

Chapter 4

Fiscal Developments and External Debts

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The Cambodian government always pledged that fiscal policy is at the core of the government's adjustment and reform strategy. The aim was to strengthen the role of the budget as a key tool of economic management and also at developing a fiscal structure that generates the domestic resources required for increased public spending in priority social and infrastructure areas. As in every year, however, the government's budget operations in 2004 were characterized by a shortfall in revenue and a significantly lower-than-expected amount of disbursements within the social and economic sectors. In 2005 and beyond, the fiscal situation will be even more difficult, as revenue from the garment quota exports will disappear.

4.1. Budget Revenue

In the post-election period, when the formation of the government was up in the air and neither the National Assembly nor the government had been re-organized, the caretaker government was entitled to execute its expenditures each month by one-twelfth of the annual allocated budget of 2003. This transition period lasted about 8 months (from January to August 2004) before a Budget Law of 2004 was adopted by the new National Assembly.

According to the Budget Law of 2004, total domestic revenue was planned at CR 2,126 billion (about US\$530 million), representing an increase of 6 percent compared to the budget law of 2003 and an increase of 20 percent compared to the budget that was actually implemented in 2003. During the first eleven months of 2004, domestic revenue recorded at a 15 percent increase compared with the same period in 2003. Tax collections reached 25 percent. Under some pressure from the public, the Cambodian government seems to be making some efforts to fight tax evasion by the smuggling of petroleum products. Tax revenue generated from these items increased by 13 percent, though it was still far lower than the budget target.

However, non- tax revenue collection seems to remain very weak, seeing a decline of 5 percent compared to the same period of previous year. Revenue from civil aviation and tourism also remained very low, even

though foreign tourists visiting the Angkor temples dramatically increased during the same period. Statistics also show that the quota auctions and export licenses dropped by about half, while the export of garments increased by about 25 percent during the same period. Overall, thanks to the good performance in tax collections, the government budget revenue effectively collected in 2004 will likely increase by 13 percent, compared to the actual budget of 2003.

In 2005 and beyond, improving state revenue collection will become a real challenge for the Cambodian government. With an expected sharp economic slowdown due to the phasing out of the quota system, many companies will face financial difficulties, and consumers will be less ready to spend money. As a result, government revenue generated from corporate profit or household consumption will be flat.

Table 4.1: Cambodia's Government Revenue (as a percentage of GDP)

	2002	2003	2004	2005	2006-2008
Total Domestic Revenue	11.3%	10.5%	10.7%	10.5%	9.9%
Tax Revenue	8.0%	7.3%	8.1%	8.5%	8.0%
Profit Taxes	0.6%	0.7%	0.7%	0.7%	0.7%
Excise Taxes	1.3%	1.2%	1.6%	1.6%	1.6%
Value Added Taxes	2.9%	2.6%	3.1%	3.1%	3.1%
Trade Taxes	2.7%	2.4%	2.5%	2.8%	2.4%
Other Tax Revenue	0.4%	0.4%	0.3%	0.2%	0.2%
Non-tax Revenue (1)	3.3%	3.2%	2.6%	2.0%	1.9%
Contribution from Tourism (2)	0.6%	0.5%	0.6%	0.6%	0.7%
Quota & Export Licenses	0.7%	0.9%	0.4%	0.1%	0.1%
Posts & Telecommunication	0.8%	0.7%	0.5%	0.5%	0.5%
Other Revenue (1)	1.2%	1.1%	1.1%	0.8%	0.6%
Memorandum Items					
<i>Taxes on Petroleum Products</i>	2.0%	1.7%	1.7%	1.6%	1.5%
<i>Tax Department Revenue</i>	1.9%	2.1%	2.3%	2.4%	2.6%
<i>Customs Department Revenue</i>	6.1%	5.2%	5.8%	6.1%	5.5%

Source: Ministry of Economy and Finance for 2002-2003, EIC estimates for 2004, based on the eleven months implementation trends, and EIC model projection for 2005-2008

(1) Including Capital Revenue

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

Despite government efforts in fighting corruption and smuggling, EIC estimates that domestic revenue will progressively decrease (as a percentage of GDP), because of the decline in non-tax revenue. The

revenue generated from garment quota auctions that represented about 0.5% of GDP will disappear. Revenue from natural resource exploitation will also vanish due to over-exploitation in the past. The current efforts on collecting taxes from car smuggling will be fruitful in 2005 but could not last forever.

Therefore, total domestic revenue will fall to less than 10 percent of GDP in the next 3 or 4 years, unless the “war against corruption” in government becomes really effective. Based on recent EIC interviews with some policy makers and business people, the success of this war is very doubtful, as three elections are expected to be held in the next three years.²² It is generally perceived that these elections are at least partly funded by corrupt officials.

4.2. Budget Expenditure

On the expenditure side, total government spending during the first eleven months of 2004 reached only 70 percent of the budget level. Capital expenditure reached the expected level, while current expenditure was far behind the target, reaching only 58 percent of total annual planned budget. Every year since 2001, current expenditure from January to November reached on average about 73 percent of the annual planned budget, and the expenditure in December represented 27 percent. The weakness in budget disbursement for 2004 was likely linked to lack of cash, resulting from the low foreign budget support and substantial payments of arrears occurring in the budget of 2003.

During the first eleven months of 2004, total government current expenditure declined by about 10 percent, compared with the same period in 2003. Spending on wages declined by 1 percent and non-wages by 23 percent compared with the same period in 2003. Compared with the budget law figures, salary payments for civil servants reached only 76 percent of the annual allocated budget for 2004. Subsequently, this would affect the rate of salary payments to civil servants and other public service deliveries.

Moreover, figures released by the Ministry of Economy and Finance concerning budget expenditure for the priority sectors raised concerns, as levels were exceptionally low compared with the budget target. During the first eleven months of 2004, these sectors received only, on average, 48 percent of the annual allocated budget, less than “non-priority” sectors (more than 60 percent in average). Rural Development received just 32

²² Senatorial election in 2006, Commune election in 2007, and general election in 2008.

percent, Health 35 percent, Agriculture 56 percent and Education 57 percent. For that reason, it is very unlikely that the cash disbursed to these priority sectors for the whole year 2004 will reach the target planned in the budget law just recently adopted by the Parliament.

**Table 4.2: Cambodia's Government Expenditure
(as a percentage of GDP)**

	2002	2003	2004	2005	2006-2008
Total Expenditure	17.7%	17.4%	15.7%	15.6%	14.4%
Current Expenditure	10.1%	10.0%	9.0%	9.0%	9.2%
Civil Administration	7.6%	7.6%	6.8%	6.8%	6.9%
Priority Sectors (1)	3.3%	3.2%	2.8%	2.8%	2.9%
Other Civil Ministries	4.4%	4.5%	4.1%	4.0%	4.0%
Defense & Security	2.5%	2.4%	2.1%	2.2%	2.3%
Defense	1.6%	1.5%	1.5%	1.5%	1.6%
Security	0.9%	0.8%	0.7%	0.7%	0.7%
Capital Expenditure	7.6%	7.4%	6.7%	6.6%	5.2%
Through National Treasury	1.8%	2.0%	1.7%	1.9%	1.0%
Direct External Financed	5.8%	5.4%	5.1%	4.7%	4.2%
Memorandum Items					
Wages	3.8%	3.7%	3.5%	3.5%	3.7%
Non-Wages Operating Costs	6.4%	6.3%	5.5%	5.5%	5.5%

Source: Ministry of Economy and Finance for 2002-2003, EIC estimates for 2004, based on the budget law for 2004 and eleven months implementation trends, and EIC model projection for 2005-2008

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

In 2005 and beyond, government expenditure is expected to increase slower than the nominal GDP, because of projected moderate growth in government domestic revenue, and foreign aid. Total government expenditure will decline to about 14 percent of GDP in 2008, down from more than 17 percent in 2003. This decline will affect both current and capital expenditure. Same as that of the revenue side, government current expenditure is expected to decline to 9 percent of GDP, from about 10 percent in 2003. This drop will affect only the civil administration, while the defense and security budget will remain basically stable relative to nominal GDP.

4.3. Budget Financing

Although domestic revenue and foreign aid were basically flat, the Cambodian government seems to tighten its fiscal policy by significantly slowing down expenditure. As a result, the overall budget deficit dropped by 2 percentage points of GDP in 2004 compared to 2003. This deficit was mainly financed by foreign assistance under grants or loans. Direct bank financing to the budget remained firmly under control.

Table 4.3: Cambodia's Financing Budget (as a percentage of GDP)

	2002	2003	2004	2005	2006-2008
Total Domestic Revenue	11.3%	10.5%	10.7%	10.5%	9.9%
Total Expenditure	17.7%	17.4%	15.7%	15.6%	14.4%
Total Deficit (cash basis)	-6.5%	-7.0%	-5.0%	-5.1%	-4.4%
Foreign Financing (1)	6.9%	6.0%	5.4%	5.1%	4.4%
Grants	2.9%	2.5%	2.1%	2.1%	1.8%
Loans (net)	4.0%	3.6%	3.3%	3.1%	2.6%
Domestic Financing	-0.4%	1.0%	-0.4%	0.0%	0.0%
Banks	-0.7%	0.0%	0.0%	0.0%	0.0%
Others	0.2%	0.9%	-0.4%	0.0%	0.0%
Memorandum Items					
<i>Net Foreign Reserves at NBC</i>	14.5%	15.2%	14.7%	14.2%	13.1%

Source: Ministry of Economy and Finance for 2002-2003, EIC estimates for 2004, based on the budget law for 2004 and eleven months implementation trends, and EIC model projection for 2005-2008

(1) Including only project aid

4.4. Foreign Aid and External Debts

According to a recent report made by the Council for Development of Cambodia (CDC),²³ the amount of foreign aid disbursed during the last twelve years (1992-2003) has reached US\$5.2 billion. The CDC report showed that foreign aid disbursements increased steadily, reaching US\$546 million in 2003, up from US\$531 million in 2002 and US\$472 million in 2001. The increase of aid disbursement in 2003 came only from European Union countries and the European Commission. Aid from other international donors was flat. By country, Japan has so far been the most important donor. It provided US\$101 million of aid to Cambodia in 2003,

²³ Royal Government of Cambodia (2004), Development Report 2002 and 2003, CDC and CRDB, October 2004

although its share of total foreign aid has slightly declined each year (down to 18.5 percent in 2003 from 22 percent in 1999).

Loans represented about 21 percent of total foreign aid disbursed during the last twelve years, but the share of loans has been steadily growing over that period. In 2003, the share of loans represented more than 30 percent of total foreign aid, up from only 17 percent in 1999. Bilateral donors also started to provide substantial loans to Cambodia in 2002, amounting to US\$32 million in 2002 and US\$13 million in 2003. Loans provided by international financial institutions (ADB, World Bank and IMF) reached US\$148 million in 2003.

Based on a recent government report,²⁴ the amount of grants and loans provided by foreign donors in 2004 was estimated to be basically flat compared with 2003. Cambodia's outstanding foreign debts recognized by the government (owed to the international financial institutions and to some bilateral donors) are estimated to reach US\$ 1.2 billion at the end of 2004. The Cambodian government has started as of 2003 to pay back some of the early loans, though a small amount of interest has been paid since 1993.

However, if the growth of loan disbursement remains strong over the next ten years, and no critical reforms are made to improve tax collections, Cambodia will inevitably face a debt reimbursement crisis. The amortization of loans (excluding the IMF loans that support the balance of payments at the National Bank) reached US\$9 million in 2003, up from US\$2 million in 2002 and US\$1 million in 2001. In 2004, this amortization might reach US\$16 million, according to the IMF assessment.

²⁴ Ministry of Economy and Finance, State Budget Implementation January to November 2004