

Chapter 4

Fiscal Development and External Debts

4.1. Budget Revenue

Budget revenue reflects effective and efficient public finance mobilization needed for public service deliveries. The main sources of budget income are from taxes and non-taxes such as service charges from public utilities, rental of public assets, concession fees from exploitations of natural and cultural resources, and other revenues from public service deliveries (both tangible and intangible).

Table 4.1: Cambodia's Government Revenue (Billion Riel)

	2002	2003	2004	2005e	2006p
Total Domestic Revenue	1,762	1,765	2,127	2,356	2,588
Tax Revenue	1,249	1,220	1,577	1,857	2,069
Profit Taxes	97	110	117	130	149
Excise Taxes	210	198	304	384	412
Value Added Taxes	452	460	598	693	780
Trade Taxes	424	395	513	605	679
Other Tax Revenue	66	57	44	44	49
Non-tax Revenue (1)	513	545	549	499	519
Contribution from Tourism (2)	93	83	103	107	127
Quota & Export Licenses	106	146	76	25	25
Posts & Telecommunication	121	120	94	112	125
Other Revenue	192	196	275	255	242
Memorandum Items					
Taxes on Petroleum Products	322	294	335	358	379
Tax Department Revenue	298	345	405	448	519
Customs Department Revenue	952	875	1,173	1,408	1,551
Total Domestic Revenue (% of GDP)	11.0%	10.2%	10.8%	10.7%	10.6%

Source: Ministry of Economy and Finance for 2002-2004, and EIC model projection for 2005-2006.

(1) Including Capital Revenue.

(2) Including Tourism Incomes, Civil Aviation and Visa Fees.

In 2004, the government achieved its budget target again after half a decade. Actual current revenue was slightly higher than the target due largely to tax revenue which was more than 29 percent higher than the amount collected in 2003. Both collections of VAT and taxes on international trade increased by 30 percent. Excise duties were also up about 50 percent compared with 2003. However, non-tax revenue was below the budget target due to a huge decline in income from quota auction, tourism (visa fees and concessions), and post and telecommunications.

Nonetheless, overall budget revenue in terms of GDP recovered and almost reached 11 percent of GDP in 2004, back to its peak level in 2002. This ratio of budget revenue to GDP is still the lowest compared with other developing countries. Even with gradual improvements in revenue mobilization, leakages are still large due to smuggling and tax evasion.

For example, while the estimated import of petroleum by NIS was more than US\$600 million in 2004, total tax revenue from petroleum products was just US\$84 million. This revenue included the collection of VAT tax, excise duties and other taxes (compound tax rate was 108 percent for gasoline and 52 percent for diesel¹³). Revenue from visas was US\$15 million and from tourism fees was US\$7 million in 2004, while the number of tourist arrivals was 1 million (visa fee is US\$20 per person and fees to visit Angkor Wat complex per person is US\$20 per day and US\$35 for 3 days).

Moreover, there are other potential budget revenues the government has yet to consider. Since most tax revenues are from indirect taxes and taxes on imports, consuming households have to bear most of the tax burdens (90 percent) as direct taxes accounted for just 10 percent of the total tax revenue in 2004. There are some loopholes in tax exemptions and unnecessary tax holidays that cost the country millions of US\$.

Yet, revenue from taxes on large-scale idle lands¹⁴ and property are negligible. Weak enforcement of tax laws is one of the factors which encourages land speculations and land grabbing. This consumer-based structure is biased against the poor, thus needs to be reconsidered. Should taxes be duly collected, the government could reduce the tax burden on the poor (pro-poverty-reduction tax) by lowering taxes on basic consumptions and on petroleum.

¹³ IMF (2004). Cambodia Selected Issues. p. 82

¹⁴ Ministry of Economy and Finance. Prakas No. 162 on Establishment of Working Group on Stamp Tax and Taxes on Unused Lands dated 15/03/2005. No actual enforcement is identifiable.

According to official data for the first eight months of 2005, budget revenue continues to increase and is likely to meet its target. Tax revenue increased by 22 percent compared with the first eight months of 2004 and reached 68 percent of the budget target. Surprisingly, all taxes (VAT and Import Duties) on petroleum were 23 percent lower than for the first eight months of 2004, while petroleum imports (except diesel) increased significantly compared with that of 2004. Non-tax revenue increased however only very slightly. If the trend can be maintained till the end of the year, total revenue will reach the budget target for 2005.

However, the target of budget revenue was set on low economic growth 2 – 3 percent for 2005. Should the growth scenario be more than 6 percent as forecasted by the government, the revenue must be higher. Therefore, the current good tax collection is just a simple phenomenon.

4.2. Budget Expenditure

The purpose of budget expenditure is to provide public services mainly national security, fundamental infrastructure and utilities, basic needs and social safety nets such as the most basic access to education and health care. In other words, the budget must be enough to provide public goods and services and to compensate negative “externalities” to maximize social welfare such as equitable distribution of income and equal opportunities for all.

With this regard, the government has made concerted efforts in reforming its public financial management to transform the budget as a tool to implement government policy. The government intends to reduce spending on security and defense and to increase budgets for health, education, agriculture, and rural development, the priority sectors.

In 2004, overall expenditure increased by 7 percent but its share of GDP was lower than that of 2003, since nominal GDP was much higher. On average, spending on priority sectors rose by 8 percent while those on the remaining ministries increased by 20 percent. However, expenditure on defense and security in 2004 was just 2 percent higher than the amount spent in 2003. As a share of GDP, the budget released for defense and security declined from 2.4 percent in 2003 to 2.2 percent in 2004, whereas expenditure on civil administration increased slightly. The share of spending on priority sectors reached only 2.9 percent of GDP against the 3.6 percent target set by the government.

Table 4.2: Cambodia's Government Expenditure (Billion Riel)

	2002	2003	2004	2005e	2006p
Total Expenditure	2,770	2,757	2,962	3,333	3,593
Current Expenditure	1,579	1,586	1,769	2,004	2,260
Civil Administration	1,192	1,175	1,346	1,497	1,680
Priority Sector (1)	512	529	573	665	757
Other Civil Ministries	680	646	773	832	923
Defense & Security	387	411	423	507	580
Defense	245	270	272	329	374
Security	142	141	151	178	206
Capital Expenditure	1,191	1,171	1,193	1,329	1,333
Through National Treasury	288	333	296	407	371
Direct External Financed	903	838	896	922	962
Memorandum Items					
<i>Wages</i>	<i>586</i>	<i>615</i>	<i>640</i>	<i>741</i>	<i>848</i>
<i>Non-Wages Operating Costs</i>	<i>993</i>	<i>971</i>	<i>1,130</i>	<i>1,263</i>	<i>1,413</i>
Priority Sectors (% of GDP)	3.2%	3.1%	2.9%	3.1%	3.1%
Defense & Security (% of GDP)	2.4%	2.4%	2.2%	2.3%	2.4%

Source: Ministry of Economy and Finance for 2002-2004, and EIC model projection for 2005-2006.

(1) Including Health, Education, Agriculture, and Rural Development.

Poor public expenditure is one of the main obstacles in improving public service deliveries due to inadequate operational funds and low salaries of public servants. Low wages have discouraged qualified Cambodians from serving in the public sector and encouraged existing qualified public servants to leave the public sector and seek employment opportunities elsewhere.

For the first eight months of 2005, expenditure reached only 56 percent of the budget level. Most of the ministries' spending was below 68 percent of their allocated budget. Salary payments were about 57 percent of the budget and non-wage disbursement was just 50 percent of the annual earmark. A slow reporting process from line ministries may be a reason for the low figures. However, overall expenditure in 2005 is expected to reach the target given better revenue performance. Budget disbursement as a share of GDP for priority sectors may reach 3.1 percent and will slightly increase for wages but will still be below the target.

Even though, the government has recently declared a salary raise for its bureaucrats¹⁵, only its already “relatively-well-off¹⁶” public servants will benefit from the raise while most still live far below a “decent wage”. For that reason, morale of normal public servants continues to be low and they keep “moonlighting” just to survive. Unless salaries can be raised for all public servants to a decent level, public service deliveries will not be much improved. The raise can only be done through reduction of large revenue leakages and wastage in unnecessary expenditures.

4.3. Budget Financing

In developing countries, under-collection of budget revenue results in a shortage of funds to meet public expenditures. Budget revenue is too low to cover both current (basic operations) and capital expenditure (infrastructure and public investment). The deficits need to be financed through domestic and international borrowing and foreign assistance.

Table 4.3: Cambodia's Financing Budget (Billion Riel)

	2002	2003	2004	2005e	2006p
Total Domestic Revenue	1,762	1,765	2,127	2,356	2,588
Total Expenditure	2,770	2,757	2,962	3,333	3,593
Total Deficit (cash basis)	-1,008	-992	-835	-977	-1,005
Foreign Financing (1)	1,074	886	894	977	1,005
Grants	451	382	372	410	437
Loans (net)	622	504	522	567	568
Domestic Financing	-65	106	-59	0	0
Banks	-104	-3	25	0	0
Others	38	109	-84	0	0
Memorandum Items					
<i>Net Foreign Reserves at NBC</i>	<i>2,267</i>	<i>2,539</i>	<i>2,707</i>	<i>2,782</i>	<i>2,858</i>

Source: Ministry of Economy and Finance for 2002-2004, and EIC model projection for 2005-2006.

(1) Including only project aid.

In 2004, the total deficit was lower than that of 2003 because of improvements in budget revenue. The deficit was 4.3 percent of GDP

¹⁵ Sub-decree No.96 ANK.BK, effective from August 01, 2005

¹⁶ EIC's sporadic interviews and observations confirmed that majority of government officials from the rank of deputy director of a department or above are already better-off compared with normal officers. Most of them have been enjoying extra benefits such as monthly gasoline allowances.

down from 5.7 percent in 2003 and from more than 6 percent in 2002. The main sources of deficit financing are from foreign grants and loans of which the latter shares a higher proportion. Of particular notice, bilateral loans keep increasing from US\$20 million in 2003 to US\$29 million in 2004. As the central bank has refrained from financing government deficits, domestic financing is done through selling of Treasury bills and other domestic borrowings. In 2004, the government did not borrow in recent years but was able to repay its liabilities to the private sector. However, the government will continue to depend on foreign assistance and some private loans to meet its budget shortages in the following years.

4.4. Foreign Aid and External Debts

Flows of aid from advanced to war-inflicted and poorer countries are common practices whether done for world commitments to reduce poverty, humanitarian, or political reasons. Aid is delivered in different forms: bilateral, multilateral, grants or loans to deal with financial constraints of recipient countries. However, the nature and effectiveness and efficiency of aid needs closer scrutiny. The utilization of foreign borrowings is important to ensure proper value for money and viable management of debts.

Since 1993 after the peace settlement and general election, Cambodia has been enjoying large inflows of foreign aid to rebuild the country, totaling US\$5.66 billion by 2003. Most assistance in the past decades focused on multifaceted institutional and technical assistance (TAs), and the rest on social sectors and infrastructure rehabilitation. Terms of aid deliveries have shifted from grants to loans as the share of grants in the total aid decreased from 89 percent in 1993 to 73 percent in 2003, whereas loans increased from 13 percent of the total aid flows to 26 percent during the same period¹⁷.

Due to a lack of government technical capacity, TAs increased from 24 percent of total aid in 1993 to 50 percent in 2003¹⁸. On average, 50 percent of the total aid was on health, education, and infrastructure development, while aid to agriculture was less than 10 percent per year. These assistances have greatly contributed to the reconstruction of Cambodia, boosting economic growth, financing trade and budget deficits and, to some extent, to alleviating poverty.

However, the effectiveness of assistance has been raised by both the donor community and the government. Poverty is believed to remain

¹⁷ Council for Development of Cambodia. 2004. *Development Cooperation Report 2002 and 2003*. p.15

¹⁸ International Monetary Fund. 2004. *Cambodia: Selected Issues*. p. 62

widespread. Both the physical and social infrastructure of the country are still lagging behind neighboring countries. More emphasis should be given to investment in agricultural development, health care, education, and fundamental infrastructure. Technical assistance should be reduced and be done either by Cambodian professionals or in partnership between foreign and local experts.

As Cambodia continues to borrow abroad to meet cash limitations, proper debt management is necessary to ensure financial viability of the country. According to the IMF, total public external debt was estimated to be US\$3 billion (including debt owed to the US and Russia before 1993) by 2003 and debt services was US\$71 million¹⁹. Cambodia is negotiating with the US and Russia for debt forgiveness and rescheduling. But as Cambodia is starting to pay interest on loans borrowed after 1993, more funds are needed for debt services. This will exacerbate the current scarcity of funds for development unless domestic revenue is strengthened to reach around 15 percent of GDP or more, annually.

¹⁹ International Monetary Fund. (2004). *Cambodia: 2004 Article IV Consultation – Staff Report*. p. 31