

Remarks by

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I am deeply honored to have been invited to make a few remarks today. When David King asked me back in August if I'd accept this invitation, I thought it would be relatively easy to elaborate the changes that I have observed since I arrived in November 2001.

Not so. Maybe this is predictable. H.E. Senior Minister Keat Chhon once quoted a foreign expert as having said something along the following lines: If you visit Cambodia for a few days, you can write a book. If you stay a month, you can write an article. But if you stay for months or years, you may be unable to write even a paragraph! On this score, I should perhaps be speechless!

Notwithstanding, what I would like to do today is threefold. First, I will talk about positive developments during the past several years. Looked at objectively, we can see that a lot has been achieved. At the same time, more reform is clearly needed to put Cambodia on a *sustainable* path of *satisfactory* growth. So I will spend a few moments elaborating what we at the IMF think has not gone so well. Before concluding, however, I will spend a few moments on what new strengths and old weaknesses I detect in the government's capacity to launch Cambodia on the needed growth path for poverty reduction.

What has gone well

First, let's talk about economic performance. Surely the government's most significant economic accomplishment has been macroeconomic stability. Annual real growth averaged 6.3 percent during 2001-2004, a rate that is expected to be replicated this year. Per capita income also grew during this period, although by much less. Most remarkable is the fact that this relatively high growth has been accompanied by low inflation and a broadly stable exchange rate. After the phenomenally high inflation rates reached during the 1990s, in the 40-50% range during 1992-94, and another (though lesser) surge in 1998, this is really quite an achievement.

* The views expressed in these remarks are those of the speaker and should not be attributed to the International Monetary Fund, its Executive Board, or its management.

The last five years have witnessed other accompanying successes:

- Fiscal policy, the lynchpin to macro-stability in Cambodia, has remained appropriately cautious, especially by avoiding bank financing of the deficit. Revenue performance has broadly improved, in an exceptionally challenging environment of very generous tax advantages and weak tax compliance.
- Boosted by strong garment exports and tourism receipts (as well as sizeable flows of ODA), gross official reserves have risen steadily, from \$ 548 million in 2001 to well over \$ 800 million this year. Recent and commendable improvements in trade facilitation, together with safeguard measures in the United States and the European Union against Chinese garment exports, point to a continued positive outlook during the next year or two.
- Growing confidence in a strengthened banking sector is reflected in steady growth of both riel and dollar bank deposits, a rising loan-to-deposit ratio, and improving bank profitability at most banks. We even see the welcome arrival of a new, large, international bank (ANZ), following the departures of Standard Chartered and Crédit Agricole/Indosuez in 2002. Recent passage of the Negotiable Instruments and Payments Transactions Law should contribute to yet further improved confidence in the banking sector.
- Cambodia's accession to the WTO is clearly a major success in the country's pursuit of re-integration into the world economy. It has usefully given an impetus to reforms needed to benefit the most from accession.
- In terms of improving the investment climate, we finally have clarity with respect to implementation of the *Amended Law on Investment* with the recent approval of the implementing regulations. Dialogue between the government and the private sector has been restored, and assertive actions have been demonstrated in the areas of trade facilitation, SME promotion, and the overall investment environment.
- On transparency, the draft *Law on Concessions*, presently at the Council of Ministers, and the Prime Minister's interim order of June 13, are very welcome initiatives.

Although I am not a political analyst, and heaven knows it's a challenge to understand the complex politics of Cambodia, it seems to me that, for the moment, a degree of political stability reigns, one that bodes well for investors and citizens in general. The key issue is whether or not the new political reality—the apparent consolidation of the coalition, and the seemingly weakened opposition—are favorable or not to structural reforms. Time will tell.

Finally, on the socio-economic front, there are also indications of improvements. Hard data are still not available, but preliminary results from the 2004 Socio-Economic Survey suggest that there may have been a lowering of the poverty rate in recent years. But we will have to await the publication of the official results before taking comfort in the preliminary indications, especially against a backdrop of poor performance with respect to most of Cambodia's other Millennium Development Goals (CMDGs).

What has not gone so well

Now, for the flip side of the coin. First, on growth. The narrowness of both the *sources* and *distributional impact* of growth remain of concern, the former because it exposes Cambodia to considerable risks of adverse shocks to growth, and the latter because of the possible social and, eventually political, consequences. There is particular urgency to promoting rural development and agriculture, and more generally to improving the competitiveness of the Cambodian economy to help diversify growth. Clearly, diversification is key to reducing both of the risks I just mentioned. To improve the lot of rural households, we need better access to land, to markets, and to public services, as well as increased investments in rural infrastructure. Diversification more generally hinges on creating a much more welcoming environment for risk-taking and investment, by removing unnecessary impediments, reducing corruption, and strengthening the rule of law. Sure, we need new laws, such as the anti-corruption law. But what we really need is more political courage to implement existing laws, and greater recognition to those who work to further those efforts. For instance, despite the anti-corruption provisions under UNTAC laws, not a single corruption case has been prosecuted. Not a show-case of political will! Let's hope that the next draft law, soon to be submitted to the Council of Ministers, will be up to international standard, and, even more importantly, that its implementation will demonstrate the political will we are all looking for.

Also, judicial reform has been at a standstill, when we know it will take a long time to effect, and that it is therefore urgent to accelerate the pace. Courts are still unreliable and judges poorly trained, and it is high time the government starts doing more than just promising this or that action plan.

Public administration reform has also only very recently accelerated, after years of slow progress at best. The introduction of merit-based pay initiatives through the government's so-called Priority Mission Groups is a step in the right direction, but a strategy for taking forward performance-based remuneration on a government-wide yet fiscally sustainable basis is very far off in the future. I do not see how the government will achieve this in any reasonable timeframe in the absence of some strategy to reduce the number of redundant civil servants, although perhaps my arithmetic skills need to be sharpened!

Governance problems continue to undermine fiscal integrity, sapping whatever confidence there is, if any, in public institutions. The lack of transparency in the granting of concessions has been very harmful to economic development. The lack of transparency has been especially egregious in regard to land concessions, facilitating rampant land grabbing, and in turn reducing access to arable land by the poor. Until recently, relatively little effort had been made to enforce legal restrictions on the use of public assets, resulting in swaps of state property for real estate of very dubious value and, it would seem, the pocketing by public officials of some portion of the monetary proceeds accompanying the opaque deals. It's bad enough that these deals are not favorable to the government; it's all the worse when funds are siphoned off rather than making their way into the National Treasury!

Just as my list of achievements was abbreviated, so have I kept short the list of disappointments, all in the interest of time. Moreover, it's likely that none of this is "news" to any of you in this room.

What is promising, and what is not

At this point, I'd like to offer some remarks on how I see the future, based on what I have observed in this privileged position of Resident Representative for the IMF in Cambodia.

First of all, several influences on the developmental process have, in my view, improved during the past two years, holding promise for the future. There seems to be much more assertiveness in the government's efforts to undertake and implement reforms. The backlog of delayed initiatives is being reduced, and some of these are very important; I have mentioned a few above.

Second, the government has clearly shown much more ownership than heretofore; it is in the driver's seat on private sector development, public financial management reform, anti-corruption legislation, public administration reform, and in preparing the *National Strategic Development Plan 2006-2010*, to name a few. And the authorities appear to be taking relatively seriously the so-called harmonization and alignment initiatives with their development partners, striving to improve the coordination of policies, the predictability of development assistance funding, and the setting of goals and targets to implement the *Rectangular Strategy*.

Third, the government is keenly aware of the urgency—pressured by explosive demographics—of creating jobs. I had certainly not detected this cognizance four years ago, when the admittedly welcome creation of 250,000 or so jobs in the garment and footwear sectors always seemed to suffice for a political platform. That slightly fewer than this number will be needed every year has certainly grabbed the attention of the leadership. EPZs and SPZs may have their merits for some purposes, but I am doubtful they can solve Cambodia's job creation challenge! Thankfully, the government is looking to broader reforms to help address the challenge.

Three years ago, I proposed that we needed to look at Cambodia's reform challenge as reversing a vicious circle, to find ways to reduce unofficial costs and lower the demand for tax breaks and other favors so as to boost revenue without raising tax burdens; to be able to increase and improve public spending, including by building better infrastructure; to help reduce operating costs and help boost Cambodia's competitiveness. I hope that the balance of what I have said above suggests I think the conditions may exist more now than before for setting in motion a virtuous circle.

At the same time, there remain troubling signs of a lack of political will in very important areas of reform. Transparency is one. We continue to hear about contract deals agreed without transparent procedures being respected. And I repeatedly hear stories about rigged competitive bidding for public procurement contracts, such as the inflation of prices well above levels that would be assured by competitive bidding, and the arbitrary refusal to sell tender documents to potential bidders. These practices are glaringly anti-poor, as far as I am concerned.

I think it's time I end my remarks. Before doing so, let me say something about the relationship between the IMF and the private sector in Cambodia. I once said at a working

group meeting that suggestions from some of you that the IMF was anti-private sector were incoherent and unfair, since our mandate is, among other things, to promote sustainable growth. As economists, we know that the private sector is the only source of real and sustainable job creation. In the pursuit of this mandate, we strive, at the behest of the membership of the IMF, and in partnership with governments and central banks, to improve the transparency of public and financial institutions, to make more efficient the functioning of economies, to ensure macroeconomic stability and to help secure a fair sharing of the benefits of economic growth. I know all of you here present would endorse these goals. I hope that during the past four years, I have succeeded in convincing you of our partnership with not only the government, but with the private sector as well.

I have been delighted to have had the opportunity to establish friendships with many of you, and I regret not getting to know many more of you. Many of you work tirelessly not only for your own profit, but also for Cambodia, through the sacrificing of your time, the taking of risks, and sticking to the long view, or, as they say, “staying the course.” For your sake and that of all Cambodians, I hope your dedication holds promise for a bright future for this martyred country.

Thank you for your attention.