



CAMBODIA

SELECTED ISSUES

September 2026

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September 1, 2026

Approved By

Prepared By Dallal Bendjellal, Max-Sebastian Dovi, Sylwia Nowak, and Liangliang Zhu

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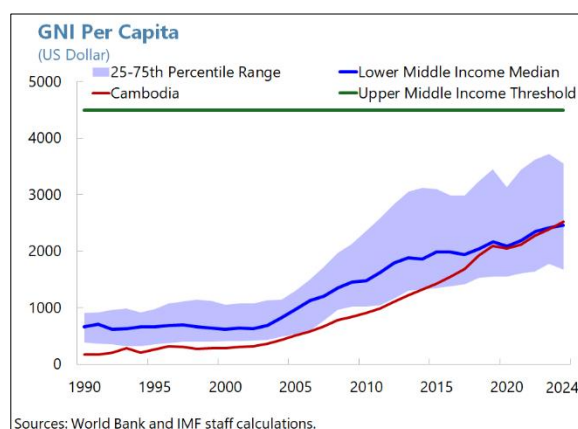
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POLICY PRIORITIES FOR MORE EFFICIENT CAPITAL ALLOCATION, LABOR ABSORPTION, AND HIGHER PRODUCTIVITY¹

Cambodia approaches LDC graduation with real strengths: sustained foreign investment, deep export integration, and a young workforce. These advantages give Cambodia a strong foundation for the transition, but not a guarantee that convergence toward the authorities' income ambitions will continue. LDC graduation raises the stakes: as preferences erode and market access requirements tighten, growth will depend more on domestic capabilities, firm upgrading, and productive employment that raises earnings and supports higher value added. The priority is therefore to raise the domestic payoff from investment by developing local suppliers, connecting workers to more productive firms, and reducing the regulatory and infrastructure bottlenecks that prevent firms from scaling.

A. The Next Growth Test

1. Cambodia's development record shows how much can be achieved when capital, trade, and jobs move together. Over the past two decades, macroeconomic stability, foreign direct investment (FDI), export integration, and labor reallocation into expanding sectors helped raise incomes and reduce poverty. The model still has momentum: investment remains resilient, manufacturing continues to expand, and Cambodia's young workforce still offers scope for a demographic dividend if workers can move into more productive jobs. But as LDC graduation approaches, these growth engines will need to generate more domestic value added (**Box 1**).² Reaching the authorities' income ambitions—upper-middle-income status by 2030 and high-income status by 2050—will require continued capital deepening, stronger domestic linkages, and more productive jobs from the investment Cambodia attracts.



¹ Prepared by Sylwia Nowak and Liangliang Zhu. We thank Kenichiro Kashiwase and the Cambodian authorities for valuable feedback and comments.

² Cambodia's real GDP growth averaged 7.6 percent during 2009–19. Sustaining growth near that pace from a higher income base would be demanding: the Growth Commission found that only 13 economies had sustained average growth of 7 percent or more for at least 25 years since 1950 (Commission on Growth and Development, 2008).

Box 1. Growth after LDC Graduation: Selected Lessons for Cambodia

Only eight countries have graduated from LDC status since 1994, and their experience does not suggest that graduation automatically leads to either faster or slower growth. The sample is small and heterogeneous—Botswana (1994), Cabo Verde (2007), Maldives (2011), Samoa (2014), Equatorial Guinea (2017), Vanuatu (2020), Bhutan (2023), and São Tomé and Príncipe (2024)—with outcomes shaped by resource cycles, tourism dependence, natural disasters, and the pandemic. A simple event study suggests that average real GDP growth was broadly unchanged in the five years around graduation, at about 2.9 percent before and after graduation.¹ These patterns do not support treating graduation itself as the main driver of future growth, but they also caution against assuming that past growth drivers will continue to deliver at the same pace.

No previous graduate is a close structural comparator for Cambodia. Cabo Verde and Bhutan offer useful partial lessons: Cabo Verde on managing graduation in a small open economy exposed to external shocks, and Bhutan on the role of infrastructure and long-term planning in a recent Asian graduation. For Cambodia, the main issue is whether firms can adjust as preferential trade treatment is gradually withdrawn and market access requirements become more demanding after LDC graduation. This makes Bangladesh a more relevant reference point, given its reliance on export manufacturing, trade preferences, imported inputs, and labor-intensive job creation. This does not mean graduation is costless for Cambodia. Rather, the cross-country evidence suggests that the growth impact depends on country-specific exposure and adjustment capacity. Cambodia's Ministry of Planning and UNDP (2024) notes that graduation will gradually withdraw preferential trade arrangements, more flexible rules of origin, and some WTO-related flexibilities. That assessment estimates that, absent timely mitigation, trade-related graduation effects during the four years immediately after graduation could reduce annual GDP growth by 0.5–1.5 percentage points relative to the baseline in that assessment and lead to about 165,000 job losses, mainly in garments, where LDC preferences matter most.²

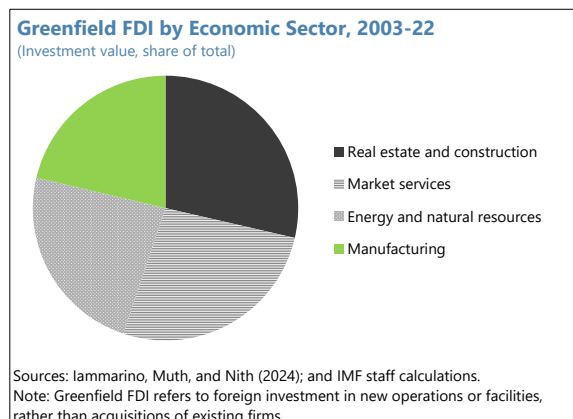
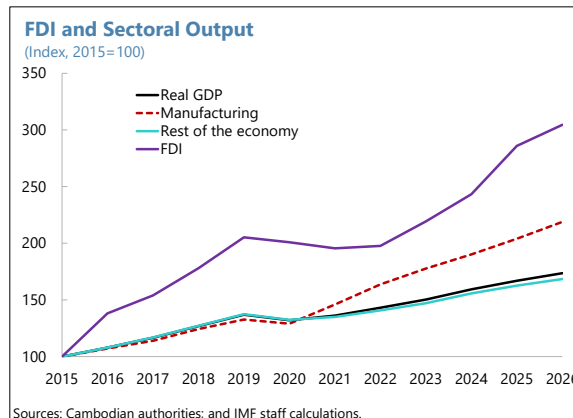
For Cambodia, graduation is better understood as a transition risk than as a one-off threshold. The main exposure is in garment, footwear, and travel goods, where firms have relied on preferential access, imported inputs, and labor-intensive production. If duty-free treatment is reduced while firms still struggle to meet stricter rules of origin, the sector's cost advantage could erode. The transition risk is also broader than tariff preferences: as global trade increasingly incorporates environmental and social compliance requirements, firms will need stronger labor standards, traceability, and supply-chain due diligence to mitigate market-access risks. The relevant lesson from past graduates and from Cambodia's own graduation assessment is that outcomes depend less on graduation itself than on the strength of the production base, institutions, and adjustment capacity during the transition period. As **Annex II** shows, Cambodia compares well with many LDC peers on several broad structural indicators; the main risks are concentrated in sectors exposed to preference erosion and imported-input dependence.

¹ Excluding Equatorial Guinea, where oil-sector contraction dominates the growth path, average real GDP growth rose from about 3.6 percent before graduation to about 4.0 percent after graduation over the five-year window. Over a ten-year window, average growth moderated from about 4.2 percent before graduation to about 2.7 percent after graduation, or from about 4.6 percent to 3.5 percent excluding Equatorial Guinea.

² Ministry of Planning and UNDP (2024), *Cambodia's Graduation from Least Developed Country Status: Preparedness and Potential Economic and Social Impacts*, Policy Brief, Phnom Penh.

2. FDI has supported manufacturing growth, but broader spillovers remain uneven.

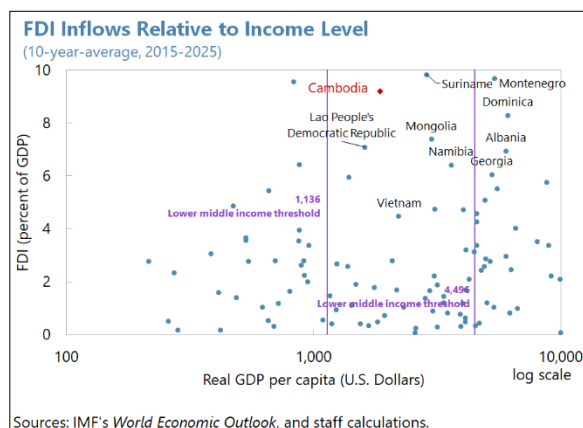
Manufacturing has been resilient, supported by continued FDI and export demand. FDI has also helped transform Cambodia's economy, shifting labor out of agriculture, expanding garment and footwear manufacturing, and upgrading the export structure (Iammarino, Muth, and Nith, 2024). Yet the spillovers have remained thinner than the inflows: export manufacturers still rely heavily on imported inputs, links to domestic firms are limited, and productivity gains have not spread broadly across the economy. Greenfield FDI data show the same pattern.³ During 2003–22, real estate and construction accounted for the largest share of reported greenfield investment, while manufacturing accounted for only about one-fifth and remained concentrated in lower technology activities. Sustaining high growth will therefore require continued capital deepening, with more investment flowing into activities that strengthen the domestic production base, reduce reliance on imported inputs, and generate a larger productivity payoff.



3. Recent shocks have raised the premium on using Cambodia's capital inflows and labor force more productively.

Trade policy uncertainty, border tensions with Thailand, higher energy prices, and confidence effects from scam-related financial integrity risks have tested Cambodia's adjustment capacity. The return of nearly 1 million migrant workers has raised the stakes further: the economy now needs to generate more productive domestic jobs and higher national income for a larger labor force. If returnees are absorbed into formal, higher-productivity activities, the shock could become a significant labor windfall. At the same time, cross-country experience suggests that FDI inflows alone do not ensure convergence:

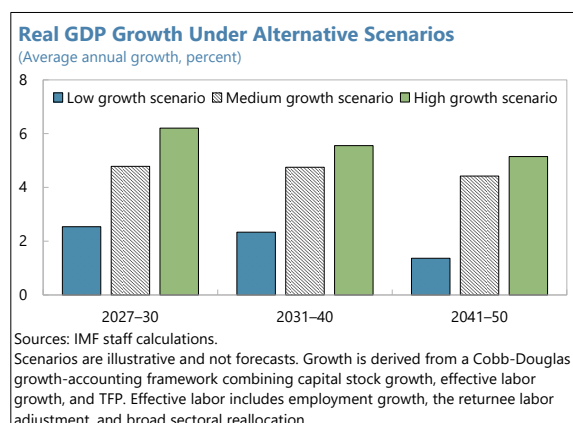
some countries with similar or lower FDI-to-GDP ratios have reached much higher income levels.



³ Greenfield FDI refers to foreign investment that creates new operations or facilities in the host economy, such as plants, offices, or business sites, rather than acquisitions of existing firms.

4. Cambodia's challenge is not a shortage of strategies, but a shortage of integration. The Pentagonal Strategy provides the overarching reform framework, while the Program for Enhancing Competitiveness, Promoting Diversification and Strengthening Resilience translates this agenda into priorities for competitiveness, diversification, skills, firm upgrading, and resilience. The risk is fragmentation. Digital registration, investment approval, and trade facilitation systems have improved, but firms do not always experience them as a coherent reform package. Existing initiatives would have a larger payoff if they were organized around three measurable outcomes: stronger domestic supplier links, higher worker retention after training, and lower compliance and logistics costs for firms. Integration also requires aligning these priorities with the budget, public investment decisions, and the financing envelope.

5. The growth scenarios provide a quantitative illustration of the integration problem (Annex I). Cambodia can still grow by attracting FDI and absorbing more workers, but sustained convergence will depend on whether those inflows and labor gains generate higher domestic value added. Capital needs to flow to activities with stronger spillovers, workers need to move into jobs where earnings and productivity can rise, and firms need to upgrade enough for productivity gains to spread. The exercise is illustrative, not a forecast or an estimate of individual reform effects. It shows the scale of productivity gains needed to sustain faster convergence and how growth outcomes differ when investment, labor absorption, and firm upgrading reinforce each other.



B. From Job Creation to Productive Employment

6. Cambodia's labor challenge is shifting from structural reallocation to productive absorption. Earlier movement out of agriculture supported growth as workers moved into industry and services, where productivity and wages were higher. That source of catch-up is now less powerful. Recent evidence suggests that the gains from reallocation have been limited by barriers that keep workers from moving into better jobs, including weak job matching, limited certification of prior learning and work experience, and working conditions that make retention difficult (Ngov and Cheng, 2025). Many workers remain in low productivity or informal activities. Future gains will depend less on movement between broad sectors than on whether workers can access higher-quality jobs within them—stable paid work with scope for progression and higher earnings.

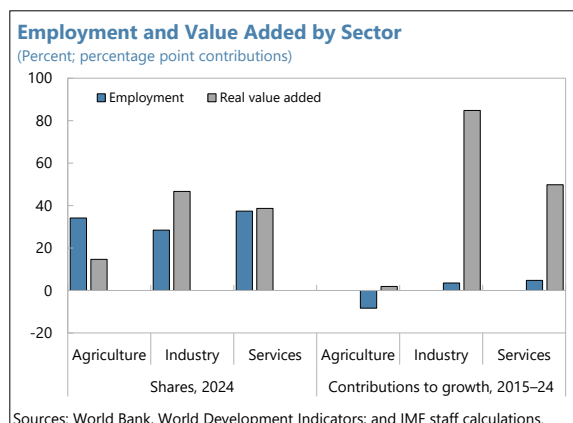
7. Returned migrant workers make productive absorption an immediate policy test. Border tensions with Thailand prompted the return of nearly 1 million Cambodian migrant workers, weighing on remittances and household incomes. Although many returnees have found work, including in the formal sector, job retention remains weak, and many remain in agriculture and informal employment. The test is whether this labor supply shock becomes a growth dividend rather

than a source of low-productivity underemployment. Policy should therefore focus on job matching, employer-linked training, and incentives for firms that create durable jobs with progression and earnings growth.

8. Cambodia has considerable scope to expand wage employment. Own-account and family work still account for a larger share of employment than in upper-middle-income peers, underscoring the importance of moving workers into paid jobs with clearer progression paths. But formalization will raise productivity only if firms also invest, meet higher standards, and move into better products and tasks.

9. Services are not only a destination for workers leaving agriculture; they are also a productivity channel. Low-productivity informal services can absorb labor without raising earnings or firm capabilities, while logistics, business services, and higher-quality tourism can raise productivity across the economy. This is consistent with regional evidence that services can support productivity growth when they are tradable, digitally enabled, and linked to other sectors (IMF, 2024). These services help exporters meet buyer requirements, support supplier development, and connect farmers and firms to markets. A higher-growth path will therefore depend not only on manufacturing and agro-processing, but also on the services that allow those sectors to scale and upgrade.

10. Job creation has not kept pace with the shift in value added toward industry and services. Export growth has helped reduce informality and raise hours worked, especially for women, but the effects appear modest and tend to fade over time (World Bank, 2024a). Agriculture still employs about one third of workers but generates less than one sixth of measured value added, while industry accounts for a much larger share of output than employment. Since 2015, industry and services have accounted for most value-added growth, while employment gains have been much smaller and agriculture has continued to shed labor. The challenge is therefore both to create more paid jobs with scope for progression and to raise productivity in the activities where workers remain.



11. Agro-processing can turn Cambodia's agricultural scale into more productive rural employment, but only if policies address the whole value chain. Cambodia already has scale in major crops, including rice, cashew, and cassava. The main constraints increasingly lie beyond the farm gate: Cambodia needs stronger links between agricultural production, processing capacity, and market access to move from exporting raw agricultural materials to higher-value semi-processed and finished products. Cashews illustrate the challenge: Cambodia is among the world's largest raw cashew producers, but processes only a small share of its harvest domestically; raising domestic value added will require processing capacity, export readiness, and finance. Recent investment in

rubber processing points to similar opportunities in commodities where Cambodia has scale but retains limited value beyond primary production.

12. Agro-industrial parks can support productive rural employment, but only as a part of an integrated value chain. They should connect raw-material supply, processing capacity, and market access rather than operate mainly as serviced sites. Modern agricultural cooperatives can complement them by aggregating smallholders, improving quality control, and strengthening links to finance and processors. For Cambodia, the practical test is whether these platforms address three binding coordination gaps: processing capacity, logistics and storage, and access to markets with enforceable standards. Done well, agro-industrial investment can help producers move beyond primary production, support local job creation and workforce upgrading, and reinforce labor formalization through contracts and social security coverage. The border conflict reinforced the same lesson: rural producers need stronger links to domestic processing and alternative market channels, rather than access to land and labor alone (Yarrow and Kenh, 2026).

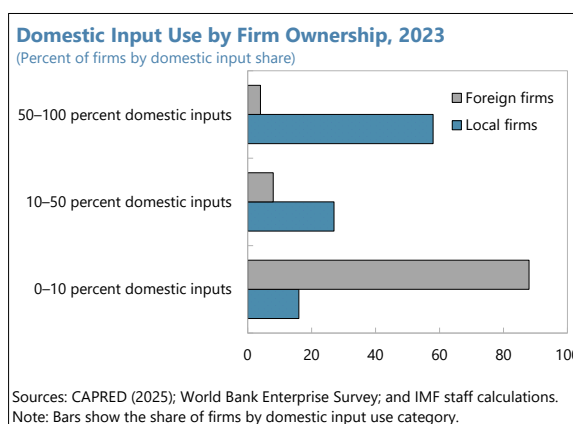
C. From Attracting FDI to Raising Its Domestic Payoff

13. Cambodia's investment agenda should continue to support capital deepening while raising the domestic payoff from FDI. FDI

remains a strength, and Cambodia should preserve an open and predictable investment regime. But the next growth payoff will depend increasingly on the composition of investment and the strength of its links with domestic firms and workers. The issue is not only the volume of inflows, but how to bridge the gap between a dynamic export sector dominated by foreign investors and domestic firms

that remain constrained by scale, finance, logistics, and supplier readiness. Export manufacturers remain heavily reliant on imported inputs, and foreign firms are especially concentrated among firms with very low domestic input use, underscoring the still thin links between FDI and the local economy (CAPRED, 2025). The objective is not to reduce openness, but to make foreign investment more likely to raise standards, crowd in domestic private investment, create productive jobs, and connect Cambodian firms to higher value segments of regional and global value chains (Winkler, 2023). This requires stronger backward linkages to Cambodian suppliers and the selective development of upstream activities where local firms can realistically meet buyer requirements.

14. A stronger domestic payoff from FDI would help Cambodia adapt to shifts in global supply chains while moving into higher-value activities. As climate-related standards and demand shifts reshape investment decisions, Cambodia could position itself for new projects linked to low-carbon goods and services (World Bank, 2023). The emerging pipeline in automotive components, electronics, and EV-related investment provides an early test of whether new FDI can broaden manufacturing, create demand for more technical and specialized workers, and raise domestic value added. The question is whether these activities also crowd in domestic private



investment and generate supplier networks—or simply become another import-dependent production segment. Developing upstream industry would not mean replacing imports across the board, but building domestic capacity in selected upstream inputs and services where Cambodia has scale, investor demand, and feasible supplier potential. A similar opportunity exists in garments, where reliable access to clean electricity could help Cambodia retain buyers and expand beyond final assembly to the input-production stage, reducing reliance on imported materials. More broadly, energy security and clean-power access will shape whether new investment raises domestic value added or remains assembly-heavy.

15. Investment incentives should be tied more closely to the outcomes Cambodia wants from FDI. Tax incentives, SEZ benefits, and investment facilitation can help attract projects, but their growth payoff depends on what projects deliver after approval. Cambodia’s Law on Investment already provides a useful basis, including incentives for local inputs, training, and machinery upgrading. The next step is to apply these tools more selectively, with public support linked to measurable outcomes: worker training, supplier development, and technology or standards upgrading. Targeted support is more likely to raise productivity when it addresses clear market failures and is backed by competition, capable firms, and credible implementation (Arias and others, 2026). Rigid local content requirements would risk deterring investors or raising costs; a better approach is practical supplier upgrading, clear expectations, and incentives linked to measurable improvements in these outcomes.

16. Supplier linkages are constrained by a two-sided matching problem. Foreign firms cannot always find reliable domestic suppliers, while many Cambodian firms still struggle with quality, scale, and certification. The investment sub-decree’s after-care provisions provide a useful platform for supplier matching, local supply-chain clustering, and backward and forward linkages. This matters because FDI spillovers are more likely to materialize through backward linkages with domestic suppliers than through automatic economy-wide technology transfer (Javorcik, 2004). Cambodia-specific evidence points to similar constraints: firms report limited availability of domestic inputs, costly supplier search, and VAT refund frictions as barriers to local sourcing (CAPRED, 2025).

17. Matching must be paired with capability upgrading. Firm-level evidence suggests that upgrading depends on incentives to improve, access to better inputs and finance, and the know-how needed to strengthen management practices, quality control, and technology adoption (Verhoogen, 2023). Productive know-how is accumulated through learning by doing and embedded in workers, managers, suppliers, and firm networks; it is not transferred automatically through imported machinery or market access (CAPRED, 2025). For Cambodia, the practical implication is to make supplier upgrading more targeted. Support should focus on firms with realistic potential to enter export-linked supply chains and on three constraints that most directly limit buyer readiness: quality control, certification and standards, and finance for upgrading.

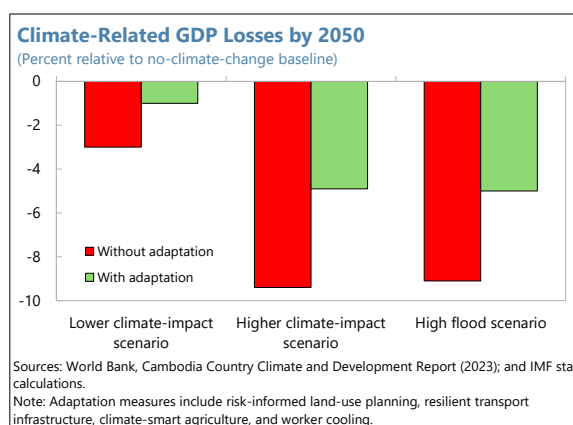
18. Domestic firm capabilities determine whether investment translates into broad-based productivity gains. Micro, small, and medium enterprises account for most nonagricultural employment and nearly two thirds of GDP, so their ability to grow and connect to larger firms will shape Cambodia’s productivity path. Informality compounds the problem by weakening incentives

to scale: firms may stay small to avoid visibility but in doing so remain less able to invest, professionalize, and build durable buyer relationships (La Porta and Shleifer, 2014). Without stronger domestic firm capabilities, new investment may expand output and employment without generating enough local value added, technology diffusion, or wage gains. The objective is therefore to move beyond firm entry toward firm upgrading, so that more Cambodian businesses can become productive employers, reliable suppliers, and channels through which FDI and structural transformation raise economy-wide incomes.

19. Trade and customs frictions can keep capable domestic firms outside export supply chains. Recent customs reforms—including pre-arrival declarations, online duty payments, the National Single Window, and expanded Authorized Economic Operator certification—could support supplier development if they reduce clearance times and become easier for small firms to use. Streamlined procedures, better data sharing, and clearer guidance would make existing reforms more effective in connecting Cambodian firms to foreign-owned buyers.

20. Public investment should target the infrastructure and services that keep domestic firms outside export value chains. For supplier development, the most binding gaps are likely to be logistics, energy reliability, and testing and certification facilities. These determine whether Cambodian firms can meet buyer requirements and deliver at scale. With fiscal space narrowing and development financing becoming more constrained after LDC graduation,⁴ the priority is not simply more infrastructure, but investment that addresses these specific bottlenecks. The authorities' ongoing Public Investment Management (PIM) reforms can help strengthen project readiness, appraisal, and implementation discipline.

21. Climate adaptation protects the returns from better capital allocation. Supplier linkages, agro-processing, and export participation depend on infrastructure and energy supply that remain reliable under more frequent floods and extreme heat. Energy resilience is part of this agenda: Cambodia's high fossil-fuel import dependence and relatively high electricity costs make reliable, lower-carbon power important for competitiveness and shock preparedness. Adaptation should therefore be built into project selection, not treated as an add-on. The draft PIM framework's inclusion of climate adaptation and climate risk assessment in the project cycle is a useful step toward embedding resilience in investment decisions. Infrastructure appraisal should account for resilience, maintenance needs, and the services projects provide to firms and households, rather than upfront costs alone.

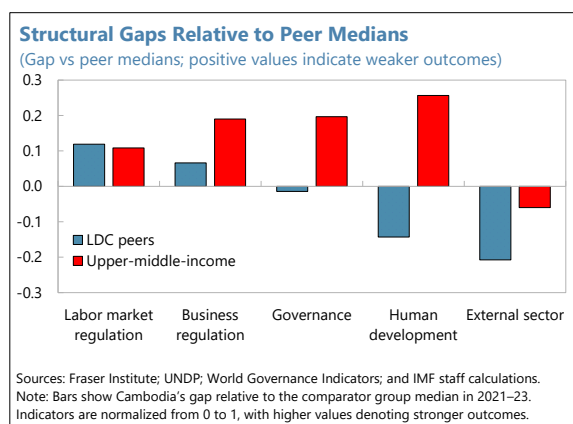


⁴ See the accompanying Selected Issues Paper on development outcomes and financing needs for an assessment of spending needs, financing options, and revenue mobilization to help close infrastructure and human capital gaps.

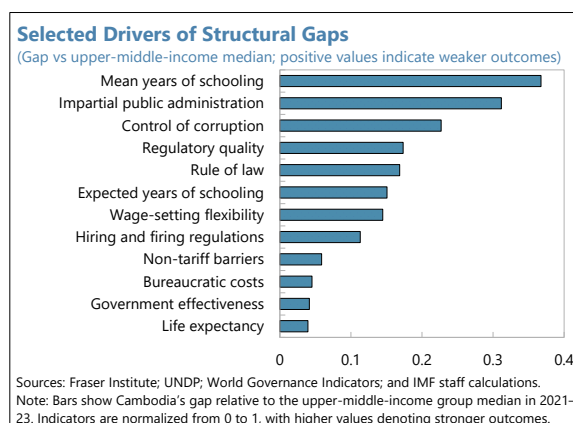
D. Structural Reforms to Make the Package Work

22. Cambodia does not need another reform catalogue; it needs reforms that make the growth model work better in practice. The transition risk highlighted in Box 1 makes this implementation agenda more urgent: as preferences erode and market access requirements tighten, stronger domestic capabilities, more productive firms, and better jobs will be needed to strengthen resilience and keep growth inclusive and sustainable. The priority is to ease the constraints that keep firms from scaling, meeting buyer requirements, and creating better jobs. That requires better capital allocation, lower costs of firm entry and expansion, and training and regulation that respond more closely to private sector needs. The structural indicators help identify where institutional and regulatory gaps are most likely to weaken the link between investment, jobs, and productivity.

23. The structural indicators help identify the constraints most likely to limit the package's effectiveness. Following Budina and others (2023), the analysis benchmarks Cambodia against income-group peers using composite indicators for governance, external sector openness, business regulation, labor market regulation, and human development, each scaled from 0 to 1. Cambodia performs better than the LDC median on governance, human development, and the external sector, but still lags LDC peers on business and labor market regulation. The more demanding benchmark is upper-middle-income convergence, where the largest gaps are in governance, business regulation, labor market regulation, and human development. These are the areas that shape whether capital is allocated efficiently, whether firms can enter and expand, and whether workers can move into more productive jobs (**Annex II**).

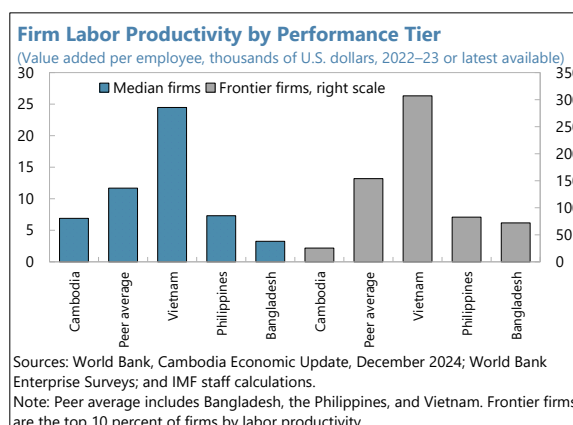


24. The selected drivers clarify the sources of these broad reform gaps. The LDC comparison points to areas of relative strength, especially governance, human development, and external openness, but also to near-term weaknesses in business and labor market regulation. Relative to upper-middle-income peers, the gaps are broader and more demanding, especially in schooling and public-sector governance. These gaps remain despite progress in several areas: governance improved markedly in the 2000s but has plateaued since the mid-2010s, while human development has improved gradually but remains well below upper-middle-income levels. Business regulation has improved more modestly, and gaps in bureaucratic costs and non-tariff barriers are consistent with firm-level concerns about registration,

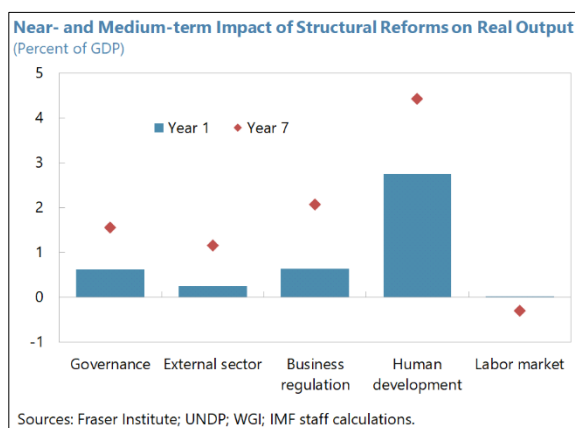


licensing, tax administration, customs, and overlapping documentation requirements. Labor market regulation remains a persistent gap, but the indicator should be read narrowly: the composite captures hiring and firing regulation and wage-setting flexibility, not the broader labor market constraints emphasized in this paper.

25. Cambodia's binding constraints are complementary, not sequential. Governance and business regulation shape where capital goes and whether firms can scale. Education, training, and job-matching determine whether workers can move into more productive tasks as firms upgrade. External openness remains a strength, but it will not deliver the next growth dividend if domestic firms cannot supply exporters, workers cannot move into higher value tasks, and rules remain difficult to navigate. The firm-level evidence is consistent with these constraints: Cambodia's lower average productivity reflects both a long tail of weak firms and the relative underperformance of its better firms. Its frontier firms generate much less value added per worker than frontier firms in comparator economies, suggesting that the economy is not yet producing enough high-productivity firms that can pull workers, suppliers, and investment into better activities (World Bank, 2024b).



26. Cross-country estimates illustrate the value of a focused reform package. Following Budina and others (2023), the estimates show the average output response for lower-middle-income countries as structural indicators move toward upper-middle-income norms. These estimates are illustrative and are not Cambodia-specific forecasts. Combined with Cambodia's structural gaps, they suggest that the largest potential gains lie in improvements in human development, governance, and business regulation, while external sector and labor market regulation have smaller estimated effects.



- **Human development** delivers the largest estimated gains. Closing the gap with upper-middle-income norms is associated with output gains of about 2.7 percent in the first year and 4.4 percent by year 7. The large payoff is consistent with the role of human capital accumulation in raising worker productivity, supporting technology absorption, and enabling movement into higher value activities (Mankiw, Romer, and Weil, 1992).
- **Governance** reforms have a sizable medium-term payoff. Governance reforms are associated with output gains of about 0.6 percent in the first year and 1.6 percent by year 7. These gains are

consistent with the importance of predictable rules, stronger investor confidence, and better capital allocation.

- **Business regulation** reforms deliver gains that build over time. Business regulation reforms are associated with output gains of about 0.6 percent in the first year and 2.1 percent by year 7. The rising payoff underscores the importance of lowering administrative burdens and making it easier for firms to enter, expand, and upgrade.
- **External sector** reforms have smaller estimated effects. For Cambodia, this is consistent with its relatively strong external-sector score and high openness to trade and capital flows. The implication is not that openness matters less, but that the next gains are more likely to come from making openness work better through domestic linkages, firm capabilities, and productive absorption.
- **Labor market** regulation reforms should be read narrowly. The estimated output effects are near zero in the first year and slightly negative by year 7. This does not weaken this paper's labor argument: the composite captures hiring and firing regulation and wage-setting flexibility, while Cambodia's labor constraints lie more in skills, matching, informality, certification, retention, and job quality.

Taken together, the estimates support a focused package centered on human development, governance, business regulation, and firm upgrading, rather than a broad structural reform catalogue.

27. The policy implication is selectivity. Public support is more likely to raise productivity when it targets clear market failures, is transparent and time-bound, and is backed by broader governance, regulatory, competition, and financial reforms (Arias and others, 2026). For less efficient sectors, these enabling reforms may deliver more than industrial policy alone by improving the conditions under which firms invest, upgrade, and compete (Baquie and others, 2025). For Cambodia, the priority is to make FDI, productive employment, and firm upgrading operate as one package.

28. Implementation is where firms see whether reforms have simplified the state or merely digitized its frictions. Private sector feedback points to a common problem: firms face overlapping registration and licensing requirements, duplicated document requests, uneven tax interpretation, manual steps in otherwise digital systems, and weak data sharing across agencies (American Chamber of Commerce in Cambodia, 2025; European Chamber of Commerce in Cambodia, 2026). These frictions are often described as business climate issues, but they also affect macroeconomic performance. They slow firm entry, discourage formalization, delay investment, and make it harder for domestic firms to become reliable suppliers. Digital systems will raise productivity only if they replace paper-based approvals rather than duplicate them.

29. Digital reforms can lower compliance and trade costs only if systems are integrated across agencies. Cambodia has built useful platforms for payments, identity, and e-invoicing, but

their payoff depends on whether firms can use them to operate, comply, and reach markets more efficiently. Digital skills matter for the same reason: firms need workers who can apply technology to business problems, not only workers trained in coding.

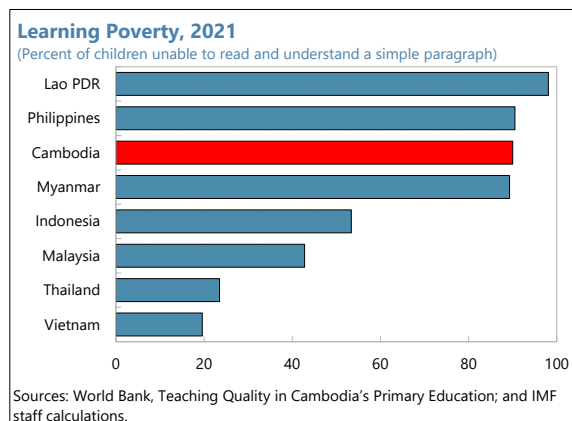
30. **Governance reforms are productivity reforms because they affect where capital goes.**

Clear rules, predictable enforcement, and credible contract protection affect investor confidence and the allocation of capital. Weak dispute resolution, unclear treatment of bad debts, and opaque legal interpretation can keep resources tied to weak firms or activities with limited spillovers rather than flowing to firms that innovate, train workers, and build supplier networks. The real estate correction makes this more pressing, given its links to bank balance sheets, rising asset quality pressures, and the risk that capital remains concentrated in activities with weaker productivity spillovers. Faster dispute resolution, clearer collateral valuation, and greater transparency in land and property markets would improve legal predictability and help capital move toward more productive firms.

31. Human capital reforms need to work for both workers and firms. Recent evidence points to weak vacancy information, limited certification of prior learning and work experience, and working conditions that make retention difficult (Ngov and Cheng, 2025). For returnees and other jobseekers, the most relevant reforms are employer-linked training, recognition of prior experience, and job matching with firms that are hiring. Training systems should therefore be judged by labor market outcomes, not enrollment. As technical and vocational education and training (TVET) programs expand, the test is whether training improves placement, retention, and wage progression in firms with productivity potential. The low-carbon transition adds a forward-looking dimension, as it is likely to raise demand for higher-skilled jobs and greener technologies, even if the current green-job base remains small (World Bank, 2023).

32. **Foundational learning is the upstream constraint on productive employment.**

Employer-linked training can improve job matching and short-cycle reskilling, but its payoff will be limited without strong literacy, numeracy, and problem-solving skills. Cambodia's learning challenge is as much about teaching quality as time in school. Teacher pay and policy reforms have helped make the profession more attractive, but the next gains depend on classroom practice, accountability, and learning outcomes (World Bank, 2025a, 2025b).



33. The reform agenda should be monitored against outcomes that show whether the package is changing firm and worker behavior. A small delivery dashboard could focus on three indicators: domestic supplier participation in FDI-linked sectors, worker retention after training, and domestic processing and logistics performance in priority value chains. Clear ownership and regular problem-solving would keep attention on execution rather than new announcements.

E. Conclusions

34. Cambodia's medium-term growth challenge is not a lack of strategies, but ensuring that they deliver. LDC graduation will gradually erode preference margins and raise market-access requirements, while recent shocks have increased the premium on resilience. Sustaining convergence will require a more integrated growth model: FDI that builds domestic supplier linkages, firms that can enter, scale, and upgrade, and productive employment that raises earnings over time. Policies should therefore be selective and measurable, with incentives linked to supplier development and worker training, fewer regulatory and administrative frictions, and public investment aligned with logistics, energy, and certification bottlenecks. Fewer priorities, implemented together, would do more than another broad reform catalogue to turn capital inflows and labor absorption into higher productivity, domestic value added, and inclusive growth.

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Annex I. Growth Scenarios: Capital Deepening, Labor Absorption, and Productivity

1. This annex sets out the growth arithmetic used to frame the scenario analysis in the main text. It describes the production-function identity, the assumptions used to construct low-growth, medium-growth, and high-growth paths through 2050, and the data sources used for labor, capital, productivity, and sectoral employment. The exercise is illustrative rather than a forecast: it shows how different assumptions on capital accumulation, labor absorption, sectoral reallocation, and productivity affect Cambodia's convergence path.

2. The exercise uses a Cobb–Douglas growth-accounting framework. Output growth is decomposed into contributions from capital stock growth, effective labor growth, and total factor productivity (TFP):

$$GDP\ growth = \alpha \times capital\ stock\ growth + (1 - \alpha) \times effective\ labor\ growth + TFP,$$

where the capital share α is set at 0.4. The three components are defined as follows:

- **Capital** captures the contribution of capital accumulation to growth. The capital stock is projected using the investment-to-GDP ratio, the capital-output ratio, and depreciation. Cambodia has already accumulated capital rapidly: the capital-output ratio more than doubled from about 2.0 in 2004 to about 4.6 in 2023. As capital deepening continues, the growth contribution of additional capital will depend not only on the level of investment, but also on the productivity of that investment.
- **Effective labor** captures the labor contribution to growth. It combines employment growth, the returned-worker adjustment, and broad sectoral reallocation. The demographic base is derived from UN population projections and employment assumptions, while the returned-worker adjustment captures the absorption of Cambodian workers returning from Thailand. Given Cambodia's already high employment-to-population ratio, labor-force expansion is assumed to contribute only modestly to growth. Accordingly, effective labor growth is driven mainly by returnee and entrant absorption and intersectoral labor reallocation toward higher-productivity activities. Broad sectoral shifts are captured in effective labor, while within-sector upgrading is reflected in TFP.
- **TFP** captures the efficiency with which capital and effective labor are used. It is interpreted narrowly to avoid double-counting gains already captured through capital accumulation or effective labor. TFP therefore reflects within-sector upgrading, including stronger firm capabilities, technology adoption, supplier linkages, and reform implementation. In the high-growth scenario, TFP also includes an illustrative reform premium that raises the productivity payoff from capital and labor over time.

3. The scenarios vary the three growth-accounting inputs shown in Annex Table I.1: capital stock growth, effective labor growth, and TFP.

- **Low-growth scenario:** Capital deepening slows, and FDI remains concentrated in real estate and other activities with limited domestic spillovers. Labor reallocation continues, but slowly: agriculture still employs a large share of workers, industry gains are limited, and services absorb much of the labor force increase in low-productivity or informal activities. With limited reform progress, structural gaps with upper-middle-income peers remain wide. TFP growth stays subdued.
- **Medium-growth scenario:** Recent trends continue, with only limited change in sectoral labor shares. Capital deepening continues and FDI remains resilient, but its composition and domestic payoff improve gradually. Agriculture continues to shed labor, services remain the main absorber, and manufacturing does not expand enough to materially change the employment structure. Returnees are gradually absorbed, but not enough to materially raise growth above the medium-term path. Structural gaps with upper-middle-income peers narrow modestly. TFP growth improves gradually in line with historical productivity trends and medium-term growth assumptions, but without a step change in firm upgrading or economy-wide spillovers.
- **High-growth scenario:** Reforms continue to attract FDI and crowd in domestic private investment, raising capital accumulation above the medium-growth path while improving the productivity and composition of investment. Capital shifts more toward activities with stronger domestic value added and better jobs, supporting continued sectoral reallocation as the economy moves up the value chain. Services still become the dominant employer; the scenario assumes better manufacturing and more productive services, not a mainly manufacturing economy. Returned workers are absorbed into formal and higher-productivity activities, turning the returnee shock into a labor windfall rather than a pressure point. Structural gaps with upper-middle-income peers close over time. TFP rises above the medium-growth path through a phased reform premium: early gains come from easing visible bottlenecks, then the premium becomes more gradual as initial catch-up gains are absorbed.

Table 1. Cambodia: Scenario Assumptions and Model-Implied Growth Outcomes

Scenario	Capital	Labor	TFP	Resulting Real GDP Growth (Period Averages; Average Annual Growth, Percent)
Low Growth	Investment-to-GDP falls from 30 percent in 2030 to 25 percent in 2050; capital-output ratio rises from 5.0 to 5.4. Capital stock growth averages 2.1 percent in 2027–30, 1.4 percent in 2031–40, and 0.7 percent in 2041–50.	Employment-to-population ratio reaches 80.5 percent in 2030 and 78.5 percent in 2050. The returned-worker employment adjustment is 400,000 in 2030 and 180,000 in 2050. Sectoral reallocation contributes -0.2 percent in 2027–30, 0.1 percent in 2031–40, and 0.1 percent in 2041–50. Effective labor growth averages 0.5 percent in 2027–30, 1.2 percent in 2031–40, and 0.8 percent in 2041–50.	Subdued productivity path. 2027–30: 1.4 percent 2031–40: 1.1 percent 2041–50: 0.6 percent	2027–30: 2.5 percent 2031–40: 2.4 percent 2041–50: 1.4 percent
Medium Growth	Investment-to-GDP reaches 33 percent in 2030 and 31 percent in 2050; capital-output ratio falls from 4.3 to 3.7. Capital stock growth averages 3.3 percent in 2027–30, 3.6 percent in 2031–40, and 4.0 percent in 2041–50.	Employment-to-population ratio reaches 82.0 percent in 2030 and 80.0 percent in 2050. The returned-worker employment adjustment is 600,000 in 2030 and 350,000 in 2050. Sectoral reallocation contributes 0.0 percent in 2027–30, 0.2 percent in 2031–40, and 0.2 percent in 2041–50. Effective labor growth averages 1.4 percent in 2027–30, 1.3 percent in 2031–40, and 0.9 percent in 2041–50.	Based on historical productivity trends and medium-term growth assumptions. 2027–30: 2.4 percent 2031–40: 2.5 percent 2041–50: 2.3 percent	2027–30: 4.6 percent 2031–40: 4.7 percent 2041–50: 4.4 percent

Table 1. Cambodia: Scenario Assumptions and Model-Implied Growth Outcomes (Concluded)

High Growth	Investment-to-GDP reaches 36 percent in 2030 and 34 percent in 2050; capital-output ratio falls from 4.2 to 3.5. Capital stock growth averages 3.9 percent in 2027–30, 4.6 percent in 2031–40, and 5.2 percent in 2041–50.	Employment-to-population ratio reaches 83.0 percent in 2030 and 81.0 percent in 2050. The returned-worker employment adjustment is 700,000 in 2030 and 450,000 in 2050. Sectoral reallocation contributes 0.7 percent in 2027–30, 0.1 percent in 2031–40, and 0.1 percent in 2041–50. Effective labor growth averages 2.4 percent in 2027–30, 1.2 percent in 2031–40, and 0.8 percent in 2041–50.	Medium-growth path plus reform premium. 2027–30: 3.2 percent 2031–40: 3.0 percent 2041–50: 2.6 percent	2027–30: 6.2 percent 2031–40: 5.6 percent 2041–50: 5.2 percent
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Source: IMF staff calculations.

Scenarios are illustrative and not forecasts. The framework uses a Cobb-Douglas growth-accounting decomposition with capital share $\alpha = 0.4$. Effective labor includes employment growth, the returned-worker adjustment, and broad sectoral reallocation. TFP entries report the assumed productivity path used in the growth calculation; reform examples are not separately quantified.

Annex II. Structural Reform Indicators: Methodology and Sub-Indices Analysis

1. **This annex contains the technical details underlying the structural gap analysis in the main text.** It describes the construction of composite indicators, the normalization and benchmarking approach, and the decomposition of headline gaps into sub-indices for governance, business regulation, labor market regulation, human development, and the external sector.
2. **Structural indicators are constructed for five areas following Budina et al. (2023), with composite indices built as simple averages of sub-indices: governance, external sector, business regulation, labor market regulation, and human development.** Data are sourced from the Worldwide Governance Indicators, the Fraser Institute's Economic Freedom database, and UNDP. All indices and sub-indices are normalized to a 0 to 1 scale, with higher values indicating stronger structural fundamentals. Cambodia's scores are benchmarked against two comparator groups: least developed countries (LDCs), reflecting Cambodia's current status and imminent graduation, and upper-middle-income countries (UMICs), reflecting its medium-term development aspiration. The LDC comparison is mixed: Cambodia performs better than the LDC median in governance, human development, and the external sector, but worse in business and labor market regulation. The UMIC comparison shows the more demanding convergence challenge. A positive gap indicates that Cambodia's outcome is worse than the comparator median; a negative gap indicates that Cambodia outperforms the median.
 - **The governance index** averages control of corruption, government effectiveness, regulatory quality, and rule of law. Control of corruption captures perceptions of the extent to which public power is used for private gain; government effectiveness captures the quality of public services, policy implementation, and the civil service; regulatory quality captures the ability of the government to formulate and implement regulations that support private sector development; and rule of law captures confidence in property rights, contract enforcement, and impartial application of laws.
 - **The external sector index** captures the ease of cross-border trade and financial transactions. It averages tariff barriers, non-tariff barriers, exchange rate distortions, and restrictions on capital flows and the movement of people.
 - **The business regulation index** captures the extent to which the regulatory and administrative environment constrains private sector entry and competition. It averages bureaucracy costs, administrative requirements, and impartial public administration. Bureaucracy costs capture the burden of regulatory requirements on day-to-day business activity; administrative requirements capture the burden of compliance, licensing, and permitting; and impartial public administration captures the extent to which firms are treated even-handedly by public officials.
 - **The labor market regulation index** captures the flexibility of employment arrangements, averaging hiring and firing regulation and wage-setting flexibility. The index should be read

narrowly and does not capture the broader labor market constraints emphasized in the paper, including skills, matching, certification, informality, retention, and job quality.

- **The human development index** captures foundational dimensions of welfare and productivity. It averages life expectancy at birth, education outcomes measured by mean years of schooling and expected years of schooling, and GNI per capita in purchasing power parity terms.

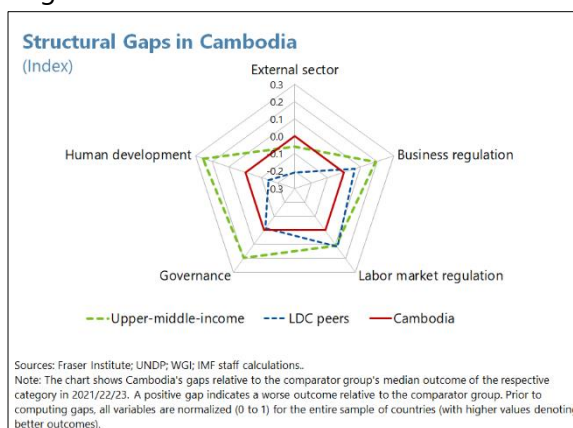
Table 1. Cambodia: Structural Reform Composite Indicators

Composite Indicators	Components	Sources
Governance (2022)	- Control of corruption - Rule of law - Government effectiveness - Regulatory quality	Worldwide Governance Indicator Database
Business regulation (2021)	- Bureaucracy cost - Administrative requirements - Impartial public administration	Fraser Institute Economic Freedom Database
External sector (2023)	- Tariffs - Non-tariff barriers - Parallel market exchange rate - Control of the movement of capital and people	Fraser Institute Economic Freedom Database
Labor market (2021)	- Hiring and firing regulation - Flexible wage determination	Fraser Institute Economic Freedom Database
Human development (2022)	- Life expectancy at birth - Average years of schooling - Gross national income per capita	United Nations Development Programme

3. Cambodia's structural indicators show both graduation progress and the scale of the next convergence challenge.

Relative to LDC peers, Cambodia performs better on governance, human development, and the external sector, while regulation of business and labor markets remains weaker. Business regulation has improved modestly since 2017, but still points to regulatory and administrative frictions for private firms. Human development has improved steadily and now stands above the LDC median, though the gap with upper-middle-income peers remains large. Labor market regulation also remains below the LDC median, but should be read narrowly because the indicator captures hiring and firing rules and wage-setting flexibility rather than broader labor market

outcomes. External sector openness remains a clear strength, with outcomes close to the upper-middle-income median. Graduation is therefore consistent with the broad structural data, but sustained convergence will require stronger institutions, better business regulation, continued human capital gains, and stronger foundations for productive labor absorption.



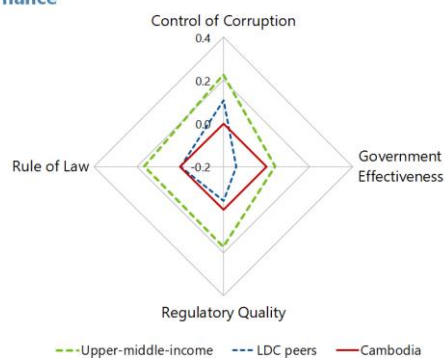
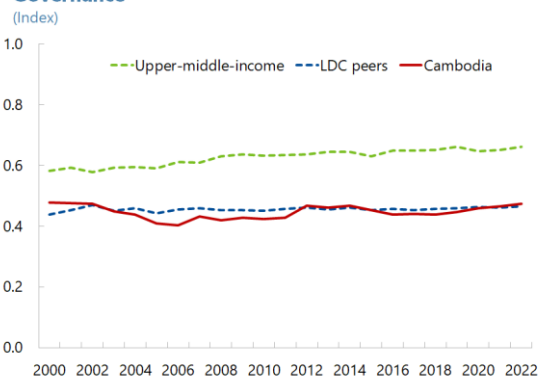
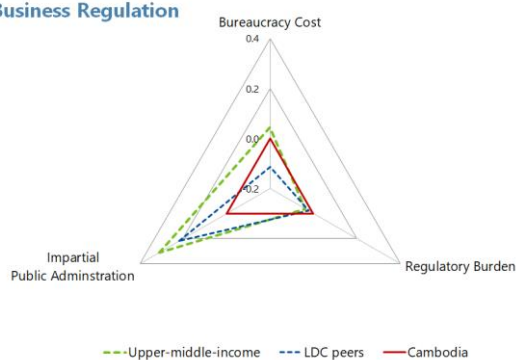
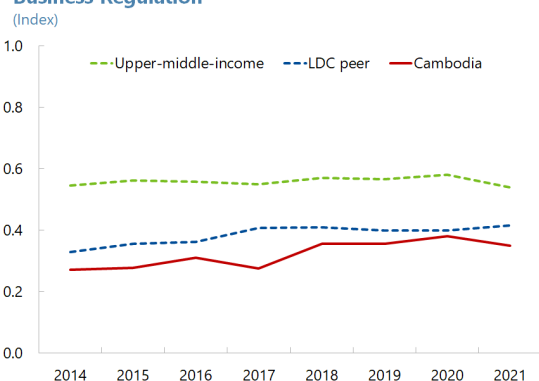
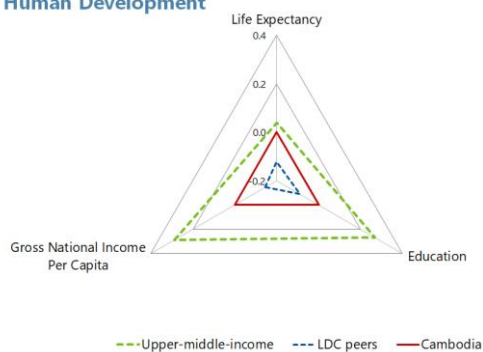
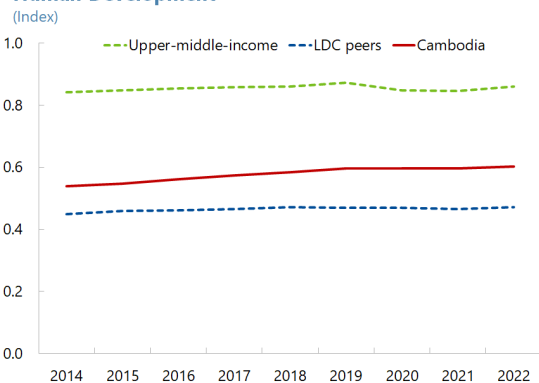
4. The sub-indices clarify where the UMIC gaps are largest.

The biggest shortfalls are in schooling and public-sector governance, especially mean years of schooling, impartial public

administration, control of corruption, regulatory quality, and rule of law. Business regulation gaps are consistent with firm-level concerns about registration, licensing, tax administration, customs, and overlapping documentation requirements. Labor market regulation should be interpreted narrowly, since the indicator captures hiring and firing regulation and wage-setting flexibility, not the broader constraints on skills, matching, certification, retention, and job quality.

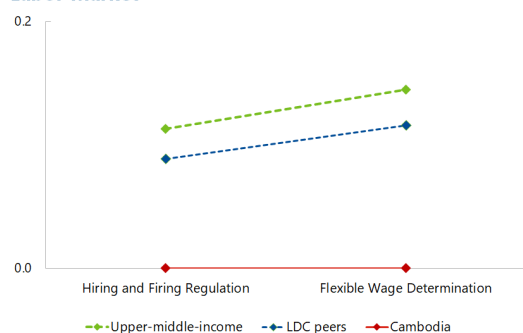
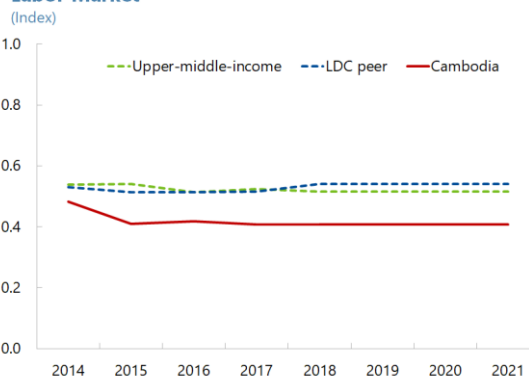
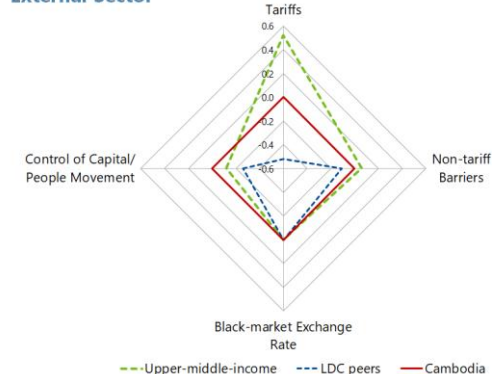
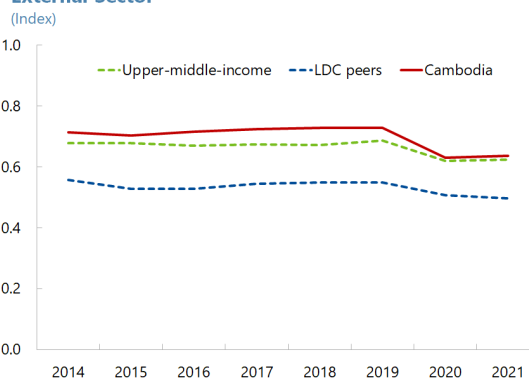
- **Governance** gaps are broad-based across all four sub-indices, with control of corruption and rule of law standing out. Control of corruption weakened from the mid-2000s and remains well below peer medians, leaving a large gap with upper-middle-income countries. Rule of law also remains below comparator medians, constraining contract enforcement and legal predictability for private sector development.
- Within **business regulation**, impartial public administration is the largest gap. The indicator has deteriorated and diverged from peer groups, pointing to concerns about the predictability and even-handedness of implementation. Bureaucracy costs have improved in recent years, consistent with efforts to streamline administrative procedures, while the regulatory burden indicator is close to, or stronger than, comparator medians. This suggests that implementation and administrative predictability may be more binding than formal regulatory requirements alone.
- **Human development** sub-indices show positive momentum, but from low bases and with large remaining gaps relative to upper-middle-income countries. Life expectancy has risen steadily, reflecting sustained improvements in health outcomes. Education has also improved but remains well below the upper-middle-income median, a critical shortfall given the role of schooling in productivity growth. GNI per capita remains below upper-middle-income medians, reflecting the broader convergence challenge.
- **External sector** sub-indices show diverging trends. Tariffs have improved gradually, reflecting Cambodia's deepening integration into regional trade arrangements. Non-tariff barriers have remained broadly stable and close to the upper-middle-income median. The control of capital and people movement indicator declined sharply after 2018 and appears to explain much of the recent softening in the overall external sector index.

5. Cambodia's structural reform agenda has a clear hierarchy. Cambodia performs close to the UMIC median on external openness—a strength that reflects deep trade and financial integration—but faces large and persistent gaps in governance, business regulation, and human development, the areas that most directly shape whether investment translates into stronger firms, better jobs, and higher productivity. Closing these gaps is the structural reform priority.

Figure 1. Cambodia: Structural Gaps Relative to Comparator Country Groups**Governance****Governance****Business Regulation****Business Regulation****Human Development****Human Development**

Sources: Fraser Institute; UNDP; WGI; and IMF staff calculations.

Note: The chart shows Cambodia's gaps relative to the comparator group's median in the respective category. Indicators are normalized from 0 to 1, with higher values denoting stronger outcomes.

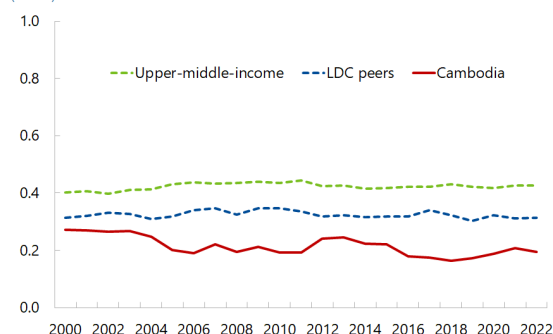
Figure 1. Cambodia: Structural Gaps Relative to Comparator Country Groups (cont.)**Labor Market****Labor Market****External Sector****External Sector**

Sources: Fraser Institute; UNDP; WGI; and IMF staff calculations.

Note: The chart shows Cambodia's gaps relative to the comparator group's median in the respective category. Indicators are normalized from 0 to 1, with higher values denoting stronger outcomes.

Figure 2. Cambodia: Sub-index Trends Relative to Comparator Groups**Governance - Control of Corruption**

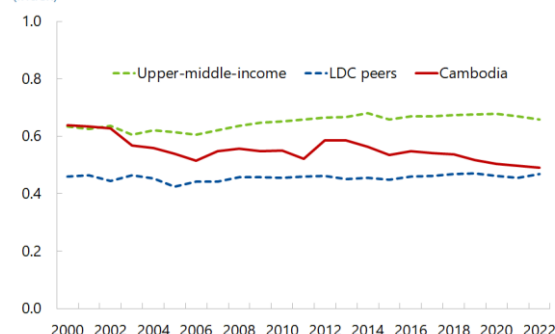
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Sources: Worldwide Governance Indicators database and IMF staff calculations.

Governance - Regulatory Quality

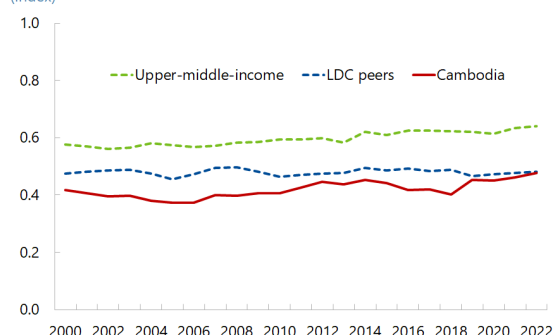
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Sources: Worldwide Governance Indicators database and IMF staff calculations.

Governance - Rule of Law

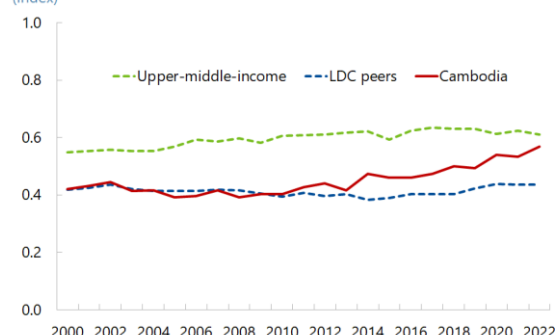
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Sources: Worldwide Governance Indicators database and IMF staff calculations.

Governance - Government Effectiveness

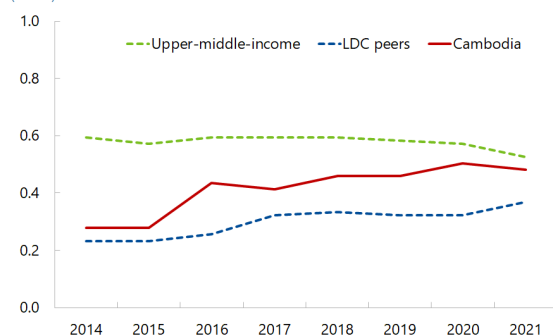
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Sources: Worldwide Governance Indicators database and IMF staff calculations.

Business Regulation - Bureaucracy Cost

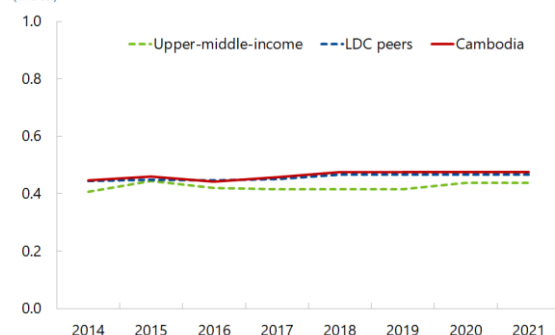
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Sources: Fraser Institute database and IMF staff calculations.

Business Regulation - Regulatory Burden

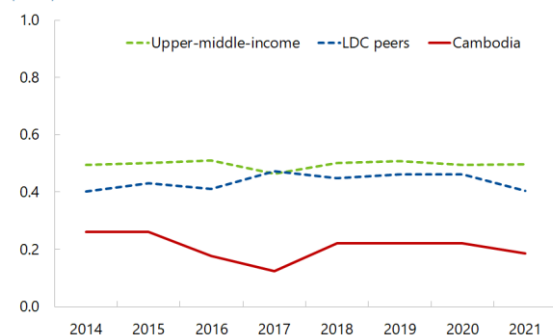
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Sources: Fraser Institute database and IMF staff calculations.

Business Regulation - Impartial Public Administration

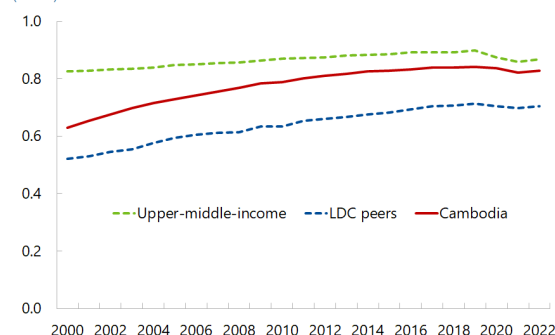
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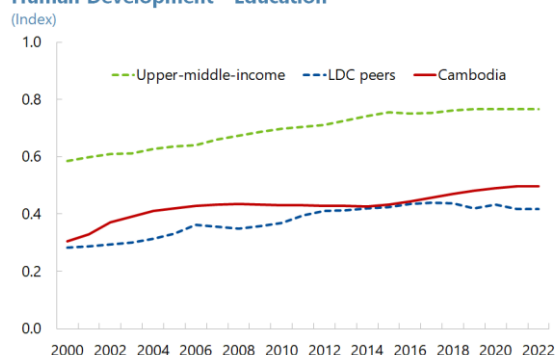
Sources: Fraser Institute database and IMF staff calculations.

Human Development - Life Expectancy

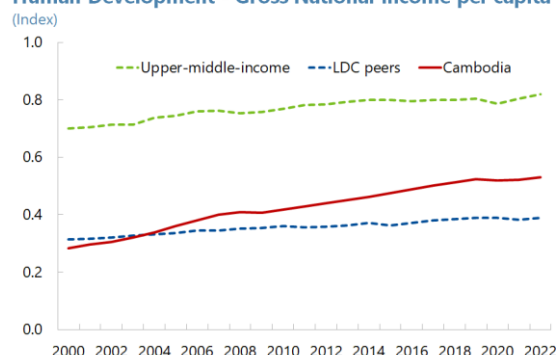
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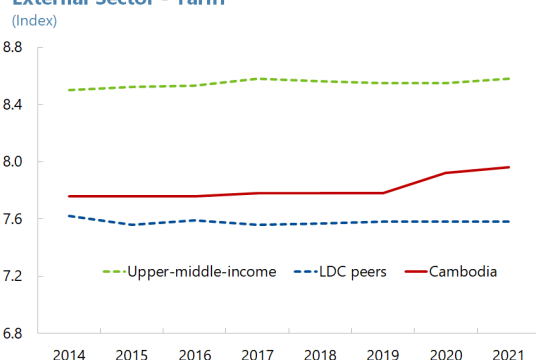
Sources: Worldwide Governance Indicators database and IMF staff calculations.

Figure 2. Cambodia: Sub-index Trends Relative to Comparator Groups (cont.)**Human Development - Education**

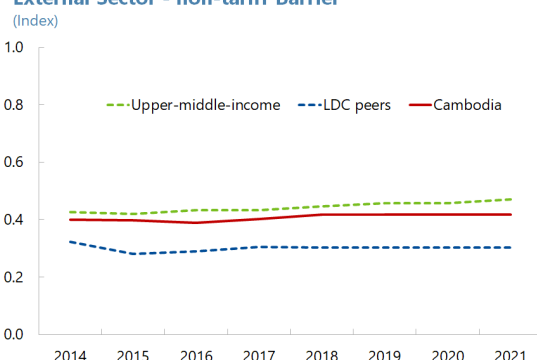
Sources: Worldwide Governance Indicators database and IMF staff calculations.

Human Development - Gross National Income per capita

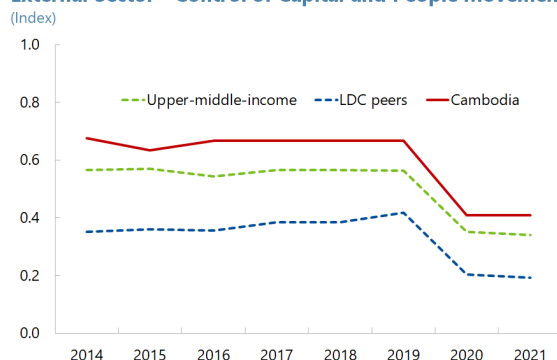
Sources: Worldwide Governance Indicators database and IMF staff calculations.

External Sector - Tariff

Sources: Fraser Institute database and IMF staff calculations.

External Sector - non-tariff Barrier

Sources: Fraser Institute database and IMF staff calculations.

External Sector - Control of Capital and People Movement

Sources: Fraser Institute database and IMF staff calculations.

Sources: Fraser Institute; UNDP; WGI; and IMF staff calculations.

Note: The chart shows Cambodia's gaps relative to the comparator group's median in the respective category. Indicators are normalized from 0 to 1, with higher values denoting stronger outcomes.

FINANCING CAMBODIA'S PROGRESS TOWARD THE SUSTAINABLE DEVELOPMENT GOAL¹

Cambodia faces substantial additional spending needs—estimated at about 9.3 percent of GDP annually—to advance selected SDGs in health, education, and infrastructure. The analysis shows that no single policy instrument is sufficient: stronger domestic revenue mobilization can reduce the remaining spending gap by about half by 2040, while improvements in spending efficiency can substantially strengthen the growth impact of existing resources. A joint strategy combining moderate revenue mobilization, efficiency reforms, and selective borrowing accelerates progress and generates the largest growth dividend, but rising debt-service costs progressively reduce the fiscal space available for SDG spending. The results therefore point to a balanced approach that combines sustained revenue reforms, better spending quality, prudent and well-targeted borrowing, and greater private-sector participation.

A. Introduction

1. Cambodia's growth performance over the past two decades has been remarkable, but significant development gaps remain. Real GDP expanded by an average of around 7 percent per year between 2000 and 2019—one of the fastest sustained growth episodes among emerging and developing economies—supporting a substantial reduction in poverty and a rapid increase in living standards. Growth has moderated in the post-pandemic period, reaching 5.3 percent in 2025 and projected at around 3.0 percent in 2026 reflecting higher energy prices, trade policy uncertainty and tighter financial conditions, before recovering to 4.0 percent in 2027. Despite these achievements, Cambodia's social and infrastructure outcomes remain below those of many countries at comparable income levels. Cambodia ranks 101st out of 166 countries in the Sustainable Development Report, reflecting persistent shortcomings in health, education, water and sanitation, and infrastructure access. Public spending in key social sectors remains low, with health expenditure at about 2.1 percent of GDP and education expenditure at around 2.2 percent of GDP in 2020—well below high-performing peers and estimated spending needs associated with achieving the Sustainable Development Goals (SDGs). As Cambodia seeks to advance the Pentagonal Strategy and achieve upper-middle-income status by 2030, closing these gaps will be critical to strengthening human capital, raising productivity, and ensuring that the gains from economic development are broadly shared.

2. Cambodia's development model has relied extensively on private sector participation in health and education. Private providers account for an estimated 69 percent of health services and 70 percent of education services (Carapella and others (2023)), while out-of-pocket payments represent more than 50 percent of total health expenditure (WHO Global Health Expenditure Database). This strong private presence has helped expand service provision despite relatively low

¹ Prepared by Dallal Benjallal and Max-Sebastian Dovi. We thank Kenichiro Kashiwase, Aiko Mineshima, and the Cambodian authorities for valuable feedback and comments.

levels of public spending, but access to privately financed services remains skewed toward wealthier households (see, e.g., Asante and others, 2019; Brehm and Silova, 2014). Achieving the SDGs will require addressing remaining gaps in the quality, affordability, and inclusiveness of service delivery, particularly for underserved populations and regions. Strengthening public spending will therefore remain essential to finance the infrastructure, workforce development, and institutional capacity needed to expand access and improve outcomes.

3. Closing Cambodia's sustainable development gaps is not only a social objective but also an economic imperative. Cambodia's past growth model was driven largely by labor-intensive manufacturing and tourism. As the country seeks to attain upper-middle-income status, sustaining rapid growth will increasingly require stronger human capital, higher productivity, and greater economic diversification. Improvements in education, health, and basic infrastructure can strengthen workforce skills, raise labor productivity, facilitate structural transformation, and enhance economic resilience to future shocks. Accelerating progress toward the SDGs can therefore support both inclusive development and the transition to a more productive and diversified growth model.

4. This paper examines how Cambodia can finance progress toward selected SDGs while preserving macroeconomic stability. It first discusses Cambodia's SDG spending needs in health, education, roads, electricity, and water and sanitation, drawing on the IMF SDG costing framework and adapting the implementation horizon to 2040. It then uses the SDG-FIT macro-fiscal framework to assess three illustrative policy scenarios: stronger domestic revenue mobilization, improvements in spending efficiency, and a joint strategy combining moderate revenue mobilization, efficiency reforms, and prudent debt financing. The analysis highlights the trade-offs between accelerating SDG progress, generating growth dividends, and maintaining fiscal and debt sustainability.

B. Cambodia's SDG Spending Needs

5. Spending needs are estimated using the input-outcome approach of Carapella and others (2023), which updates and extends the methodology of Gaspar and others (2019). The framework identifies the service-delivery inputs associated with strong SDG performance among income peers and estimates the resources needed for Cambodia to attain comparable outcomes by 2030.² For health and education, targets are benchmarked to high-performing peer economies with similar income levels, while accounting for country-specific demographic and economic characteristics. For infrastructure, targets are based on universal access objectives for electricity and water and sanitation, and on closing the remaining rural accessibility gap in roads. Infrastructure costs are derived from engineering-based investment estimates and annualized over the period to 2030. Spending needs are expressed relative to projected 2030 GDP.

6. While the SDG costing framework is conventionally calibrated to a 2030 horizon, achieving the SDGs by 2030 is increasingly unlikely for many developing countries. The scale of spending increases required to close remaining development gaps within such a short timeframe

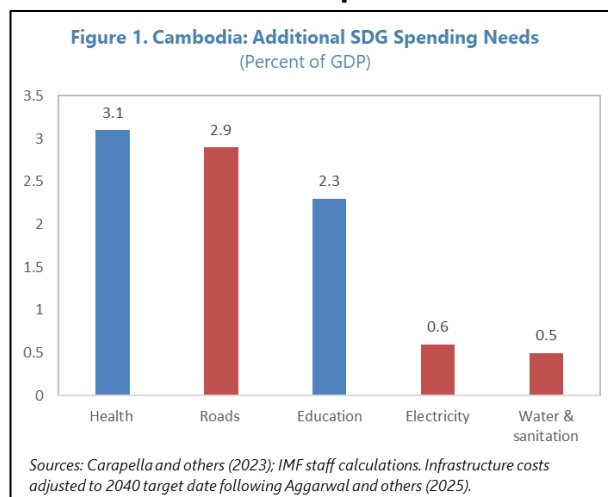
² Annex I provides additional detail on the methodology, as well as a comparison of Cambodia's SDG indicators relative to peers.

would often exceed realistic financing, implementation, and absorptive capacity (IMF Staff, 2025a). Accordingly, this analysis adopts a 2040 implementation horizon, allowing for a more gradual and feasible scaling-up of investment and service delivery while preserving the underlying SDG objectives. Consistent with IMF Staff (2025a), health and education spending needs are treated as recurrent annual expenditures. Infrastructure needs are expressed as annualized investment costs required to achieve the target coverage and capital stock by 2040, implying lower annual spending requirements as investments are spread over a longer implementation period.

7. Cambodia's additional annual spending needs are estimated at 9.3 percent of GDP across health, education, electricity, water and sanitation, and roads.

Human capital accounts for over half of total needs (5.4 percent of GDP), reflecting remaining gaps in service provision despite substantial development progress over the past two decades. Infrastructure needs amount to 4.0 percent of GDP, largely driven by road connectivity.

8. Health and education account for the bulk of Cambodia's SDG spending needs, estimated at 3.1 percent and 2.3 percent of GDP, respectively. In health, the largest driver is a severe shortage of medical personnel relative to high-performing peers: Cambodia has only 0.19 doctors per 1,000 inhabitants, compared with a benchmark of about 2.3. In education, spending needs reflect both shortages of teachers—evidenced by a student-to-teacher ratio of 25.9 compared with a peer benchmark of 18.3—and relatively low teacher remuneration.³ Additional resources are also needed to expand enrollment, particularly at the pre-primary and tertiary levels. Overall, the estimates suggest that closing Cambodia's human capital gaps will require a substantial expansion of both the health and education workforces, alongside continued improvements in service coverage and quality.



SDG	Spending gap (percent of GDP)	Illustrative change in selected metrics under SDG
Health	3.1	2.1 additional doctors per 1,000 people
Education	2.3	21.5 percentage point increase in tertiary enrollment rate
Roads	2.9	66.0 percent increase in road network length
Electricity	0.6	3.9 million additional people connected to the electricity grid
Water & sanitation	0.5	1.3 million additional people gaining access to improved water, sanitation, and health services

Note: Only selected outcome indicators are reported for illustrative purposes and these should not be interpreted as implying a one-to-one relationship between individual spending gaps and specific outcomes.

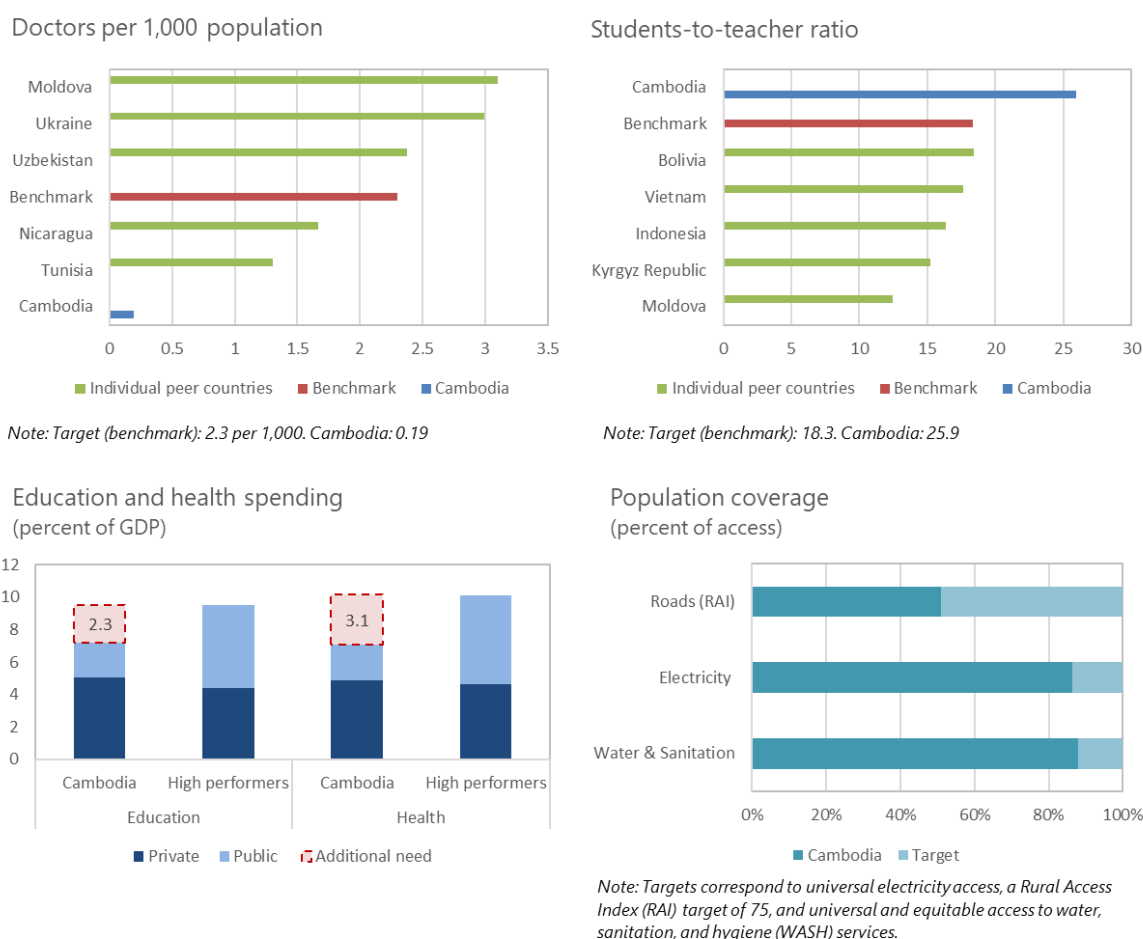
9. Road infrastructure represents the largest infrastructure-related spending need, at 2.9 percent of GDP.

Despite notable improvements in connectivity, Cambodia continues to face

³ The costing methodology already accounts for projected demographic changes in estimating health and education workforce needs. Flexible workforce and wage-bill policies would nevertheless be important to allow the composition of staffing to adjust over time as demographic and development needs evolve.

significant gaps in rural accessibility, particularly outside major economic corridors. Given the country's relatively dispersed rural population and the high cost of expanding all-season road networks, closing the remaining Rural Access Index gap accounts for the bulk of infrastructure spending needs. By contrast, additional needs for electricity (0.6 percent of GDP) and water and sanitation (0.5 percent of GDP) are comparatively modest, reflecting Cambodia's relatively high existing coverage rates. Nevertheless, important service gaps remain in rural and peri-urban areas, requiring continued investment to achieve universal access.

Figure 2. Cambodia: Drivers of SDG Spending Needs



Sources: Carapella and others (2023); IMF staff calculations.

C. Financing SDG Spending

10. The remainder of the paper examines how alternative financing strategies could accelerate Cambodia's progress toward the SDGs. Given the magnitude of estimated spending needs, the analysis focuses on the level of SDG attainment that can be achieved under realistic financing scenarios rather than on fully closing the spending gap. Using a macro-fiscal framework, the paper assesses the scope for financing additional SDG-related spending through domestic

revenue mobilization, improvements in public spending efficiency, and additional borrowing, and evaluates the implications of these strategies for development outcomes, economic growth, and fiscal sustainability. The results highlight the trade-offs between accelerating progress toward the SDGs, the financing effort required, and the associated fiscal and debt implications.

Analytical Framework

11. The SDG-FIT framework provides a structured macro-fiscal framework to assess the impact of scaling up SDG-related spending under alternative financing strategies. Building on a simplified financial programming framework, it integrates the real, fiscal, monetary, and external sectors to capture the interactions between development spending, economic growth, and fiscal sustainability over the medium term. A key feature of the framework is its endogenous growth structure, whereby investments in infrastructure, health, and education raise productive capacity and generate feedback effects on output, revenues, and financing capacity. The framework therefore allows for a joint assessment of SDG progress, growth dividends, and macro-fiscal trade-offs under different financing scenarios.

12. The real sector is modeled through an augmented production function that incorporates both public capital and human capital as drivers of growth.⁴ Output depends on private capital (K_P), public infrastructure (K^G), labor (L), and human capital (H). The framework also allows private participation in infrastructure provision ($K_{priv,t}^G$) to enhance the productivity of public capital through an efficiency gain ($\theta > 1$). Through these channels, investments in infrastructure, health, and education not only improve development outcomes but also expand the economy's productive capacity and support long-run growth. The production function is given by:

$$Y_t = A_t (K_{pub,t}^G + \theta \cdot K_{priv,t}^G)^\beta \cdot (K_{P,t})^\alpha \cdot \left(L_t \cdot \frac{H_t}{L_t} \right)^{\sigma(1-\alpha)}$$

Note that private and public capital are Edgeworth complements: higher public capital raises the marginal productivity of private capital, increasing the contribution of the existing private capital stock to output and strengthening the growth payoff from public investment in SDG-related infrastructure.⁵

13. Public investment raises the stock of productive infrastructure over time, subject to depreciation and the efficiency with which spending is translated into capital assets. Higher investment increases the stock of roads, electricity networks, water and sanitation systems, and other infrastructure that supports economic activity and productivity growth. However, not all investment spending is converted into productive capital. The efficiency parameter (e_k) captures implementation capacity and the effectiveness of public investment institutions, reflecting factors such as project selection, procurement practices, cost overruns, and execution delays. In the model, Cambodia's public investment efficiency is calibrated at

⁴ Detailed descriptions of the model parameters and calibration assumptions are provided in Annex II.

⁵ Because the model does not include optimizing households or an endogenous private investment decision, the higher marginal product of private capital does not induce additional private investment.

0.59, based on the country-specific investment efficiency estimates reported in the October 2025 Fiscal Monitor (IMF, 2025b). This implies that each additional dollar of public investment spending generates approximately 59 cents of productive capital, with the remainder lost to implementation and institutional inefficiencies. The 2022 update to the Cambodia Public Investment Management Assessment links these inefficiencies to shortcomings in project appraisal, intergovernmental coordination, medium-term capital budgeting, maintenance, procurement, project implementation, and monitoring. The evolution of physical capital is described by:

$$K_{i,t} = (1 - \delta_k) \cdot K_{i,t-1} + e_k \cdot I_{i,t}$$

14. Spending on health and education contributes to the accumulation of human capital, raising labor productivity and supporting long-term growth. The model treats health and education spending as complementary investments that improve workforce skills, knowledge, and health outcomes, thereby increasing the productivity of labor over time. However, the growth impact of social spending is neither immediate nor one-for-one. The efficiency parameter (e_h) captures the extent to which additional spending translates into improved human capital outcomes, reflecting factors such as the quality of service delivery, institutional capacity, and the effectiveness of spending programs. For Cambodia, the efficiency parameter is calibrated at 0.64, based on the country-specific estimate reported in the October 2025 Fiscal Monitor (IMF, 2025b), implying that only part of additional spending is effectively translated into improvements in human capital outcomes. The model also incorporates a diffusion parameter (ω) that captures the gradual transmission of these improvements to the labor force. For example, the benefits of higher education spending materialize only as students enter the workforce, while improvements in health outcomes affect worker productivity with a lag. The evolution of human capital is given by:

$$H_{i,t} = (1 - \delta_h) \cdot H_{i,t-1} + \omega[(e_h \cdot h_i)^\varphi \cdot n^\nu]_{t-1}$$

15. The fiscal sector determines the resources available to finance SDG-related spending. Government revenues comprise tax revenues, non-tax revenues, and grants, with the tax base evolving endogenously in response to real GDP per capita growth. As SDG-related spending raises growth through the accumulation of physical and human capital, higher output expands the tax base and generates additional revenues, creating a feedback loop between development spending and financing capacity. The framework allows alternative financing strategies—including domestic revenue mobilization, efficiency gains, and borrowing—to be assessed within a consistent macro-fiscal framework, capturing their implications for growth,⁶ fiscal balances, and public debt dynamics.

Scenario Design and Calibration

16. The baseline scenario reflects current policies and serves as the counterfactual for the analysis. It incorporates the macroeconomic projections underlying the IMF's medium-term

⁶ The analysis does not impose an explicit output cost from revenue mobilization measures.

framework for Cambodia, including the projected path of growth, revenues, expenditures, and public debt under unchanged policies. SDG-related spending evolves in line with current spending trends, and no additional financing effort beyond the baseline is assumed. The baseline therefore provides a benchmark against which the impact of alternative financing strategies on SDG outcomes, growth, and fiscal sustainability can be assessed.

17. The model is calibrated using a combination of Cambodia-specific data and parameter values drawn from the empirical literature on developing economies. Parameters governing the composition of public expenditure—including the share of SDG spending allocated to infrastructure, health, and education, as well as the split between SDG and non-SDG spending—are calibrated to match Cambodia's current spending patterns. Initial public capital stocks are taken from the FAD Capital Stock Database (2019), while efficiency parameters are calibrated using the country-specific investment efficiency estimates reported in the October 2025 Fiscal Monitor (IMF, 2025b). Other structural parameters governing the accumulation of physical and human capital, as well as the production function, are calibrated using values commonly applied to low-income and developing economies. Detailed parameter definitions, data sources, and calibration assumptions are provided in Annex II.

18. The analysis evaluates Cambodia's progress toward the SDGs under three alternative financing scenarios. Scenario 1 examines the impact of stronger domestic revenue mobilization (DRM), with additional revenues gradually mobilized through 2040 and fully allocated to SDG-related spending while maintaining the fiscal deficit at its baseline level. Scenario 2 assesses the gains from improving the efficiency of both public investment and human capital spending, allowing a larger share of spending to be translated into productive infrastructure and human capital outcomes while holding financing conditions unchanged. Scenario 3 combines a more moderate DRM effort with improvements in spending efficiency and selective debt financing, calibrated to remain broadly consistent with the medium-term debt anchor of 40 percent of GDP. Comparing these scenarios provides insights into the extent to which alternative financing approaches can accelerate progress toward the SDGs, support economic growth, and affect fiscal and debt sustainability.

19. The simulations should be interpreted as illustrative scenarios rather than forecasts. While the framework captures key macro-fiscal feedbacks from SDG spending to growth, revenues, and debt dynamics, it remains a stylized model. It does not fully capture implementation bottlenecks, sector-specific absorptive capacity constraints, distributional effects, or the potential growth costs of higher taxation. The results therefore provide an internally consistent assessment of policy trade-offs under alternative financing strategies, rather than precise estimates of the impact of each reform.

Results

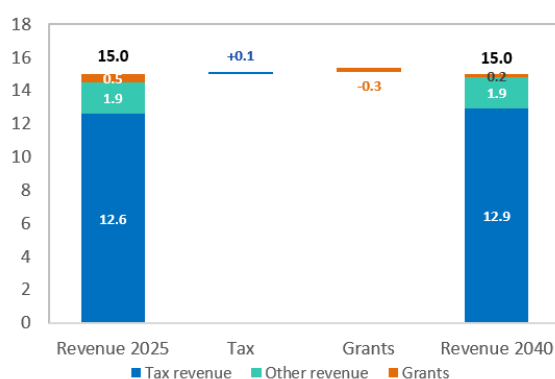
20. The baseline scenario reflects continued macroeconomic stability and sustained growth, but limited gains in fiscal space. Real GDP growth is projected to remain robust at 5.7 percent in 2030 and 5.2 percent in 2040. The tax-to-GDP ratio increases only gradually, from

12.6 percent in 2025 to 12.9 percent in 2040, as progress on rationalizing tax expenditures remains limited, while non-tax revenues remain broadly stable at around 1.9 percent of GDP. Grants decline progressively as Cambodia approaches LDC graduation from about 0.5 percent of GDP in 2025 to 0.2 percent of GDP by 2040. The overall fiscal deficit is projected to widen from 1.4 percent of GDP in 2024 to around 2 percent by 2040. The baseline also assumes a modest reallocation of spending from non-SDG to SDG sectors, amounting to about 0.5 percent of GDP by 2040. Additional spending is allocated across SDG sectors in proportion to the estimated spending needs, resulting in a relatively larger increase in road infrastructure spending than in electricity and water and sanitation.

21. Under the baseline, SDG spending gaps narrow only modestly. By 2040, relative to 2025 (Figure 1), the health spending gap declines from 3.1 to 3.0 percent of GDP and the education gap from 2.3 to 2.2 percent of GDP. Infrastructure gaps also remain sizeable, with road investment needs falling from 2.9 to 2.7 percent of GDP, while electricity and water and sanitation gaps remain broadly unchanged at around 0.6 and 0.4–0.5 percent of GDP, respectively. Consequently, progress toward SDG benchmarks remains gradual, reaching about 71 percent in health, 77 percent in education, and 61 percent in infrastructure sectors by 2040. Overall, current spending trajectories leave substantial SDG gaps unaddressed by 2040, underscoring the importance of additional financing and efficiency-enhancing reforms.

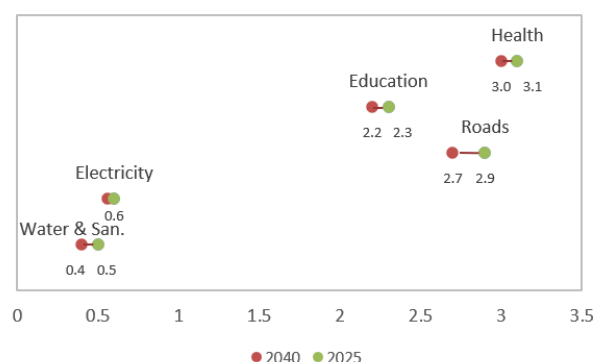
Figure 3. Cambodia: Baseline Scenario: Limited Fiscal Space and Persistent SDG Spending

Evolution of revenue under the baseline
(Percent of GDP)



Source: IMF staff calculations.

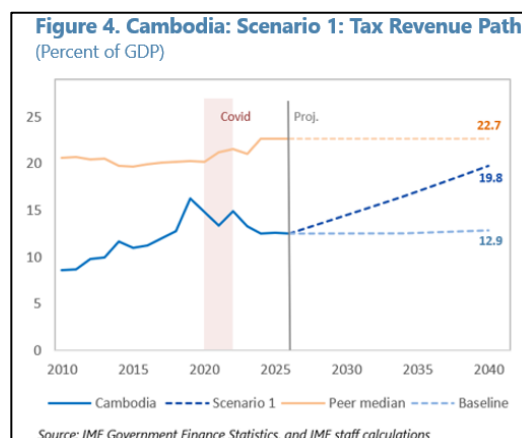
SDG spending gaps remain large through 2040
(Percent of GDP)



Gaps

22. Scenario 1 assesses the scope for financing SDG spending through a sustained domestic revenue mobilization effort.

The scenario keeps the baseline macroeconomic assumptions and the overall fiscal deficit unchanged, while assuming that tax policy and revenue administration measures are implemented from 2027 onward. These reforms gradually raise the tax-to-GDP ratio from 12.6 percent in 2025 to 19.8 percent by 2040, compared with 12.9 percent under the baseline, with all additional revenues allocated to SDG-related spending. The reform package is calibrated to generate about 0.4 percentage points of GDP in additional tax revenue per year. In the near term, revenue gains are assumed to



come primarily from rationalizing tax expenditures and strengthening revenue administration—including compliance management, risk-based audits, digitalization, customs modernization, taxpayer registration, and greater use of third-party information. Over the longer term, these efforts could be complemented by broader tax policy reforms, such as the PIT reform and carbon pricing. The scenario does not rely on large or distortionary increases in statutory tax rates that could materially weigh on growth.⁷ By 2040, these reforms account for about 6 percentage points of the 6.9 percentage point increase in the tax-to-GDP ratio relative to the baseline. The remaining 0.9 percentage point arises endogenously through the model: higher SDG spending lifts human and physical capital accumulation, raises output, broadens the tax base, and generates additional revenues. The assumed revenue path is ambitious and would require sustained implementation over more than a decade, but the implied pace of revenue mobilization is not unprecedented for Cambodia. Cambodia raised its tax-to-GDP ratio by around 6 percentage points between 2010 and 2020—more than 0.5 percentage points per year—before the COVID-19 shock interrupted this trajectory (Figure 4). Moreover, even under the DRM scenario, Cambodia's tax-to-GDP ratio by 2040 would remain below the current global median of 22.7 percent of GDP, suggesting that the assumed effort remains within the range observed in comparable developing economies.

23. The DRM scenario substantially narrows Cambodia's SDG spending gaps, but does not fully close them by 2040.

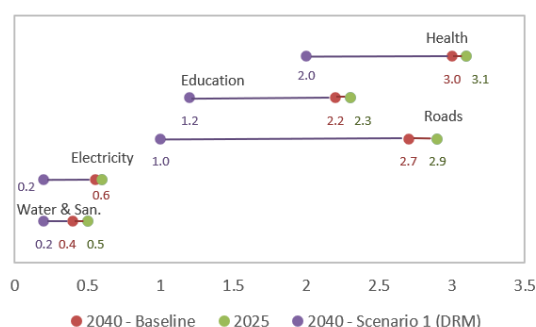
By 2030, the aggregate SDG gap declines from 9.1 percent of GDP under the baseline to 7.9 percent; by 2040, it falls from 8.9 percent to 4.6 percent of GDP, reducing the remaining gap by 4.3 percentage points, or about half. The largest gains are concentrated in roads, health, and education, reflecting the allocation of additional revenues toward sectors with the largest initial gaps. The reduction in SDG gaps is smaller than the 6.9 percentage point increase in tax revenue by 2040, as implementation inefficiencies limit the extent to which additional spending translates into effective human and physical capital accumulation. With spending efficiency parameters of about 60 percent, only part of the additional fiscal effort is converted into effective SDG progress. The sensitivity analysis in Annex III confirms that these parameters are an important driver of the results. When the efficiency parameters for both human and physical capital are set at

⁷ Such contractionary effects are not explicitly modeled in the framework.

0.9, the remaining gap under Scenario 1 falls to 2.1 percent of GDP by 2040, compared with 7.1 percent when both parameters are set at 0.3 (see Annex III). This underscores the importance of improving spending quality alongside revenue mobilization.

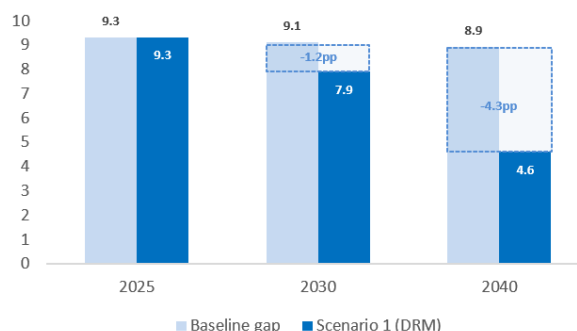
Figure 5. Cambodia: Scenario 1: Domestic Revenue Mobilization Narrows SDG Spending

SDG spending gaps through 2040 - scenario 1
(Percent of GDP)



Source: IMF staff calculations.

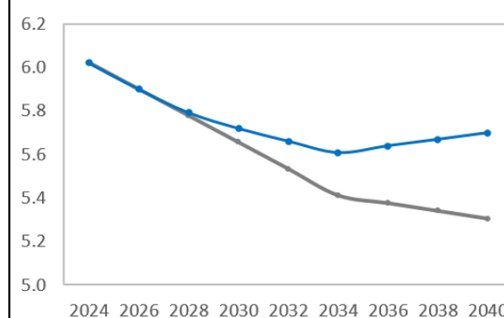
SDG remaining gap
(Percent of GDP)



Gaps

24. Higher SDG spending also generates a growth dividend. By channeling additional revenues into health, education, and infrastructure, the DRM scenario accelerates the accumulation of human and physical capital, raising the economy's productive capacity through the model's endogenous growth channels. Real GDP growth remains above the baseline throughout the projection horizon, reaching 5.7 percent by 2040 compared with 5.3 percent under the baseline.

Figure 6. Cambodia: Real GDP growth rate



25. Scenario 2 assesses the impact of improving the efficiency with which SDG-related spending is translated into productive capital and human capital outcomes. Unlike the DRM scenario, the fiscal envelope, spending allocation, and macroeconomic assumptions are kept unchanged relative to the baseline; the only change is a gradual increase in the efficiency parameters governing physical and human capital accumulation (e_k and e_h). Specifically, both parameters are raised by 0.1 by 2032 and by a further 0.1 by 2040, reflecting a phased improvement in implementation capacity and service delivery effectiveness.⁸ This implies that, by 2040, the model

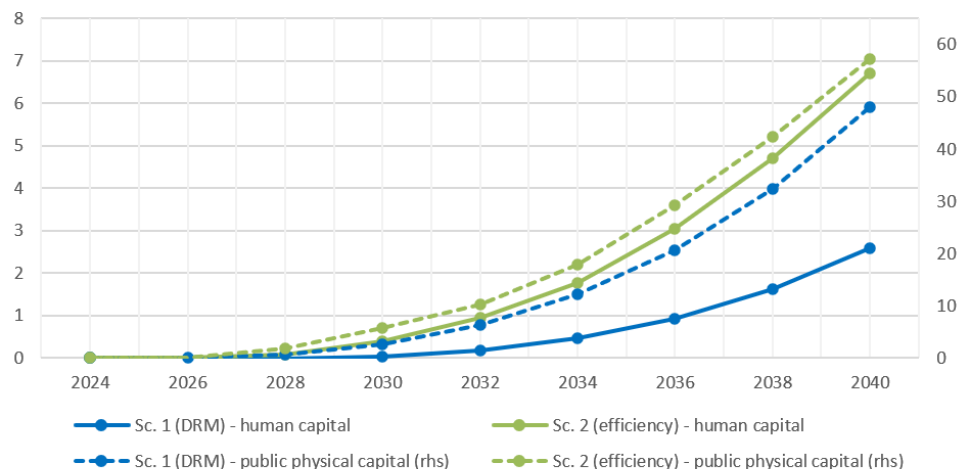
⁸ Benchmarked against stochastic-frontier efficiency estimates for 168 countries (2022), the intermediate value of around 0.7 corresponds to roughly the 90th percentile of advanced economies, while the terminal value of around 0.8 is at the top of the observed global distribution and is therefore best read as an illustrative upper bound.

treats an additional 20 cents of every dollar spent as being converted into productive infrastructure and improved human capital outcomes. For public investment, such gains could be achieved through stronger project appraisal and selection, better procurement practices, improved execution and maintenance planning, and reduced cost overruns and delays. For health and education, higher efficiency could reflect better targeting of resources, stronger workforce management, improved quality assurance, and reforms that raise the effectiveness of spending in improving learning and health outcomes. The scenario therefore isolates the potential development and growth gains from “spending better,” holding the overall level of financing unchanged.

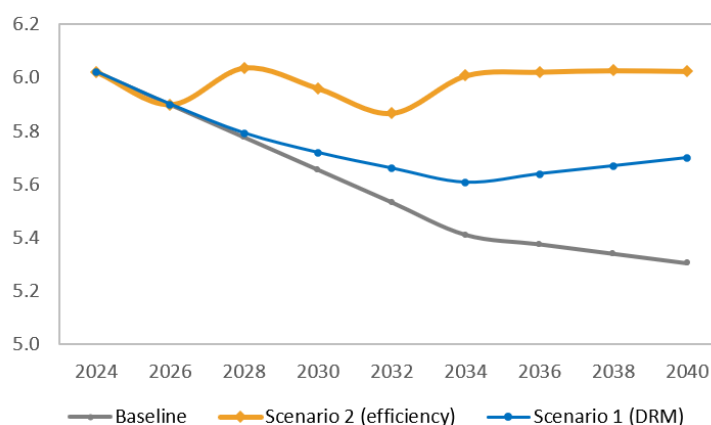
26. The efficiency scenario illustrates the central role of spending quality in translating SDG resources into development outcomes. Even with the financing envelope unchanged relative to the baseline, higher implementation and service delivery efficiency allows a larger share of existing spending to be converted into productive infrastructure and human capital, reducing waste and raising the growth impact of public outlays. Because the SDG gap is measured in expenditure terms, however, higher efficiency does not mechanically reduce the reported financing gap; instead, it allows the same spending envelope to generate greater human and physical capital and stronger development outcomes. As a result, Scenario 2 generates larger gains in both human and physical capital than the DRM-only scenario, with the gap relative to the baseline widening steadily through 2040 (Figure 7). These efficiency gains also translate into a stronger growth dividend, with real GDP growth remaining above both the baseline and the DRM scenario over most of the projection horizon and stabilizing around 6 percent by 2040 (Figure 8). However, achieving such efficiency gains would be reform-intensive. It would require moving beyond higher budget allocations toward stronger links between budgets and results, including credible medium-term sector plans, better prioritization of high-impact projects, timely budget execution, stronger monitoring of learning and health outcomes, and mechanisms to identify and correct underperforming programs. The results therefore suggest that efficiency reforms can generate meaningful SDG progress without additional financing, but that the largest gains would likely come from combining stronger DRM with reforms that improve the quality and effectiveness of public spending.

Figure 7. Cambodia: Scenario 2: Efficiency Gains Raise Human and Physical Capital and Support Growth

Additional human and physical capital vs. baseline
(Index points above baseline)



Real GDP growth rate
(Percent of GDP)



Source: IMF staff calculations.

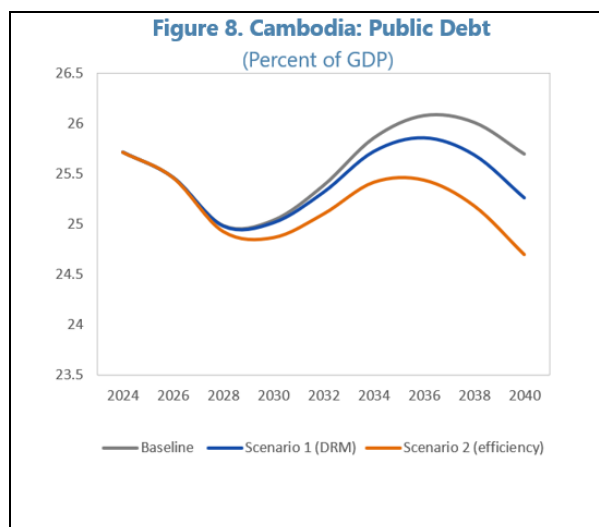
27. Beyond their effects on development outcomes and growth, Scenarios 1 and 2 also improve debt dynamics. Additional revenue mobilization supports debt dynamics by strengthening the revenue base and raising growth, thereby lowering the debt-to-GDP ratio relative

to the baseline. Efficiency gains do not directly reduce the expenditure financing gap, since the same spending envelope is maintained, but they generate more productive human and physical capital from each unit of spending. This raises output and endogenous revenues, improves the growth–debt trade-off, and can gradually reduce the financing required to achieve a given level of development outcomes.

28. Scenario 3 assesses the impact of a combined financing and spending-efficiency strategy that brings together domestic revenue mobilization, prudent debt financing,

and improvements in the effectiveness of SDG-related spending. The scenario assumes a more moderate revenue effort than in Scenario 1, with tax policy and revenue administration reforms generating an additional 0.3 percentage point of GDP in revenue per year, complemented by about 0.1 percentage point arising endogenously as higher SDG spending raises output and broadens the tax base. Additional borrowing finances SDG spending of 2 percent of GDP per year, a level calibrated to keep public debt consistent with the medium-term debt anchor of 40 percent of GDP recommended by recent FAD technical assistance, thereby preserving a buffer against shocks. To better align the timing of investment returns with the cost of borrowing, all debt-financed spending is directed toward infrastructure—roads, electricity, and water and sanitation. Infrastructure spending is converted relatively quickly into productive public capital and output, helping generate additional revenue as debt-service costs accrue. By contrast, the growth returns from health and education materialize more gradually through human-capital accumulation, supporting greater reliance on DRM to finance these sectors. Finally, as in Scenario 2, the efficiency parameters governing the accumulation of physical and human capital are increased by 0.1 by 2032 and by a further 0.1 by 2040. The scenario therefore illustrates how a diversified and mutually reinforcing policy package can expand resources for development, preserve debt sustainability, and increase the growth impact of additional spending.

29. The combined strategy narrows the SDG spending gap more rapidly than DRM alone, but its advantage diminishes over time as debt-service costs accumulate. The remaining aggregate gap falls from 9.3 percent of GDP in 2025 to 7.1 percent in 2030, compared with 7.9 percent under Scenario 1, reflecting the additional resources provided by borrowing and the stronger conversion of spending into development outcomes as efficiency improves. Progress is therefore initially faster under the joint scenario. By 2040, however, the remaining gap reaches 4.5 percent of GDP, only marginally below the 4.6 percent achieved under Scenario 1. As public debt rises, higher interest payments⁹ absorb an increasing share of the fiscal envelope, reducing the

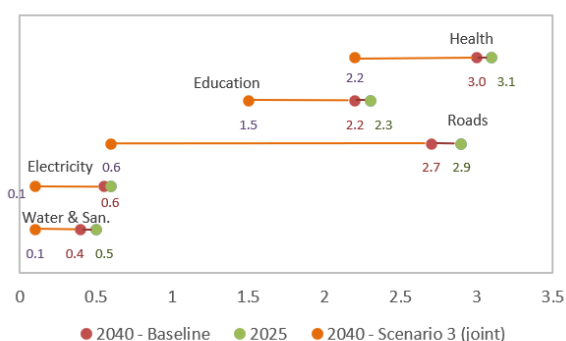


⁹ The nominal interest rate on domestic borrowing is calibrated at 4.5 percent, while the nominal interest rate on external borrowing is set at 1.5 percent initially and gradually increases to about 5 percent by 2050.

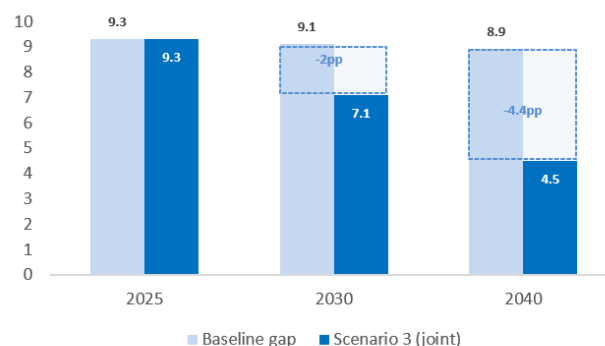
resources available for SDG-related spending and progressively offsetting the benefits of the additional financing. The convergence of the two scenarios by 2040 underscores that debt financing is costly: while it can accelerate development progress in the near term, its lasting contribution depends on whether the growth and revenue gains generated by the financed spending are sufficient to compensate for the associated debt-service burden.

Figure 9. Cambodia: Scenario 3: Combined Financing and Efficiency Reforms Narrow SDG Spending Gaps

SDG spending gaps through 2040 - scenario 3
(Percent of GDP)

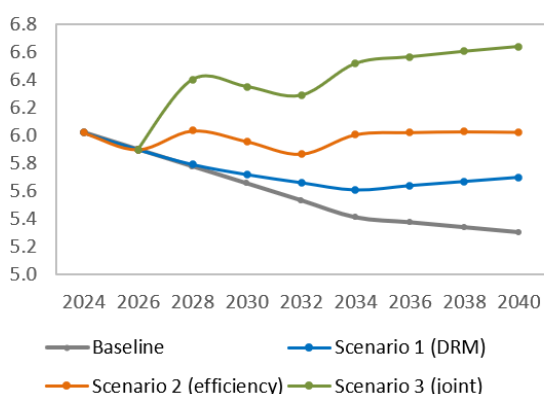


SDG remaining gap
(Percent of GDP)

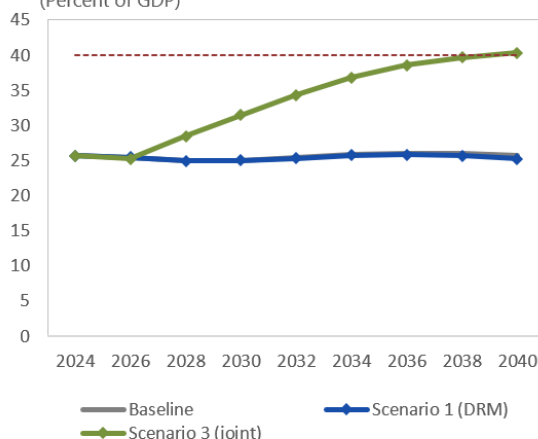


Source: IMF staff calculations.

Real GDP growth rate
(Percent of GDP)



Public debt
(Percent of GDP)



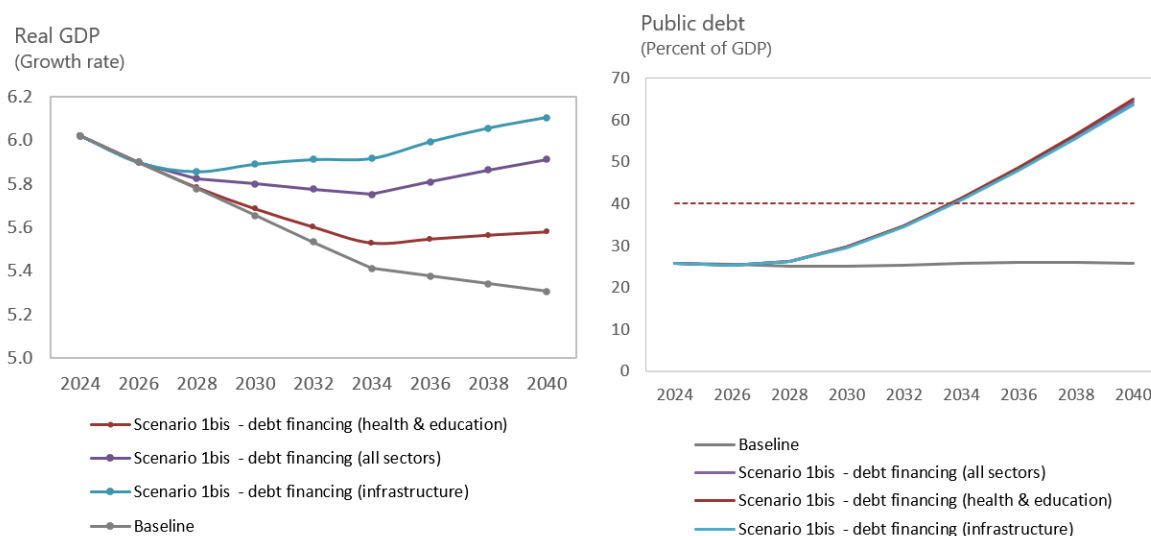
Source: IMF staff calculations.

30. The main additional payoff from combining the three policy levers is substantially stronger growth. Real GDP growth rises to about 6.4 percent in 2028 and, after some moderation,

increases further to around 6.6 percent by 2040. This compares with 5.3 percent under the baseline, 5.7 percent under the DRM scenario, and about 6.0 percent when only spending efficiency is improved. The relatively rapid initial growth response reflects the allocation of debt-financed resources to infrastructure, which is converted comparatively quickly into productive public capital. The further acceleration after 2032 is reinforced by the second increase in spending efficiency, which raises the productive capital generated by each dollar of additional spending. Higher output also broadens the tax base and generates additional revenue, partly offsetting the fiscal cost of borrowing. Public debt nevertheless rises steadily, reaching around the 40 percent of GDP ceiling by 2040, indicating that the strategy makes full use of the available debt space.

31. A debt-financing-only counterfactual underscores both the importance of the spending composition and the limits of relying on borrowing alone. When the additional spending is financed entirely through debt, public debt rises to about 64–65 percent of GDP by 2040, well above the ceiling, irrespective of how the resources are allocated. The allocation nevertheless matters for growth: directing borrowing exclusively toward infrastructure produces the largest and fastest payoff, raising growth to about 6.1 percent by 2040, compared with roughly 5.9 percent when borrowing is distributed across all sectors and 5.6 percent when it is allocated to health and education. Health and education spending still raises growth relative to the baseline, but its effects materialize more gradually through human-capital accumulation, while interest and debt-service costs begin accruing immediately. Even the stronger infrastructure-related growth response is insufficient to prevent debt from rising well above the medium-term anchor, creating substantial fiscal-sustainability risks. These results support using debt selectively for high-return infrastructure, while relying more heavily on DRM—and grants where available—to finance health and education, and combining additional financing with reforms that improve spending efficiency.

Figure 10. Cambodia: Growth and Debt Implications of Alternative Debt-Financed Spending Allocations



32. Private investment will also be important to close the remaining SDG gap. Given Cambodia's already significant private-sector role, particularly in health and education, reforms that improve the investment climate, strengthen fiscal institutions and public-sector governance, and crowd in additional domestic and foreign investment could complement public financing. Mobilizing these resources would help sustain progress while limiting further pressure on the budget and public debt.

D. Conclusion

33. Cambodia's current spending trajectory would leave substantial development gaps unresolved by 2040. Sustained domestic revenue mobilization could create meaningful fiscal space and reduce the aggregate SDG spending gap by almost half, while improvements in spending efficiency could generate considerably more human and physical capital—and stronger growth—from the existing resource envelope. Combining these reforms with limited borrowing would accelerate progress and raise growth further. However, its advantage over DRM alone diminishes over time because higher interest payments absorb an increasing share of the budget. Debt financing alone would push public debt far above the medium-term anchor, demonstrating that borrowing cannot substitute for stronger revenues and better spending quality.

34. The central policy trade-off is therefore between accelerating SDG progress in the near term and preserving the fiscal space needed to sustain it over time. Borrowing is better suited to productive infrastructure, whose growth and revenue benefits materialize relatively quickly, while health and education—whose returns emerge more gradually and require recurrent expenditure—

should rely more heavily on domestic revenues and grants. Efficiency reforms can ease this trade-off by raising the payoff from every unit of spending, but they are institutionally demanding and cannot directly finance the expenditure gap. A sequenced strategy combining stronger DRM, improved public investment and service-delivery systems, selective borrowing, and additional private investment offers the most credible path to advancing Cambodia's development objectives while safeguarding macroeconomic and debt sustainability.

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Annex I. Translating SDG Targets into Spending Needs

1. Spending need estimates are produced using the third edition of the IMF SDG Costing Tool. Estimates cover health, education, water, sanitation and hygiene, electricity, and roads. The tool does not attach a cost directly to an SDG outcome indicator. It first identifies the service-delivery inputs (for human capital outcomes) or infrastructure stock consistent with strong performance in 2030, translates that target into physical quantities, and then values those quantities (Table A1). For health and education, targets are drawn from strongly performing income peers: each country is grouped with countries of similar projected 2030 GDP per capita, and its input targets are set at the current average of the best performers on the relevant sectoral SDG index within that group (see paragraph below). The infrastructure sectors instead use absolute access targets and unit costs. In all cases, targets are applied to country-specific projections for population, demographic composition, urbanization, and GDP. (Table 1).

Table 1. Cambodia: Conversion of Physical Measures into Additional Annual Costs

SDG	Physical quantity estimated	Conversion to monetary cost
Health	Doctors and other medical staff required in 2030, based on benchmark staff-to-population ratios and adjusted for the projected age structure.	Required staff are multiplied by benchmark doctor salaries, expressed as multiples of GDP per capita, with other medical staff paid a fixed fraction of doctors' pay. The resulting wage bill is grossed up for other recurrent and capital health spending using benchmark expenditure shares.
Education	Students implied by target enrollment and the projected school-age population; teachers implied by the benchmark student-to-teacher ratio.	Required teachers are multiplied by the benchmark teacher salary, also expressed relative to GDP per capita. The wage bill is grossed up for non-teacher recurrent and capital spending.
Roads	Additional all-season road length needed to meet the rural-access target and projected changes in income, population density, and the rural share.	The gap between target and existing road length is multiplied by a unit construction cost per kilometer. The total is then spread into a constant annual share of GDP, covering upkeep of the new network.
Electricity	Additional users and generation/network capacity needed for universal access and for consumption per user to rise with projected income.	Required capacity is obtained from projected electricity use and multiplied by a unit cost per kilowatt covering generation, transmission, and distribution, then annualized on the same basis as roads.
Water & sanitation	Additional rural and urban population to receive basic or safely managed water, sanitation, and hygiene services, by technology.	People to be served are multiplied by country-calibrated facility unit costs, with operations and maintenance added. Capital rollout is distributed across annual tranches.

2. For Cambodia, the human capital comparator group is the lowest of the three income brackets (GDP per capita under \$4,000). Within this bracket of 66 countries, education outcomes diverge sharply: 59 countries average an education SDG score of 53, while 7 high performers average 93—a 40-point gap at similar income levels. Cambodia, with a score of 66, sits between these groups. The three highest-performing peers are Moldova (99), Vietnam (98), and the Kyrgyz Republic (95). Health outcomes also vary widely: 63 countries average a score of 48, compared with 77 among 5 high performers. Cambodia’s score of 63 again places it between these groups. The three highest-performing peers are Tunisia (79), Uzbekistan (79), and Moldova (77). Together, these comparators show that strong education and health outcomes are achievable at income levels below \$4,000 per capita.

Annex II. Model Calibration and Parameter Assumptions

1. The SDG-FiT model is calibrated using a combination of Cambodia-specific data and structural parameter assumptions commonly applied to low-income developing economies.

The baseline paths for output, revenues, expenditure, and public debt are aligned with the IMF's medium-term framework for Cambodia. The composition of public expenditure—including the allocation of SDG spending across infrastructure, health, and education, as well as the split between SDG and non-SDG spending—is calibrated to Cambodia's current spending patterns, while the initial public capital stock is drawn from the FAD Capital Stock Database (2019). The elasticities of output with respect to public and private capital, the elasticity of labor productivity with respect to human capital per worker, and the human-capital depreciation rate follow Atolia et al. (2017), based on their calibration for low-income developing countries. The efficiency parameters governing the accumulation of physical and human capital are calibrated using Cambodia-specific efficiency estimates reported in the October 2025 *Fiscal Monitor* (IMF, 2025b). The remaining parameters governing production and the accumulation of physical and human capital are reported in Table 2.

Table 2. Cambodia: Model Calibration and Parameter Assumptions

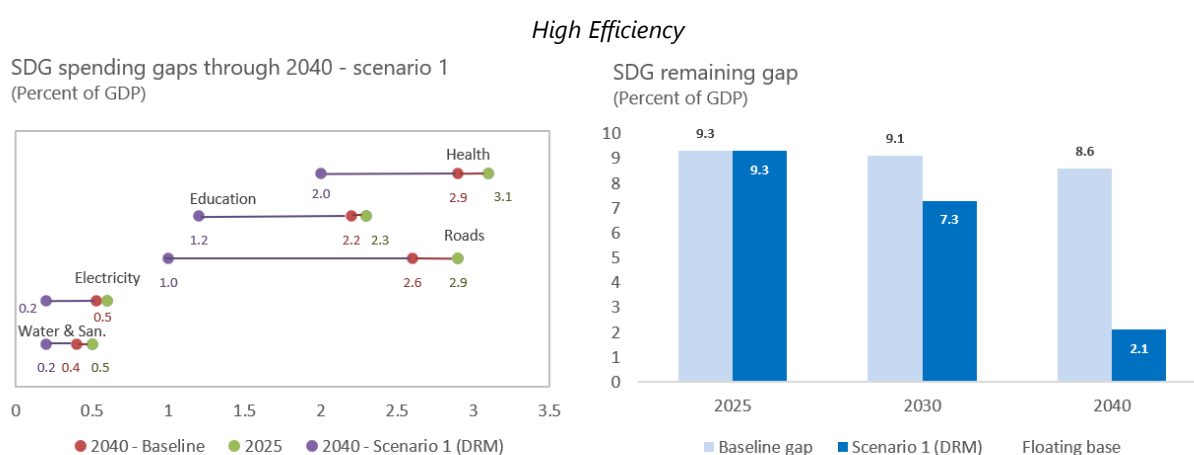
Parameter	Definition and role in the model	Calibration
β	Elasticity of output with respect to public capital	0.20
α	Elasticity of output with respect to private capital	0.50
θ	Efficiency gain associated with privately managed infrastructure in the effective public-capital stock	1.15
σ	Elasticity of labor productivity with respect to human capital per worker	0.70
δ^p_k	Annual depreciation rate of private capital	0.05
δ^g_k	Annual depreciation rate of public capital	0.01
e^g_k	Efficiency of public investment: share of investment spending converted into productive public capital	0.59
ω	Human-capital diffusion parameter governing the gradual transmission of newly accumulated human capital to the productive labor force	0.10
δ^h	Annual depreciation rate of the human-capital stock	0.05
e^h	Efficiency of health and education spending: share of spending translated into improved human-capital outcomes	0.64
φ	Elasticity of new human capital with respect to efficiency-adjusted health and education spending	0.60
γ	Elasticity of new human capital with respect to the school-age population or number of students	0.55

Source: Atolia et al. (2017), October 2025 *Fiscal Monitor*, and IMF staff calculations.

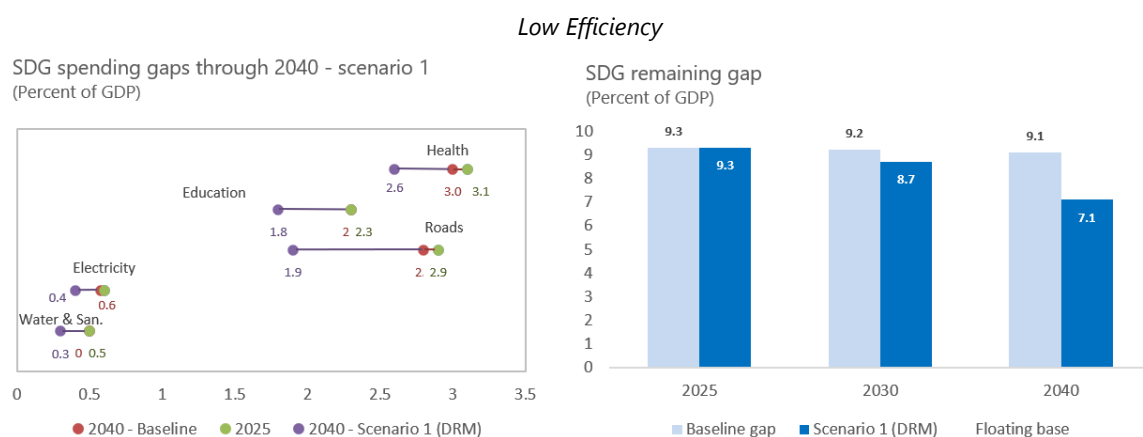
Annex III. Sensitivity of the DRM Scenario to Alternative Spending-Efficiency Assumptions

1. The sensitivity analysis confirms that spending efficiency strongly affects both the baseline trajectory and the effectiveness of additional revenue mobilization. Under the high-efficiency calibration, with the efficiency parameters for both human and physical capital set at 0.9, existing and additional resources are converted more effectively into development outcomes: the baseline SDG gap declines to 8.6 percent of GDP by 2040, while Scenario 1 reduces the remaining gap to 2.1 percent. Under the low-efficiency calibration, with both parameters set at 0.3, the baseline gap remains at 9.1 percent of GDP and Scenario 1 lowers it only to 7.1 percent. These results bracket the central estimate and underscore that the development payoff from revenue mobilization depends critically on the efficiency with which additional spending is translated into human and physical capital.

Figure 1. Cambodia: Sensitivity of Scenario 1 Results to Alternative Spending-Efficiency Assumptions



Source: IMF staff calculations.



Source: IMF staff calculations.