



វេទិកាសម្រាប់អង្គការចិន្តៃយ៍កម្ពុជា ស្តីពីកម្ពុជា  
*The NGO Forum on Cambodia*

ធ្វើការរួមគ្នាដើម្បីការប្រែប្រួលវិជ្ជមាន  
*Working Together for Positive Change*

# Cambodia Development Watch



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## FOREWORD

Cambodia Development Watch is produced by the Development Policy Project of The NGO Forum on Cambodia. It aims to highlight Civil Society Organizations (CSOs) perspectives on: i) Government development policies; ii) the implementation of those policies; iii) to share information and iv) stimulate debate among the public, students, civil society organizations, policy makers, and development partners on how the implementation of various development policies and programs contribute to poverty reduction and development in Cambodia.

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We welcome constructive comments to improve future editions of the Cambodia Development Watch.

**Mr. Chhith Sam Ath**



Executive Director  
The NGO Forum on Cambodia





## Decentralisation and De-concentration is the Main Nature of Circular 03 Implementation

### 1. Background – Efforts to resolve informal sector housing issues in Battambang

Battambang Municipality is the second largest town of Cambodia with a total population of around 150,000 inhabitants. According to a survey conducted in 2009, there are 64 informal settlements with 2,200 households and 10,000 people. During the process of land use planning in Battambang Municipality in 2005 (supported by GIZ, former DED) informal settlements were identified and realised an important issue which needs to be addressed by urban planning. The following efforts had been made since 2005;

- 2005: Establishment of a municipal Technical Working Group (TWG) to provide support to informal settlements
- 2006: 13 communities were organized and established saving groups
- Since 2007: Continuous capacity development and on-the-job training to the TWG by GIZ (former DED)
- Since 2008: Implementation of the “Garden Area Pilot Project” (LASED)<sup>1</sup>. Testing sub-decree on Social Land Concession (SLC) to upgrade and regularize an existing informal settlement
- 2009: Comprehensive survey of informal settlements
- 2009: CMDP assessment visit to Battambang to strengthen community organisation/saving in informal settlements and to outline alternate housing solutions
- 2009: CEDT provided TOT on community mapping to 6 informal settlements communities.
- Since 2010: Community empowerment:
  - Community coordination formation of 13 informal settlements and regular monthly meetings (CMDP)
  - Community Empowerment and Development Team (CEDT) provided ToT on community mapping to informal settlements communities
  - Formation of Community Youth Coordination and Community Youth Groups in communities (CVS)

### 2. Initiative for pilot projects on Circular 03 (C03) implementation

In May 2010, the Royal Government of Cambodia (RGC) approved Circular 03 on “Resolution of temporary settlements on illegally occupied land in the Capital, municipal and urban areas”. The C03 consisted of the following seven steps; 1) Identification of informal settlements, 2) Mapping and classification of the identified sites, 3) Conducting household interviews, 4) Development of resolution options for each site (on-site upgrading or relocation), 5) Development of on-site upgrading or relocation plans, 6) Preparation of infrastructure and basic public services on the sites, 7) Timing and participation of different stakeholders

When Circular 03 was approved, 3 initial steps (from 1 to 3) out of 7 had already been completed in Battambang Municipality. The C03 is based on UPDF experiences to strengthen community led decision making process able to negotiate with authorities for housing solutions and implementation in principle with Decentralisation and Deconcentration (D & D) Policy of the RGC.

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<sup>1</sup>Land Allocation for Social and Economic Development (LASED)

## 2.1. Good Governance Role of MBB – Green Light for on-site Upgrading

The C03 provides clear legal jurisdiction to sub national authorities to resolve informal settlements issues with multiple alternate solutions. This removed the hurdle of unclear responsibilities between national and sub national level authorities opening opportunities for MBB to convert their willingness into reality. In November 2010, MBB decided to give green light for on – site up grading to 10 informal settlements and selected 4 informal settlements as focus communities for pilot projects on C03 implementation.

## 2.2. Positive Response from Communities

### 2.2.1. Community Saving Strengthening

After the green light for on-site upgrading, the community savings were improved. The table below is showing how community saving was improved after the announcement of on-site upgrading for informal settlements in November 2010.

**Table 1: Saving Strengthening (in Riel)**

Month	Soksan Tabong		Santhapheap		Andoung Chen	
	Saving members	Total Saving	Saving Members	Total Saving	Saving members	Total Saving
<b>2010</b>						
Oct	8	18,000	29	78,500	Saving activity was not good due to conflict in community. Conflict in community resolved with assistance of other communities in Dec 2010.	
Nov	10	36,000	29	73,000		
Dec	14	35,000	28	109,500		
<b>2011</b>						
Jan	21	124,000	36	193,000	30	139,000
Feb	25	142,000	43	156,500	35	140,000
Mar	28	145,000	50	207,000	45	210,000
Apr	13	38,000	52	224,000	70	200,000

### 2.2.2. Community Resource-Based Development - We are poor but not destitute

Table below is showing community led development based on 100% community resources.

**Table 2: Community Resource-Based Development**

#	Community	Size	Cost	Community Contribution
<b>Garbage Cleaning in Community Environment</b>				
1	Soksan Tabong	Whole community	57 Community volunteers	100% community labor
2	Soksan Cherng	Whole community	40 community volunteers, including 25 female	100% community labor
3	Vcasna Amatak	Whole community	Community Youth & 82 community volunteers	100% community labor
4	Ekapheap	Whole community	30 community volunteers	100% community labor



<b>Drainage Cleaning</b>				
1	<b>Soksan Cherng</b>	20mx0.6m	23 community volunteers	labor by community
2	<b>Santhapheap</b>	174mx1m	\$36.75+community volunteers	100%
<b>Road Improvement</b>				
1	<b>Soksan Cherng</b>	210m x 4m (after moving house from Railway track)	\$725.00	100%
2	<b>Veasna Amatak</b>	30mx4m	\$230	100%
3	<b>Santhapheap</b>	94mx4m	\$195 + community labor	100%
4	<b>Ekaphaep</b>	161mx35m	\$120 + community labor	100%
5	<b>Veasna Amatak</b>	Land fill on dumpy patches of the road	community labor	100%
<b>Drainage Line Construction</b>				
1	<b>Ekapheap</b>	582.36m	\$5,417.93	100%

### 2.3. Formation of Working Coalition on Circular 03 Implementation

To strengthen coordinated efforts among NGOs to complement each other work on C03 implementation with an ENGAGEMENT perspective an informal forum “Working Coalition on Circular 03 Implementation” was established in February 2011 by CMDP, CEDT, CVS, SLG, GIZ, NGO F, UN Habitat, HPFH, UNOCHR and COHRE. CMDP is acting as secretariat for this working coalition.

### 3. Donors support needs to balance National and Sub National Level in accordance with Decentralisation and Deconcentration (D&D) Policy of RGC

The achievements in such a short time in Battambang regarding pilot projects on C03 are clear evident that where the national level is important for policy formulation, the sub national level is important for policy implementation which includes local authorities, communities and NGOs. However, all/ most of the donors support is at national level neglecting the D & D and undermining the role of sub national authorities, NGOs and communities in implementation of policies. This unbalance support is definitely promoting the CENTRALISATION and donors needs to change the current practice by balancing the support at national and sub national level by a mechanism which can provide direct support to sub national authorities, communities and NGO.

### 4. Future Directions Outline – Very Brief

#### 4.1. Short Term (end of 2011):

- Encourage and expand community mobilization in 10 target communities
- Document city infrastructure to identify requirement for external development
- Determine short term tenure security on the basis of future city development

#### 4.2. Mid Term (2012 – 2013)

- Expansion of good practices on city wide level
- Identify permanent housing solutions beyond short term tenure security
- Formalise and institutionlise the process/delivery mechanism identified in implementation
- Recommendation to improve Circular 03 based on pilot project implementations and extension to other parts of Cambodia

#### 4.3. Long Term (2014 onwards)

- Pilot Projects on affordable housing to address increasing demand for housing due to increase in population and rural-urban migration
- Battambang as a model for affordable housing for everyone
- A prosperous city with pro poor development

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## Cambodia's External Debt: Is it an alarming issue?<sup>2</sup>

This article is written for the purpose of informing the readers who are interested in figuring out or conducting further research and stimulate public debate about Cambodia's debt. Being informative base on literature and desk review, it intends to put together existing research findings about the reasons for countries in taking public external debt, current status and issues of Cambodia's debt and debt sustainability in brief.

### Reasons for Country like Cambodia to take Foreign Loans or External Debt

Cambodia like many developing countries in her early stage of development foreign capital is highly needed to address three possible gaps in the economy (Malcolm et al, 1996). Firstly, foreign capital inflows can finance the foreign exchange gap, mostly trade balance deficit which equal to imports less exports of goods and nonfactor services. Secondly, foreign capital can finance the gap between investment and domestic saving, which means low level of domestic saving and higher level of capital needed to finance investment. Thirdly, foreign borrowing can also finance the government budget deficit, which normally in the forms of fulfilling needed public investment or repayment of old debt. Government's taxing capacity will also be insufficient in the early stages of development. Annually Cambodia generates revenue at around 13% of its gross domestic product (GDP) which is low compared to other countries in Southeast Asia.

Aside from external sources of financing, the government may borrow from domestic sources (i.e. from its citizens and/or private sector) through issuing government bond with interest and it can build up debt over a period of time if bond holders or citizens who buy government bonds continue to have faith in the stability of the government and its ability to pay off each individual bonds. If there is a strong inflationary impact of deficits in times of strong demand, a large or growth in government debt may raise interest rates and crowd out private borrowing. Cambodia's domestic debt remains very small until 2011<sup>3</sup>. It is worth to be noted that one important difference between public and private debt is the recourse of creditors if default occurs. If a company goes bankrupt and defaults on a loan by declaring her inability to pay, bondholders have legal recourse through seizure and division of the company's remaining assets. It may be difficult to enforce that claim against a government.

### Current Situation of External (public) Debt in Cambodia<sup>4</sup>

Up to March 2011, Cambodia's external debt (excluding debt owed to Russia (USD 457 millions) and USA (USD 162 millions)) in the form of concessional loan has accumulated to USD 3.67 billion of which USD 0.621 billion or USD 621 millions are pipeline projects/loans. By

<sup>2</sup>Most part of this article relating to general reason and issues of external public debt was extracted from Stuart R. Lynn (2003). *Economic Development: Theory and Practice for a Divided World*. Prentice Hall, New Jersey, USA.

<sup>3</sup>ADB (2011). *Asian Development Outlook 2011 (on Cambodia)*. Page 182. See [www.adb.org](http://www.adb.org). The report put Cambodia's current level of public debt as manageable and debt is estimated at USD 3.5 billion up to end of 2010. The People's Republic of China accounted for about 58% of total bilateral loan disbursements in 2010. This informs the needs for Cambodia to balance the sources of public debt.

<sup>4</sup>External Public Debt refers to "public and publicly guaranteed disbursed long-term debt" that is, debt with maturities of one year or longer owed by governments or owed by private borrowers and guaranteed by their governments.



subtracting this amount of pipeline loan projects, total external debt or concessional loan recorded in the Official Development Assistance (ODA) database of Cambodian Rehabilitation and Development Board (CRDB) of the Council for Development of Cambodia ([www.cdc-crdb.gov.kh](http://www.cdc-crdb.gov.kh) or <http://cdc.khmer.biz>) is USD 3.02 billion. The terms of repayment of debt owed to the two countries (USD 619 millions) remains under negotiation between the Royal Government of Cambodia and both governments. Analysis of Terms of Assistance by the NGO Forum on Cambodia<sup>5</sup> in 2010 showed that among bilateral and multilateral donors providing concessional loans to Cambodia, China is an emerging donor<sup>6</sup> providing the least favorable terms of assistance. With limited information available on all concessional loan projects, China charges highest annual interest rate up to 2% per annum and shortest grace and amortization period in comparison to other traditional donors (EU, ADB, World Bank, Japan) and emerging donor like South Korea.

Stuart R. Lynn (2003) quoted the World Bank classification of countries as to whether they are severely, moderately, or less indebted. The designation of “severely indebted” is given to countries that meet three of the following four criteria: 1) a debt to Gross National Products (GNP)/Gross Domestic Products (GDP) ratio of 50 percent or more; 2) a debt to export ratio of 275 percent or more; 3) a debt service to export ratio of 30 percent or more; and 4) an interest payment to export ratio of 20 percent or more. Up to 2010, the status of Cambodia remains far behind these debt crisis indicative benchmarks or thresholds. This has been further reiterated by the Joint IMF/World Bank Debt Sustainability Analysis (DSA) 2010 that Cambodia’s scope for absorbing additional risks from taking additional external debt would be significantly reduced due to the implication that the Royal Government returned to original legal limit for new borrowing of SDR<sup>7</sup> 200 million in 2010 budget law. However, in 2011 budget law the legal limit for amount of new borrowing (external debt) increased up to SDR 400 million; this implies that if amount of new borrowing really reaches maximum level of that legal limit and its growth rate is faster than those indicative thresholds especially GDP and revenue, it would increase both higher level of external debt and probably the level of indicative thresholds for Cambodia in the later rounds of analysis.

Joint IMF/World Bank DSA 2010 rated Cambodia external public debt by the end of 2009 a moderate risk of debt distress; however, accumulation of Cambodia’s external public debt in the last few years has increased its percentage to total national budget revenue and GDP toward approaching the indicative thresholds (see table below). In addition, Cambodia’s policies and institutions, as measured by the World Bank’s Country Policy and Institutional Assessment (CPIA), averaged 3.26 over the past three years which slightly exceeded the threshold of 3.25. Thus Cambodia was classified as a “weak performer” for fiscal year 2009. This was based on relevant policy-dependent indicative thresholds under the baseline scenario. Last few years of DSA rating Cambodia at a moderate risk was also partly explained by the concessional terms of repayment offered by bilateral and multilateral donors. The low-income country debt sustainability framework (LIC DSF) recognizes that better policies and institutions allow

<sup>5</sup> Factsheet on Terms of Assistance of Concessional Loans to Cambodia produced end of 2010 and information about the NGO Forum on Cambodia can be accessed via its website at [www.ngoforum.org.kh](http://www.ngoforum.org.kh)

<sup>6</sup> Concessional loans refer to those loans provided in concessional terms which include charging interest rate below market rate, and has a grant element of at least 25 per cent, calculated at a discount rate of 10 percent or against a notional reference rate of 10 per cent per annum. The grant element is not reportable as a flow. For details on the calculation of grant element, please see [www.oecd.org](http://www.oecd.org).

<sup>7</sup> SDR: Special Drawing Rights, currency standard used within the IMF system. Exchange rate for 30 March 2010, 1 USD = SDR 0.633033 or 1 SDR = 1.58 USD. See [www.bankofcanada.ca/en/rates/exchform.html](http://www.bankofcanada.ca/en/rates/exchform.html).

countries to manage higher levels of debt, and thus the threshold levels for debt indicators are policy dependent.

<b>Cambodia: External Public Debt Indicators at End-2009</b>		
	Indicative Thresholds	End-2009 (Cambodia)
Net Present Value of debt, as a percent of:		
GDP	30	22
Exports	100	41
Revenue	200	189
Debt service <sup>8</sup> , as a percent of:		
Exports	15	1
Revenue	25	5
Sources: Cambodian authorities; and IMF and World Bank staff estimates.		
Adapted from IMF/World Bank DSA 2010 for Cambodia		

At the end of 2009, Cambodia's external public and publicly-guaranteed (PPG) debt stock was around 28 percent of GDP in nominal terms and 22 percent in net present value (NPV)<sup>9</sup> terms. Until 2008, strong economic growth and favorable external conditions contributed to a decline in debt ratios. However, since 2009, the external PPG debt ratios have risen, partly reflecting increased assistance from existing and emerging donors in the face of the global recession. As a result, the PV of debt to revenue was around 189 percent, approaching the 200 percent threshold. For 2010, the debt stock in PV terms as a share of GDP, as a share of exports of goods and nonfactor services, and of government revenues is projected at 23 percent, 42 percent and 178 percent, respectively. (Adapted from IMF/World Bank DSA 2010 for Cambodia)

#### **What is sustainable level of debt?**

There is no simple answer to this question. An economy has a sustainable level of debt if it is growing steadily; if its exports are growing rapidly enough to buy needed imports and to handle net short-term capital outflow; and if it has a realistic, stable exchange rate. Government debt is sustainable if debt service remains a small enough portion of its budget that it can pay without having to sacrifice the people's standard of living or growth rate<sup>10</sup>. South Korea, for example, has borrowed heavily and successfully over many years. From 2006 to 2011 national budget laws, Cambodia's debt repayment (interest and loan principal) as percentage of total national budget expenditure has remained stable at an average of 3.3%; however, in value terms, it has increased from USD 36 million to USD 78 million over same period. Maintaining this stable percentage rate of debt repayment, Cambodia has to ensure that new borrowing will be used to boost economic growth and revenue collection will be generated at stable and progressive pace or at least at similar speed of debt increase if it intends to retain this level of debt as percentage of total national budget expenditure and to not sacrifice budget to the growth of other sectors of the economy and quality of public services i.e. health, education and agriculture.

<sup>8</sup> Debt service is repayment of principal and interest.

<sup>9</sup> For formula on how to calculate NPV, please see World Bank website ([www.worldbank.org](http://www.worldbank.org)) and look for 'How to do DSA for Low-Income Countries (2006)'.

<sup>10</sup> See details in Joint World Bank/IMF Debt Sustainability Analysis 2010 which can be downloaded from [www.imf.org](http://www.imf.org) or [www.worldbank.org](http://www.worldbank.org).



Trouble starts, however, when the economy does not generate sufficient foreign exchange for repayment over a fairly long period of time or when debts rise unusually rapidly. This may occur for two main reasons. Firstly, **policy failures**<sup>11</sup> come in many forms such as discrimination against agriculture, which reduce output for both domestic consumption and export; inefficient import substitution policies; interest rate levels that discourage savings and encourage wasteful investments; excessive money supply growth, which causes inflation; failure to invest sufficiently in basic infrastructure and efficient institutions; extensive price controls; and wasteful military spending. The more difficult the economic situation becomes, the more governments and private firms try to borrow overseas. Secondly, **external shocks**<sup>12</sup> and shock in conjunction with poor domestic policy and external shocks that arise from outside the country can force a crisis. The shocks include climate change, inflationary pressure, drop in export price due to protectionism, possible paradox like Dutch disease<sup>13</sup> causing higher export value and less competitive advantage of domestically produced goods and economic downturn in the main markets for country exports.

A debt crisis is more indicative of an overall economic crisis when the economy is not sufficiently productive to create confidence in continued repayment. It is not the size of the debt that is crucial, but the productivity of capital (compared to the rate of interest) and growth of the economy that are important (or return on investment using the loans borrowed from outside sources). If the economy is growing rapidly enough, and in the right direction, it can handle an increasing debt. What is critical is the ability of the economy to pay the debt service (interest and principal on the debt), which means the economy must be growing in such a way as to earn sufficient foreign exchange (and tax revenues, in the case of government debt) to pay external creditors. If it is performing adequately, it can easily borrow to roll over old debt. If debt grows faster than the GDP, there is an indication that the economy is being burdened, although there is some range within which this may not be a problem. As the debt grows, a greater portion of the economy's resources- and a greater part of the government budget-become tied up in simply paying debt services, with no assurance that interest income is used productively. When a large or increasing portion of a government's borrowing comes from sources outside the country and is in foreign currency, rolling over debt tends increasingly to rely on, and interest payment go to, foreigners. When the government's prospects are not viewed favorably by foreigners, it is facing a debt problem. Countries that face a high debt distress or over-indebtedness may seek for debt relief from the Paris Club of country of lenders and multilateral lenders, which fall under the Highly Indebted Poor Countries (HIPC) Initiative and Multilateral Debt Relief Initiative (MDRI)<sup>14</sup>.

### Issues in Cambodia Debt Management and Future Risks

Overall, a fact sheet on Terms of Assistance of Concessional Loans to Cambodia highlighted that 34% of 104 concessional loan projects retrieved in June & July 2010 from the ODA database did

<sup>11</sup> As observed in the ODA database, concessional loans to Cambodia mostly are mixed by directing at building physical infrastructure (irrigation projects, roads and bridges) that aim to promote agriculture production, and better transportation. However, since the start of Thai invasion into surrounding areas of Preah Vihear Temple in 2008, the military spending in the form of current expenditure has been increased very fast since 2009 and this in turn, may have exhausted the budget availability for supporting other priority sectors i.e. agriculture (see analysis of 2010 and 2011 draft budget law by the NGO Forum on Cambodia at [www.ngoforum.org.kh](http://www.ngoforum.org.kh) or [www.cambodianbudget.org](http://www.cambodianbudget.org)).

<sup>12</sup> During the period of impact of global economic downturn on Cambodia, agriculture growth was recognized by the government as a factor that helped reduce and mitigate the severity of the impact on the Cambodian economy especially the poor and vulnerable group.

<sup>13</sup> See detail explanation on the Dutch disease in Macartan et al (2007). Escaping the resource curse. edited.

<sup>14</sup> For details on HIPC and MDRI, please visit website of International Monetary Fund (IMF) at [www.imf.org](http://www.imf.org).



not have sufficient information on their terms of assistance including interest rate, grace period and payback period. In addition, the government produces monthly, quarterly and annual reports on debt management; however, the report is not published for public monitoring. Information other than the terms of assistance presented here and in relation to decision on external debts is not fully aware by Cambodian citizens<sup>15</sup>. More researches could be done to explore what sources we are taking debts or loans from, which are better sources of loans or how to choose creditors in a balanced and sustainable manner, how much cost of current debt or debt burdens will be to Cambodia's tax payers and public services, where those loans have been used or will be used, and whether those loans have been used efficiently and effectively and what factors that ensure the accomplishment of their efficient and effective uses.

In conclusion, although Cambodia's external debt and its indicative thresholds showed its moderate risks of distress, there are signs of high increase in external debt starting from 2011 (i.e. increasing maximum of legal limit for new borrowing in 2011 budget law and emerging donors like China with less favorable terms of assistance) and these may push Cambodia to a higher level of risks of debt distress, indicative thresholds to be assessed by the World Bank in later rounds. Although the assessment showed that Cambodia is in at a moderate risk of debt distress; but its policies and institutions performance, as measured by the World Bank's CPIA<sup>16</sup>, was rated as weak performer. This raises concerns that Cambodia is at a dilemma of improving its institutions performance at the same time of signs of increasing external debt or else, it will risk facing higher level of debt distress, taking into account low level of revenue as percentage of GDP.

There are some implications suggested by the Joint IMF/World Bank DSA 2009 to the Cambodian government for consideration in avoiding any future debt crisis or distress. Firstly, Cambodia should ensure and balance appropriate concessional terms of assistance from new emerging creditors or lenders (i.e. China and South Korea) and their increasing presence in Cambodia, given Cambodia's needs for sustainable development and its capacity to service new debt. Secondly, The DSA 2009 also suggested the need for the authorities to strengthen the capacity in debt management and ensure that new debt is contracted on a sustainable basis. Given the level of debt to revenue ratio reaching the indicative threshold and as underlined by International Monetary Fund (IMF)<sup>17</sup>, Cambodia should step up the efforts to improve revenue (mainly tax) collection so that it could reach a suggested minimum rate of revenue as percentage of GDP at 18% for Southeast Asian countries. Thirdly, the information on debt or reports on debt management should be made publicly available which will allow wider public debate over the issues of debt management and its transparency; this will also help ensure appropriate targeting of loans to the most needed and areas or sectors that provide appropriate return on investment or stimulate faster economic growth. In addition, with the information in hand the

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<sup>15</sup> This is due to the fact that Cambodian citizens or tax payers will bear the cost relating to the repayment of those public external debts.

<sup>16</sup> The World Bank's IDA Resource Allocation Index (IRAI) is based on the results of the annual CPIA exercise that covers the IDA eligible countries. The CPIA rates countries against a set of 16 criteria grouped in four clusters: (a) economic management; (b) structural policies; (c) policies for social inclusion and equity; and (d) public sector management and institutions. The criteria are focused on balancing the capture of the key factors that foster growth and poverty reduction, with the need to avoid undue burden on the assessment process. To fully underscore the importance of the CPIA in the IDA Performance Based Allocations, the overall country score is referred to as the IRAI. (extracted from world bank website: [www.worldbank.org/ida](http://www.worldbank.org/ida))

<sup>17</sup> This 18% was underlined by Mr. John Nelmes, Country Resident Representative of IMF during his presentation in the 2010 Annual Economic Outlook Conference organized by Cambodia Development and Research Institute in cooperation with ANZ Royal Bank in Cambodia at Phnom Penh Hotel.

oversight institution i.e. the National Assembly could also monitor more closely and have tighter control over external debt through demanding more detailed debt ceiling regulation in the annual budget law and adjusted budget law and increasing financial resources for National Audit Authority in conducting more extensive audit on external debts and improving timing of audit report publication.

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## Managing Cambodia: The Next Phase of Growth

What Cambodia thinks today affects where it goes tomorrow. In the face of lingering uncertainty and global competition, planning and setting up the platform for the next phase of sustained and broader-based growth is timely and important. With young and hopeful population, the average annual growth of around 8% over the last decade should give us enough confidence to do so and think bigger.

Although agriculture and tourism will continue to play important roles in Cambodia's growth in the coming decades, this essay focuses on agriculture-based industrialization, which should be another key to effectively develop Cambodia's economy to a higher growth path. Materialization and success of this type of industrialization will not only boost Cambodia's productive capacity, but also enhance network and synergy effects among the core existing sectors. First, it would help create more value-added for our agriculture output through "forward linkage". Second, it would help capture a large proportion of value chain in core industries through "backward linkages" by supplying more domestic input materials for other sectors, i.e supplying cotton to garment industry, which currently is just only trim and cut; and processed food to tourism. Third, by connecting the core existing industries through supply chain and demand dynamics, this resource-based and labour - intensive industrialization would serve as a stepping stone to a more advanced-technology based industrialization. In short, agro-industrialization and the core sectors (agriculture, tourism, garment) would reinforce one another and increase productive capacity across sectors of the Cambodian economy.

To achieve this, Cambodia needs to overcome many capacity constraints ranging from infrastructure, technology, capital, management skills, to institutional framework. A lot has been done, yet much remains to be improved. Here, policies towards SMEs and energy costs and the role of state deserve a bit more attention because these three factors would help boost the dynamics of our economy in the process of industrialization.

As the majority of Cambodian SMEs is informal and poorly managed, they do not have efficient access to cheap credit and good technology support. Even if they do, it would be at higher costs. The challenge is, in this regard, to bring them into the formal economy, in which SMEs can do better to attract potential investors/creditors as a result of a more reliable accounting standard/report and management structure. Tax policy would be a major issue in this challenge. Current profit tax policy discourages SME in at least two ways; to be formally registered, and to compete with foreign firms which enjoyed tax holidays for a period of time (3-6ycars). The current profit tax rate (standard, 20%) should be much lowered (2-5%); Or better, domestic SMEs should enjoy tax holidays as in the case of foreign firms too. Besides, SME tax credit, in which profit is not taxed if it is invested for upgrading or expanding the companies, should be also introduced. The suggested tax policies would not only bring our SME into the formal economy, but also help them compete fairly with foreign firms and imported products.

High energy cost is one of the bottlenecks for SME's entry and growth, and for foreign companies to come in. Debates have been done on gasoline tax, subsidy, and alternative energy. Yet we need to move to lower our energy costs at least to a level, equal to those of our neighbors if Cambodia is to compete and industrialize.

The role of a facilitating state is essential. For instance, apart from directing to potential markets at our comparative advantages, government could provide institutional support to private sector, particularly SMEs in terms of capacity building, technology support, and consulting service. However, moving from the status quo to a productive facilitating state requires a long process and strong political will. The first step should be from the status quo to non-obstructive and encouraging government. Only when we have a non-politicized effective bureaucrat and technocrat at place shall government intervene and facilitate. Indeed, an ineffective facilitator, even with good intention, will do more harm than good.

To summarize, agriculture-based industrialization is promising in the next phase of Cambodia's growth, and would be a process to build our absorptive capacity for more advanced production technology at the next stage. As a late comer, we have a lot of advantages in learning curves, not competing curves. Thus, we will not only "learn to compete", but also "compete to develop" and indeed "develop to compete".

Cambodia is currently being squeezed by the two big growing economies and overlooked by big foreign investors and blue-chip companies due to relatively low productivity, insufficient infrastructure, and high informal costs. But in the next few decades when these constraints are overcome, who would deny possibility that the stable Cambodia could be a good production base given its proximity to the two markets and its liberal system?

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