

INTERNATIONAL MONETARY FUND

WORLD BANK GROUP

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT
INTERNATIONAL FINANCE CORPORATION
INTERNATIONAL DEVELOPMENT ASSOCIATION
INTERNATIONAL CENTRE FOR SETTLEMENT OF INVESTMENT DISPUTES
MULTILATERAL INVESTMENT GUARANTEE AGENCY

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Press Release No. 31

October 3, 2004

Statement by the Hon. **CHEA CHANTO**,
Governor of the Bank for **CAMBODIA**,
and by the Hon. **KEAT CHHON**,
Governor of the Fund for **CAMBODIA**,
at the Joint Annual Discussion

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It is an honor and pleasure for us, on behalf of the Royal Government of Cambodia (RGC), to participate in this the 2004 Annual Meetings of the International Monetary Fund and the World Bank here in Washington DC. We would like to take this opportunity to express our gratitude to the Funds and the Bank, as well as the Government of the United States for their efforts in arranging the meetings.

This statement will provide an overall assessment of the status of the economy of Cambodia, the Economic Policy Agenda, and provide information on the initiatives of the Royal Government of Cambodia to advance its reform agenda aimed at reducing people's poverty and promoting development.

Political Platform

The Royal Government of Cambodia enters into its third mandate of the second era of the Kingdom of Cambodia, humbled by the people's will and fully committed to the cause of peace, national reconciliation, political stability, social order, enhanced democracy, respect for human rights and dignity, national independence, integrity and credibility, sovereignty and sustainable development that will bring progress, prosperity, harmony and dignity to the nation and people at all walks of life.

The successful solving of the unusual political situation within a peaceful and stable environment and in a spirit of national reconciliation and democracy has provided us with a renewed and hopeful opportunity to embark on faster pace, more diversified and in-depth reforms in all the sectors where we have started in earlier terms.

At the forefront of the political and economic agenda of the Royal Government in its third term 2003-2008 are: (a) promotion of economic growth; (b) generation of employment for Cambodian workers; (c) implementation of its Governance Action Plan (GAP) and thereby ensuring equity, social justice and enhanced efficiency and effectively of the RGC; and (d) implementation of broad reforms in all sectors to reduce poverty and accelerate sustainable development.

The Royal Government of Cambodia stands fully committed to the *Millennium Declaration* adopted on 8 September 2000 by the General Assembly of the United Nations. The Leaders of the UN member states have agreed on the strategic targets and timetables in their common cause to combat poverty, hunger, disease, illiteracy, inequity, gender bias and environmental destruction. The Royal Government shall, with

full determination, exert its utmost efforts to bridge the gaps between universally-held goals and national progress, and between the national development and regional disparities.

The Economic Performance

Cambodia has displayed positive economic performance over the last few years, especially on the macroeconomic front. During the last five years, the Cambodian economy grew at an annual average rate of 6.7%, while the exchange rate was stable. On average, industrial production increased 19% per annum, services 5.3% and agriculture 1%. Inflation was kept very low and on average increased by 1.6% a year. The international reserves doubled to USD 670 million in 2003.

Despite the political uncertainty related to the elections and despite the pandemic and insecure international situation, Cambodian economy grew by 5.2% in real term 2003, led by continued growth in garment exports, a rebound in investments and strong increase in agriculture production. Overall, during the first half of 2004, the RGC has exerted serious efforts to ensure our country's take-off toward sustainable economic development.

Recognizing the positive developments, the Executive Board of the International Monetary Fund completed the sixth review of Cambodia's economic performance under the Poverty Reduction and Growth Facility program (PRGF) and the result was satisfied.

▪ Fiscal Development

The country's fiscal position deteriorated in 2003, as revenue performance in 2003 experienced worse difficulties, due to the outbreak of SARS, problems with revenue collection and political uncertainty during the election year, while the overspending associated with the elections and international obligation put significant pressures on the budget.

As a result, the 2003 fiscal deficit, including grants, widened to 7.4 % of GDP. To reduce budget deficit, the RGC will ensure substantial expenditure compression, while increasing revenue to at least 11.9 % of GDP in 2004. This will require tax and non-tax collection measures equivalent to about 0.8 % of GDP.

▪ Monetary Policy

Money supply increased by 15% during 2003 due mainly to increasing bank loans to the private sector. The bank credit to the private sector grew by 27%, while net claims on government fell by 7%, foreign assets rose by 11% and foreign currency deposit increased by 15%. The external balance is expected to slightly deteriorate in 2004. The international reserves were kept at the equivalent of 2,8 months of imports.

Cambodia's level of inflation remains relative low through the use of monetary and exchange rate policy, supported by a prudent managed fiscal position. At the end of 2003, the year-on-year inflation rate was just 0.5 %, while the national currency depreciated by some 1.4% against the US dollars as compared to the end of the previous year. Nevertheless, services and income partly offset the negative evolution of exports, so that the balance of current accounts shows a lessening deficit.

The National Bank of Cambodia (NBC) remains committed to the maintenance of price stability as the principle objectives of its monetary policy in order to control the liquidity and credit growth by utilizing more direct instruments, as indirect policy tools such as statutory reserve requirement and refinancing facilities for commercial banks remained largely ineffective due to dollarization. The tight domestic credit stance and official intervention in foreign exchange market have been so far successful to contribute to the stability of the domestic currency and the sustaining of low inflation.

▪ **Outlook of External Sector**

The overall balance of payments slightly deteriorated. The current account deficit, excluding transfers, increased from 10.2 percent of GDP in 2003 to 10.8 percent of GDP in 2004, reflecting the impact of higher petroleum prices and service receipts. However, improved fiscal control following the elections has been accompanied by a gradual increase in foreign currency deposits.

Together with the expected increase in foreign direct investment due to improved political stability, gross international reserves are expected to increase to US\$782 million, or about 3months of imports, by at the end of 2004.

▪ **Outlook for Growth**

The government's program and policy measures are supportive of further economic stability, with stable prices and low inflation, a stable exchange rate with concurrent economic growth, higher output and export.

The growth in 2004 is expected to increase to around 4.3 percent as tourism recovers and garment exports continue to increase, but at a slower rate of 13 percent. Tourism is expected to rebound by at least 17 percent, boosting growth of services by over 6 percent. Manufacturing growth will thus slow to about 8,7 percent. Agriculture production is projected to growth at an unpleasant level of only 0.4 percent, with crops projected to grow on average by 3.2 percent.

The end of the garments quota system will adversely affect growth in 2005-06, with GDP slowing to around 2 to 4 percent. The slowdown is expected to dampen growth in services and construction, but the impact will be somewhat offset by continued strong growth in tourism. Improving performance of the agricultural sector will further offset

any manufacturing decline. Logging is expected to resume, but given tight controls for sustainability, forest sector growth will not exceed 4 percent.

Sustainable future economic growth in Cambodia remains heavily dependent on the ability of the government to diversify the economy and broaden the base for growth. The Royal Government recognizes that strong efforts are needed for Cambodia to improve economic infrastructure, deliver basic services, and enhance governance. The impediments of high transaction costs, poor infrastructure and hidden costs need to be addressed.

The Reform Strategy for 2004-2008

The Royal Government has implemented structural reforms in all aspects, encountering enormous challenges, difficulties and obstacles. Soon after the July 2003 elections, the RGC drafted a comprehensive reform agenda, which selects from and prioritizes actions arising from the NPRS and the *Socio-Economic Development Plan 2001-2005*, and has “good governance” as its backbone.

In the first of the Council of Ministers’ Meeting for the third mandate of the National Assembly on the 16th of July 2004, Samdech Prime Minister Hun Sen introduced the “*Rectangular Strategy*” for Growth, Employment, Equity and Efficiency in Cambodia. The core of the *Rectangular Strategy* is good governance focused at four reform areas: (1) anti-corruption, (2) legal and judicial reform, (3) public administration reform including decentralization and deconcentration, and (4) reform of the armed forces, especially demobilization.

Environment for the implementation of *Rectangular Strategy* consists of four elements: (1) peace, political stability and social order; (2) partnership in development with all stakeholders, including the private sector, donor community and civil society; (3) favorable macroeconomic and financial environment; and (4) the integration of Cambodia into the region and the world.

Four strategic “growth rectangles” are: (1) enhancement of agricultural sector; (2) private sector development and employment generation; (3) continued rehabilitation and construction of physical infrastructure; and (4) capacity building and human resource development.

In Public Finance, the government is embarking in a comprehensive reform so that Cambodia can afford a Public Finance System reaching the international standard by year 2015. The first platform aiming at building a credible budget to be achieved before the end of 2006. More than 200 actions are underway from now on. After the first platform, three more will follow.

Promoting Tourism Development

Tourism has indeed played a key role in the socio-economic development as it creates employment opportunities, enhances living standard of local people and generates national revenues. At the same time, tourism brings in foreign direct investment and hard currency, thereby contributing principally and actively to the core objective of poverty reduction. Furthermore, cultural tourism is a dynamic source of the influx of tourists, who admire and are aspired to explore cultural heritage. Therefore, the diversity of culture and heritage needs to be appropriately conserved, safeguarded and maintained for the benefit of next generations.

Culture has played an important role in promoting tourism in Cambodia. The creation of natural recreation areas and tourism sites based on geographical criteria with the abundances of attractiveness from nature and rare culture and with the construction of road network to link all of these areas, such as an airport in Ratanakkiri province, are the priorities for the Royal Government in this sector. On the other hand, based on these advantages, the government set the development of tourism sector in Cambodia as the “Cultural and Natural Tourism”. These potentialities will play a role as an important energy for the economic growth in Cambodia. In this sense, the Royal Government has considered tourism sector as the most prioritized sector among the 6 prioritized sectors in the strategy to promote economic growth to reduce poverty.

Complementing the policies and programs in support of competitiveness is more intensive attention to the promotion of tourism opportunities. In this regard, the private sector constitutes the main thrust to develop tourist destinations. They are working to promote attractions that enable greater tourist traffic in underserved areas, as well as longer stays and increased spending by tourists.

Streamlining Trade Facilitation

Cambodia's accession to the WTO in September 2004 can be seen as an important step forward in attracting FDI. Cambodia will use this membership to implement a comprehensive policy reform agenda aimed at the achievement of sustainable development. In order to effectively integrate the country into the regional and world economy and market, Cambodia must deepen reforms in all sectors, especially in institutional capacity building and human resource development, a process which takes time and requires strong commitment and political will at all levels. Moreover, to reap the benefits presented by the WTO accession, the Cambodian administrative system needs further improvement to allow for an expansion of industrial base in light of small domestic market.

The RGC's policy on trade facilitation is aimed at (i) rationalizing all agencies that contribute to high costs and delays including those in the Customs and Excise Department, the Ministries of Interior, Commerce, Public Works and Transport, Industry, Health, Agriculture and Labor; (ii) decreasing the total import and export

transaction costs to the private sector while at the same time increasing formal revenue flow to the RGC; (iii) decreasing unnecessary and redundant operational costs to the RGC to manage the trade process; (iv) decreasing the overall time it takes to import and export products; (v) increase the visibility and predictability of the process with respect to both time and cost, and (vi) consistent with WTO and WCO guidelines.

On 20 August 2004, during the Government-Private Sector Forum the Government decided to have a single document for export by September 1st 2005 and to set up one single window for import-export operations by December 31st 2005.

Private Sector Development

The Royal Government entrusts private sector as the engine of the economic growth. Therefore, strengthened partnership between the Government and Private Sector must be harmonious or consistent with the State's rational intervention in the economy, combined with thorough development and enforcement of laws and regulations, as well as the effective support and facilitation by the relevant Government agencies.

The Private Sector Growth and Employment Platform covers the following aspects: (1) strengthened private sector and attraction of investments; (2) promotion of SMEs; (3) creation of jobs and ensuring improved working conditions; and (4) establishment of social safety nets for civil servants, employees and workers.

The challenge for Cambodia in the next five years is to broaden the base of economic growth driven by private investment and trade. To this end, the RGC is taking actions to remove impediments to private sector development by taking serious strides to combat red tape and hidden cost in the business, while to train human resources and build up institutions. With the private sector it is formulating the policy and law and the implementing regulations for the private participation in infrastructure (PPI) notably the rule of law, rehabilitate physical infrastructure. The reform will focus on the improvement to the investment climate, including the legal, regulatory and administrative environment. The reform should also allow for improvements in access to key factor inputs, including skilled personnel and competitive access to finance.

To help strengthening the private sector, the Government continues to develop the financial sector by following 2001-2010 Road Map. The first phase of this Road Map 2001-2004 contributed to the successful restructuring of the banking sector. As regular, the Government is also strengthening and cleansing the insurance sector, while efforts has been voted to build legal infrastructure for the financial sector.

Continuing Partnership for Development

The Royal Government considers as top priority the strengthening of partnership with all stakeholders in national development. Strengthened partnership will help ensure effective coordination with donors, international financial institutions and civil society

organizations. The parameters of partnership shall be based on the resolutions of the UN General Assembly, principles adopted by the Development Assistance Committee of the Organization for Economic Cooperation and Development (DAC OECD) the Rom Declaration on Harmonization. The roles of donors and multilateral institutions in Cambodia's development process shall be determined on the basis of capacity and comparative advantage of each partner. Such partnerships will require the nurturing of mutual trust, respect and flexibility in accordance with the exigencies of the cooperation process.

On September 2004, during the consultation with donor community and with their consent, the Royal Government announced the setting up of coordination umbrella mechanism to strengthen and rationalize different RGC-development partner working groups, i.e. Public Finance Reform, Administrative Reform, Management of Natural Resources, Social Development, Land Management, Partnership. Ownership by the Royal Government of the working group mechanism is crucial to the further promotion and progress of reforms. It is also crucial that all donors and multilateral institutions strive to be better organized and coordinated among themselves in order to streamline their partnership with Cambodia.

Toward Integration and Peace

Economic integration and international cooperation will help Cambodia to ensure its economic growth. Market access is critical for promoting growth and poverty reduction. Therefore, Cambodia's membership in ASEAN and the WTO, as well as cooperation within the framework of the Greater Mekong Sub-Region (GMS), and providing opportunity to push further reforms in investment and foreign trade regime. The Government is focusing on the liberalization and decentralization of decision making process, reducing the bureaucratic red tapes, removing impediments to investments. Implementing reform programs and initiating the modernization of the national economy will enhance Cambodia's competitiveness, while working to reach the regional and international standards.

The Royal Government is strongly committed to ensure full benefit from the reforms advanced by membership in the WTO. To gain the benefits in full, Cambodia must strengthen its cooperation with its neighbors through mechanisms such as "*Four Countries, One Economy*", and the establishment of *Growth Triangles* and joint Export Processing Zones (EPZs).

One of the most important achievements of the Royal Government over the recent decade is the establishment of peace, security and safety for all, while ensuring sustainable macro-economic stability for the country. The Royal Government of Cambodia secured full peace by implementing its "win-win" strategy. Henceforth, the main task of the Royal Government is to strengthen the fabric of peace that has already hardly been won.

Cambodia is very pleased with the fact that it is not left alone with its own problems and efforts. We do hope that these Annual Meetings will provide stronger impetus for the Bank and Funds, and for the international community to contribute more effectively to the development process of the poor and poorest countries in the world, including Cambodia. And we also strongly hope that a new PRGF and new CAS can be arranged for Cambodia to ensure sustainability of economic reforms in this country.

In conclusion, we would like to assure this international gathering of the strong willingness and commitments of the Royal Government of the Kingdom of Cambodia to work actively in partnership with the international community towards achieving our common goal of reducing poverty, starting by committing itself to reforms and development in its national domain.