

Chapter 4

Fiscal Developments and External Debts

Fiscal policy has been 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 2003 were characterized by a shortfall in revenue and a significantly lower-than-expected amount of disbursements within the social sectors.

4.1. Budget Revenue

According to the Budget Law of 2003, total domestic revenue was planned at CR 2,074 billion (about US\$520 million), representing an increase of 14.2 percent compared to the budget law of 2002 and an increase of 17.7 percent compared to the budget that was actually implemented in 2002. To reach this target, the government introduced a number of revenue-boosting strategies, such as upgrading information systems and strengthening enforcement measures at the customs and tax department, as well as the National Treasury.²⁵ Enforcement of tax arrears collections also was pledged. However, according to statistics compiled by the Ministry of Economy of Finance, the total domestic revenue shortfall was about 17 percent compared with the planned budget.²⁶ The shortfall was likely the result of the *"laissez-faire"* attitude during the election period, especially at the customs department.

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. During the first eight months of 2004, domestic revenue recorded at a 22 percent increase compared with the same period in 2003. Tax collections reached 33 percent. Under some pressure from the public, the Cambodian government seems to be making some efforts to fight tax evasion or the smuggling of petroleum products. Tax revenue generated

²⁵ Letter of intent sent by the Cambodia's Minister of Finance, and the Governor of the National Bank to the Managing Director of the IMF dated January 17, 2003, also available at <http://www/omf.org/external/np/loi/2003/khm/01/index.htm>

²⁶ Ministry of Economy and Finance (2004), "State Budget Implementation, January to December 2003", February 2004

from these items increased by 23 percent, though it was still far lower than the budget target.

However, non tax revenue collection seems to remain very weak, seeing only a 4 percent growth compared to the same period of previous year. Revenue from forestry and fisheries continued to decline to only CR 7 billion for the first eight months of 2004, down from CR 12 billion in 2003 and CR 24 billion in 2002. 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 27 percent, while the export of garments increased by about 30 percent during the same period. Helping to make up for these shortfalls seems to be the Cambodian government's new source of revenue from casino activity, which should contribute to the national budget CR40 billion in 2004, a sharp increase from CR 29 billion in 2003, and nil in 2002. Overall, thanks to the good performance in tax collections, the government budget revenue effectively collected in 2004 will likely reach the budget target.

Table 4.1: Cambodia's Government Revenue

	Billion Riels			Percentage of GDP		
	2002 Actual	2003 Actual	2004 Projection	2002 Actual	2003 Actual	2004 Projection
Total Domestic Revenue	1,762	1,746	2,126	11.2%	10.4%	11.4%
Tax Revenue	1,249	1,218	1,535	8.0%	7.3%	8.2%
Profit Taxes	97	118	135	0.6%	0.7%	0.7%
Excise Taxes	210	197	310	1.3%	1.2%	1.7%
Value Added Taxes	452	433	530	2.9%	2.6%	2.8%
Trade Taxes	424	395	510	2.7%	2.4%	2.7%
Other Tax Revenue	66	75	50	0.4%	0.4%	0.3%
Non-tax Revenue (1)	513	528	591	3.3%	3.1%	3.2%
Contribution from Tourism (2)	93	77	118	0.6%	0.5%	0.6%
Quota & Export Licenses	106	146	115	0.7%	0.9%	0.6%
Posts & Telecommunication	121	114	120	0.8%	0.7%	0.6%
Other Revenue (1)	192	191	238	1.2%	1.1%	1.3%
Memorandum Items						
<i>Taxes on Petroleum Products</i>	309	279	352	2.0%	1.7%	1.9%
<i>Tax Department Revenue</i>	298	343	375	1.9%	2.0%	2.0%
<i>Customs Department Revenue</i>	952	875	1,160	6.1%	5.2%	6.2%

Source: Ministry of Economy and Finance for 2002-2003, and EIC estimates for 2004, based on the budget law for 2004 and eight months implementation trends

(1) Including Capital Revenue

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

4.2. Budget Expenditure

On the expenditure side, total government spending in 2003 reached 91 percent of the budget level, about 5 percent higher than the level of 2002. Priority has been accorded to spending on four major sectors: Education, Health, Agriculture and Rural Development. The Cambodian government intended to increase the budget for these priority sectors to 3.7 percent of GDP in 2003.²⁷ Again, Ministry of Economy and Finance figures show, however, that the real disbursement reached only 2.5 percent of GDP in 2003, though it slightly increased from 2002.²⁸ The Ministry of Health received only 59 percent of the amount allocated by the budget law, and the Ministry of Rural Development received 53 percent. Relative to GDP, budget spending for other civil ministries and for Defense and Security declined slightly. The most significant drop of government spending in 2003 was the public investment funded by foreign aid, likely due to the prolonged political deadlock after the July 2003 election.

Although government revenue collection was adequate, the line ministries seemed to continue to suffer from a lack of cash. During the first eight months of 2004, total government current expenditure declined by about 23 percent, compared with the same period in 2003. Spending on wages declined by 4 percent and non-wages by 35 percent compared with the same period in 2003. Compared with the budget law figures, salary payments for civil servants reached only 52 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 eight months of 2004, these sectors received only, on average, 33 percent of the annual allocated budget. Rural Development received just 19 percent, Health 22 percent, Agriculture 30 percent and Education 42 percent. For that reason, it is very unlikely that the effective 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.

²⁷ Letter of intent sent by the Cambodia's Minister of Finance, and the Governor of the National Bank to the Managing Director of the IMF dated January 17, 2003, also available at <http://www/omf.org/external/np/loi/2003/khm/01/index.htm>

²⁸ Ministry of Economy and Finance (2004), "State Budget Implementation, January to December 2003", February 2004

Table 4.2: Cambodia's Government Expenditure

	Billion Riels			Percentage of GDP		
	2002 Actual	2003 Actual	2004 Projection	2002 Actual	2003 Actual	2004 Projection
Total Expenditure	2,770	2,914	3,128	17.7%	17.4%	16.7%
Current Expenditure	1,579	1,670	1,746	10.1%	10.0%	9.3%
Civil Administration	1,192	1,273	1,316	7.6%	7.6%	7.0%
Priority Sectors (1)	373	426	483	2.4%	2.5%	2.6%
Other Civil Ministries	819	847	833	5.2%	5.1%	4.4%
Defense & Security	387	397	430	2.5%	2.4%	2.3%
Defense	258	256	280	1.6%	1.5%	1.5%
Security	129	141	150	0.8%	0.8%	0.8%
Capital Expenditure	1,191	1,244	1,382	7.6%	7.4%	7.4%
Through National Treasury	288	334	350	1.8%	2.0%	1.9%
Direct External Financed	903	910	1,032	5.8%	5.4%	5.5%
Memorandum Items						
<i>Wages</i>	<i>586</i>	<i>615</i>	<i>665</i>	<i>3.7%</i>	<i>3.7%</i>	<i>3.6%</i>
<i>Non-Wages Operating Costs</i>	<i>993</i>	<i>1,055</i>	<i>1,081</i>	<i>6.3%</i>	<i>6.3%</i>	<i>5.8%</i>

Source: Ministry of Economy and Finance for 2002-2003, and Budget Law for 2004

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

4.3. Budget Financing

Due to a significant decline in domestic revenue, the overall budget deficit grew to 7 percent of GDP in 2003, from 6.4 percent in 2002. Thanks to better prospects in tax collection, however, the budget deficit for 2004 is expected to decline slightly to 5.8 percent of GDP. This deficit was mainly financed by foreign assistance, under grants or loans. In 2003, domestic financing to the budget deficit was substantial (about 1 percent of GDP), compared with previous years when it was more or less nil. Direct bank financing to the budget remained firmly under control.

4.4. Foreign Aid and External Debts

According to a recent report made by the Council for Development of Cambodia (CDC),²⁹ external development partners of Cambodia have been generous in providing support to its development programs. 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

²⁹ Royal Government of Cambodia (2004), Development Report 2002 and 2003, CDC and CRDB, October 2004

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

Table 4.3: Cambodia's Financing Budget

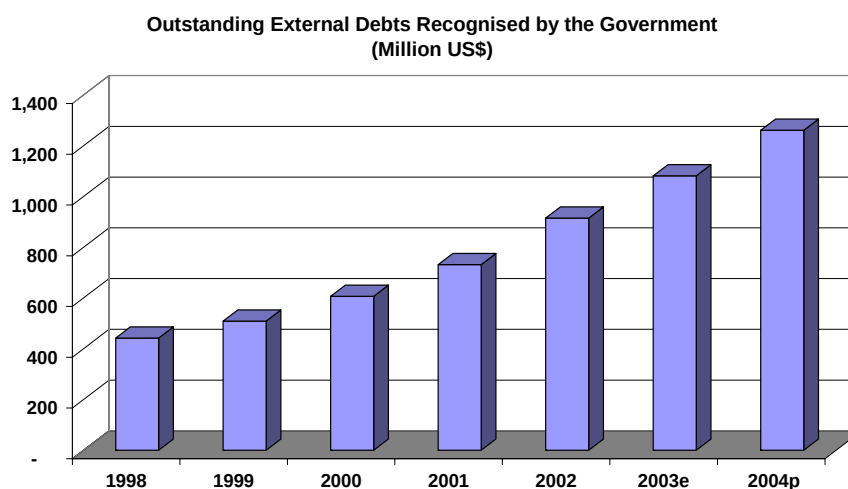
	Billion Riels			Percentage of GDP		
	2002 Actual	2003 Actual	2004 Projection	2002 Actual	2003 Actual	2004 Projection
Total Domestic Revenue	1,762	1,746	2,126	11.2%	10.4%	11.4%
Total Expenditure	2,770	2,914	3,128	17.7%	17.4%	16.7%
Total Deficit (cash basis)	-1,008	-1,168	-1,002	-6.4%	-7.0%	-5.4%
Foreign Financing (1)	1,074	1,009	1,081	6.9%	6.0%	5.8%
Grants	451	412	428	2.9%	2.5%	2.3%
Loans (net)	622	597	653	4.0%	3.6%	3.5%
Domestic Financing	-65	159	-79	-0.4%	0.9%	-0.4%
Banks	-104	4	-57	-0.7%	0.0%	-0.3%
Others	38	155	-22	0.2%	0.9%	-0.1%
Memorandum Items						
<i>Net Foreign Reserves at NBC</i>	2,267	2,539	2,719	14.5%	15.1%	14.6%

Source: Ministry of Economy and Finance for 2002-2003, and EIC estimates for 2004, based on the budget law and seven months implementation trends

(1) Including only project aid

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 2002 and 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) were flat in 2003 compared to 2002, reaching US\$148 million, but these loans have significantly increased compared with previous years (US\$115 million in 2001, US\$95 million in 2000 and US\$65 million in 1999).

Based on an IMF assessment in July 2004 and the trend over the last eight months, the amount of grants and loans provided by foreign donors in 2004 was estimated to have increased slightly compared with 2003. Project grants will increase to US\$100 million in 2004 from US\$90 million in 2003, while total net loans (including budget support and project loans) will reach US\$164 million, up from US\$150 million in 2003.



Source: Council for the Development of Cambodia

With rapid disbursements of loans, Cambodia's outstanding foreign debts recognized by the government (owed to the international financial institutions and to some bilateral donors) also sharply increased, reaching US\$1,082 million at the end of 2003. However, the outstanding debt owed to the US during 1970-1975 (about US\$300 million) has yet to be recognized by the government. The recognition and repayment of this debt is under negotiation. In the meantime, as the majority of the other loans are concessional, with a seven to ten years grace period, 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.