since the 2000 CG meeting, all TA programs have been discussed with an official high-level committee. This move has also served to meet donors' calls for greater accountability, and enhanced coordination to ensure ownership and adequate prioritization.

IV. Evaluation of Program Conditionality and Compliance

A. Program Goals and Achievements

22. **The macro-economic objectives of the programs were broadly met, but the foundations for sustainable growth and poverty reduction remain fragile.** Inflation was reined in and kept low, the external position strengthened, and growth was on average robust. There was also important progress in setting up key economic institutions and advancing structural reforms in certain areas, especially the financial sector and privatization of SOEs. However, growth has remained narrowly based and subject to the political cycle, and private investment has been subdued since 1998. Moreover, the task of building up a government that effectively controls public revenues and provides adequate social service delivery has proven to take longer than envisaged. Altogether, the programs have had little impact on reducing poverty, particularly in the rural areas, where it remains widespread and high.

B. Quantitative Performance Criteria and Benchmarks

23. **Cambodia complied with most of the quantitative performance criteria and benchmarks set for the STF, the first two reviews of ESAF-I, and all of the reviews under ESAF-II/PRGF** (Table 1).[23] Notwithstanding formal compliance in all the reviews completed by the Board, there were persistent fiscal pressures resulting from chronic revenue

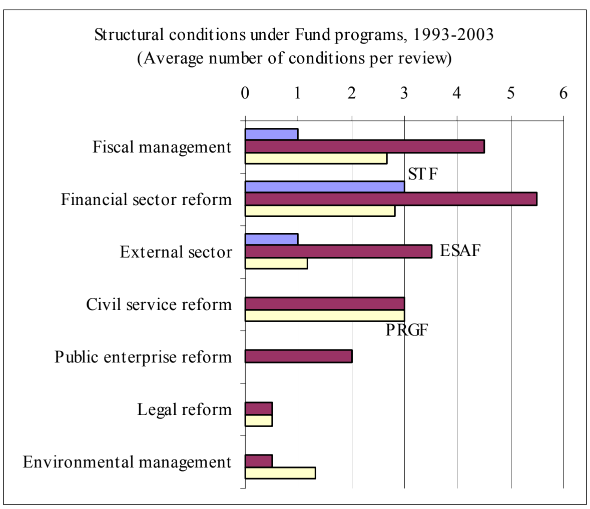
[23] The zero-limit on nonconcessional external borrowing was breached in 1994–95.

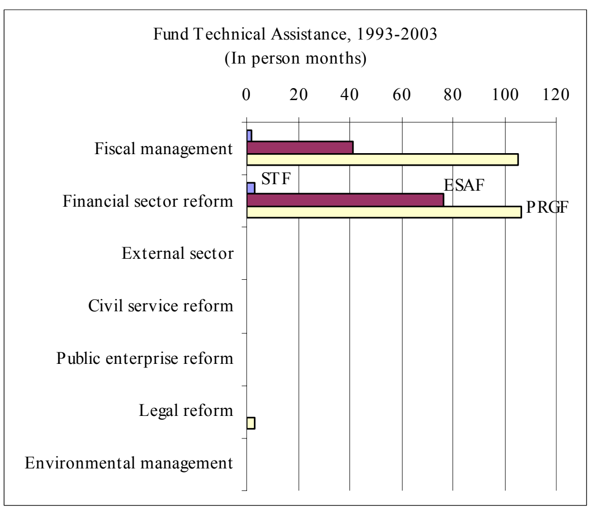
underperformance and difficulties in compressing non-priority expenditures, in particular military outlays until the beginning of the ESAF-II/PRGF and the World Bank SAC. The collapse of ESAF-I was in part caused by the government's decision not to introduce the program's measures to stop a significant erosion of the revenue due to illegal logging activities. Similarly, the targeted increase in fiscal revenues under ESAF-II/PRGF was not achieved, limiting the availability of funds for social expenditures, giving rise to the accumulation of expenditure arrears in critical areas, and ultimately compromising fiscal sustainability. In retrospect, direct conditionality on revenues, a closer monitoring of the stock of arrears and a plan for their repayment, and some additional conditionality to protect priority expenditures could have strengthened the program's architecture. However, compliance still would have depended on the government's will to take the necessary steps.

C. Structural Performance Criteria and Benchmarks

24. **Structural conditionality generally covered a wide range of areas reflecting Cambodia's comprehensive needs, but it was streamlined over time.** The core conditions related to fiscal management and financial sector reform, whereas conditions in other areas of macroeconomic relevance were applied to trade reform, civil service reform, public enterprise reform, and environmental management (Table 2). Altogether, a total of 113 prior actions, performance criteria and structural benchmarks were introduced, most of them under ESAF-II/PRGF reflecting the completion of all 6 reviews. However, the average number of conditions per review declined from 20 under ESAF-I to 12 under ESAF-II/PRGF, reflecting efforts at streamlining, and the concurrence of conditionality under the World Bank lending operations. Structural performance criteria were used sparingly.

25. **Compliance with structural conditionality was mixed, and experience showed that there was a trade-off between streamlining conditionality and retaining as conditions certain elements of key structural reform actions critical for sustaining stability and promoting growth** (Table 3 and Annex V). Compliance tended to be better in the areas of fiscal management and financial sector reform, which, as the Fund's core areas





of expertise, were also best covered by technical assistance provided or coordinated by the Fund.[24] By contrast, 80 percent of structural benchmarks in civil service reform under ESAF-II/PRGF were not met, and compliance with conditionality on forestry remained a problem, even after causing the halt of the program supported by ESAF-I. It should be noted, however, that in the attempt to streamline conditionality in 2001, the only structural performance criterion on forestry concessions under ESAF-II/PRGF was converted into a benchmark, on the understanding that conditionality would be better covered under the World Bank operations. In the event, Cambodia complied with Bank conditionality on forestry only after the ESAF-II/PRGF had expired, diluting the sector's expected contribution to the program.

D. Prior Actions

26. **Prior actions increased between ESAF-I and ESAF-II/PRGF, but their impact was generally transitory**. Prior actions appropriately signaled a renewed government commitment at the outset of a program, or the intention to take decisive actions to address program slippages. Most of the increase in prior actions was in the fiscal area (from one in ESAF-I to nine in ESAF-II/PRGF) and geared at enhancing revenue, including from logging activities. However, revenue shortfalls ensued shortly after the period covered by the prior actions. ESAF-II/PRGF also made extensive use of prior actions in financial sector reform (none under the predecessor arrangement), but mostly to redress slippages with respect to structural benchmarks during the program. Most of the key prior actions concerning forestry (environmental) management and civil service reform sought to redress problems that had arisen under the predecessor ESAF arrangement.

V. Lessons for Policy and Program Design

A. Why was a Long-Term Engagement Needed for Cambodia?

27. **Cambodia's prolonged use of Fund resources reflected mainly the changing role of the Fund in support of low income countries and, to a lesser extent, factors affecting the implementation of the programs.** As noted above, Fund-supported programs under review evolved from dealing with a postconflict-*cum*-transition to a market economy to establishing the foundation for high and sustained growth and reducing poverty. It follows, that long-term Fund engagement was largely unavoidable, if only because of the changing nature of the problems to be addressed. On the other hand, while recognizing that Cambodia's program implementation capacity improved during ESAF-II/PRGF, it will take significant efforts and political determination to achieve fiscal sustainability, enhance governance, and ensure a timely and successful implementation of the remaining vast development and poverty reduction agenda.

[24] The Fund technical assistance on fiscal management included support for the reform of import tariffs and preparatory work for the accession to the WTO.

B. Lessons for Policy Design

28. **Fiscal policy progressively assumed broader and higher responsibilities for achieving the programs' objectives, without a clear and sustained resolution of key weaknesses**.

- Revenue mobilization received great attention in the design of policy, but key expenditure priorities should have been sheltered more effectively from compression in case of revenue shortfalls.

- The tax structure appears to be broadly adequate, and the problems in mobilizing revenue reside more on compliance and a self-inflicted reduction in the tax base. Thus, future revenue-enhancing efforts will require strong political support and should focus on enhancing governance and transparency both in the revenue collecting bodies, and in the decision-making process related to the extension of exemptions and tax holidays, and the concession of contracts.

- The management of expenditures still leaves much to be desired, as evidenced by the rising arrears and the inappropriate practice of offsetting them against tax liabilities being used. Also, the medium term expenditure framework should be enhanced to incorporate the medium term implications on current expenditure of the high level of aid-financed development expenditures.

- A short term deficit financing strategy needs to be developed to support the day to day management of expenditure. Also, efforts to normalize relations with foreign creditors should continue to seek the most favorable terms within a medium-term fiscal sustainability context which clearly assigns expenditure priorities and is based on a realistic revenue projection.

- Progress in recent years in raising outlays for social priority expenditures (health, education, and rural development) has been supported by the PRSP process. Implementation of poverty-reducing expenditures through the medium-term expenditure framework (MET) and budget will need to be strongly backed by adequate costing of measures and a transparent and consultative mechanism to adjust social spending priorities annually in line with needs and available funds.

- The absence of what is called a combined-sources development expenditure plan is conspicuous and needs to be addressed together with the donor community. To this end, it is of utmost importance to collect information on the type of quasi-public investments being supported outside the budget, which eventually could revert to the government.

29. **Reliance on a flexible exchange rate and a firm control over domestic credit should continue, while steps are taken to promote de-dollarization.**

- While acknowledging the limitations imposed by dollarization on the short-term impact of changes in the exchange rate, official intervention in the foreign exchange market should be limited to smoothing fluctuations. The authorities should not resist pressures on the exchange rate that reflect fundamental changes in underlying market conditions.

- De-dollarization will require, besides maintaining political stability as the ultimate anchor of confidence in the riel, steps to (i) address the lingering trauma of demonetization, including by requiring that all government domestic transactions be paid in local currency; and (ii) promote the supply of basic banking services to the rural areas, by offering high-yield riel denominated deposits and facilitating access to credit. It will also be important to research further what other factors influence Cambodian investors to hold most of their financial portfolios in foreign currency.[25]

30. **The pursuit of a flexible exchange rate combined with progress toward de-dollarization would allow monetary policy to be conducted independently.** As such, monetary policy could, over time, complement fiscal policy in addressing unanticipated short-term shocks. Meanwhile, the fact that there is a growing demand for riel makes it important to continue enhancing NBC's capacity to design and conduct monetary policy.[26]

31. **Institutional and structural reforms need to regain momentum and focus, including on addressing more directly poverty reduction.**

- On the institutional side, limited progress in strengthening budgetary processes, reforming the civil service and combating corruption, has consistently undermined macroeconomic policy implementation and social service delivery.

- Although plans have been formulated and regulations drafted in all these key areas and significant technical assistance has been provided, implementation of reforms has met with delays. Besides the issue of political will this points to the need to break

[25] A Fund multi-country study (IMF WP/98/28) found that dollarization is correlated positively with the variance of inflation and negatively with the variance of the rate of depreciation of the real exchange rate. The policy implication was that stabilization may fail to reduce dollarization if accompanied by policies that target the real exchange rate. The study used data for Cambodia for 1995–96 and estimated that underlying dollarization was about 65 percent, close to measured dollarization. While updated results for longer periods of time are robust, calculations for shorter and more recent periods seem quite sensitive to the measure of inflation and depreciation used.

[26] Riel in circulation grew at an average of about 18 percent a year (over 1994–2003), and as a result significant seigniorage accrued to the NBC equivalent to more than 6 percent of government revenues.

down reform plans into more manageable and effective steps, and place greater emphasis on knowledge transfer.

- The experience in reforming the financial sector suggests that a sound banking system in itself is not sufficient to promote financial intermediation and growth. Attention needs to be given now to overcoming the impediments to financial market development, including further development and enforcement of an adequate legal framework.

- Lack of progress in agricultural and rural development has hampered efforts at poverty reduction. Further structural reforms are needed to promote agricultural growth and productivity, and lift living standards of the rural population accounting for 90 percent of Cambodia's poor.

- Private sector-led growth and investment has been robust, but limited mainly to the export-oriented textile sector, reflecting Cambodia's privileged access to industrial countries' markets. Such dependence has turned attention away from structural impediments to broad-based growth, including weaknesses in governance, inadequate and poorly enforced legal framework, and a limited supply of skilled workers.

C. Lessons for Bank-Fund Collaboration and Technical Assistance

32. **Intense Bank-Fund collaboration will continue to be necessary.** The success of any future program will depend on substantive inputs from other multilateral donors, in particular the Bank. Given that both the Fund and the Bank's involvement in TA is expected to become more selective, with emphasis on the transfer of know-how, collaboration will need to be strengthened. In particular, efforts to expedite the preparation of specific action plans are needed in the areas of governance, civil service reform, and fiscal management.

33. **Looking ahead, several areas are in need of immediate assistance.** In the area of governance, plans for sustainable forestry have not been finalized, monitoring of logging activities remains ineffective, and there is a need for the adoption and enforcement of an anti-corruption law. In the fiscal area, a fundamental strengthening of revenue collecting agencies and a review of the government contract concessions to the private sector is urgent. The medium-term expenditure framework under development needs to include a comprehensive and explicit review of the current expenditure implications of all government- and donor-financed investment projects. In the area of civil service reform, there is an urgent need to address wage issues and staffing of at least certain key agencies.

VI. Strategy for Future Fund Relations with Cambodia

A. Policy Challenges

34. **Cambodia's policy strategy during the 1990s adapted well to the changing circumstances and progressively more complex challenges.** Having made progress in addressing the postconflict and transition to market problems, the government's policies were

appropriately redirected toward promoting high growth and reducing poverty in the latter part of the 1990s. However, the government's comprehensive poverty reduction agenda took longer to be completed and to become operational, and, as a result, little inroads were made in the period under review as regards poverty reduction, particularly in rural areas.

35. **Against this background, the main policy challenges to achieve the desired reduction in poverty continue to be:** (i) improving governance and eliminating corruption; (ii) creating the conditions for a revival of investment, with a view to broaden the growth base (particularly agriculture and tourism), and diversify exports; (iii) building up human capital to meet future private sector needs; (iv) raising the efficiency of the delivery of public services and improving the provision of public goods, including basic infrastructure; (v) developing further a stable and predictable legal framework and a strong judiciary system; and (vi) keeping the trust of donors.

B. Rationale for Continued Fund Involvement and Exit Prospects

36. **Cambodia's vast development and poverty reduction agenda is yet to be implemented and will continue requiring internationally concerted financial assistance.** Financing requirements are likely to be high (NPRS estimates are in the order of $200 million per year over the next five years).

37. **The Fund is likely to be asked both by the authorities and the donor community to continue to provide policy advice, technical assistance, and financial support to Cambodia.** The first two roles are clear, although lessons indicate that there is need to focus on the promotion of ownership of the policy measures and on building up an indigenous expertise. Whether and for how long the Fund should continue to assume a catalytic financial role is less clear. Cambodia is likely to require two types of financial involvement from the Fund: (i) to catalyze support for implementing the unfinished poverty reduction agenda; and (ii) to help confront the likely adverse impact of the imminent elimination of the garment quotas. Both types of needs could be met by seeking understandings on a medium-term strategy that could be supported by a successor arrangement, with access to be determined by the strength of the program, taking into account public debt dynamics. It should be expected, however, that a steadfast implementation of a sound policy strategy should help reduce external financial requirements steadily over time, and provide the required policy flexibility to address future shocks without resorting to short-term financing.

38. **It is difficult at this juncture to believe that Cambodia will be a candidate for early graduation from using Fund resources any time soon.** However, such a question should be raised at the time of approval of each yearly program, since proximity to achieving the MDGs, reducing reliance on concessional external financial resources, and increasing policy flexibility should be key tests of progress under a program.

C. Suggested Key Features of a Successor Arrangement

39. **Goals:** Consistent with the Government's National Poverty Reduction Strategy and the Development Plan, any future Fund-supported program should aim at maintaining

macroeconomic stability and placing the economy on a path of high and sustained growth, led by the private sector, with a view to foster Cambodia's human development, including through the reduction of the prevailing high degree of poverty.

40. **Policy strategy:** The set of economic and structural reform policies should be broad enough to help the authorities not only to set the course for high, private sector-led growth and export diversification, but also to gain policy flexibility to addressing imbalances and countering shocks to maintain stability. The success of a future policy framework should not depend on the strength of fiscal policy alone.

41. **Having said this, fiscal policy should continue to be at the center of the economic policy strategy.** The emphasis should be on:

- Strengthening revenue performance, including through further efforts to expand the tax base, a decisive attack on tax evasion and smuggling; and a thorough revision of tax incentives and government concessions. Ensuring a strict control of expenditures, a timely execution of the budget to avoid accumulation of arrears, and a reduction in the scope for corruption, including by upgrading the quality and pay of public servants.

- Aligning donors' assistance priorities with those of the government, enhancing the medium term expenditure framework to anticipate future operating costs of aid-financed projects, and initiating the development of a combined sources budget.

- Developing a deficit financing strategy, including a definitive normalization of outstanding external debts on terms consistent with fiscal sustainability, and the development of the securities market.

- Program fiscal conditionality should target the primary deficit (not the current balance), and have an indicative path for the overall deficit consistent with a sustainable path for the public debt. Revenues could be subject to a floor target, with accompanying contingent measures to enhance revenues and reduce expenditures on low-priority expenditures to offset any shortfalls. Alternatively, revenues could be projected conservatively, and a mechanism established to increase expenditures as additional revenues become available. Agreements should also be reached on the definition, measurement, and timetable for the elimination of expenditure arrears.

42. **Maintaining a flexible exchange rate policy should be another key element of the program**. To enhance the role of the exchange rate as shock absorber, steps to broaden the use of the riel as the sole legal tender should be included, provided they do not entail distortionary administrative measures. The program should also contain steps to enhance the NBC's capacity to design and implement monetary policy, as its role should be expected to grow over time with progress in de-dollarizing the economy.

43. **Targeted efforts at public administration reform are urgently needed, even if a comprehensive strategy will take longer to be finalized.** Given the slow progress to date and pervasive weaknesses in governance, key steps should include:

- Providing revenue collecting agencies with effective, well-paid, and accountable staff, while continuing to streamline the rest of the civil service.[27]

- Strengthening considerably the Treasury by accelerating the adoption of an integrated cash management system and budget accounting policies in line with best practices.

44. **Other structural reforms need to be focused on promoting broad-based private sector-led growth and reducing poverty. In particular:**

- Addressing the impediments to agricultural growth by strengthening land titling procedures, ownership transfer and property rights, auditing existing land concessions and upgrading access to markets and infrastructure facilities.

- Promoting financial market development by strengthening the legal framework for contract enforcement and collateral-based borrowing, upgrading corporate accounting and disclosure standards to ensure reliable borrower information, and promoting the development of banking services in rural areas.

- Creating an environment conducive to broad-based private sector investment and growth by strengthening the legal framework and liberalizing further labor market regulations consistent with WTO accession commitments, and by combating corruption.

D. Risks

45. **The main risks to the success of a medium-term program would be:**

- Lack of political cohesion could undermine the commitment and resolve to pursue further reforms, and perpetuate the adverse influence of the political situation on the overall economic conditions and outlook.

- Insufficient progress in improving fiscal management, strengthening fiscal institutions, and enhancing accountability, transparency and governance, coupled with a continued lack of policy options to address shocks.

- Complacency in addressing governance issues, compounded with delays in implementing the legal and judicial reforms.

- A larger and more disruptive-than-anticipated adverse impact of the removal of the garment quotas.

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[27] Consistent with this view, development partners are increasingly of the view that progress on civil service reform will need to occur at the sectoral level in the medium term, given the lack of movement on overall system-wide reform.

Box 1. Cambodia: Fund-Supported Programs, 1993–2003

Systemic Transformation Facility (STF), 1993–94: The STF was preceded by a year-long informal monitoring arrangement with Fund staff and by an Article IV consultation in May 1993, the first in 20 years. The STF (with a single purchase of SDR 6.25 million) was approved in October 1993, immediately following the clearance of about SDR 37 million in arrears to the Fund. The authorities' program was fairly successful in restoring macroeconomic stability in the second half of 1993, reflecting tighter fiscal and monetary policies, renewed access to donor support, and the confidence boost resulting from a successful political transition. The authorities also unified the exchange rate and implemented some institutional reforms, including the adoption of an organic budget law. All quantitative and structural benchmarks were observed.

Enhanced Structural Adjustment Facility (ESAF), 1994–97: The three-year arrangement under the EASF was approved in May 1994, in an amount of SDR 84 million (129 percent of quota). The authorities' aim was to consolidate macroeconomic stability and begin the process of long-term reconstruction, supported by tight financial policies, aid-financed public investment, institution building, and growth-oriented structural reforms. During the program period, Cambodia experienced robust GDP growth, low inflation and strong export growth. There were, however, persistent fiscal pressures resulting from low revenues and large military outlays. Performance under the program deteriorated after the approval of the second annual arrangement in September 1995 and no further disbursements were made until the arrangement expired in August 1997, largely as a result of difficulties in implementing agreed forestry policies.

Poverty Reduction and Growth Facility (PRGF), 1999–2003: After a period of somewhat weaker economic performance in 1997 and 1998, reflecting political instability and spillovers from the Asian crisis, the economy returned to strong growth in 1999. The three-year arrangement under the PRGF (initially ESAF) was approved in October 1999, with total access of SDR 58.5 million (67 percent of quota). The program's main focus was on fiscal reform, in particular efforts to increase revenues; reduce military spending; reform public administration; and provide additional funds for social services and public investment. The authorities also aimed to improve forestry management, building on efforts made in the first half of 1999 (prior actions), advance structural reforms to support private growth and poverty reduction. Macroeconomic performance under the program was generally positive, with sustained high GDP and export growth, low inflation, and a rebuilding in international reserves. All quantitative performance criteria and all but one structural performance criteria were met, and all six reviews were completed with only minor delays. However, the targeted increase in fiscal revenues was not achieved, forestry management remained problematic, and poverty remained pervasive.

Box 2. Cambodia: The Role of Poverty Reduction Strategies

Cambodia developed a comprehensive strategy directly aimed at poverty reduction only during the latter part of the period under review. Under ESAF-I, the government's approach to poverty alleviation was only indirect and consisted of establishing an environment conducive to rapid economic growth. Under ESAF-II/PRGF, a similar approach was initially set out in an overall structural reform strategy (Medium-Term Economic and Financial Policy Framework Paper, EBD/99/119). A more direct approach to poverty reduction only came with the *Interim Poverty Reduction Strategy Paper* that was finalized in late 2000. In December 2002, a full *PRSP* was completed, as Cambodia's *National Poverty Reduction Strategy* (NPRS). It is based on the five-year Socio-Economic Development Plan for 2001-2005.

The PRSP commits the government to the Millennium Development Goals by 2015, in particular: (1) halving the proportion of people under the $1 poverty line, (2) halving the number of people suffering from hunger, (3) achieving primary education for all, and (4) reduce by two thirds from the 1990 level the child mortality rate.

To achieve these goals, the government has set out the following priorities: (1) maintaining macroeconomic stability, (2) rural sector development, (3) facilitating private sector job growth and promoting exports, (4) achieving education for all and improving health services, and (5) strengthening institutions and improving governance.

The PRSP has benefited from extensive and open participation, but a number of key challenges have been noted in the 2003 Joint Staff Assessment (EBD/03/8) for its successful implementation. These include:

- Improving costing and prioritization of key measures with a clear link to the annual budget and a medium-term expenditure framework;
- Improving governance and combating corruption;
- Building capacity for poverty monitoring as well as evaluation of projects;
- Further developing pro-poor and infrastructure development strategies.

Box 3. Cambodia: Measures to Increase and Restructure Revenues, 1993–2002

Tax Measures

- *Trade:* Switching from specific to *ad valorem* tax rates for the consumption tax on imports (1993); rationalizing the tariff structure (1993); imposing a tax on car imports; imposing a 10 percent export tax on rubber (1995); tariff bands reduced from 12 to 4, lowering the maximum tariff to 35 percent, and adjusting excises (2001); reducing *ad hoc* tax and customs exemptions.
- *Consumption:* Increasing petroleum duties from 8–10 percent to 20 percent (1993), and from 20 percent to 35 percent (1994); increasing the turnover tax from 1–2 percent to 4 percent (1996); imposing an export tax at 10 percent, and a reforestation tax.
- *Services:* 10 percent hotel room tax extended to other hotel services; tax on rents extended to domestic residents; 10 percent tax on entertainment services (2001).
- *VAT:* Introduced in connection with the Law on Taxation. Coverage expanded to include more firms in 2001, and diesel purchases treated as final sales starting 2001.
- *Excises:* Introducing 10 percent excise on selected goods (1995); excise on gasoline increased to 20 percent (1996) and further in 2002, with an increase for beer.
- *Income:* Wage tax imposed on monthly salaries exceeding US$200 at rates of 10–40 percent. Law on Investment amended (2003) to eliminate certain exemptions and make procedures more transparent.

Nontax measures

Imposing a tax on construction permits (1993), introducing permit fees for casinos, increasing fees and royalty payments from tourist service providers, implementing the timber royalty US$14/$m^3$ to US$54/$m^3$ (1999), introducing a system of stamps for taxing cigarettes (2001).

Administrative measures

Improving the capacity for tax auditing and to collect tax arrears, establishing a large tax payers unit, clarification of customs codes and legislation, simplification of customs procedures, automation of duty calculation, regular rotation and professional training of customs officers, strengthening incentives and discipline for tax and customs officers, implementing preshipment inspection. The authorities also made great efforts to collect revenue from the telecommunications and civil aviation companies and urged line ministries to transfer revenue to the Treasury.

The above changes helped make the tax system more neutral, efficient, and equitable, revenue productive, elastic, and less dependent on trade taxes. By 2002, trade taxes only represented about 35 percent of tax revenues while indirect and direct taxes accounted for 55 percent and 10 percent, respectively. Still, Cambodia's tax structure relies more on trade taxes than a group of selected Southeast Asian countries, with the average trade tax ratio of 2¾ percent of GDP over the review period more than twice that of Lao PDR and 1 percentage point of GDP higher than that of Thailand. On the other hand—reflecting generous investment tax concessions and low salaries for civil servants—the share of direct taxes is about 3 to 7 times lower than that for Lao PDR, Thailand, and Vietnam. Similarly, the share of excises in total taxes is significantly less than in all these other countries. In addition, the continued widespread use of tax holidays and other tax exemptions has narrowed the income tax base.

Box 4. Cambodia: Debt and Fiscal Sustainability

The level of external public debt has remained high, totaling US$3 billion at end-2003, or about 70 percent of GDP and almost 700 percent of revenues (excluding grants). Two-thirds of this debt continues to be in arrears (mainly to Russia, but also to the United States), despite repeated efforts at regularization. The remainder is owed mainly to multilateral institutions, whose claims on Cambodia have risen by almost US$600 million since end-1999. Domestic public debt accounts only for only about 5 percent of total public debt at end-2003.

Progress toward public external debt sustainability will not only depend on the rescheduling of arrears, but also on overall fiscal sustainability. Critical considerations include:

- *Liquidity:* If a debt restructuring agreement on Naples terms is reached with Russia and the United States, Cambodia's scheduled debt service would decrease on an accrual basis, but increase on a cash basis by about 5-10 percent of projected revenues (excluding grants), implying a significant additional demand on public resources.

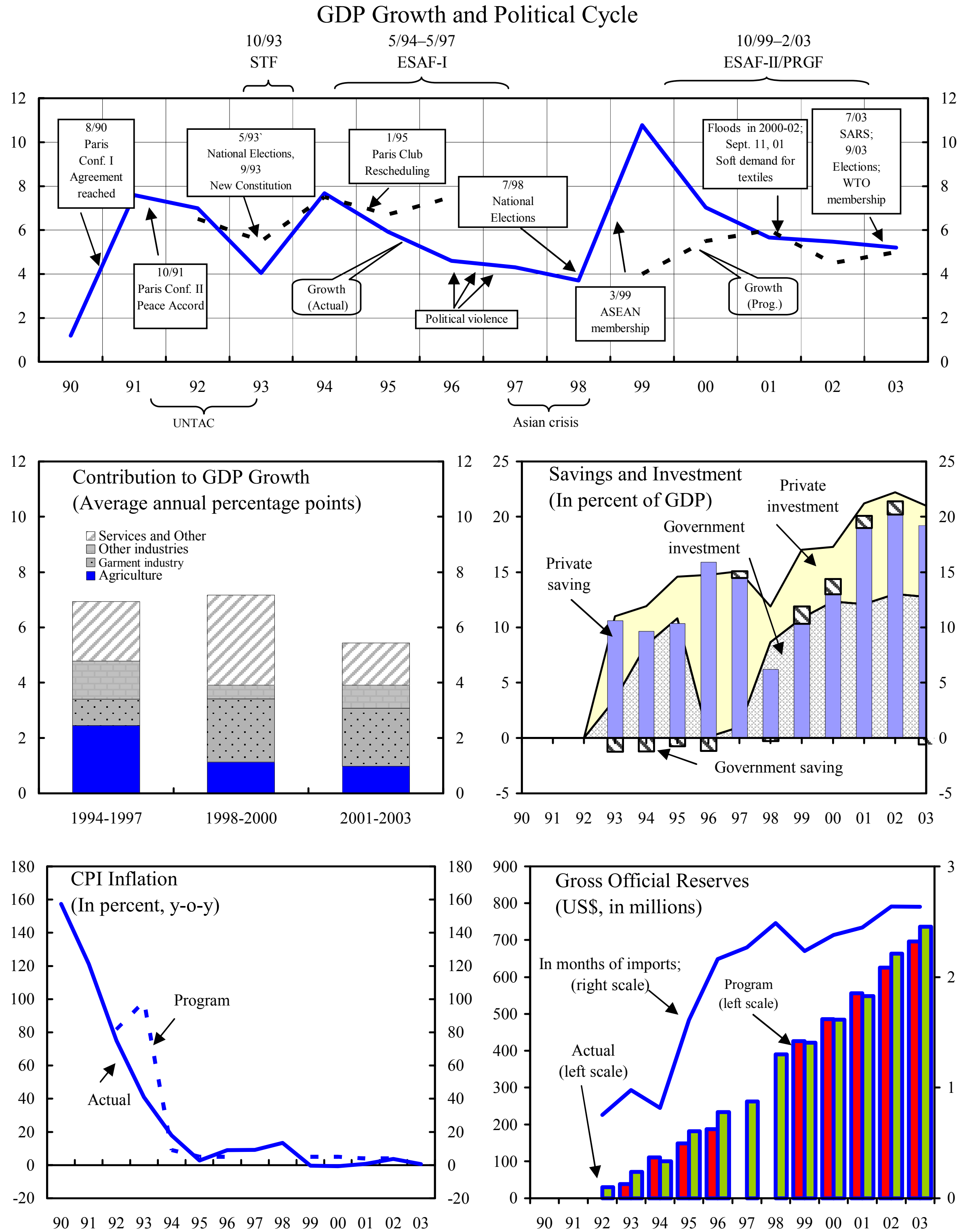
- *Debt overhang:* Even after the assumed upfront 70 percent discount on Russian debt and concessional rescheduling, external debt would still be equivalent to about 350 percent of 2004 revenues (excluding grants), provided revenue targets for the year are met. In net present value terms, public external debt would be equivalent to about 70 percent of exports (net of re-exports and garment imports), and not much below the HIPC threshold of 250 percent of revenues. Concerns about fiscal sustainability may thus persist and possibly deter private capital, which would be needed for reducing Cambodia's reliance on international aid over the long term.

- *Vulnerability to shocks:* A real exchange rate depreciation, a decline in revenues, or a decline in GDP could severely worsen the NPV of debt-to-revenues ratio and exacerbate liquidity problems. For instance, a 30 percent real depreciation would increase the NPV of debt after restructuring to more than 300 percent of government revenues.

- *Dependence on foreign project financing:* Continued heavy reliance on multilateral loans implies that debt ratios would remain high, even if bilateral debt were to be gradually amortized. This concern is highlighted by the external financing requirement under the NPRS with projected loan disbursements averaging US$ 200 million annually over the next five years.

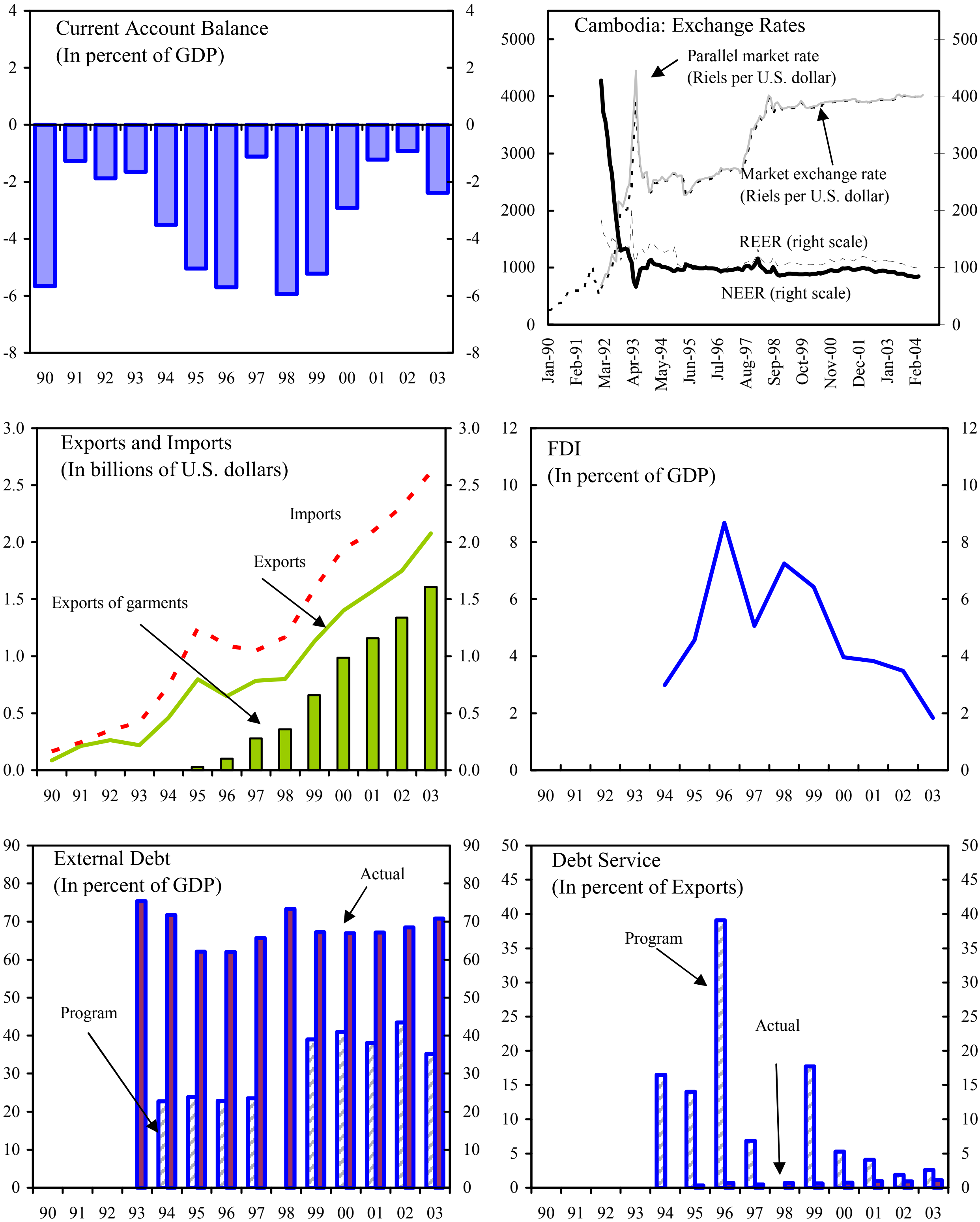
Against this background, the need for reducing the public external debt burden should be considered in the context of a comprehensive assessment of the factors affecting fiscal sustainability. This would include possible future economic shocks, increases in social-priority outlays and implementation of non-priority expenditure cuts as well as revenue-enhancing measures. In the absence of a credible medium-term fiscal plan, it is not clear what debt rescheduling terms would be appropriate for Cambodia.

Figure 1. Cambodia: Selected Economic Indicators



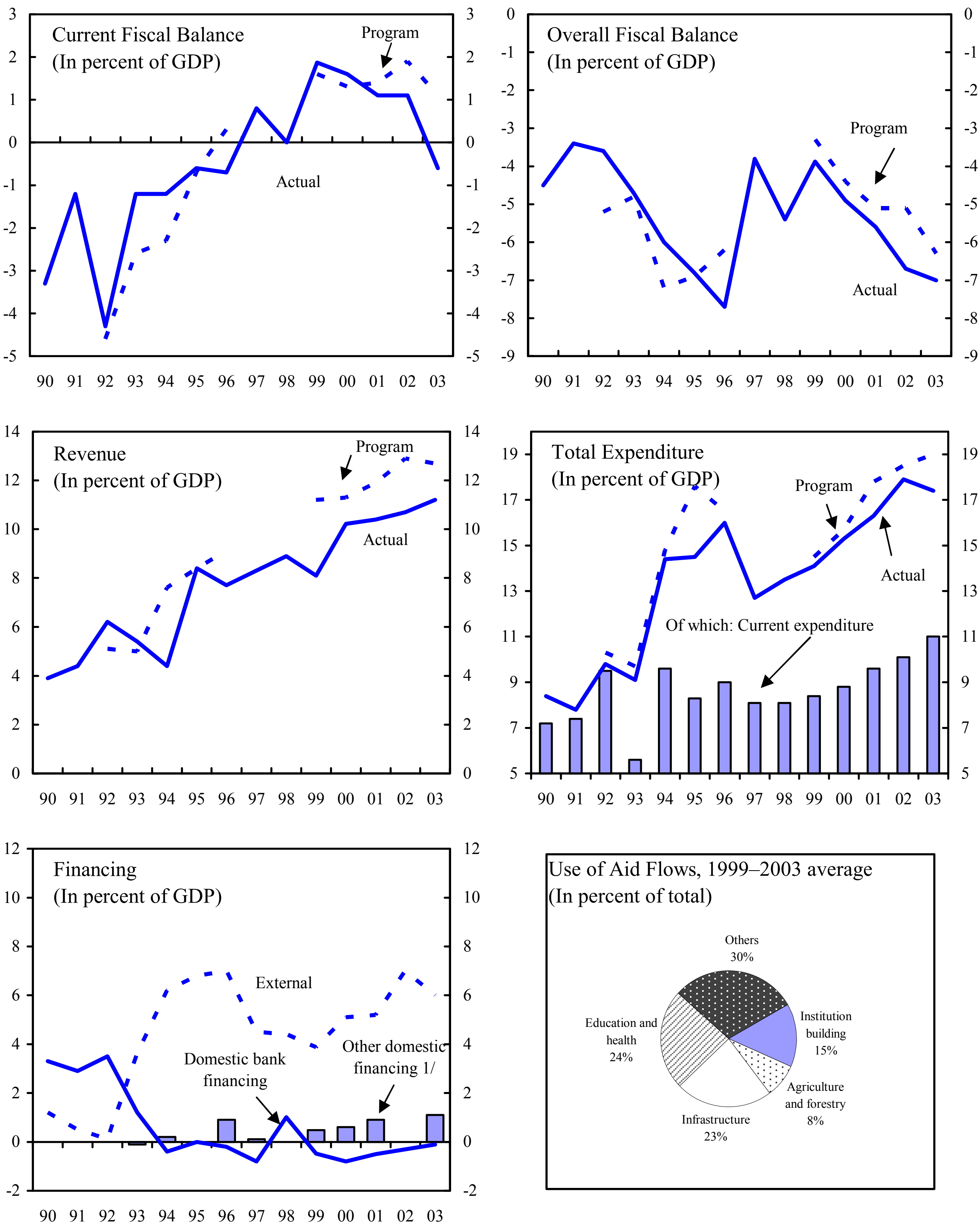
Sources: Cambodian authorities; and IMF Staff estimates.

Figure 2. Cambodia: External Sector Indicators



Sources: Cambodian authorities; and IMF Staff estimates.

Figure 3. Cambodia: Fiscal Indicators



Sources: Cambodian authorities; and IMF Staff estimates.

1/ Includes domestic arrears.

Table 1. Cambodia: Quantitative Performance Criteria and Benchmarks Under Fund Programs, 1993–2002

	STF 1/		ESAF-I (5/94–8/97) 2/				ESAF-II/PRGF (10/99–2/03) 3/											
	Sep-93 BM	Dec-93 BM	**Sep-94 PC**	Dec-94 BM	Mar-95 BM	Dec-95 PC	Dec-99 BM	**Mar-00 PC**	Jun-00 BM	**Sep-00 PC**	Dec-00 BM	**Mar-01 PC**	Jun-01 BM	**Sep-01 PC**	Dec-01 BM	**Mar-02 PC**	Jun-02 BM	**Sep-02 PC**
Net domestic assets of the banking system (ceiling)	met	met	**met**	met	met	n/a 4/	met	**met**	met	**met**	...	**...**	...	**...**	...	**...**	...	**...**
Net domestic assets of the NBC (ceiling)	...	...	**...**	...	...	...	...	**...**	...	**...**	met	**met**	met	**met**	met	**met**	met	**met**
Net bank credit to budget (ceiling)	met	met	**met**	met	met	n/a 4/	met	**met**	met	**met**	met	**met**	met	**met**	met	**met**	met	**met**
Net domestic financing of the budget (ceiling)	...	...	**...**	...	...	...	met	**met**	met	**met**	not met	**met**	met	**met**	met	**met**	met	**met**
Gross credit to public enterprises (ceiling)	...	...	**met**	met	met	n/a 4/	...	**...**	...	**...**	...	**...**	...	**...**	...	**...**	...	**...**
Contracting of external public debt (ceiling)	met	met	**not met 5/**	not met 5/	not met 5/	n/a 4/	met	**met**	met	**met**	met	**met**	met	**met**	met	**met**	met	**met**
International reserves of the central bank (floor)	met	met	**met**	met	met	n/a 4/	met	**met**	met	**met**	met	**met**	met	**met**	met	**met**	met	**met**

Sources: Various IMF staff reports.

1/ The Systemic Transformation Facility (STF) was approved in October 1993 and contained quantitative benchmarks from September 1993 to June 1994.

2/ The first annual arrangement under the Enhanced Structural Adjustment Facility (ESAF) was approved in May 1994, setting quantitative performance criteria for September 1994, as well as indicative targets for December 1994 and March 1995. The 2nd annual arrangement was approved September 1995. The mid-term review was never completed and a 3rd annual arrangement never approved, reflecting lack of progress on forestry policy and revenue collection.

3/ The Poverty Reduction and Growth Facility (PRGF), initially ESAF, was approved in October 1999, setting performance criteria for March 2000. The first review was completed in September 2000, setting performance criteria for September 2000. The 2nd review was completed in January 2001, setting performance criteria for March 2001. The 3rd review was completed in July 2001, setting performance criteria for September 2001. The 4th review was completed in February 2002, setting performance criteria for March 2002. The 5th review was completed in July 2002, setting performance criteria for September 2002. The 6th review was completed in February 2003. There was a continuous performance criterion on the non-accumulation of external arrears, which was met throughout.

4/ Observance of December1995 performance criteria was not formally reported, as the mid-term review for the 2nd annual arrangement was never completed. The staff report for the 1996 Article IV consultation indicated that the main macroeconomic targets for 1995 were met.

5/ About US$30 million in nonconcessional debt was contracted in 1994 to finance the purchase and repair of military hardware.

Table 2. Cambodia: Structural Conditionality in Fund Programs, 1993–2003

	Total	Fiscal Management	Financial Sector Reform	External Sector	Civil Service Reform	Public Enterprise Reform	Legal Reform	Environmental Management
STF (1993–94)	5	1	3	1	0	0	0	0
Prior actions	0	0	0	0	0	0	0	0
Performance criteria	0	0	0	0	0	0	0	0
Benchmarks	5	1	3	1	0	0	0	0
ESAF-I (1994–97)	39	9	11	7	6	4	1	1
Prior actions	2	1	0	1	0	0	0	0
Performance criteria	7	1	2	3	0	1	0	0
Benchmarks	30	7	9	3	6	3	1	1
ESAF-II/PRGF (1999–2003)	69	16	17	7	18	0	3	8
Prior actions	28	9	5	3	7	0	0	4
Performance criteria	6	2	2	0	2	0	0	0
Benchmarks	35	5	10	4	9	0	3	4

Sources: Various IMF staff reports.

Table 3. Cambodia: Percent of Structural Conditionality Met Under Fund Programs, 1993–2003 1/

	Total	Fiscal Management	Financial Sector Reform	External Sector	Civil Service Reform	Public Enterprise Reform	Legal Reform	Environmental Management
STF (1993–94)	80	100	67	100	...	...	...	...
Performance criteria	...	...	...	...	...	...	...	...
Benchmarks	80	100	67	100	...	...	...	...
ESAF-I (1994–97)	54	75	64	50	50	25	0	0
Performance criteria	71	100	50	67	...	100	...	...
Benchmarks	50	71	67	33	50	0	0	0
ESAF-II/PRGF (1999–2003)	56	100	67	50	36	...	0	50
Performance criteria	83	100	50	...	100	...	...	...
Benchmarks	51	100	70	50	22	...	0	50

Sources: Various IMF staff reports.

1/ Met or met with minor delays. Excludes prior actions.

CAMBODIA: A CHRONOLOGY OF KEY POLITICAL EVENTS AND FUND RELATIONS

Date	Event
November 1953	Independence
December 31, 1969	Cambodia joins the IMF with a quota of SDR 19 million, subsequently increased to SDR 25 million (about US$35 million) in December 1970.
March 1970	A war and internal strife begin resulting in massive loss of life and human capital as well as a serious deterioration in the economic and social infrastructure.
October 1970	Monarchy is abolished and Cambodia is renamed “Khmer Republic.” US and South Vietnamese enter Cambodia to destroy North Vietnamese bases. New government is plagued by disunity and insurgency begins to grow, initially with support from North Vietnam.
May 1971	A resident Fund advisor arrives in Phnom Penh.
September 1971	Cambodia makes a Gold tranche purchase of SDR 6.25 million.
October 1971	Cambodia introduces an economic stabilization program to curb inflationary pressures.
March 1972	An Exchange Support Fund (ESF) is created with total resources of US$34 million with participation of Australia, Japan, Malaysia, New Zealand, Thailand, and the United States. Cambodia makes a compensatory financing purchase of SDR 6.25 million.
October 1972	Cambodia renegotiates its external debt with France and Germany resulting in debt relief to the extent of 65 percent of principal and interest payments falling due during 1973.
April 1973	Cambodia makes another compensatory financing purchase of SDR 6.25 million.
October 1973	The Fund Executive Board concludes the last Article IV consultation with Cambodia for the next 20 years.
December 1974	Communist forces launch offensive. US-funded support for ammunition and food ends.
April 1975	Communications from Cambodia to the Fund end with the take over by the Khmer Rouge Regime in Phnom Penh and Cambodia begins to accumulate arrears to the Fund.
1975–79	Khmer Rouge regime: Cambodia becomes “Democratic Kampuchea,” widespread executions with an estimated human loss of 1.7–3.0 million people (out of a total of 7.3 million), collectivization of agriculture, destruction of industrial base, elimination of currency, and banking system.
Mid 1978	Vietnam invades Cambodia.
January 1979	After the fall of Phnom Penh Cambodia is renamed “New People’s Republic of Kampuchea.” Vietnamese advisors placed at all levels of government. 600,000 refugees at Thai border. Rebuilding efforts begin within framework of centrally planned economy.
1979–82	Significant humanitarian relief efforts, including from World Food Program ($400 million). Resistance of Khmer Rouge in remote regions continues.
March 1980	People’s National Bank is reestablished as a central bank and the riel is reintroduced.
1986–89	Vietnam withdraws occupation forces. Market-oriented reform are introduced.
April 1989	National Assembly adopts a new constitution. Cambodia is renamed “State of Cambodia.”

CAMBODIA: A CHRONOLOGY OF KEY POLITICAL EVENTS AND FUND RELATIONS

Date	Event
September 1990	Creation of the Supreme National Council (SNC) in Djakarta with representatives of all Cambodian factions.
June 1991	Communication of the SNC to the Fund requesting re-admission to the membership.
October 1991	Following the Paris Peace Accord in October 1991 on a comprehensive agreement between parties to settle the Cambodian conflict, the UN Transitional Authority of Cambodia (UNTAC) is established. Fund staff visit Phnom Penh to examine steps to start the process of normalizing Cambodia's relations with the Fund.
May 1992	Khmer Rouge tries to obstruct demobilization under Peace Accord.
September 1992	Donors establish a support group for Cambodia.
October 1992	Authorities implement a package of stabilization policies under an informal monitoring arrangement with the Fund.
May 1993	United Nations-sponsored elections are held for first time after the war. Khmer Rouge try to bar participation in remote areas.
September 1993	Cambodia promulgates a new Constitution. Cambodia is renamed "Kingdom of Cambodia." The new government has two prime ministers from the two biggest parties.
October 4, 1993	Following the clearance of its arrears to the IMF, the limitation on Cambodia's rights to use the IMF's general resources is lifted and a credit of SDR 6.25 million (about US$9 million) is approved under the Systemic Transformation Facility (STF).
May 6, 1994	IMF approves a three-year loan under the ESAF totaling the equivalent of SDR 84 million (about US$120 million).
April 22, 1994	Cambodia's quota increases to SDR 65 million (about US$93 million).
January 1995	The Paris Club finalizes terms for rescheduling Cambodia's pre cut-off date external debt (arrears and current maturities falling due through end-June 1997) to Paris Club creditors.
1997	Political violence resurfaces, one prime minister forced out of the country.
July 1998	A coalition government is elected with a broad majority and remaining pockets of conflict with the former Khmer Rouge are resolved around the same time.
December 1998	Cambodia regains its seat at the United Nations.
March 1999	Cambodia is admitted to ASEAN.
October 22, 1999	IMF Board approves a PRGF arrangement totaling SDR 58.5 million (about US$78.5 million).
May 2001	A comprehensive Technical Cooperation Action Plan (TCAP) is approved.
January 1, 2002	Cambodia accepts the obligations of Article VIII.
September 11, 2003	WTO ministers approve Cambodia's membership agreements.

CAMBODIA: TRENDS IN POVERTY AND OUTLOOK

Cambodia belongs to the poorest countries in the world, with per capita gross national income (Atlas method) at US$270 in 2001 lower than in any other East-Asian country, except for Myanmar. Less than a third of its population had access to safe water, and less than 20 percent to electricity in 2000.

Cambodia: Selected Land Use Indicators

	1990	1995	2000
	(In percent of land area)		
Agricultural land area	30.3	30.1	30.1
Arable land	20.9	21.0	21.0
Of which: Under cereal production	10.1	10.4	11.1
Pastures	8.8	8.5	8.5
Permanent crop land	0.6	0.6	0.6
	(In percent of agricultural land area)		
Irrigated land	4.5	5.1	5.1
	(In hectars per person)		
Agricultural land area	0.58	0.50	0.44
Arable land	0.40	0.35	0.31
Of which: Under cereal production	0.20	0.17	0.16
Crop land	0.01	0.01	0.01
Pastures	0.17	0.14	0.12
Irrigated land	0.03	0.03	0.02
Memorandum items:			
Population (in million)	9.1	10.7	12.0
Land contaminated by mines (in thousand hectares) 1/	43	...	22
Land contaminated by mines (in percent of arable land) 1/	0.8	...	0.4

Sources: World Bank (World Development Indicators); FAO; and International Campaign to Ban Landmines (ICBL).

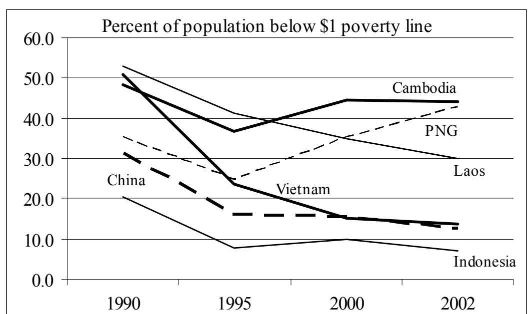
1/ Conservative estimate. The *Cambodian National Level One Survey* estimates the contaminated areas to be about 10 times larger, which would be equivalent to twice the size of all irrigated land in 1990.

Poverty is particularly severe in rural areas. Notwithstanding concerns about reliability of poverty and household data, headcounts during the 1990s indicate that about 40 percent of the rural population are poor, compared with about 20 percent in urban areas, and 11 percent in the capital Phnom Penh. About 90 percent of Cambodia's poor live in rural areas and about 70 percent are employed in the agricultural sector.

Despite efforts during the 1990s at promoting economic growth and alleviating poverty, progress has been mixed at best. Although overall real GDP growth has been consistently higher than population growth since the early 1990s, growth in agricultural output has been significantly lower and subject to considerable volatility, reflecting the impact of natural disasters and largely undiversified crops. Agricultural productivity was hampered further by growing landlessness and insufficient plot sizes per households in the wake of rapid population growth. Moreover, after elimination of all land titles by the Khmer Rouge, security of land tenure has remained a major concern.

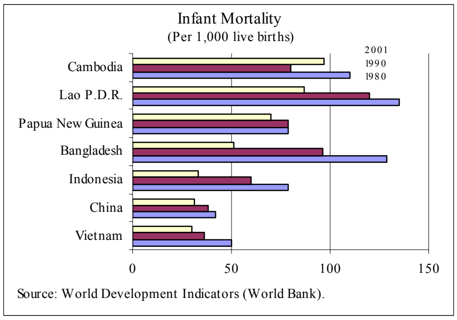
There is little evidence that key-poverty indicators have improved, both over time and relative to other low income countries in the region. In particular:

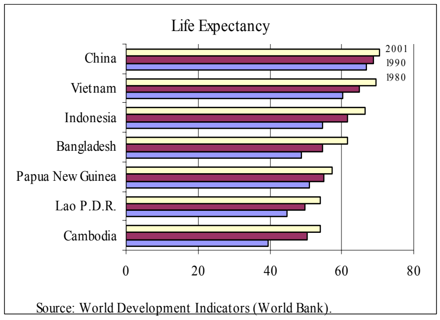
- Measured against the $1 poverty line, the percent of people in poverty may have actually increased from 37 percent in 1996 to 42 percent in 2002. By contrast, in a number of other countries in the region, in particular China, Lao PDR, and Vietnam, poverty has been essentially halved since 1990.

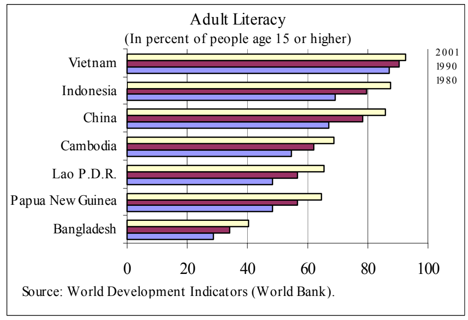


Source: UN ESCAP (2004)

- In terms of capability indicators, Cambodia's performance is particularly worrisome in several ways: (1) After some progress in the 1980s, infant mortality went up during the 1990s, with the result that today Cambodia has one of the highest infant mortality rates in the region. (2) Similarly, life expectancy, which rose sharply during the 1980s, in part reflecting the end of armed conflict, at 54 years in 2001 it still the lowest in the region. (3) Likewise, progress in increasing adult literacy appears to have been more difficult during the 1990s than the 1980s.







In response to the mounting poverty challenge, the government began to develop a comprehensive poverty reduction strategy in early 2000. The full PRSP, which is linked to the government's medium-term socio-economic development plans (SEDP), commits the government to the Millennium Development Goals by 2015, in particular: (1) halving the proportion of people under the $1 poverty line; (2) halving the number of people suffering from hunger; (3) achieving primary education for all, and reducing by two-thirds from the 1990 level the child mortality rate. Although Cambodia is still at an initial stage, it is clear from the track record during the 1990s that the MDGs constitute very ambitious targets.

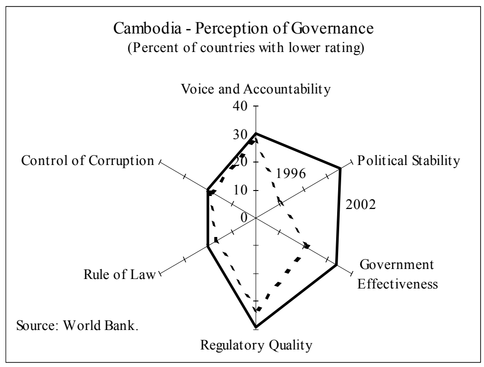
With the poor concentrated in the rural area, progress toward the MDGs will critically depend on sustained high growth in agricultural output and productivity. This will require giving the rural poor access to land and to markets through land reform and a physical upgrading of the rural infrastructure, in particular through investments in roads, irrigation, and modern technology. Effective land reform and titling will critically depend on improved governance to protect the poor from continued land grabbing by powerful interest. Clearing the land from mines also remains high on the agenda to bring land use closer to its potential and limit the additional burden that victims place on the rural population.

Measures to lift rural incomes by agricultural growth will need to be complemented by effective delivery of social services. For the government, this entails the challenge of substantially increasing revenues to provide for sufficient funds for health, education, and basic infrastructure and to increase the effectiveness of its civil service to ensure the productive use of these funds. From the donor perspective, it entails greater efforts at coordination to reduce the administrative burden on the government and to ensure alignment of priorities with Cambodia's national poverty reduction strategy.

CAMBODIA: TRENDS IN GOVERNANCE AND OUTLOOK

Governance problems and corruption have been pervasive during the Fund-supported programs. They have negatively affected revenue performance, impeding revenue collection consistent with laws, and eroded the tax base through nontransparent ad-hoc exemptions to corporate taxes and the ban on logging. Moreover, governance problems have also contributed to unreliable budget execution and protracted weaknesses in expenditure allocation, in particular delays in cutting military expenditures, restructuring the civil service and creating room for social priority outlays. Private sector development has also been hampered while foreign direct investment has remained largely limited to the textile sector benefiting from quota protection.

Progress in improving governance has been made in certain areas. An organic budget law was adopted in 1993 to provide for a unified national budget, a comprehensive demobilization program was introduced in 2000 and forestry management was rationalized by canceling 25 ad-hoc concessions, reducing logging permits and establishing a Forest Crime Monitoring Unit (FCMU). At the same time, significant challenges remain, notably in the areas of judicial and legal reform, further strengthening public administration, and in directly tackling corruption. Cambodia's progress since the mid-1990s is reflected in improved perceptions regarding political stability and government effectiveness, while perceptions of corruption and the rule of law have remained virtually unchanged at low levels.[28]



When compared with a group of low-income countries in the region, however, Cambodia's uneven progress is no trivial achievement. Reflecting in part economic and social disturbances during the Asian financial crisis, Cambodia's peers have on average witnessed a deterioration of governance indicators on all fronts since 1996. The situation worsened in particular in the areas of corruption and government effectiveness. By contrast, Cambodia has achieved significantly higher levels of voice and accountability, which could help it consolidate gains made so far in the areas of political stability and government effectiveness.

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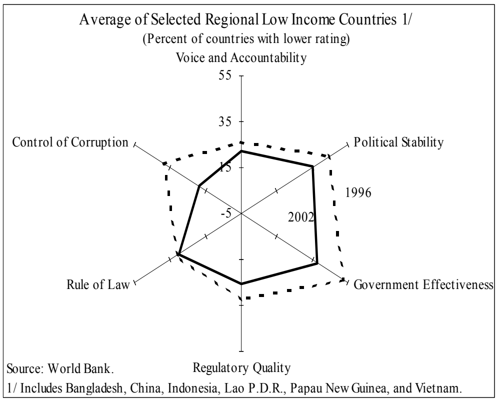
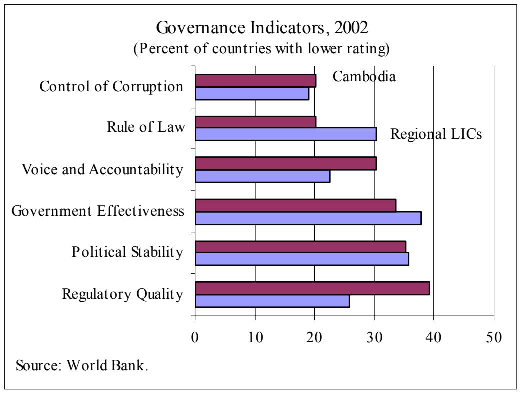
[28] The indicators of governance used for this assessment are available at: www.worldbank.org/wbi/governance/govdata2002/. The database covers six dimensions of governance (voice and accountability, political stability, government effectiveness, regulatory quality, rule of law, and control of corruption) for 199 countries and territories over four time periods (1996, 1998, 2000, and 2002). The indicators are based on several hundred individual variables measuring perceptions of governance, drawn from 25 separate data sources constructed by 18 different organizations. Further methodological details can be obtained in Kaufmann, Kray, and Masstruzzi (2004).





Looking ahead, the comparison of governance indicators over time and across countries points to corruption as the most difficult challenge for improving Cambodia's overall governance. While the government has recognized corruption as a major challenge, a comprehensive set of measures does not appear to be in place any time soon. Although the first phase of a *Governance Action Plan (GAP I)* was adopted in April 2001 that targets improvements in fiscal management and public administration, bolstered by anti-corruption legislation, specific measures have met with substantial delays or only been carried out incompletely, in part owing to the political stalemate following the 2003 general elections. As a result, the agenda remains very challenging and would need to address the following priority issues:

- exemptions remain excessive in the amended investment law;
- monitoring of the ban on logging to protect a potentially significant source of government income continues to be weak;
- demobilization of another 15,000 soldiers has been on hold because of misprocurement of donor funds;
- the awarding of government contracts has remained intransparent, undermining revenue collection, while its overhaul based on World Bank proposals including competitive bidding is pending legislative approval. A planned review of existing contracts may also stretch the capabilities of the newly established National Audit Authority (NAA);
- procurement reform, requiring competitive bidding on selected goods and services, has not yet been introduced by all ministries, and does not yet include capital goods;
- civil service reform is pending further analytical studies. Short-term measures to increase wages for high performing civil servants selected for priority mission groups (PMGs) could be perceived as intransparent and unfair, while not providing a long-term solution for the fundamental problem of widespread inadequate pay; and
- the adoption of an anti-corruption law has been delayed pending more comprehensive changes to the judiciary and legal framework.

CAMBODIA—THE ROLE OF TECHNICAL ASSISTANCE IN FUND-SUPPORTED REFORM PROGRAMS

Cambodia's devastated human capital base and institutions have required comprehensive and significant technical assistance (TA) in support of reconstruction and economic reform. In addition to the Fund, the World Bank, AsDB, and UNDP, more than 20 bilateral donors and NGOs have provided TA over the period under review. Aggregate data does not allow for a clear distinction between TA in a narrow sense and technical cooperation, also including investments, maintenance, and other operational expenditures. The available data suggest that about 40 percent of all aid flows to Cambodia since 1992, or about $2 billion, have been spent on technical cooperation and assistance, which would roughly be equivalent to 20,000 person years.[29] By contrast, direct Fund, or Fund-led TA amounted to about 60 person years, while TA disbursements from the Bank stood at $24½ million.

Coordination of the Fund's TA activities with other agencies, in particular the World Bank, AsDB, and UNDP, was critical to ensure adequate support for Fund-program implementation.

During the first ESAF period, the UNDP, AsDB, World Bank, and IMF jointly put in place a medium-term technical assistance program.[30] Initial high priority was given to building the central institutions of macroeconomic management. Fund TA focused on the policy and management capabilities in the in Ministry of Economy and Finance (MEF) and the National Bank of Cambodia (NBC), while the World Bank first focused on the budget and treasury management capacity, but later extended activities to long-term development issues including forestry management, enterprise reform, and civil service reform. Support from the UNDP and AsDB complemented these efforts by improving the

Cambodia: Distribution of TA projects in areas of Fund conditionality, 1994-1997 1/
(Number of projects)

	Total	IMF	World Bank	AsDB	UNDP	Other
Fiscal management	29	5	11	5	5	3
of which:						
Tax policy/administration	7	1	0	0	3	3
Expenditure management	15	0	10	4	1	0
Financial sector reform	20	15	0	3	2	0
External sector	0	0	0	0	0	0
Civil service reform	5	0	2	0	3	0
Public enterprise reform	6	0	4	2	0	0
Legal reform	1	0	1	0	0	0
Environmental management	8	0	3	1	2	2
Memorandum item:						
Person years	120	23	...	...	...	...

1/ Only lists involvement as provider of TA under the joint UNDP/AsDB/IMF/World Bank TA umbrella.

[29] On the basis of $100,000 per person, per year.

[30] The three-year ESAF program lapsed in August 1997 following a serious deterioration in governance, primarily illegal logging, and growing political turmoil in mid-1997. The representative office was closed in October that year and the provision of TA significantly scaled down.

statistical base, developing a public investment program, and improving external aid and debt management. In total, 120 person-years of TA were provided, of which about 23 person-years from the Fund.

At the beginning of the second ESAF/PRGF a TA and cooperation action plan (TCAP) was formulated with IMF assistance. Concerted TA activities under the TCAP involved the Fund, the AsDB, and the UNDP as lead agencies and covered four areas: (1) fiscal sector reform, including tax and customs administration, and overall budget management; (2) banking system reform, including commercial bank restructuring, enhanced banking supervision, and payments system reform; (3) economic statistics; and (4) the legal framework, in particular corporate solvency, secured transactions and enforcement of contractual claims. The World Bank did not directly participate in the TCAP, but continued to provide the lead TA in other important reform areas through support for: (1) civil service census, (2) functional review of ministries, (3) implementation of the national environment action plan, (4) forestry management, and (5) a public investment program. The World Bank also provided assistance in VAT implementation, expenditure management, and poverty monitoring and the PRSP process.

Cambodia: Distribution of TCAP assistance and World Bank TA in key areas of Fund conditionality, 2000-2003 1/
(In millions of US dollars)

	TCAP	World Bank 2/
Fiscal management	4.993	...
of which:		
Tax policy/administration	1.832	...
Expenditure management	3.161	0.162
Financial sector reform	0.657	0.000
External sector	0.000	0.000
Civil service reform	0.000	1.372
Public enterprise reform	0.000	0.000
Legal reform	0.036	0.235
Environmental management	0.000	0.161
Memorandum items:		
Total	5.686	2.345 3/
Person years	38.0	...

Sources: IMF Country Report No. 01/35; World Bank.
1/Only includes funds directly earmarked for areas of Fund conditionality. Total TCAP budget was US$ 6.3 million. Total World Bank funds estimated at US$ 12.6 million with the bulk of funds outside Fund-program conditionality earmarked for infrastructure projects
2/ TA related to funds effective after 2000 (including).
3/ Includes TA for poverty monitoring and unallocated TA under the PRSC.

Since the 2000 Consultative Group Meeting, the TCAP and World Bank TA efforts were supported further by the setting up of sector-wide working groups on TA coordination. Seventeen high-level committees of the authorities and donor community have been established to ensure ownership and alignment between the government needs and the provision of TA.

Key outcomes of the technical assistance programs, include the 1997 tax law, building local capacity to administer the tax system, adoption of a WTO compliant customs law, and a strengthened banking system. However, in the area of fiscal management in particular, but also regarding the civil service in general, the institution building process has been undermined by weakness in governance and a lack of knowledge transfer. As a result, the expected benefits of improved administrative capacity, above all revenue mobilization and expenditure control, were not realized in a sustained way. Moreover, coordination of TA activities has also continued to be a challenge for Cambodia's administration.[31]

[31] TA activities in Cambodia are also subject to an ongoing Fund-wide assessment by the IEO.

Cambodia: Structural Conditionality Under Fund-Supported Programs, 1993–2003

Measure	Type	Comment
1. STF (1993–94)		
Fiscal management		
Introduce new budget nomenclature and accounting procedures (December 1993).	Benchmark	Met.
Financial sector		
Introduce reserve requirements for commercial bank deposits (December 1993).	Benchmark	Met.
Centralize management of official foreign reserves at the National Bank of Cambodia.	Benchmark	Not met, contingent upon delivery of technical assistance; performance criterion under first ESAF arrangement.
Maintain the interest rate provided under the three-month riel deposit scheme positive in real terms.	Benchmark	Met.
External sector		
Maintain the spread between the official and parallel market exchange rates, averaged over any two-week period, within the margin of 5 percent through December 1993 and within 3 percent through June 1994.	Benchmark	Met.
2. ESAF-I (1994–97)		
Fiscal management		
Formulate the 1994 budget.	Prior action	
Conduct mid-term budget review (August 1994).	Benchmark	Met.
Formulate medium-term tax reform plan (December 1994).	Benchmark	Met with delays; outline of reform plans presented in MEFP of August 1995.
Formulate budget for 1995 consistent with program targets (December 1994).	Benchmark	Met.
Formulate budget for 1996 consistent with program targets (December 1995).	Benchmark	Met.
Issue decree announcing competitive bidding for government projects and contracts (September 1995)	Benchmark	Met.
Enact harmonization of excise duty rates (September 1995).	Performance criterion	Met.
Assign financial controllers to each ministry (October 1995).	Benchmark	Met with significant delays.
Institute a direct payments system by the Treasury for procurement over a specified amount by the 5 largest spending ministries (October 1995).	Benchmark	Partially met with significant delays.
Financial sector		
Present new central bank law to parliament to strengthen central bank independence and limit central bank credit to Government (June 1994).	Benchmark	Met, but law was pending approval.
Centralize official foreign reserve management in the National Bank (June 1994).	Performance criterion	Partially met with delays; working group set up to review all public sector foreign exchange accounts.
Clarify status of Foreign Trade Bank with view to privatization (December 1994).	Benchmark	Met; privatization options under consideration in mid-1995.
National Bank circular specifying only minimum deposit rates (June 1994).	Benchmark	Met.
Establish credit window at National Bank (June 1994).	Benchmark	Met.
Maintain positive real interest rates on riel deposits (throughout 1994).	Benchmark	Met.
Define and introduce foreign exchange exposure limits on banks and design prudential ratios to be observed by banks (December 1994).	Benchmark	Met with delays.
Enact the central bank law (September 1995).	Benchmark	Met with minor delays.
Present draft commercial bank law to National Assembly (December 1995).	Benchmark	Met with significant delays.
Complete the shift to the new plan of accounts for the National Bank, and establish a profit and loss statement on that basis (December 1995).	Performance criterion	Met.
Privatize the Foreign Trade Bank and the Municipality Bank (June 1996).	Benchmark	Not met, but protracted process underway.

Cambodia: Structural Conditionality Under Fund-Supported Programs, 1993–2003

Measure	Type	Comment
External sector		
Unify the exchange rate system.	Prior action	
Introduce new foreign exchange law (June 1994).	Benchmark	Met with significant delays; in mid 1995 only draft under consideration.
Eliminate ban on rice exports (December 1994).	Performance criterion	Met with minor delays.
Introduce new foreign investment legislation (June 1994).	Benchmark	Met with minor delays.
Eliminate external arrears to official creditors (November 1994).	Benchmark	Met with significant delays; discussions with creditors ongoing in mid-1995.
Nonaccumulation of new external payments arrears.	Performance criterion	Met.
Establish a system for regular reporting and monitoring for foreign investment inflows (December 1995).	Performance criterion	Partially met, but monitoring system incomplete.
Civil service reform		
Formulate civil service reform program (June 1994).	Benchmark	Met with significant delays, in part contingent upon TA provided by UNDP.
Announce new rules and conditions for entry in the civil service (July 1994).	Benchmark	Met with delays.
End automatic civil service recruitment of high school graduates (July 1994).	Benchmark	Met.
Keep number of civil servants at or below 143,855 (throughout 1995).	Benchmark	Not met.
Avoid increase in civil service wage rates (throughout 1995).	Benchmark	Benchmark not well defined; salaries of top officials raised, benefits adjusted for rice prices.
Develop a plan to increase the efficiency of the military service (March 1996).	Benchmark	Met.
Public enterprise reform		
Formulate privatization strategy with timetable for privatization of SOEs during 1995 and 1996 (September 1994).	Performance criterion	Met.
Clear cross-debts among the SOEs and the Government (March 1994).	Benchmark	Partially met; cross debt cleared with significant delays.
Offer the trading company, KAMPEXIM, and the petroleum distribution company, CKC, for sale (December 1995).	Benchmark	Partially met; considerations on KAMPEXIM by Council of Ministers ongoing.
Announce timetable for privatization of additional SOEs during 1995, and finalize list of firms to be privatized (September 1995).	Benchmark	Met with significant delays; list approved by Council of Ministers in July 1996.
Legal reform		
Present commercial code to the National Assembly (June 1994).	Benchmark	Approval by National Assembly subject to significant delays.
Environmental management		
Prepare and publish a revised forest management code (December 1995).	Benchmark	Met with significant delays with submission to National Assembly in October 1996. However, the second annual ESAF review was never completed and the ESAF expired in 1997 due to protracted governance problems in forestry
3. ESAF-II/PRGF (1999–2002)		
Fiscal management		
Rigorously implement timber royalties of $54 per cubic meter.	Prior action	
Full and timely transfer to the budget of garment quota management fees and all revenue from quota auctions, and the use of this transfer to reduce the government's net debt to the NBC.	Prior action	
Meeting monthly targets for revenue and expenditure for June-August 1999 including for defense and priority spending, as agreed with the Fund staff.	Prior action	
Continue to strictly avoid ad hoc exemptions, unify customs duty on cigarette imports, and launch an open tender for PSI service provider.	Prior action	

Cambodia: Structural Conditionality Under Fund-Supported Programs, 1993–2003

Measure	Type	Comment
No ad hoc tax exemptions to be granted any time during the program period.	Benchmark	Met; remaining exemptions limited to those specified under Investment Law and duty free shops in border regions.
Submission of the 2001 budget to the National Assembly according to the agreed framework and with the tariff reforms and new tax measures as described in the MEFP.	Prior action	
Timely transfer to the budget of revenue from ticket sales at the Angkor Temple Complex according to the terms of the revised contract of September 1, 2000.	Prior action	
Implement several of the other tax measures as specified in Annex I, including: (i) treatment of diesel sales as final for VAT purposes; (ii) improved monitoring of visas (visa sticker); and (iii) additional adjustment in selected excise rates.	Prior action	
Establish large taxpayers unit, with the possibility of direct payment by check or transfer into National Treasury accounts at the NBC for the largest taxpayers (October 2001).	Performance criterion	Met.
Submit the 2002 budget to the National Assembly (November 2001) according to the agreed framework, and with new tax measures (from the options recommended by FAD) and legal authorization for the issuance of FTB recapitalization bonds.	Benchmark	Met with minor delays.
Implement remaining tax measures agreed in 2001, including application of tax stamps for cigarettes at the factory level and use of visa stickers.	Prior action	
Review telecommunications contract for the second international gateway and prepare assessment report to ensure appropriate transfer of revenue to the budget.	Prior action	
Issue Prakas detailing a specific format for cash management procedures as a basis for improving the operations of the Cash Management Unit and establishing better coordination between the National Treasury and the Foreign Currency Unit (January 2001)	Benchmark	Met.
Submit the Law on Negotiable Instruments and Payments Transactions to the Council of Ministers (May 2002).	Benchmark	Met with minor delays.
Reduce the number of government accounts by integrating revenue accounts held by line ministries with the National Treasury single account (March 2002).	Performance criterion	Met.
Identify the 50 largest accounts in the LTU that are in arrears, complete an analysis of the arrears, and establish an action plan with collection targets and reports on performance. The first performance report is to be completed by end-July 2002.	Benchmark	Revised to incorporate 100 largest taxpayers.
Identify the 100 largest accounts in the tax department that are in arrears, complete an analysis of the arrears, and establish an action plan with collection targets and reports on performance. The first performance report is to be completed by end-July.	Benchmark	Met.
Financial sector		
Approval by National Assembly of the Financial Institutions Law.	Prior action	
Complete on-site inspections of the remaining commercial banks (December 1999).	Benchmark	Met.
Following adoption of the Financial Institutions Law, subject all banks to relicensing and move to close insolvent or noncomplying banks accordingly (June 2000).	Benchmark	Met with delays; initial steps taken to close three banks and decisions on remaining banks pending.
Complete evaluation of all remaining banks that have reapplied for a banking license, and announce relicensing decisions.	Prior action	
Award banking license and provide initial capital injection to the Foreign Trade Bank.	Prior action	
Begin dollar clearing and settlement service (January 2001).	Benchmark	Met.
First quarterly review of performance of relicensed banks against their MOUs (April 2001).	Benchmark	Met with minor delays.
Appoint outside directors and prepare and updated business plan outlining commercial prospects of FTB (June 2001).	Benchmark	Met.
Complete final recapitalization of FTB (June 2001).	Performance criterion	Met.

Cambodia: Structural Conditionality Under Fund-Supported Programs, 1993–2003

Measure	Type	Comment
Preparation of the first quarterly report by the NBC on the implementation of the banks' MOUs and on actions taken against noncomplying banks.	Prior action	
Prepare a new chart of accounts for fully licensed banks based on international standards, to be operational by January 2002.	Benchmark	Partially met; new chart of accounts finalized in September 2001, dates for full implementation to be agreed with Bankers' Association.
Complete quarterly reports on the implementation of the banks' MOUs (August 2001 and October 2001) indicating actions to be taken against non-complying banks, with a view to consolidating further the banking system.	Benchmark	Met.
Publish the 2000 external audit report of the NBC.	Prior action	
Revoke banking licenses for banks that have not met the requirements under their MOU, including additional closures if necessary (February 2002).	Benchmark	Met with minor delays.
Complete an unqualified audit of the 2001 accounts of the Foreign Trade Bank (March 2002).	Performance criterion	Partially met with delays; 2001 audit was qualified; 2002 audit was unqualified and submitted in June 2002.
Finalize a new chart of accounts for fully licensed commercial banks based on international standards and begin implementation (July 2002).	Benchmark	Met with significant delay; implementation expected in July 2003.
Initiate privatization of the Foreign Trade Bank by issuing a public notice (November 2002).	Benchmark	Met with minor delays.
External sector		
Initiate dialogue with major creditors with a view to concluding rescheduling agreement.	Prior action.	
Commit to reduce the maximum tariff rate to 30 percent and the average tariff rate to 13-14 percent by 2002.	Prior action.	
Reduce the average tariff rate to below 15 percent in the context of the 2002 budget (November 2001).	Benchmark	
Issue subdecree to reduce the number of tariff bands from 12 to 4 and to lower the maximum tariff rate to 35 percent, with associated adjusments in excise rates.	Prior action	
Submit a new customs code (in line with WTO requirements) to the Council of Ministers (March 2002).	Benchmark	More comprehensive revisions than envisaged necessary; revised law to be submitted by end-July 2002.
Implement the next stage of tariff restructuring to reduce the unweighted average rate below 15 percent (September 2002).	Benchmark	
Taking into account technical assistance recommendations, complete proposal for the next stage of tariff restructuring to reduce the unweighted average rate below 15 percent (October 2002).	Benchmark	Delayed; based on TA report in October 2002, tariff restructuring is expected to be completed by June 2003.
Civil service reform and governance		
Remove redundant workers from civilian payroll of at least 1,200 and ghost soldiers from defense (12,868) payrolls. Adopt a strict limit (920) on new hiring for the civil service.	Prior action	
Complete census to ascertain the precise number and status of civil servants and military personnel (March 2000).	Performance criterion	Met.
Formulate a medium-term strategy and reform program for the civil service entailing annual phasing for downsizing (June 2000).	Benchmark	Met with significant delays; based on studies and TA from World Bank, AsDB, and UNDP.
Preparation of a financial and technical assessment of the pilot demobilization program.	Prior action	
Using the computerized payroll for the central administration, verify that "ghost" employees and other irregular cases were removed as directed by the August 15 subdecree.	Prior action	
Complete computerization of the civil service payroll (July 2001) and eliminate irregular cases as they arise.	Benchmark	
Formulate, in consultation with the World Bank, a civil service reform strategy (March 2001).	Benchmark	Met with minor delays; finalization under discussion with World Bank.
Launch the first phase of military demobilization involving at least 10,000 soldiers (May 2001).	Benchmark	Delayed, but expected to include 15,000 soldiers after approval of a World Bank project.

Cambodia: Structural Conditionality Under Fund-Supported Programs, 1993–2003

Measure	Type	Comment
Establish and staff the National Audit Authority (March 2001).	Benchmark	Partially met with delays; candidate to head NAA proposed to National Assembly at end-June 2001.
Prepare a comprehensive blueprint in consultation with donors, outlining specific and financial requirements for implementing the Governance Action Plan (March 2001).	Benchmark	Partially met with delays; specific financing requirements not outlined.
Propose a candidate to head the National Audit Authority to the National Assembly.	Prior action	
Establish the Steering Committee for preshipment inspection (PSI), as defined in the PSI contract.	Prior action	
Release second quarter allocation of the Priority Action Program (PAP).	Prior action	
Complete civil service census, and fingerprinting and registration of civil servants, in all provinces (July 2001).	Benchmark	Met with minor delays.
Issue government decision (by Prime Ministerial Order) specifying the means for strengthening inter-agency cooperation to reduce smuggling, and detailing assistance requirements and practical arrangements among the Customs Department, Ministry of Interior.	Prior action	
Establish anti-smuggling unit in key-border provinces with clear definition of roles and responsibilities (April 2002).	Benchmark	Partially met; provisional units set up in border provinces.
Issue final report of the working group in the National Treasury on standardized accounting procedures and methodology for the public sector in line with international standards (October 2002).	Performance criterion	Met.
Pursue further centralization of accounting in the National Treasury as defined in the technical memorandum of understanding (October 2002).	Benchmark	Partly met; Line ministries and department of investment and cooperation not integrated.
Public enterprise reform		
Legal reform		
Submit two commercial laws (as part of a comprehensive commercial code) to the National Assembly for approval (December 1999).	Benchmark	Partially met with delays, contingent upon delivery of technical assistance from the World Bank and the Fund (LEG).
Submit two draft laws to the National Assembly covering corporate insolvency and secured transactions (December 2001).	Benchmark	
Submit the Payments Transactions Law, the Law on Bills of Exchange, and the Law on Checks and the Collection and Payments of Checks to the Council of Ministers (May 2002).	Benchmark	
Environmental management		
Publish the list of log collection quotas that have been repealed.	Prior action	
Establish forestry crime monitoring unit, and submit the first quarterly report of the Unit to Council of Ministers and to the public.	Prior action	
Submit subdecree on concession management to Council of Ministers.	Prior action	
Complete review of concession contracts and cancel concessions in violation (June 2000).	Benchmark	Met; three concessions were canceled and others severely restricted.
Submit a revised forestry law to the National Assembly, to provide a permanent framework for sustainable logging (February 2001).	Benchmark	Met with minor delays.
Cancel remaining forestry concessionaires that have not completed restructuring agreements with the government (September 2001).	Performance	Converted into benchmark.
Cancel licenses of forestry concessions that have not submitted restructured concession agreements (September 2001).	Benchmark	Submitted plans deemed insufficient with all logging operations suspended as of January 1, 2002.
Issue Prakas suspending all logging activity by concessionaires with effect from January 1, 2002 until sustainable management plans have been approved.	Prior action	
Suspend all logging activity by concessionaires with the effect from January 1, 2002 until sustainable management plans have been approved.	Benchmark (continuous)	Partially met; staff notes need to upgrade enforcement.
Poverty reduction		
Submit a PRSP preparation status report to the Bank and the Fund.	Prior action	