Cambodia Economic Update
May 2023

THE WORLD BANK
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East Asia & Pacific

Post-COVID-19 Economic Recovery

SPECIAL FOCUS

From Spending More to Spending Better – Toward Improved Human Development Outcomes

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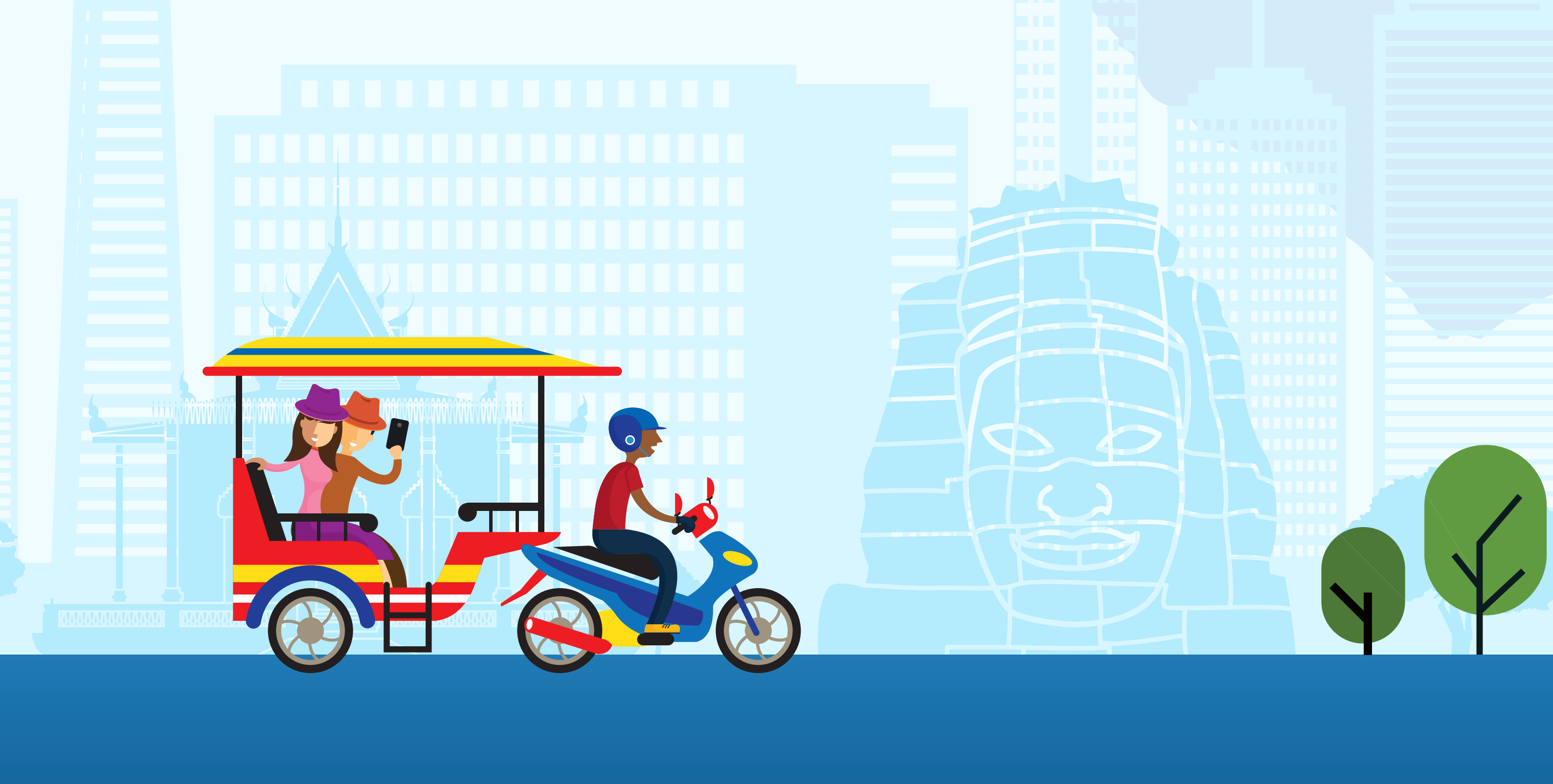

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Acknowledgements

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The CEU, produced biannually, provides up-to-date information on macroeconomic developments in Cambodia. It is distributed and discussed widely including among Cambodian authorities, development partners, the private sector, think tanks, civil society organizations, and academia.

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To be included in the email distribution list of the CEU and related publications, please contact Seakheang Heng (sheng4@worldbank.org). For questions on the contents of this publication, please contact Saroeun Bou (sbou@worldbank.org).

Abbreviations

ASEAN	Association of Southeast Asian Nations
CEU	Cambodia Economic Update
COVID-19	coronavirus disease 2019
CPI	Consumer Price Index
CR	Cambodian riel
CSES	Cambodia Socio-economic Survey
DP	development partner
EAP	East Asia and Pacific region
EMDEs	emerging market and developing economies
EU	European Union
FDI	foreign direct investment
FED	U.S. Federal Reserve
GDP	gross domestic product
GTF	garment, travel goods, and footwear
MEF	Ministry of Economy and Finance
MoEYS	Ministry of Education, Youth and Sport
MoH	Ministry of Health
NSSF	National Social Security Fund
OOP	out-of-pocket
PISA-D	Program for International Student Assessment for Development
QIP	Qualified Investment Project
U.S.	United States
US$	United States dollar
VAT	value-added tax
YTD	year to date
y/y	year on year


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CHAPTER 1
Recent Economic Developments and Outlook

Executive Summary

Recent developments

Cambodia's economic recovery solidified in 2022 with real growth accelerating to 5.2 percent. After shifting to "living with COVID-19" in late 2021, the economy is firmly on a path to recovery and has now returned to its pre-pandemic growth trajectory.

Initially led by the strong performance of export-oriented manufacturing, growth drivers are rotating to the services and agriculture sectors. Driven by pent-up consumer demand, the overall contribution of the services sector to economic growth is returning to the 2019 levels. Underpinned by the complete removal of COVID-19-related mobility restrictions and China's recent reopening, international arrivals have picked up, reaching 830,000 during the first two months of 2023, approaching pre-pandemic levels.

Meanwhile, the agriculture sector is benefitting from improved access to regional markets, thanks to newly ratified bi-lateral and regional free trade agreements. In addition to traditional agricultural commodities such as rice, cassava, and rubber, fresh mango and banana exports, especially to the Chinese market, have emerged. Banana exports quickly rose to US$182 million in 2022, up from US$49.3 million in 2019. There are also signs of a pick up in the construction and real estate sector which was a major, albeit not necessarily sustainable growth driver before COVID-19. While uncertainty in the housing market remains high, construction permit values started to accelerate for the first time since COVID-19, reaching US$802 million or a 484 percent year-on-year (y/y) increase during the first two months of 2023.

Weakening external demand is, however, starting to weigh on the country's economic recovery. Global growth is slowing sharply in the face of elevated inflation, higher interest rates, reduced investment, and disruptions caused by Russia's invasion of Ukraine. Thanks largely for the decline in exports to the U.S. and EU markets, total goods exports contracted at 14.2 percent y/y during the first two months of 2023, compared to an average growth rate of 6.7 percent in 2019. Of the 14.5 percent decline, garment exports contributed the largest, accounting for 11.8 percentage points. Approved foreign direct investment (FDI)-financed project value also shrank to US$156 million, contracting at 92.3 percent during the first two months of 2023. Of the total US$156 million, US$83 million (60 percent) went to the garment industry, while the remaining US$73 million (40 percent) financed the travel goods, footwear, and packaging industries.

Despite weakening goods export performance, the current account balance is improving, thanks to the rebound in the travel and tourism industry and remittances, while the oil price shock eased. In 2022, the current account deficit improved to an estimated 26.3 percent of gross domestic product (GDP), as the trade deficit narrowed, thanks to strong exports. The current account balance continued to be mainly financed by capital inflows and international reserves. Gross international reserves, therefore, declined to US$17.7 billion, covering about seven months of imports in February 2023, down from US$20.3 billion during the same period in 2022.

Inflation eased significantly, while the exchange rate has been stable, underpinning domestic consumption. Cambodia's Consumer Price Index (CPI) declined to 2.2 percent y/y in February 2023, after peaking at 7.8 percent y/y in June 2022, as energy and food prices stabilized. Thanks to the central bank's open market operations, the nominal exchange rate has been broadly stable, hovering at 4,100 riel per U.S. dollar. Moderating inflation helped boost domestic consumption. During the first two months of 2023, quantity imports of consumer goods such as gasoline, alcohol, cooking oil, and sugar accelerated, growing at 28.1 percent, 16.7 percent, 79.7 percent, and 49.6 percent y/y, respectively. Similarly, value imports of durable goods such as passenger cars and buses rose to 6.6 percent and 127.1 percent y/y, respectively.

Financial conditions tightened, as Cambodia "imports" U.S. monetary policy, thanks to its highly dollarized economy. Rising U.S. interest rates pushed up domestic interest rates. The 12-month (weighted average) U.S. dollar deposit and lending rates rose to 5.54 percent and 10.19 percent, respectively in February 2023, up from 3.94 percent and 9.51 percent, respectively during the same period in 2022. Given lags in monetary policy transmission, the full impact on activity of the current monetary policy tightening cycle has yet to fully materialize. Going forward, the tightening cycle will likely hurt investment and consumer spending.

Broad money growth decelerated to 6.8 percent y/y in February 2023, down from 14.5 percent during the same period in 2022, possibly caused by global financial condition tightening. The deceleration of broad money growth was driven mainly by the easing of foreign currency deposit growth, reflecting slower capital inflows. The contribution by foreign currency deposits, the main component accounting for more than 80 percent of broad money, declined to 5.7 percentage points in February 2023, down from 11.7 percentage points during the same period in 2022. Similarly, private sector deposit growth halved, declining to 7.5 percent y/y in February 2023, down from 15.8 percent during the same period in 2022. While remaining strong, growing much faster than the nominal GDP growth rate, domestic credit growth also eased, expanding at 14.8 percent y/y in February 2023, down from 22.6 percent during the same period in 2022, thanks to rising borrowing costs.

The economic recovery and good revenue administration underpinned an across-the-board improvement in domestic revenue collection. In 2022, general government revenue collection surged, expanding at 19.5 percent, helping contain the overall fiscal deficit, which is estimated to have narrowed to 4.7 percent of GDP. As a result, government deposits (fiscal reserves) rose to 17.8 percent of GDP (21.9 trillion riel), up from 17.6 percent of GDP (19.5 trillion riel). In the past decade, improvements in the fiscal space as a result of a rapid expansion of domestic revenue allowed the government to boost spending in the health and education sectors. In addition, Cambodia's budget allocation boost was driven partly by across-the-board salary increase for its civil servants. Average monthly public sector pay is now higher than private sector pay. Cambodia is currently among the countries with the highest share of its general government revenues spent on the public wage bill (see the Special Focus section).

The authorities continued to provide cash transfers for poor and vulnerable households, although the worst of the pandemic is now behind us. In this regard, the Cambodian authorities have extended the COVID-19 cash transfer program, with an additional budget of roughly US$400 million. As of March 2023, it had disbursed US$994 million since the launch in June 2020. In addition, the authorities have launched new cash transfer programs for households at risk due to inflationary pressures and severe flooding. In the first round of implementation, the cash transfer under the inflationary pressure scheme disbursed US$9.12 million and benefited 261,000 households. The cash transfer program under the flooding scheme was completed by March 2023, disbursed US$11.6 million, and benefited 99,000 households.

Outlook

Cambodia's real GDP growth for 2023 is projected to accelerate further, reaching 5.5 percent (see table ES1). Despite the easing of goods exports, the current account deficit is expected to improve to 19.3 percent of GDP on the back of the recovering services exports, especially tourism receipts and remittances. Despite the recent decline in approved FDI projects, continued robust capital inflows and concessional financing will continue to largely cover external financing needs.

In 2023, the fiscal deficit is expected to widen to 6.4 percent of GDP. Revenue, including grants, is improving, and is projected to remain strong, reaching 23.5 percent of GDP. Expenditure is expected to increase to 29.9 percent of GDP, thanks to rising post-pandemic operating expenses that include an across-the-board public sector wage increase and an increase in goods and services expense as well as general election-related spending and the hosting of the Southeast Asian Games and the ASEAN Para Games.

Over the medium term, the economy is expected to trend back to potential, growing at 6 percent. Goods and services exports and FDI inflows are expected to be bolstered by the newly ratified free trade agreements; a substantial increase in private and public investment in key physical infrastructure such as seaports and roads, especially under public-private partnerships; and structural reforms. Poverty is expected to decline due to the projected economic recovery and moderating inflation.

Table ES1 Real growth projections

	Projections			Change from March 2023		
	2023	2024	2025	2023	2024	2025
Real growth	5.5	6.1	6.3	0.3	0.4	0.2

Challenges and risks

The outlook is, however, subject to downside risks. An extended slowdown in external demand could weaken Cambodia's export-oriented manufacturing, which generates about 40 percent of total employment in the industrial sector (17.3 percent of total non-farm employment). Continued global financial tightening could affect the highly leveraged financial sector, which has been partly behind the recent construction boom. A renewed oil price shock may stoke inflation and dampen domestic consumption. Domestically, concentration of domestic credit in the construction sector remains a key risk to financial stability.

On the upside, stronger-than-expected global growth could mitigate the downside drag of weak external demand. A stronger-than-expected rebound in China could bolster stronger tourism receipts, exports, and FDI inflows which could help offset the expected decline in advanced economies to a greater extent than assumed in the baseline. In addition, growth in advanced economies, while likely slower than last year, may also turn out to be stronger than expected, dampening the projected decline in exports.

Policy options

Macroeconomic policy should continue to support growth and employment, while maintaining macro-financial stability. This has become more challenging in the context of tightening financial conditions and rising private debt levels. But inflation has quickly retreated to pre-pandemic levels, allowing the authorities to continue with accommodative monetary policy by maintaining or lowering the reserve requirement ratio. While fiscal consolidation will be necessary over the medium term, this consolidation can proceed at a relatively gradual pace given manageable public debt levels. Cambodia has the fiscal space to maintain or even increase growth-enhancing spending on connectivity infrastructure and human development which will boost the productive capacity of the economy over the longer term. Continuing to provide social assistance to the poor, while stemming the learning loss that Cambodia experienced during the time of COVID-19 and building back better, is also necessary to promote inclusive growth. Accompanying increased public investments with steps to enhance value for money and spending efficiency would ensure high spending translates into better outcomes, as discussed in more detail in part 2 of this report.

Safeguarding financial stability also remains a priority. The recent rapid credit growth and relatively high private sector debt, with a concentration in real estate related exposures pose key risks to Cambodia's macro-financial stability. Intensified supervision is called for as pandemic measures such as loan restructuring and forbearance are phased out. This could include enhanced focus on stress testing of individual institutions, systematic onsite inspections, further aligning the regulatory framework with international standards, and further assessing the quality of loan portfolios, among others. In parallel, the authorities should continue with efforts to prepare legislation on deposit insurance and bank resolution. To prepare for increasing levels of non-performing loans (NPLs), the authorities should ensure that resolution options are ready to be deployed as needed. Similarly, the country's insolvency regime can be improved. Given concerns around shadow banking activities, such as credit issued by construction or real estate developers to buyers of residential real estate, it will be of critical importance to collect the data necessary to monitor and assess the legality of these activities.

To enhance the long-term resilience and competitiveness of the economy, efforts are needed to further promote export product diversification. Unlike other countries in the region, Cambodia has had limited success in diversifying outside of garments, footwear, while the country's agroprocessing capacity remains limited. To move to the next stage of participation in global value chains (GVCs), the policy mix will need to evolve. First, attention should be paid to contract enforcement, protecting intellectual property rights, and strengthening national certification and testing capacity to ensure compliance with international standards. Second, lowering barriers to trade and improving connectivity to markets would expand the size of the market for Cambodia's products and improve access to the inputs needed for production. Third, continue improving the education and skills of Cambodia's labor force by investing in human capital. Fourth, harness the digital economy to support firms to integrate into GVCs through digital platforms as well as by connecting value chain participants.

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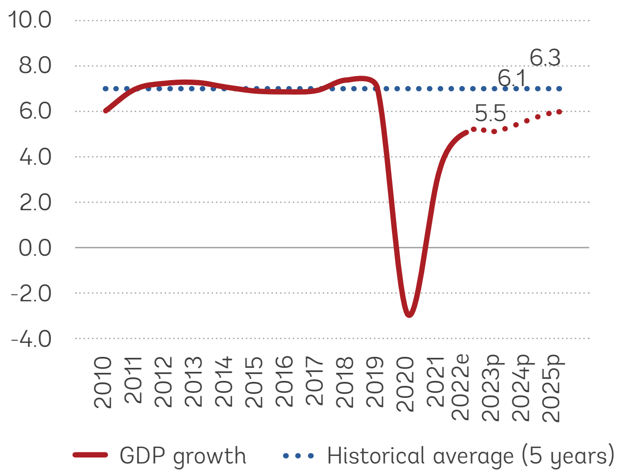
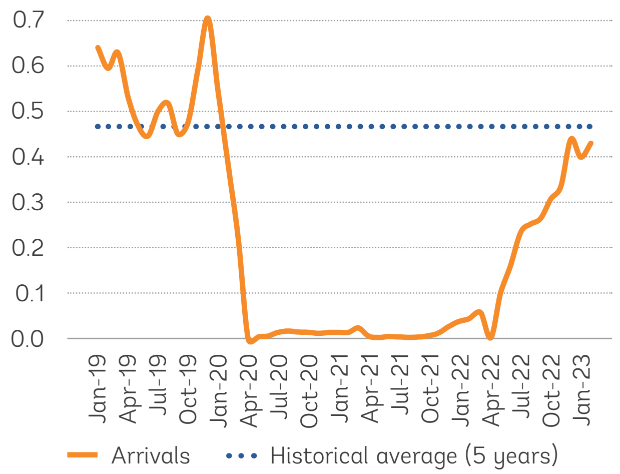
Figure ES.1 Cambodia's recent developments at a glance

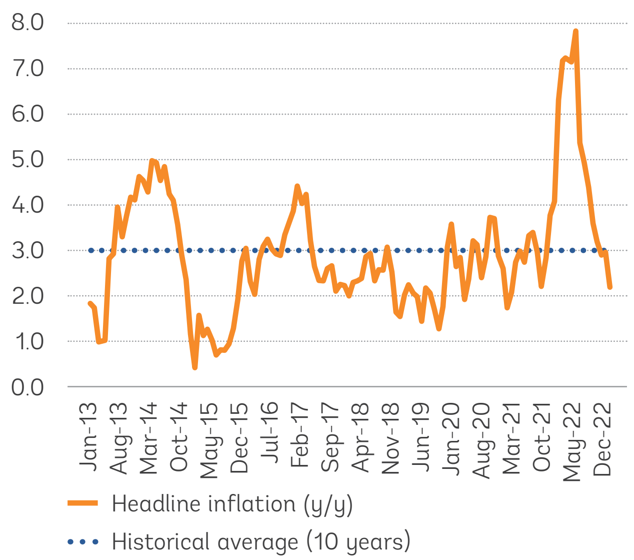
Economic growth continued to solidify…
Real growth (percent)



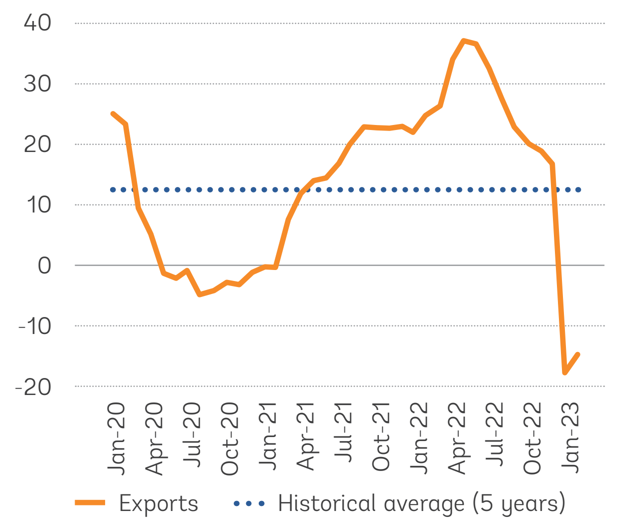
…thanks to an accelerated recovery of services…
International arrivals (million)



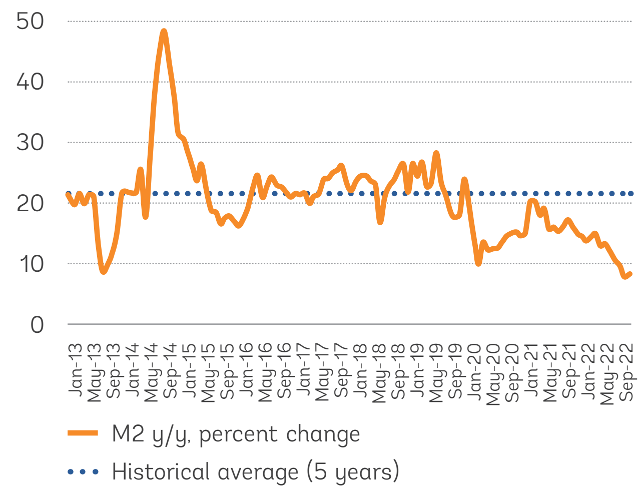
…supported by easing inflation…
(y/y percent change)



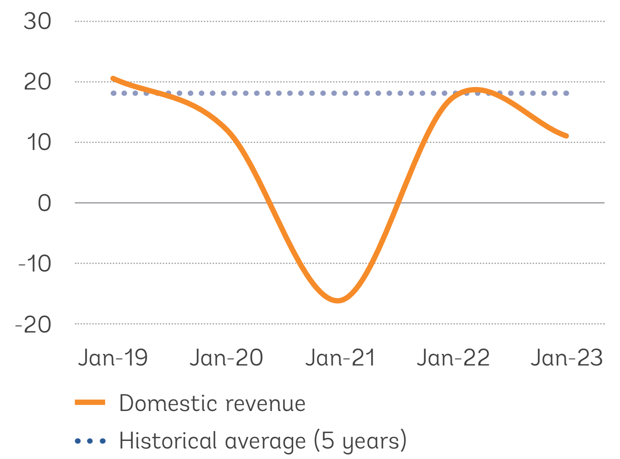
…helping offset the decline in goods exports…
Goods (excluding gold) exports (YTD, y/y percent change)



…broad money (M2) growth decelerated…
Broad money liabilities (y/y percent change)



…domestic revenue growth fully recovered.
Central government domestic revenue (y/y percent change)



Sources: Cambodian authorities; World Bank staff estimates and projections.
Note: e = estimates; p = projection; YTD = year to date; y/y = year on year.

Recent developments

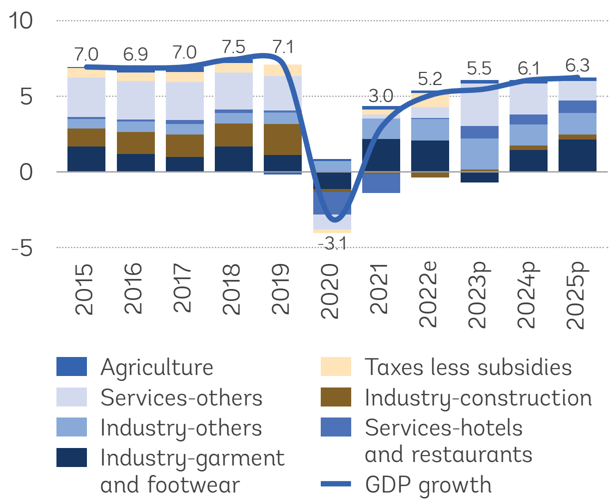
Pent-up consumer demand boosted the services sector

Cambodia's post-pandemic economic recovery is well underway. Owing to the success in rolling out its vaccination program, Cambodia shifted to "living with COVID-19" in late 2021. As a result, the country's economic recovery solidified in 2022, with real growth accelerating to 5.2 percent (figure 1). Initially led by strong performance of the export-oriented manufacturing industry, the economic recovery is now increasingly underpinned by a strong rebound in the services sector, especially the trade, travel, and hospitality industries, driven by pent-up consumer demand and the return of foreign tourists. Domestic consumption is also being boosted by the easing of inflation as energy and food prices stabilized.

Similarly, in most of the developing East Asia and Pacific (EAP) region, economic activity has recovered from the recent COVID-19 and oil price shocks, with goods exports and private consumption leading the way.[1] A regional comparison shows that even if Cambodia is able to solidify its economic recovery from the recent shocks, it has been lagging behind Vietnam and China. By the end of 2022, Cambodia and many countries in the East Asia and Pacific region, namely Indonesia, Lao PDR, Malaysia, Mongolia, the Philippines, Nauru, Kiribati, and Papua New Guinea, exceeded pre-pandemic levels of output, while China and Vietnam did so in 2020. In contrast, output remains below pre-pandemic levels in several Pacific Island countries as well as in Myanmar, Thailand, and Timor-Leste. Three broad factors influenced economic growth in EAP countries: COVID-19 containment measures, external conditions, and the capacity of the government to provide support. Cambodia has been able to avail itself of all of them.

But now there are signs of weakening external demand as global growth is decelerating sharply this year.[2] This is caused by overlapping shocks that include synchronous policy tightening aimed at containing very high inflation, worsening financial conditions, and continued disruptions from the Russia's invasion of Ukraine. Small states, including Cambodia, are especially vulnerable to such shocks because of their reliance on external trade and financing, limited economic diversification, elevated debt, and susceptibility to natural disasters (see box 1 on global economic developments and outlook).

Figure 1 Economic recovery solidified
Contribution to real GDP growth (percent)



Sources: Cambodian authorities and World Bank staff projections.
Note: e = estimates; p = projection.

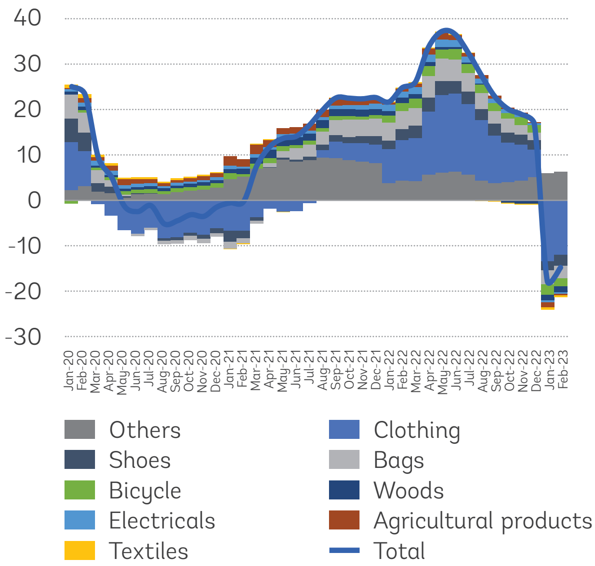
1 World Bank 2023a.
2 World Bank 2023b.

Cambodia's goods exports started contracting in recent months

Recent high-frequency indicators suggest weakening external demand. Caused largely by the decline in exports to the U.S. and EU markets, total goods exports contracted 14.2 percent year on year (y/y) during the first two months of 2023 (figure 2), compared to an average growth rate of 6.7 percent in 2019. Cambodia's small, open economy remains dependent on global demand. Elevated commodity prices and financial tightening in advanced economies continue to affect the EAP region's economies through both real and financial channels.

FIGURE 2 Goods exports contracted

Contribution to export growth (percentage point)



Source: Cambodian authorities.

As depicted in figure 2, deterioration of garment, travel goods, and footwear exports was particularly pronounced, indicating a relatively elastic demand for these products with respect to incomes of Cambodia's main export markets, especially the United States and European Union. Of the 14.5 percent decline in total exports during the first two months of 2023, garments, travel goods, and footwear contributed the largest, accounting for 11.8 percentage points, 2.7 percentage points, and 2.4 percentage points, respectively. The contribution of "other goods exports," however, expanded, accounting for 6.7 percentage points.

Box 1 Global economic developments and outlook

Global growth is expected to slow markedly this year, weighed down by significant synchronous policy tightening aimed at containing high inflation and worsening financial conditions.[a] While inflation shows signs of peaking in many advanced and emerging market and developing economies (EMDEs), it remains high overall (figure B1.1). Persistent high inflation led some central banks, notably the U. S. Federal Reserve and the European Central Bank, to continue hiking policy rates in early 2023. While monetary policy tightening cycles appear to be near their peak in many countries, the drag from existing interest rate hikes is set to deepen in the near term given the lags between changes in monetary policy and its economic impacts. Recent turmoil in the U.S. and European banking sectors has also contributed to tighter financial conditions and added to uncertainty.

Global trade is expected to slow this year alongside weakening global activity. Around the turn of the year, global goods trade contracted as weak demand in advanced economies weighed on EMDE exports. However, the services trade outlook is more positive, with the recovery in global tourism expected to continue, supported by the China reopening. Normalization of shipping conditions and weakened demand for goods contributed to the return of global supply chain pressures to pre-pandemic levels in early 2023.

Global food and energy prices have moderated from their peaks in 2022 but remain elevated, while metals prices have edged up owing to anticipated stronger demand from China. Energy and food prices are expected to ease this year, weighed down by subdued global demand. In many countries, easing commodity prices will help cool inflation in the near term, alongside weaker activity.

In the East Asia and Pacific (EAP) region, growth is expected to pick up this year. This primarily reflects stronger growth in China, where an earlier-than-expected economic reopening and a rapid decline in COVID-19 cases earlier this year are supporting a recovery in activity following very weak growth in 2022. In the first months of the year, retail sales recovered while investment remained solid, supported by infrastructure spending. By contrast, industrial production was more subdued, in part reflecting weak external demand. In the EAP, excluding China, growth is expected to moderate in 2023 following very strong growth in 2022 associated with economic reopening.

Risks to the global outlook remain tilted to the downside. Tight global financial conditions amid high debt could trigger financial stress, particularly in less creditworthy countries. Monetary policy could remain tight for longer than expected if inflation pressures persist. In the event of weaker growth, limited fiscal space in many countries reduces the ability of governments to support activity.

The expected slowdown in global growth is occurring amid a broad-based slowdown in global and EMDE potential growth.[b] Absent reform, potential growth in EMDEs is projected to continue declining over the remainder of the 2020s (figure B1.2). A combination of the pandemic-induced shock and reverberations from the war in Ukraine are expected to weigh on long-term growth, including through adverse impacts on human capital accumulation and investment. The EAP is expected to experience the sharpest slowdown of all EMDE regions, reflecting slower capital accumulation and total factor productivity growth, including in China.

Figure B1.1 Inflation

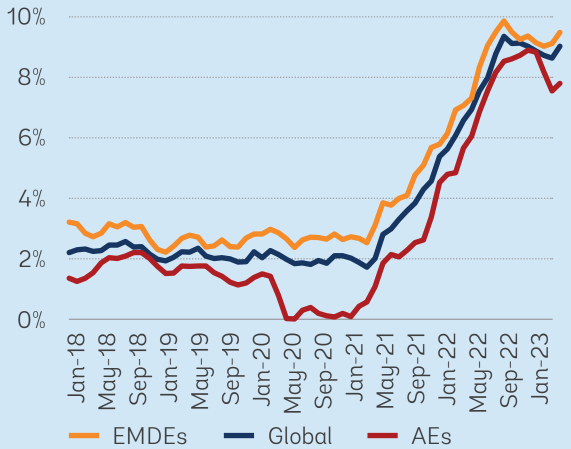
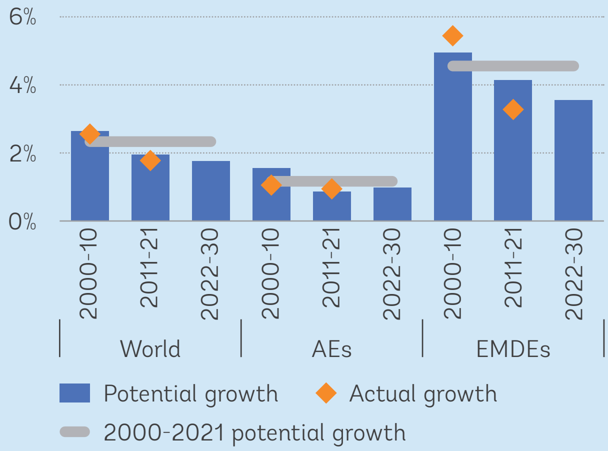


Figure B1.2 Potential growth



Sources: a. World Bank 2023a. b. Kose and Ohnsorge 2023; World Bank. 2023b.
Note: This box was prepared by Samuel Christopher Hill, DECPG.

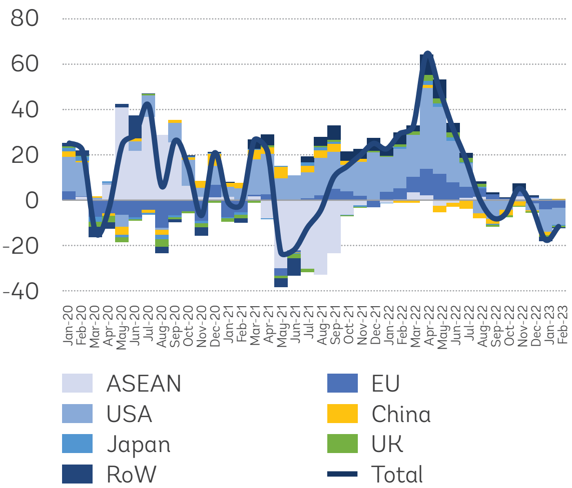
The decline in goods exports to the U.S. and EU markets accounted for 95 percent of total decline

Falling demand from the United States and the European Union caused by the economic slowdowns in the two main export markets, was the main reason for the decline in Cambodia's goods exports. The contribution of the U.S. market to the country's goods exports growth plummeted from 35 percentage points in April 2022 to negative 7.6 percentage points in February 2023, while that of the EU market shrank from 11.9 percentage points to negative 3.1 percentage points during the same period (figure 3). Given the U.S. and the EU markets are the first- and second-largest export markets for Cambodia, the declines in the two markets combined accounted for 95.4 percent of total decline in exports during the first two months of 2023.

Cambodia's merchandize exports to the United States dipped by 20.2 percent during the first two months of 2023. Consequently, the share of the U.S. market shrank to 40.9 percent of total goods exports in February 2023, after peaking at 48.3 percent in June 2022. Similarly, Cambodia's exports to the EU market dipped by 17.7 percent. The share of the EU market decreased to 17.1 percent in February 2023, after peaking at 20.6 percent in July 2022. In contrast, the contributions of the Chinese and ASEAN markets to Cambodia's goods exports growth remained positive but insignificant, accounting for only 0.7 percentage points and 0.1 percentage points, respectively.

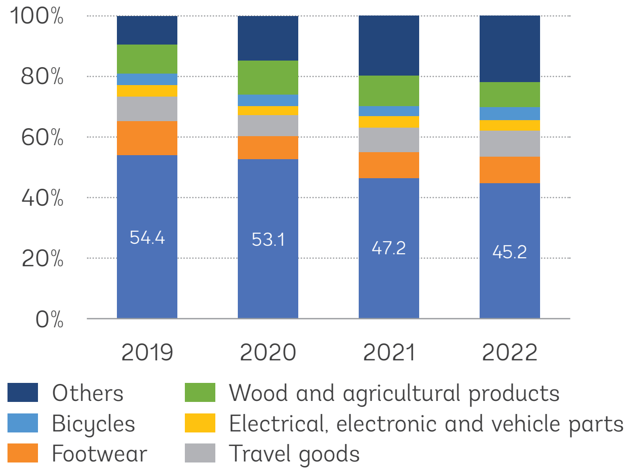
Export product diversification is slowly emerging. Despite continued dependency on garment exports, non-garment exports are increasing. The share of garment (and textile) product exports declined to 45.2 percent in 2022, down from 54.4 percent in 2019 (figure 4). The share of goods exports classified under "others" rose to 21.8 percent in 2022, up from 9.4 percent in 2019. During the same period, the share of bicycle exports rose to 4.4 percent, up from 3.7 percent. However, the share of electronic, electrical, and vehicle parts in total exports remained relatively small and unchanged at around 3.5 percent, possibly indicating that the country's electronic and electrical sector has yet to achieve competitive advantages. There have been continued challenges in addressing the high costs (and unreliable supply) of energy and logistics, and an overall lack of labor skills, which likely constrain the country's participation in electronic and electrical value chains. Similarly, the shares of travel goods and footwear products remained relatively unchanged at 8.7 percent and 8.0 percent, respectively.

Figure 3 Contribution to goods export growth (percentage point)



Source: Cambodian authorities.
Note: RoW = rest of the world.

Figure 4 Goods export diversification continued (percentage share)



Source: Cambodian authorities.

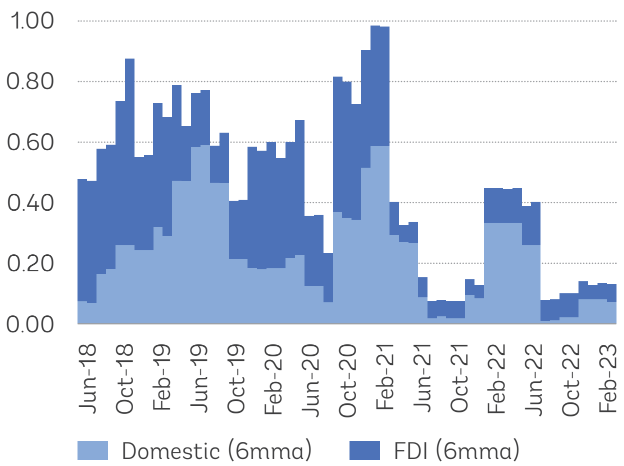
The total investment amount of approved FDI projects slowed

During the first two months of 2023, approved FDI project value classified as Qualified Investment Project (QIP) declined to US$156 million, contracting 92.3 percent (figure 5). Despite the decline in garment, travel goods, and footwear (GTF) exports, foreign investor appetite to finance the GTF industry continued. Of the total US$156 million, US$83 million (60 percent) went to the garment industry, while the remaining US$73 million (40 percent) financed the travel goods, footwear, and packaging industries. Meanwhile, the new Investment Law, adopted in late 2021, has not been implemented due to a delay in introducing its implementation sub-decree, which is expected to be ready this year.

This year's decline follows a significant increase in approved FDI project value last year. The total investment amount reached US$1.15 billion in 2022 or a 75.4 percent increase. In addition, the approved projects were diversified well beyond garment, which received only US$267 million or 22.8 percent of total investment (figure 6). Approved FDI project investment value in the non-garment industries reached US$803 million, or 68.6 percent of total investment, of which the logistics and hospitality sectors received US$1.3 billion and US$129 million, respectively. Investment in the energy sector (hydropower plant) accounted for US$389.4 million. Nevertheless, export diversification and value chain improvements remained a challenge due to the high costs of electricity (and supply unreliability) and logistics, and skills gaps, dampening the country's external competitiveness in high value-added products.

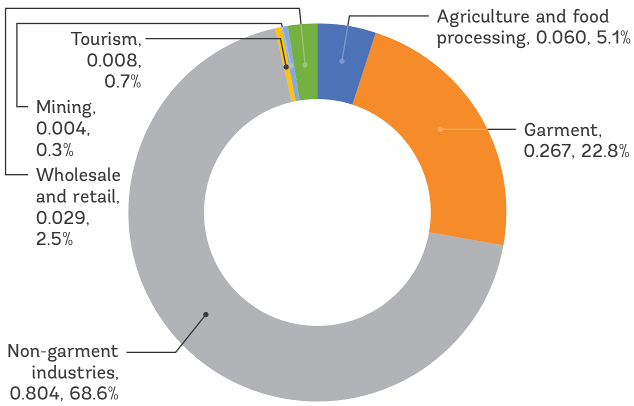
FDI inflows into Cambodia grew rapidly over the past decade and have remained relatively resilient even through the COVID-19 period. FDI inflows to Cambodia accounted for 12.9 percent of GDP in 2021, the 11th-largest FDI recipient in the world in relative (GDP) terms and second in ASEAN after Singapore (26.5 percent of GDP). Most of Cambodia's FDI comes from China and the EAP, but it is still more diversified than most other countries. As of 2022, FDI stock originated from China (including Hong Kong SAR, China); Korea; Singapore; Japan; and Taiwan, China, the top five FDI origins, accounting for US$17.2 billion, US$5.3 billion, US$2.9 billion, US$2.7 billion, and US$2.6 billion, respectively. The FDI stock from the top five combined accounted for more than two-thirds of the total FDI stock of US$44.5 billion. The inflows, however, were less successful in contributing to economic diversification or local value-adding (for more discussion on FDI, see box 2).

Figure 5 Investment appetite eased
Approved QIP value (US$ billion, 6-month moving average, fixed asset)



Source: Cambodian authorities.
Note: QIP = Qualified investment project.

Figure 6 Approved FDI-financed projects by sector (US$ billion, 2022)



Source: Cambodian authorities.

Box 2 What more can be done to improve the contribution of FDI to the economy?

Globally, the deteriorating economic environment caused by overlapping crises (the COVID-19 pandemic, Russia's invasion of Ukraine, and sharp monetary tightening to offset global inflation) has created unprecedented volatility and uncertainty for FDI inflows to developing countries. Underlying the volatility of FDI flows have been gradual but persistent shifts and pivots in the organizations of multinational corporations' international production and the associated FDI location decisions. The COVID-19 pandemic interrupted the rising share of FDI to developing countries but triggered an increase in services FDI and the changing geographic composition of FDI, such as a rise in near-shoring and diversification of supply chains, has emerged. Investment relocating from China is a key contributor to supply chain reconfiguration (figure B2.1).

FDI inflows to Cambodia grew rapidly over the past decade. FDI inflows doubled in 2019, compared to 2015's (figure B2.2) -- and have remained relatively resilient even through the COVID-19 period. The sources of Cambodia's FDI are more diversified than most other countries', although they come almost entirely from the EAP region -- China (including Hong Kong, SAR, China); the Republic of Korea; Singapore; Japan; and Taiwan, China are the top five FDI origins, accounting for 69 percent of total FDI stock (US$44 billion) in 2022. FDI inflows to Cambodia accounted for 12.9 percent of GDP in 2021, the 11th-largest FDI recipient in the world in relative (GDP) terms and second in ASEAN after Singapore (26.5 percent of GDP). FDI inflows to Cambodia have been increasingly concentrated in the accommodation, construction, real estate, and financial sectors. The inflows, however, were less successful in contributing to economic diversification or local value-adding. Low labor cost and tax incentives were the two main attractive factors.[a]

Figure B2.1 Rise in near-shoring and supply chain diversification

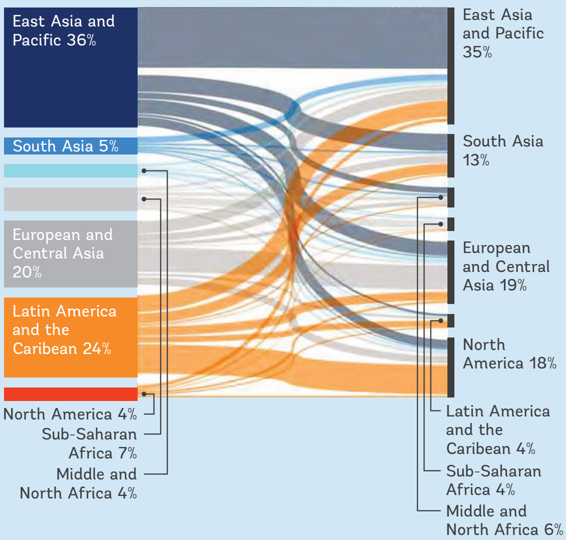
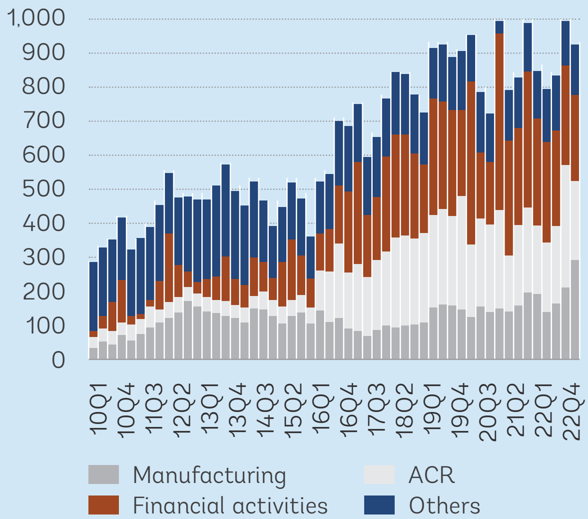


Figure B2.2 Cambodia's FDI by sector (US$ million)



Source: Cambodian authorities.
Note: ACR = Accommodation, construction, and real estate.

Box 2 What more can be done to improve the contribution of FDI to the economy? (continued)

Investment policies to attract, bolster, and connect FDI are summarized in table B2.1. While Cambodia has done relatively well in attracting FDI, it has been less successful in connecting FDI with domestic investment. Further improving the business environment and business regulations focusing on business licensing and business permits is necessary. Multinational corporations regard improvement of the business environment as the most impactful strategy to increase local sourcing.[b] Empirical evidence confirms business environment constraints are associated with the lower productivity performance of Cambodian firms. In the 2022 Global Competitiveness Index Cambodia ranks lower than peers in several business environment measures. Immediately removing restrictive policy measures introduced during the pandemic, that is, reintroduction and expansion of Customs' "green lane" is crucial to facilitate trade. Although investors note a sharp improvement in the quality and supply of infrastructure in recent years, transport and electricity still figure among the top 10 constraints.

Table B2.1 Investment Policies

1. ATTRACT	2. BOLSTER	3. CONNECT
Goal: Attract productive FDI, tasks, segments in global/regional value chains. Policy: Open entry (remove barriers and protectionism). Target investment promotion. Ensure transparent and streamlined implementation of the new Law on Investment, its sub-decree. Streamline business licensing procedures.	**Goal:** Bolster existing FDI for re-investment of corporate earnings, increase in investment, and expansion of operations. Policy: Strengthen investment protection (shareholders' rights), conflict resolution. Introduce commercial court, pro-active investment retention mechanisms, and targeted aftercare programs.	**Goal:** Connect FDI to local firms and deepen Global Value Chain integration. Policy: Establish an online portal and digital app to offer basic matchmaking services. Establish a supplier development program, SME promotion, develop human capital, and upgrade skills. Simplify VAT refunds.

Source: World Bank Global Investment Competitiveness 2021-2022 Survey data.
Note: This box was prepared by Peter Kusek, Gerlin May U. Catangui, and Sodeth Ly. a. 2018 FDI survey. b. 2018 FDI survey. SME = small and medium-sized enterprise; VAT = value-added tax.

Construction permits rose for the first time since 2019

For the first time since 2019, approved construction permit value increased during the first two months of 2023. Possibly reflecting renewed investor appetite to invest in the construction and real estate sector, approved construction permit value rose, reaching US$802 million, or a 484 percent increase during the first two months of 2023 (figure 7). Of this, approved construction permits for projects in Sihanoukville province, which experienced the most rapid construction boom during the pre-pandemic period, accounted for US$160 million, up from zero in 2022. The number of approved square meters of construction permits also rose, reaching 1.2 million, or a 278 percent increase. Despite improvements in construction permit numbers, property development activity likely continues to suffer from excess supply. Several years before the pandemic hit, Cambodia's urban centers such as the capital city of Phnom Penh, the tourist attraction site of Siem Reap, the seaside town of Sihanoukville, and the border towns of Poi Pet and Bavet, experienced a rapid construction boom. Given the country's relatively small domestic market, the boom created excess supply. In addition, the financial sector has been partly behind the recent construction boom. In this regard, it is increasingly important to safeguard financial stability (see the policy options section).

Despite rising construction permit value during the first two months of 2023, performance of construction material imports remained mixed. While steel imports mainly used for the construction industry accelerated, growing at 18.5 percent in volume terms during the first two months of 2023 (figure 8), imports of construction equipment and cement contracted at 7.1 percent and 38.3 percent, respectively.

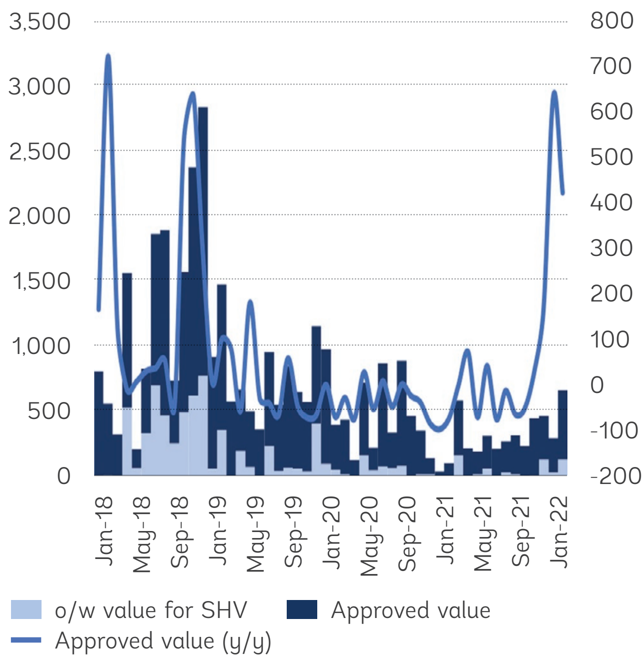
The recovery of tourism activity is picking up speed

Underpinned by a complete removal of COVID-19-related mobility restrictions, international arrivals quickly accelerated, reaching 837,000 during the first two months of 2023, approaching pre-COVID-19 levels (figure 9). Air arrivals were rising, accounting for 37.5 percent of total arrivals in 2023, up from 30.1 percent in 2022. Reflecting a rising number of foreign tourists visiting Siem Reap, Cambodia's largest tourist attraction site and where the Angkor Archeological Park is located, the share of international arrivals at the Siem Reap international airport also increased, reaching 30.4 percent (93,000) of total air arrivals during the first two months of 2023, up from 10.6 percent (3,000) during the same period in 2022. Thanks partly to a surge in international arrivals to Thailand, land arrivals skyrocketed, reaching 523,000 during the first two months of 2023, up from 42,000 during the same period in 2022.

The number of domestic tourists also surged. During the Khmer New Year in April 2023, there were about 13 million domestic tourists, which exceeded pre-pandemic levels, of which 2.1 million visited Siem Reap. Revenue from Angkor temple complex entrance fees increased to US$7.38 million during the first two months of 2023, up from US$478,000 during the same period in 2022.

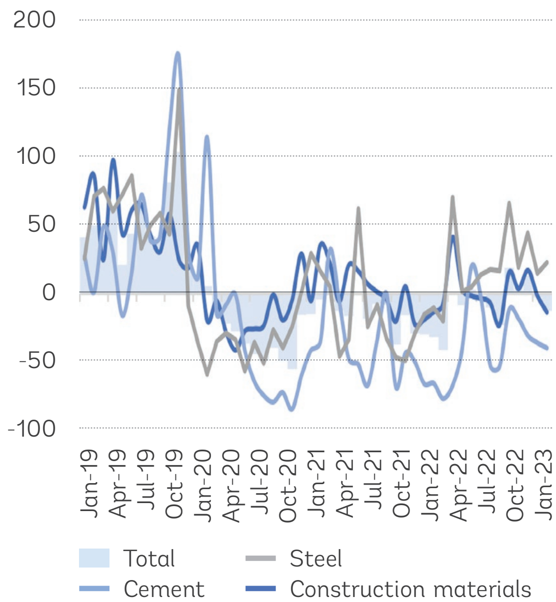
After China's reopening, Chinese tourist arrivals started to recover. Arrivals from China increased quickly in 2023 as their share rose to 9.5 percent of total arrivals during the first two months of 2023, up from 5.8 percent during the same period in 2022. Chinese tourists ranked third, after Vietnamese (28 percent) and Thai (26 percent), who ranked first and second, respectively.

Figure 7 Approved construction permit value improved (US$ million)



Source: Cambodian authorities.
Note: RHS = right-hand scale; SHV = Sihanoukville; YTD = year to date; y/y = year on year.

Figure 8 Volume of construction material imports remained subdued (y/y, percent change)



Source: Cambodian authorities.
Note: y/y = year on year.

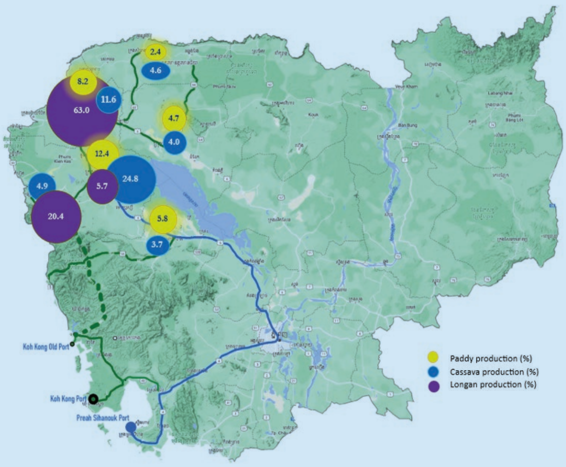
Box 3 Linking the "fourth economic pole" to the international gateways

Factors attributable to Cambodia's high transport costs include inadequate and inefficient transport networks. The high transport costs render the country's agricultural export prices less competitive, despite its competitive farmgate prices. As a result, farmers mostly sell their agricultural products to traders from neighboring countries, where they are reexported. While the country produces more than 13 million metric tons of cassava root for export, worth US$728 million a year, its direct export to China is only US$16.0 million (2.2 percent).[a] Similarly, the country's direct (milled) rice export value accounted for about 20 percent of total rice exports. Cambodia has therefore invested heavily in physical infrastructure developments, especially roads and ports, and more recently logistics hubs to improve connectivity within the country and with regional and global markets. Newly built road networks play a crucial role in Cambodia's economic development as they connect people, goods, and services domestically and regionally, while facilitating trade, promoting tourism, boosting investment, and contributing to job creation and poverty reduction.

Currently, direct exports of agricultural products, for example, 88 percent of milled rice and 78 percent of mango, are trucked from the northwestern province of Battambang, the center of Cambodia's "fourth economic pole," via National Roads 5 and then 4 (blue line) to the international gateway of Sihanoukville port, travelling as far as about 500 kilometers and taking approximately nine hours (figure B3.1). However, with the new road corridor (green line), which includes National Roads 48, 55, 5, 6, 56, 57, 66, and 68 together with National Road 10 (currently under construction) linking with Koh Kong province's Botumsakor deep seaport, the transport distance (and time) is estimated to be cut by about a quarter. Cambodia's "fourth economic pole," consisting of four main northwestern crop-producing provinces, Pursat, Battambang, Banteay Meanchey, and Pailin, together with six adjacent provinces, produces the majority of the country's agricultural products, namely rice, cassava, longan, mango, cashew nut, and more (table B3.1).[b] The new road corridor will provide better access to the main agricultural producing provinces and agroprocessing facilities in the northwestern part, potentially boosting economic activity there by facilitating the movement of agricultural products and people, enabling businesses, especially agroprocessing firms, to become more competitive.

However, it will take time to reap the full potential benefits. First, additional resources and efforts from both the public sector and private sector will be needed to "reconfigure" agricultural supply chains, which will require efforts to encourage the private sector to relocate (and invest more

Figure B 3.1 The fourth economic pole



Source: Authors' estimates.

Table B3.1 The main northwestern crop-producing provinces

Province	Rice		Cassava		Longan	
	'000MT	(%)	'000MT	(%)	MT	(%)
Battambang	1,514	12.4	3,276	24.8	7,457	5.7
BMeanchey	1,007	8.2	1,534	11.6	82,803	63.0
Pursat	702	5.8	490	3.7	355	0.3
Siem Reap	574	4.7	530	4.0	-	0.0
OMeanchey	271	2.2	1,516	11.5	200	0.2
KThom	976	8.0	1,068	8.1	75	0.1
Kampot	537	4.4	7	0.1	364	0.3
Koh Kong	27	0.2	0	0.0	30	0.0
PVihear	290	2.4	606	4.6	52	0.0
Pailin	25	0.2	649	4.9	26,780	20.4
Subtotal	5,923	48.5	9,676	73.1	118,116	89.8
Total production	12,207	100.0	13,233	100.0	131,498	100.0

Sources: Ministry of Agriculture, Forestry, and Fisheries 2022.
Note: MT = metric ton

Box 3 Linking the "fourth economic pole" to the international gateways (continued)

in) agroprocessing facilities along (or closer to) the new road corridor. This could be fostered and strengthened by the provision of resources through existing agricultural and agroprocessing financing mechanisms, technical and fiscal support, and access to energy supply. In addition, rural and provincial road networks connecting the new road corridor will need to be built and upgraded to expand access to the agroprocessing facilities for agricultural product storage, processing, and exports. Most rural and provincial road networks on which most of the agricultural production depends for input supply and market access have deteriorated, been disconnected, or are unpaved, as reflected by a fall in Cambodia's transport infrastructure quality index from 3.1 (2010) to 2.1 (2018) out of a total score of 7.0.[c]

Second, and perhaps more importantly, promoting transport and trade facilitation to enhance supply chain reliability and service quality is key for a successful reconfiguration. This will improve Cambodia's transport and logistics performance, as predictability is not just a matter of time and cost, but also a component of shipment quality. Several causes of delays or unreliability in Cambodia's logistics sector, such as the quality of service or the cost and speed of clearance processes, can be addressed through interventions by Cambodian authorities. It is therefore crucial to reduce the cost of "doing business," which includes "unofficial payments" to get documents out in time for shipment, to obtain stamps before the office closes, and to move trucks in transit to or from the ports and borders.

Note: This box was prepared by Sodeth Ly and Runsinarith Phim.
a. 2020–25 National Cassava Policy; https://www.undp.org/cambodia/publications/national-cassava-policy.
b. According to the authorities, "Economic poles" refers to geographic areas of concentrated economic activity. Currently, Cambodia has five economic poles, which include Phnom Penh, Sihanoukville, Siem Reap, the northwestern region, and the northeastern region.
c. See https://www.theglobaleconomy.com/Cambodia/roads_quality/.

Agricultural GDP is estimated to have marginally increased

The agriculture sector continued to play an important role in the economy. While the share of agriculture in GDP declined to 22 percent in 2022, thanks to the country's structural transformation, the sector continued to provide more than a third (35.7 percent) of total employment. In addition, agricultural GDP (at constant prices), which is real growth of the agriculture, forestry and fisheries sector is estimated by the authorities to have increased by 1.0 percent in 2022.[3] Nevertheless, rice production declined last year. Caused mainly by less favorable weather conditions affecting 22 provinces, total rice production during the 2022–23 production year dropped to 11.6 million metric tons, or a 4.7 percent decline. Hit by draughts and floods, which damaged 3.9 percent of total rice cultivated area, rice harvested area shrank by 5.5 percent to 3.3 million hectares. Rice harvested areas for both rainy and dry season rice declined by 6.6 percent and 1.2 percent, respectively. Average rice yield, however, marginally increased to 3.5 metric ton per hectare. Rainy season rice production accounted for 75 percent, while dry season rice production made up the remaining 25 percent.

Production of non-rice crops was mixed. In 2022, rubber production reached 382,000 metric tons, or a 3.8 percent increase, as efforts to boost smallholder rubber production paid off. Production of cassava, the second priority crop after rice, however, declined to 14.2 million metric tons or 3.2 percent, despite the introduction of the 2020–25 National Cassava Policy in 2020.[4] Cashew nut production rose, reaching 508,283 metric tons, or a 7.5 percent increase. Of the total 1.5 million hectares of non-rice crop cultivated area, 2.3 percent was affected by drought.

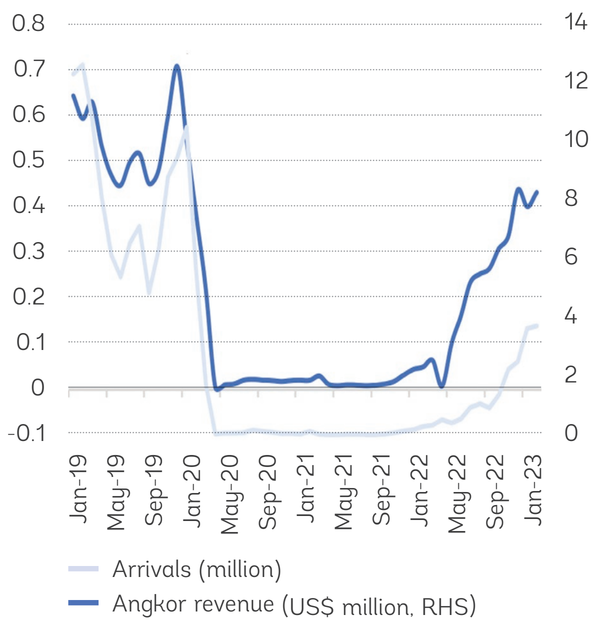
3 Ministry of Agriculture, Forestry and Fisheries 2023.
4 https://www.undp.org/sites/g/files/zskgke326/files/migration/kh/UNDPKH_ENG_Cassava-policy.pdf.

Agricultural export performance improved

According to the Cambodia Rice Federation, this year's prices of paddy and other agricultural crops increased by about 10 percent to 20 percent, underpinning Cambodia's agricultural commodity exports. The fragrant rice and soft white rice prices were US$780 and US$520 per metric ton, respectively. In value terms, exports of milled rice expanded, rising to US$72.6 million, or a 4.5 percent increase during the first two months of 2023. As shipping costs moderated and the trade safeguard measures imposed by the EU on Cambodian rice ended in January 2022,[5] rice exports to the EU market improved. In addition to traditional agricultural commodities such as rice, cassava, and rubber, fresh mango and banana exports, especially to the Chinese market, have emerged. Fresh banana exports quickly rose to US$182 million in 2022, up from US$49.3 million in 2019. China's opening will potentially boost Cambodia's agricultural commodity exports. Price volatility, however, continued to affect agricultural commodity export performance, while less favorable weather conditions affected the yields and quality of some crops.

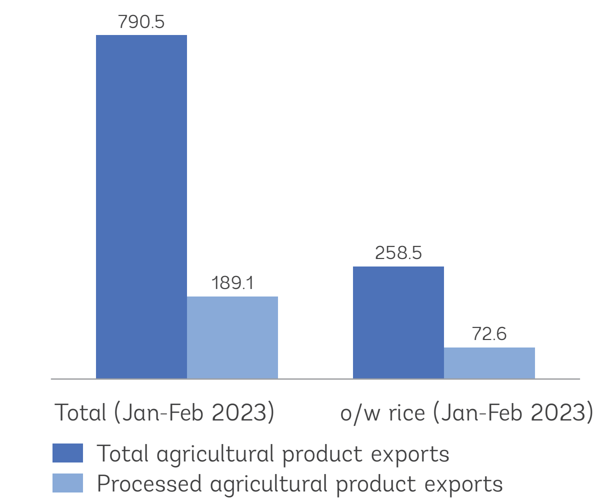
Caused by the high processing costs, farmers mostly sell their agricultural products to traders from neighboring countries, where they are reexported. Total processed and raw agricultural product exports reached US$790.5 million,[6] accounting for 29.0 percent of total goods (excluding gold) exports during the first two months of 2023, of which processed agricultural product exports accounted for less than a quarter (23.4 percent). This reflects a large untapped potential that Cambodia can gain from an expansion of its agroprocessing industry (figure 10), which remains weak due to the country's high costs of energy (and supply unreliability), transport, and doing business. The milled rice export revenue of US$72.6 million accounted for only 28 percent of total (milled and paddy) rice exports of US$258.5 million during the first two months of 2023.

Figure 9 International arrivals and Angkor revenue quickly recovered (million)



Source: Cambodian authorities.
Note: RHS = Right-hand scale.

Figure 10 Agricultural exports – unrealized agroprocessing potential (US$ million)



Source: Cambodian authorities.

5 The European Union imposed safeguard measures on rice from Cambodia. On January 18, 2019, the European Union reinstated the normal customs duty on Cambodia's rice products of €175 per ton in year one, progressively reducing it to €150 per ton in year two, and €125 per ton in year three; https://trade.ec.europa.eu/doclib/press/index.cfm?id=1970.

6 Ministry of Agriculture, Forestry and Fisheries. 2023. "Annual Report for 2022-23." Ministry of Agriculture, Forestry and Fisheries, Phnom Penh.

Consumption strengthened, driven by pent-up consumer demand

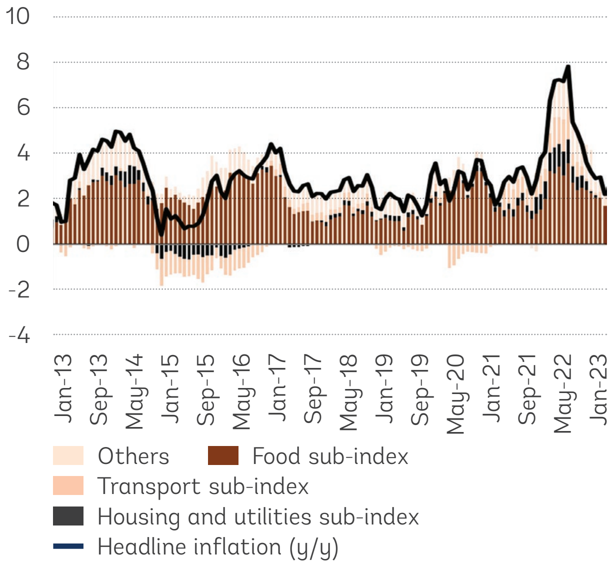
Pent-up demand, underpinned by a complete removal of COVID-19-related mobility restrictions and the decline in inflationary pressures, drove a recovery of domestic consumption, which accounts for about three-quarters of GDP. In addition, the return of international arrivals has further fueled consumption (and investment). Imports of consumer and durable goods continued to recover in 2023. During the first two months of 2023, quantity imports of consumer goods such as gasoline, alcohol, cooking oil, and sugar accelerated, growing at 28.1 percent, 16.7 percent, 79.7 percent, and 49.6 percent y/y, respectively. Similarly, value imports of durable goods such as passenger cars and buses rose to 6.63 percent and 127.1 percent y/y, respectively. As a result, the services sector, especially wholesale, retail, travel, and tourism, accelerated.

Inflation has significantly eased, returning to pre-shock levels

Thanks to the easing of food and oil prices, Cambodia's CPI significantly eased, reaching 2.2 percent y/y in February 2023 (figure 11). Inflation peaked at 7.8 percent, a 13-year high in June 2022, caused largely by rapidly rising prices of food and petroleum products resulting from the global food and oil price shock. The easing of food prices, particularly of meat and fresh fruits and vegetables, brought down inflation significantly, given the fact that the food component (subindex) captures a 43 percent weight of the inflation basket. The contribution of the food subindex to inflation declined to 1.7 percentage points in February 2023, down from the 3.6 percentage point peak in June 2022. During the same period, reflecting stabilized oil prices, especially gasoline and diesel prices, the contribution of the transport subindex shrank to 0.01 percentage points, down from the 1.8 percentage point peak. Cambodia's CPI, excluding food, decelerated to 0.5 percent y/y in February 2023, down from 4.3 percent in June 2022.

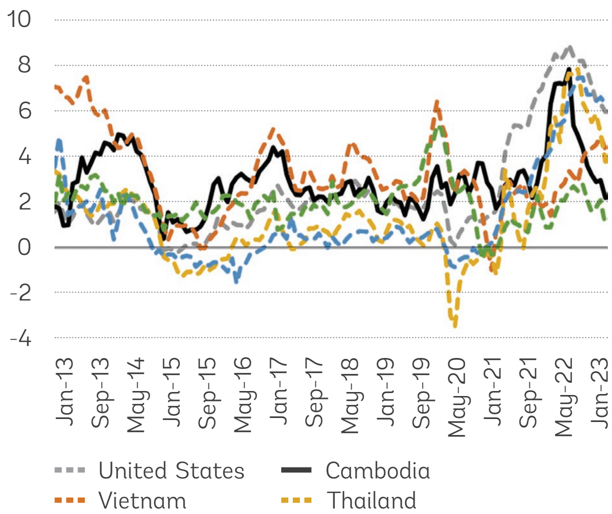
With the marginal depreciation of the local currency vis-à-vis the U.S. dollar exchange rate, the computed inflation rate in U.S. dollar terms was 1.2 percent in February 2023,[7] which is marginally below the current inflation rate of 2.2 percent y/y, in local currency terms. This has protected the value and purchasing power of riel-denominated assets (those who earn income in riel) — one of the main objectives of pegging the riel to the dollar.

Figure 11 Inflation eased after surging
Contribution to 12-month inflation
(percentage points)



Source: Cambodian authorities.

Figure 12 Inflation in Cambodia's main trading partners (y/y percent change)



Sources: Haver Analytics.
Note: y/y = year on year.

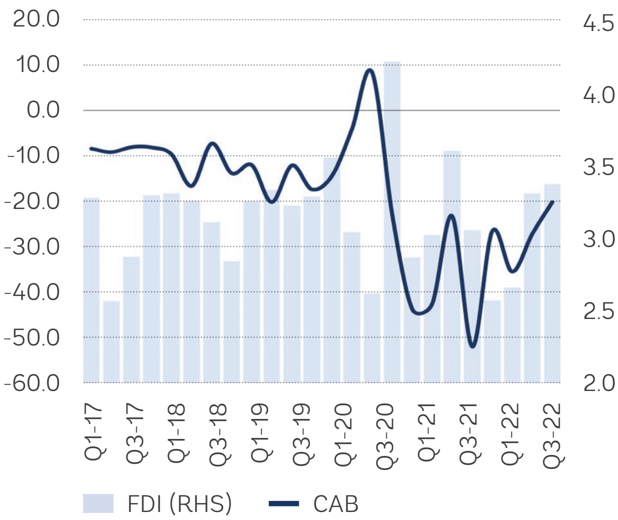
7 Inflation in U.S. terms is defined as the ratio of the changes of CPI indexes to the changes of the riel vs. U.S. dollar exchange rate indexes. The riel vis-à-vis the U.S. dollar exchange rate is first indexed, using the same base year as that of CPI. If the riel vis-à-vis the U.S. dollar exchange rate indexes are unchanged, the computed inflation in U.S. dollar terms is equal to inflation in local currency terms. As the local currency depreciates against the U.S. dollar, the index of the riel vis-à-vis the U.S. dollar exchange rate increases, and the ratio of the changes of CPI indexes to changes of the exchange rate indexes decrease. Inflation in U.S. dollar terms is, in this case, lower than that in local currency terms.

The current account balance improved as the oil price shock eased

Despite weakening goods export performance, the current account balance is improving as the oil price shock moderates. With a broad-based improvement in economic activity, including the rebound in the travel and tourism industry, net services, mainly tourism receipts, and secondary income, mainly remittances, are expanding. In 2022, the trade deficit narrowed, thanks to strong merchandise exports, resulting in an improvement in the current account balance (figure 13). Cambodia's goods export growth accelerated last year, surpassing its pre-pandemic growth rate. Merchandise (excluding gold) exports surged, growing at 22.5 percent y/y in 2022, up from 17.9 percent in 2021. During the same period, merchandise (excluding gold) imports growth eased to 11.9 percent y/y, down from 25.9 percent. This led to an improvement in the trade balance. As a result, the current account deficit is estimated to have narrowed to 26.3 percent of GDP in 2022. The current account deficit continued to be largely financed by capital inflows, especially FDI inflows which have been broadly stable and were estimated to have reached about US$4.0 billion during 2020–22, and international reserves. Continued FDI inflows and concessional financing largely cover external financing needs (see more discussions on concessional financing–debt disbursement under the fiscal section, below).

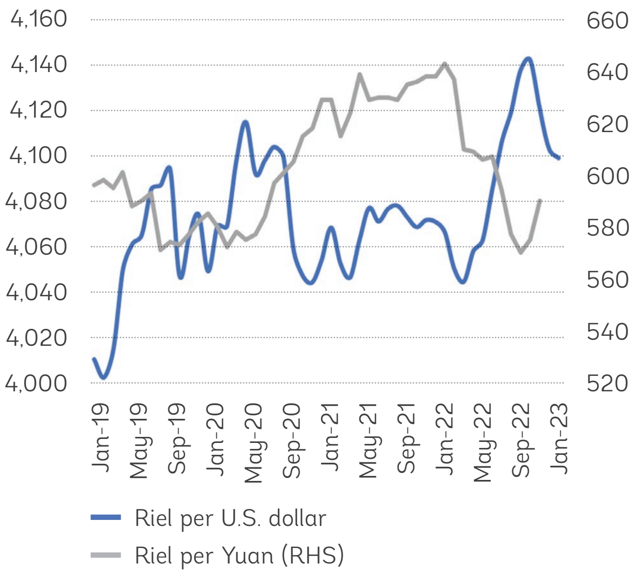
While remaining broadly stable, hovering around 4,100 riels per U.S. dollar, the exchange rate appreciated against currencies of other trading partners. The riel-U.S. dollar exchange rate was under increased pressures as the U.S. Federal Reserve hiked interest rates to keep rapid inflation from becoming entrenched (see the monetary section, below, for more discussion on rising interest rates). The riel per U.S. dollar exchange rate has marginally depreciated since May 2022 (figure 14). Pegging the riel to the strong dollar resulted in the appreciation of the riel against many regional country currencies, especially the Chinese yuan, the Thai baht, and the Vietnamese dong. The riel also appreciated against the euro, the Canadian dollar, and the British pound, making Cambodia's exports less competitive. Likely reflecting interventions to stabilize the currency, Cambodia's gross international reserves declined to US$17.7 billion (about seven months of imports) in February 2023, down from US$20.2 billion at the end of 2021.

Figure 13 The current account improved
(percent of GDP, excluding gold)



Source: Cambodian authorities and World Bank staff estimates.
Note: CAB = Current accounts balance;
RHS = Right-hand scale.

Figure 14 The riel-U.S. dollar exchange rate was under pressure



Source: Cambodian authorities.
Note: RHS = Right-hand scale.

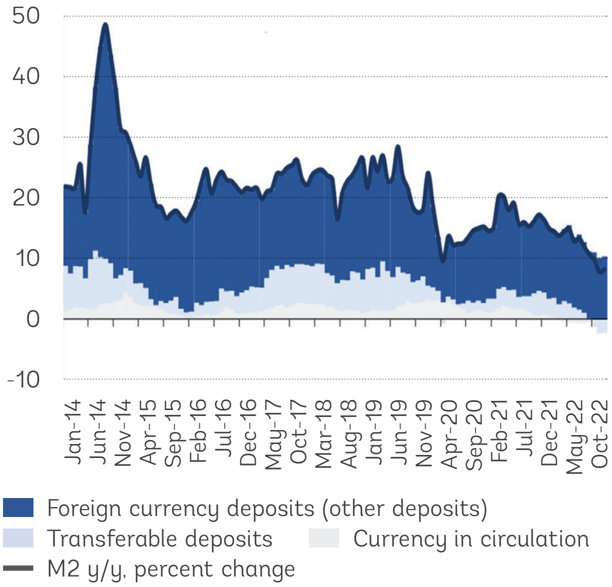
Broad money growth continued to decelerate

Broad money growth further eased, likely reflecting global financial tightening. Due to Cambodia's highly dollarized economy, the country's central bank, the National Bank of Cambodia, has limited ability to influence money supply. However, to support the liquidity needed for economic recovery, the central bank maintained a reserve requirement ratio of 7 percent for both riel and U.S. dollar deposits and borrowing. Driven by the easing of foreign currency deposits, broad money (M2) growth decelerated to 6.8 percent y/y in February 2023, down from 14.5 percent during the same period in 2022 (figure 15). Of the 6.8 percent M2 growth, the contributions of foreign currency deposits (and other deposits), transferrable deposits, and currency in circulation accounted for 5.7 percentage points, negative 2.3 percentage points, and negative 0.1 percentage points, respectively, down from 11.7 percentage points, 3.2 percentage points, and 0.3 percentage points, respectively. As capital inflows decelerate, injection of local currency into circulation is increasingly constrained, given that the economy remains highly dollarized. As mentioned, the contribution of (local) currency in circulation to broad money growth, therefore, declined to negative 2.3 percentage points in February 2023, down from 0.3 percentage points during the same period in 2022. The negative contribution of local currency in circulation to broad money growth may also reflect interventions by the central bank in the foreign exchange market by injecting U.S. dollars.

Credit growth slowed significantly, but concentration of credit in real estate remained

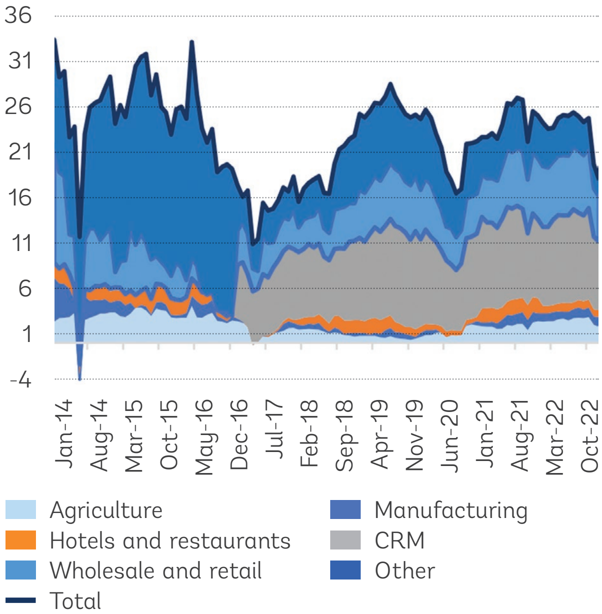
While continuing to grow faster than nominal GDP growth, domestic credit decelerated sharply, growing at 14.8 percent y/y, a 13-year low in February 2023, well below the 22.0 percent growth rate recorded during the same period in 2022 (figure 16). Credit growth is increasingly constrained as banks face rising borrowing costs, thanks to sharp rises in global interest rates.[8] However, the credit-to-GDP ratio increased further, reaching 183.7 percent in 2022, up from 37.0 percent a decade ago. A rapid expansion of domestic credit, growing at an average rate of about 30 percent a year that Cambodia experienced almost a decade during

Figure 15 Broad money growth decelerated
Contribution to broad money growth (percentage points)



Source: Cambodian authorities.

Figure 16 Concentration of credit in real estate Contribution to domestic credit growth (percentage points)



Source: Cambodian authorities.
Note: CRM = construction, real estate, and mortgage.

8 Sharp rises in global interest rates could spark corporate distress and pose wider problems for many economies. https://www.imf.org/en/Blogs/Articles/2023/01/31/countries-should-act-now-to-limit-rising-risks-from-corporate-distress.

the pre-COVID-19 period significantly slowed in 2020 as the pandemic hit. However, credit growth started to recover until the first quarter of 2022, when the Fed began to tighten its monetary policy to contain rising inflation in the United States.[9]

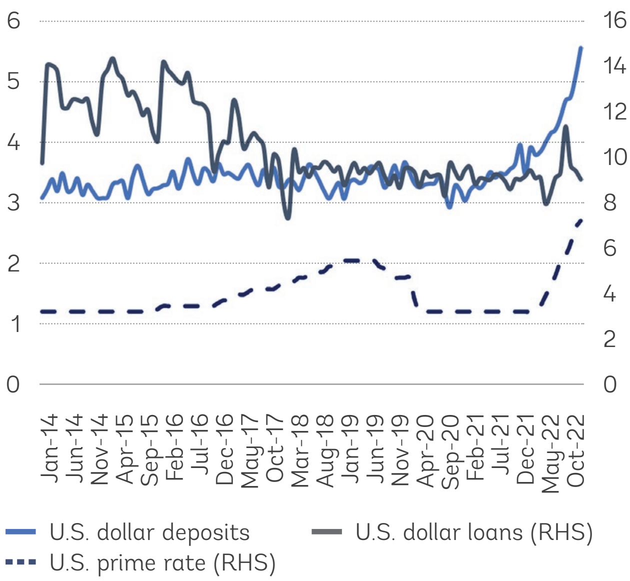
In 2023, possibly pointing to an increase in real estate speculation activity, rising and concentrating domestic credit in the construction and real estate sector continued, despite rising borrowing costs and the easing of construction activity after the construction boom stalled amid the pandemic. In February 2023, the combined contribution of construction, real estate, and mortgages to total credit growth rose to 43 percent, up from 37 percent during the same period in 2022. The contributions of the agriculture, wholesale, retail, and hotel and restaurant sectors to credit growth, however, continued to ease to 1.3 percentage points, 1.3 percentage points, 2.3 percentage points, and 0.6 percentage points, respectively, during the first two months of 2023, down from 2.4 percentage points, 2.1 percentage points, 4.5 percentage points, and 0.8 percentage points, respectively, during the same period in 2022. It remains to be seen how long the concentration of credit in the construction and real estate sector will last.

Private sector deposits eased significantly. Private sector deposit growth halved, expanding at 7.5 percent y/y in February 2023, down from 15.8 percent during the same period in 2022. The loan-to-deposit ratio, therefore, increased further, reaching 141.5 percent in February 2023, up from 132.5 percent during the same period in 2022. The easing of domestic deposits may have compelled banks and microfinance institutions to raise interest rates on deposits to attract depositors. Weighted average interest rates of U.S. dollar-denominated and riel-denominated term deposits rose to 5.54 percent per year and 6.7 percent per year, respectively, up from 3.94 percent and 5.54 percent, respectively, during the same period in 2022. By the end of 2022, the reported overall nonperforming loan ratios remained low at 3.2 percent and 2.6 percent for the banking and microfinance sectors, respectively.[10] However, this may not fully reflect declining asset quality, due to extensive loan restructuring allowed during the height of the COVID-19 pandemic. In addition, Cambodia's high private debt raises concerns about the drag on the economy if borrowers struggle to meet repayments.

Pressure on domestic interest rates continued

Significant tightening of global financial conditions put upward pressure on domestic interest rates. Cambodia's interest rates rose quickly, following the Fed's interest rate hikes, bringing the federal funds rate to 4.75 percent to 5 percent, up from 0.25 percent to 0.5 percent during March 2022–23. Rising funding costs for banks and microfinance institutions in Cambodia pushed up their operating costs, requiring them to increase interest rates on loans. In February 2023, the weighted average interest rates of U.S. dollar-denominated and riel-denominated term loans rose to 10.19 percent per year and 12.61 percent per year, respectively, up from 9.51 percent and 11.54 percent, respectively, during the same period in 2022 (figure 17). Given lags in monetary policy transmission, the full impact on activity of the current monetary policy tightening cycle has yet to fully materialize. Going forward, the tightening cycle will likely hurt investment and consumer spending.

Figure 17 Domestic interest rates continued to increase (percent per year)



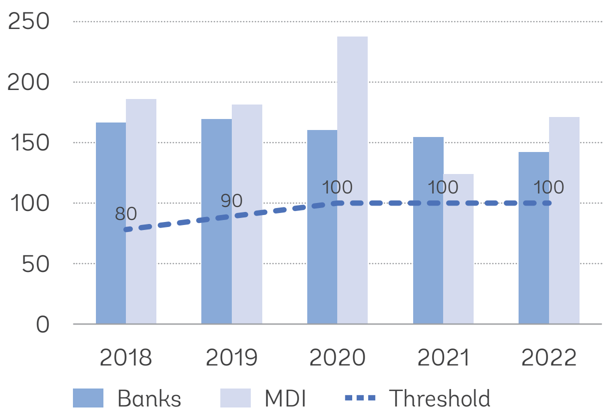
Source: Cambodian authorities.
Note: RHS = Right-hand scale.
MDI = microfinance deposit-taking. institution.

9 Ferroni, Fisher, and Melosi 2023.
10 National Bank of Cambodia 2023.

The banking system remained resilient

According to the National Bank of Cambodia, in 2022, the capital adequacy ratios were 22.5 percent and 21.2 percent for the banking and microfinance sectors, respectively, well above the 15 percent prudential threshold. The liquidity coverage ratios were 143 percent and 172.8 percent for the banking and microfinance sectors, respectively, compared to the 100 percent threshold (figure 18).[11] The number of customer deposit accounts rose to 14.3 million and customer credit accounts to 3.7 million, up from 12.7 million and 3.4 million, respectively. Total assets of the banking, microfinance, and financial lease sectors accounted for 85.2 percent, 14.2 percent, and 0.6 percent of total banking system assets, respectively. While continuing to increase, the total assets of the banking system decelerated, expanding at 14.5 percent in 2022, down from 16 percent in 2021, reaching US$79.7 billion.

Figure 18 Liquidity coverage ratios of banks and microfinance deposit-taking institutions (percent)

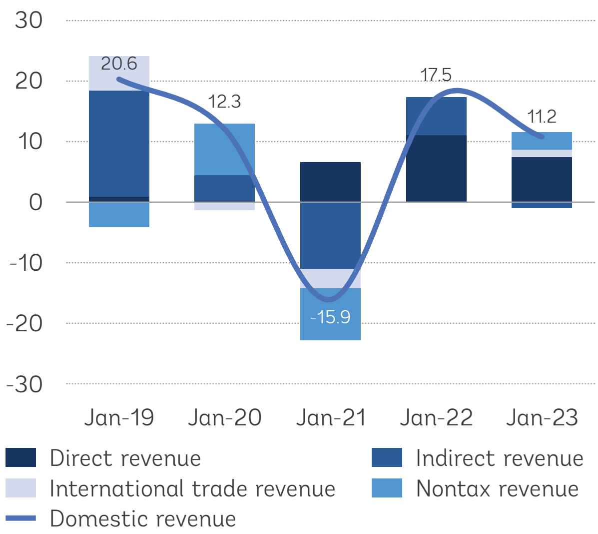


Source: Cambodian authorities.
Note: MDI = Microfinance deposit-taking institution.

Domestic revenue fully recovered and continued to increase

An across-the-board improvement in domestic revenue collection continued in 2023. After fully recovering in 2022, domestic revenue growth continued, thanks to further improvements in revenue administration. Central government domestic revenue grew at 11.2 percent in January 2023 (figure 19). Reflecting continued good performance of profit tax collection, direct revenue contributed the most, at 7.9 percentage points of the 11.2 percent increase. The contributions of indirect revenue, international trade revenue, and nontax revenue were a negative 0.6 percentage points, 1.1 percentage points, and 2.8 percentage points, respectively. The domestic revenue growth rate of 11.2 percent in January 2023, however, remained below the 20.6 percent revenue growth in January 2019, consistent with the weaker post-COVID-19 economic expansion, compared to during the pre-COVID-19 period.

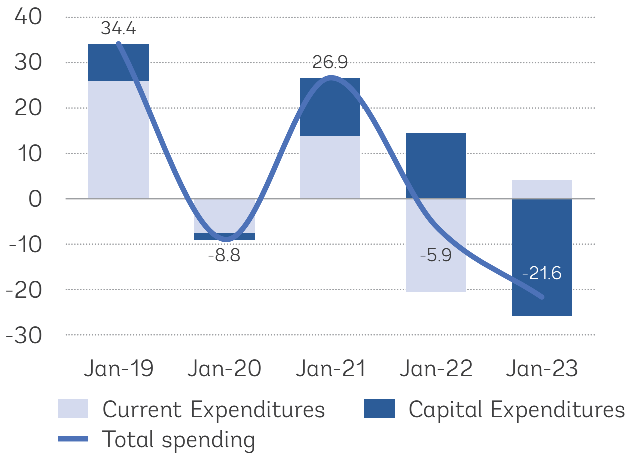
Figure 19 Contributions to domestic revenue increase (percentage point)



Source: Cambodian authorities.

11 Liquidity coverage ratio is equal to the stock of eligible liquid assets divided by net case outflows within 30 days. See https://www.nbc.gov.kh/download_files/legislation/prakas_eng/5759prakas-liquidity-coverage-ratio-english.pdf.

Figure 20 Budget expenditure decelerated amid fiscal consolidation efforts
(percentage point)



Source: Cambodian authorities.

In 2022, domestic revenue rose quickly. General government domestic revenue (excluding grants) reached 22.5 percent of GDP, representing a 21.9 percent year-on-year increase in 2022. Domestic revenue is collected mainly by two revenue collecting agencies, the General Department of Taxation (47.0 percent of total) and the General Department of Customs and Excise (44.7 percent of total). In 2022, direct revenue, consisting mainly of profit tax, rose quickly to 6.1 percent of GDP, exceeding VAT collection of 5.8 percent of GDP for the first time in the recent history of domestic revenue collection. Strong efforts to improve collection continued, with better tax administration, good governance, modernization, and the introduction of e-filing, e-payment, and taxpayer services, while eliminating loopholes in the Law on Taxation and harmonizing the legal framework to prevent fiscal evasion, transfer pricing abuses, and double taxation. A taxpayers' survey revealed that 88 percent of respondents agreed that modernization of tax administration, especially automation, helped improve tax payments.[12]

Despite fiscal consolidation efforts, budget expenditure marginally increased

On the spending side, public expenditure is expected to marginally increase, despite fiscal consolidation efforts. While both capital and current expenditures are budgeted to increase this year, public spending is shifting to support Cambodia's economic recovery, while temporary spending to boost financing the social sector, especially the health sector, is withdrawn as COVID-19-related health expenditures have been phased out. To that end, capital spending for the social sector is budgeted to decline from 0.91 percent of GDP in 2022 to 0.8 percent of GDP in 2023. The decline largely reflects a withdrawal of a spending boost for the health sector as COVID-19 infection has largely disappeared. Budgeted capital spending allocated to the Ministry of Health declined by almost a quarter, reaching only 0.44 percent of GDP in 2023, down from 0.62 percent of GDP in 2022.[13] However, as discussed in the Special Focus section of this report, Cambodia has significantly expanded public spending in social sectors over the past decade, underscoring the urgent need to ensure efficient and effective spending in these sectors to deliver public services and contribute to human capital formation. In the past decade, improvements in the fiscal space as a result of a rapid expansion of domestic revenue allowed the government to boost spending in the healthcare and education sectors. In addition, Cambodia's budget allocation boost was driven partly by across-the-board salary increase for its civil servants. Average monthly public sector pay is now higher than private sector pay. Cambodia is currently among the countries with the highest share of its general government revenues spent on the public wage bill (see the Special Focus section).

12 "Tax Bulletin - Quarter Four, 2022"; https://www.tax.gov.kh/en/tax-bulletin.
13 Annual Budgets for 2022 and 2023, Royal Government of Cambodia; https://mef.gov.kh/documents-category/law-and-regulation/budget/.

While public investment in the economic sector is budgeted to remain unchanged at 4.1 percent of GDP in 2023, some economic ministries received relatively large capital spending boosts to support Cambodia's economic recovery. Budgeted capital expenditure allocated to the Ministry of Rural Development and the Ministry of Agriculture, Forestry and Fisheries rose to 0.62 percent of GDP and 0.29 percent of GDP, respectively, in 2023, up from 0.56 percent of GDP and 0.16 percent of GDP, respectively, in 2022. After accelerating during 2020–21 to meet rising pandemic-related spending demand, public expenditures decelerated. In January 2023, central government expenditures moderated, declining by 21.6 percent, thanks largely to slow capital spending. Of the 21.6 percent decline, capital expenditure accounted for a 26.0 percentage point decline, while current spending contributed an increase of 4.4 percentage points (figure 20).

The across-the-board public sector wage increase is reintroduced

The increase in budgeted current spending reflects the reintroduction of the across-the-board public sector wage increase. The public sector wage increase was frozen during 2021–22 to save budgetary resources to finance rising spending demand to mitigate impacts of COVID-19. In addition, the government has increased social security benefits for former civil servants and veterans. The increases have been introduced for former civil servants who received lower salaries when they were working than current civil servants. The increase in current expenditure is also needed to finance hosting the 32nd Southeast Asian Games and general election-related spending.

The authorities continued to provide cash transfers for poor and vulnerable households, although the worst of the pandemic is now behind us. In this regard, the Cambodian authorities have extended the COVID-19 cash transfer program, with an additional budget of roughly US$400 million. The program has benefited nearly 2.8 million people (17 percent of the population) or 705,000 households. Of these, 110,000 are children under five years of age; 387,000 people over age 60; 60,000 people with disabilities and 2,000 people living with HIV/AIDS. As of March 2023, it had disbursed US$994 million since the launch in June 2020. In addition, the authorities have launched new cash transfer programs for households at risk due to inflationary pressures and severe flooding. In the first round of implementation, the cash transfer under the inflationary pressure scheme disbursed US$9.12 million and benefited 261,000 households. The cash transfer program under the flooding scheme was completed by March 2023, disbursed US$11.6 million and benefited 99,000 households. The poverty rate measured at the national poverty line was 17.8 percent in 2019/20. The simulation analysis, which did not account for implications of COVID-19 or for the fiscal policy response to support households between 2020 and 2022, suggests that inflation could increase poverty by 4 percentage points over the poverty rate in 2019/20.

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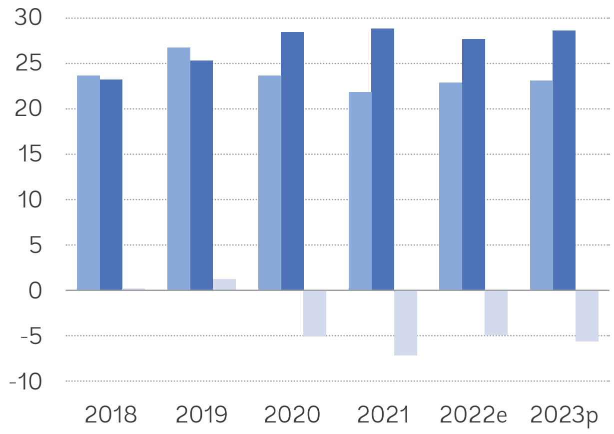
Last year's fiscal deficit is estimated to have narrowed to 4.7 percent of GDP

Thanks to a rapid expansion of domestic revenue and consolidated expenditure, the fiscal deficit is estimated to have narrowed to 4.7 percent of GDP in 2022 (figure 21). Last year, revenue, including grants, rapidly improved and was estimated to have reached 23.2 percent of GDP in 2022, boosted largely by buoyant tax revenue, thanks to the economic recovery and continued revenue administration improvements. Expenditure is estimated to have declined to 27.9 percent of GDP as expenditure on goods and services and capital expenditure moderated as some pandemic-induced spending such as COVID-19-related health expenditures were phased out. The fiscal deficit was largely financed by external funds which accounted for about 90 percent of the financing gap. The remaining 10 percent was financed by a drawdown of government deposits (fiscal reserves), which stood at 17.8 percent of GDP by December 2022, down from 23.6 percent at the end of 2020.

Figure 21 The general government deficit (percent of GDP)



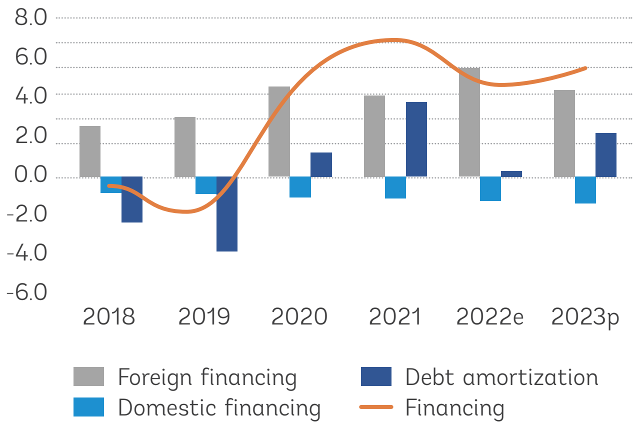
Sources: Budget Settlement Laws; and World Bank staff estimates and projections.
Note: e = estimates; p = projections.

Public debt stock reached 33.7 percent of GDP, of which 99.8 percent is public external debt

The authorities have been filling the pandemic-induced widening financing gap primarily with rising proceeds from loan disbursements, supplemented by drawdowns of government deposits (fiscal reserves). More importantly, the authorities continued to follow the borrowing principle of only contracting external debt on concessional terms, until 2022, when domestic debt (government securities) was introduced, to help maintain a low risk of a debt distress rating.

By end-2022, Cambodia's public debt-to-GDP ratio reached 33.7 percent or US$9.98 billion in outstanding debt (table 1),[14] of which the US$9,970.5 million (or 99.8 percent) is public external debt and US$17.5 million (or 0.2 percent) is public domestic debt. Of US$9,970.5 million public external debt, bilateral debt and multilateral debt accounted for 67.6 percent and 32.4 percent, respectively. Triggered by the pandemic when revenue collection slowed and demand for health and social assistance

Figure 22 General government surplus/deficit and financing (percent of GDP) (percentage points)



Sources: Budget Settlement Laws; and World Bank staff estimates and projections.
Note: e = estimates; p = projections.

14 Ministry of Economy and Finance 2023a.

Table 1 Public debt stock, newly signed loans, and loan disbursements

	Debt stock as of 2022		2022 loans		2022 disbursement	
	Amount (US$ mln)	Share (%)	Amount (US$ mln)	Share (%)	Amount (US$ mln)	Share (%)
Top 3 bilateral creditors						
China	4,001.7	40.1	567.3	26.5	301.1	22.4
Japan	1,077.7	10.8	448.0	21.0	386.2	28.7
Republic of Korea	482.3	4.8	351.1	16.4	60.4	4.5
Top 3 multilateral creditors						
ADB	2,051.2	20.6	373.0	17.4	238.3	17.7
World Bank	933.6	9.4	262.0	12.3	268.9	20.0
IFAD	129.7	1.3	0.0	0.0	29.8	2.2
Other bilateral/ multilateral creditors	1,294.4	13.0	136.5	6.4	60.3	4.5
Total	9,970.5	100.0	2,137.8	100.0	1,345.0	100.0

Sources: Ministry of Economy and Finance 2023a.

spending rose, Cambodia's debt accumulation increased to 33.7 percent of GDP in 2022, up from 28.1 percent of GDP in 2019. External borrowing remained highly concessional, with a weighted grant element of 44.8 percent in 2022. The weighted average interest rate of contracted loans was 1.09 percent per year, while weighted average maturity was 26.7 years. Of total loans contracted in 2022, 69.0 percent financed the country's public infrastructure sector such as transport, irrigation, energy, and water supply, while the remaining 31.0 percent funded other prioritized (non-infrastructure) sectors such as health, education, and agriculture.

The joint World Bank/International Monetary Fund Debt Sustainability Analysis conducted in 2022 indicated that Cambodia remained at low risk of external and overall debt distress under the Low-Income Countries Debt Sustainability Framework.[15] The total public and publicly guaranteed debt-to-GDP ratio is projected to rise by around 4 percentage points during the next decade. The present value of the external debt-to-GDP ratio breaches its threshold in the exports stress test, which would imply a moderate risk rating. However, the breaches are small, short-lived, and driven by the exceptional volatility of exports in 2020 that has increased the sample volatility for the standardized shock. Moreover, other debt burden indicators are projected to remain well below their thresholds under the baseline and the shock scenarios.

Cambodia's largest official creditor is China. Total debt owed to China reached US$4.0 billion, or 40.1 percent of total external debt stock by end-2022. Cambodia's second-largest creditor is the Asian Development Bank, to which it owed US$2.05 billion, or 20.5 percent of total external debt stock. Cambodia's third-, fourth-, and fifth-largest creditors are Japan, the World Bank, and Korea, accounting for 10.8 percent, 9.3 percent, and 4.8 percent of total external debt stock, respectively. Old debt accounted for 6.3 percent of total external debt stock. Public debt is mainly denominated in U.S. dollars, which accounted for 44.2 percent of total debt stock, followed by Special Drawing Rights (SDRs), Chinese yuan, Japanese yen, and euro-denominated debt, accounting for 21.2 percent, 12.3 percent, 10.8 percent, and 6.8 percent, respectively.

15 International Monetary Fund 2022a.

Outlook

Cambodia's real GDP growth for 2023 is projected to accelerate further, reaching 5.5 percent (see table 2). Despite the easing of goods exports, the current account deficit is expected to improve to 19.3 percent of GDP on the back of the recovering services exports, especially tourism receipts and remittances. Despite the recent decline in approved FDI projects, continued robust capital inflows and concessional financing will continue to largely cover external financing needs.

The fiscal deficit is expected to widen to 6.4 percent of GDP. Revenue, including grants, is improving, and is projected to remain strong, reaching 23.5 percent of GDP in 2023. Expenditure is expected to increase to 29.9 percent of GDP in 2023, thanks to rising post-pandemic operating expenses which include an across-the-board public sector wage increase and an increase in goods and services expense as well as general election-related spending and the hosting of the Southeast Asian Games and the ASEAN Para Games.

Over the medium term, the economy is expected to trend back to potential, growing at 6 percent. Goods and services exports and FDI inflows are expected to be bolstered by the newly ratified free trade agreements, a substantial increase in private and public investment in key physical infrastructure such as seaports and roads, especially under public-private partnership, and structural reforms. Poverty is expected to decline due to the projected economic recovery and moderating inflation.

Table 2 The macro outlook indicates continued economic recovery

	2021	2022e	2023p	2024p	2025p
National Accounts and Prices					
GDP at constant market prices (% change)	3.0	5.2	5.5	6.1	6.3
Agriculture	1.2	0.7	1.5	1.5	1.5
Industry	9.4	8.3	4.0	8.0	9.6
Services	-2.7	2.2	10.6	7.4	5.9
Consumer Price Index	2.8	5.5	2.5	2.5	2.0
General Government (% of GDP)					
Revenue and grants	22.0	23.2	23.5	24.0	25.0
Expenditure and net lending	29.0	27.9	29.9	29.0	29.2
Overall balance (including grants)	-7.0	-4.7	-6.4	-4.9	-4.2
Foreign financing	4.2	5.6	4.5	4.3	3.9
Net domestic financing (from current savings)	3.8	0.4	3.3	2.0	1.7
Amortization	-1.1	-1.2	-1.3	-1.4	-1.4
Money and Credit					
Broad money (% change)	20.0	8.2	7.2	9.0	15.6
Credit to the private sector (% change)	23.2	18.9	12.5	15.0	18.1
External Sector (US$m unless otherwise)					
Exports (goods and services)	18,565.9	24,494.7	29,149.5	35,679.0	45,186.1
Imports (goods and services)	28,120.6	38,761.9	42,333.4	49,528.1	57,945.5
Foreign Direct Investment, net inflows	3,483.5	3,578.8	4,380.6	4,745.7	5,167.2
Gross official reserves	20,272.3	17,784.6	15,828.3	16,145.4	18,085.3
(months of imports)	8.1	7.0	6.0	5.5	5.0
Current account (percent of GDP)	-42.6	-26.3	-19.3	-16.1	-13.2
Exchange rate (riel per US$ average)	4,100.0	4,150.0	4,110.0	4,100.0	4,090.0
Debt Stock and Service					
Total public debt (% of GDP)	35.2	33.7	35.1	35.6	35.9
Memorandum items:					
Nominal GDP, USD million	26,952.7	29,647.4	32,425.5	35,383.9	38,565.0

Sources: Cambodian authorities; World Bank staff estimates and projections.
Note: e = estimates; p = projections.

Challenges and risks

The outlook is, however, subject to downside risks. An extended slowdown in external demand could weaken Cambodia's export-oriented manufacturing, which generates about 40 percent of total employment in the industrial sector (17.3 percent of total non-farm employment). Continued global financial tightening could affect the highly leveraged financial sector, which has been partly behind the recent construction boom. A renewed oil price shock may stoke inflation and dampen domestic consumption. Domestically, concentration of domestic credit in the construction sector remains a key risk to financial stability.

On the upside, stronger-than-expected global growth could mitigate the downside drag of weak external demand. A stronger-than-expected rebound in China could bolster stronger tourism receipts, exports, and FDI inflows which could help offset the expected decline in advanced economies to a greater extent than assumed in the baseline. In addition, growth in advanced economies, while likely slower than last year, may also turn out to be stronger than expected, dampening the projected decline in exports.

Policy options

Macroeconomic policy should continue to support growth and employment, while maintaining macro-financial stability. This has become more challenging in the context of tightening financial conditions and rising private debt levels. But inflation has quickly retreated to pre-pandemic levels, allowing the authorities to continue with accommodative monetary policy by maintaining or lowering the reserve requirement ratio. While fiscal consolidation will be necessary over the medium term, this consolidation can proceed at a relatively gradual pace given manageable public debt levels. Cambodia has the fiscal space to maintain or even increase growth-enhancing spending on connectivity infrastructure and human development which will boost the productive capacity of the economy over the longer term. Continuing to provide social assistance to the poor, while stemming the learning loss that Cambodia experienced during the time of COVID-19 and building back better, is also necessary to promote inclusive growth. Accompanying increased public investments with steps to enhance value for money and spending efficiency would ensure high spending translates into better outcomes, as discussed in more detail in part 2 of this report.

Safeguarding financial stability also remains a priority. The recent rapid credit growth and relatively high private sector debt, with a concentration in real estate related exposures pose key risks to Cambodia's macro-financial stability. Intensified supervision is called for as pandemic measures such as loan restructuring and forbearance are phased out. This could include enhanced focus on stress testing of individual institutions, systematic onsite inspections, further aligning the regulatory framework with international standards, and further assessing the quality of loan portfolios, among others. In parallel, the authorities should continue with efforts to prepare legislation on deposit insurance and bank resolution. To prepare for increasing levels of non-performing loans (NPLs), the authorities should ensure that resolution options are ready to be deployed as needed. Similarly, the country's insolvency regime can be improved. Given concerns around shadow banking activities, such as credit issued by construction or real estate developers to buyers of residential real estate, it will be of critical importance to collect the data necessary to monitor and assess the legality of these activities.

To enhance the long-term resilience and competitiveness of the economy, efforts are needed to further promote export product diversification. Unlike other countries in the region, Cambodia has had limited success in diversifying outside of garments, footwear, while the country's agroprocessing capacity remains limited. To move to the next stage of participation in global value chains (GVCs), the policy mix will need to evolve. First, attention should be paid to contract enforcement, protecting intellectual property rights, and strengthening national certification and testing capacity to ensure compliance with international standards. Second, lowering barriers to trade and improving connectivity to markets would expand the size of the market for Cambodia's products and improve access to the inputs needed for production. Third, continue improving the education and skills of Cambodia's labor force by investing in human capital. Fourth, harness the digital economy to support firms to integrate into GVCs through digital platforms as well as by connecting value chain participants.

CHAPTER 2
Special Focus

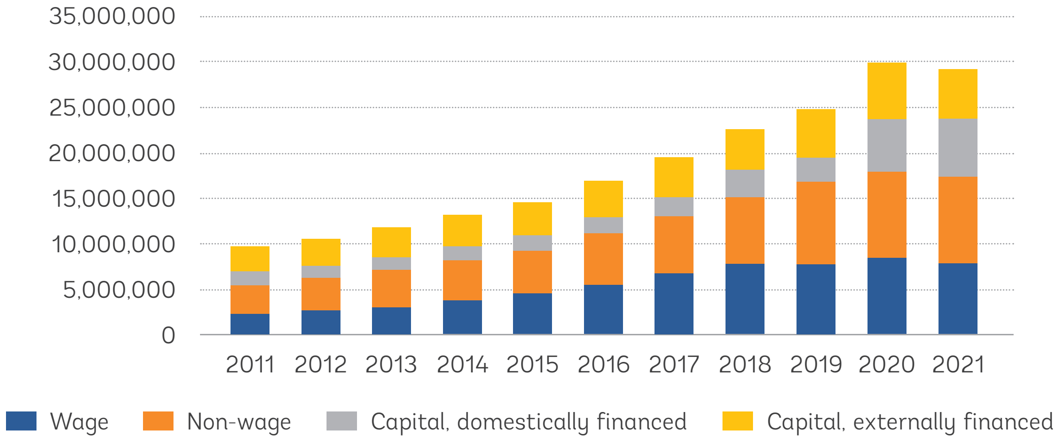
From Spending More to Spending Better – Toward Improved Human Development Outcomes[16]

Introduction

This special focus section of the Cambodia Economic Update examines public expenditures and outcomes in the health and education sectors. It is based on the recent joint exercise on a budget management effectiveness study (Public Expenditure Review) between the Cambodia Ministry of Economy and Finance and the World Bank.

Over the past decade, Cambodia has maintained prudent fiscal policies. Fiscal deficits have been contained, especially before the COVID-19 pandemic. Public debt remains low. Revenue mobilization has been steadily improved, creating vital fiscal space to enable a significant increase in public expenditures (figure S.1), particularly in the social sectors. Social sector expenditures significantly increased from 4.6 percent of GDP in 2011 to 10.5 percent in 2021, while the spending in other sectors was stable. This large expansion of public spending on critical social sectors puts emphasis on commensurate efforts to improve the quality of public services and ensure higher spending translates into better human development outcomes. More importantly, it highlights the importance of achieving efficiency and equity to ensure that increased spending translates into improved outcomes and equitable service provision.

Figure S.1 Government overall budget at the national level, by category (riels, million), 2011–21



Sources: Budget Settlement law and World Bank Staff.

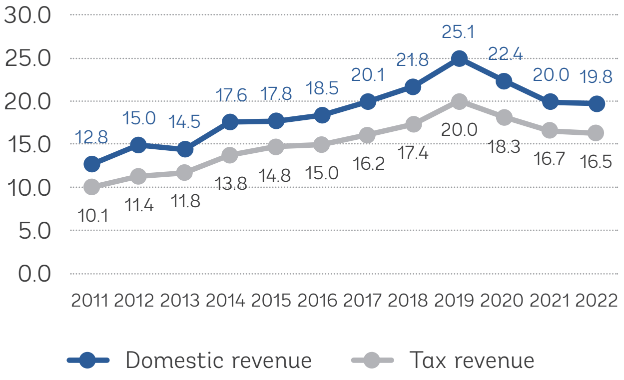
16 This Special Focus was written by Serdar Yilmaz, Sokbunthoeun So, and Khy Touk. This section of the report is financed by a Multi-Donor Trust Fund on Public Finance and Service Delivery with contributions from Australia and the European Union.

Expanded public spending supported by strong domestic revenue

Cambodia sustained an average annual growth rate of 7.6 percent between 1995 and 2019, making it one of the fastest-growing economies in the world.[17] The strong economic growth performance together with a strengthened tax administration capability under the Revenue Mobilization Strategy 2014–2018 and 2019–2023 resulted in a substantial increase in domestic revenue. Overall domestic revenues reached 25.1 percent of GDP in 2019, up from 12.8 percent in 2011 (figure S.2, panel A). This enabled the government to accumulate a relatively large fiscal reserve, amounting to 23.7 percent of GDP at the end of 2020.[18] The improvement in tax revenue put Cambodia among the leading countries in the region and in a better position than many other lower middle-income countries (figure S.2, panel B). Although domestic revenue saw a decline in 2020 and 2021 due to the impact of the COVID-19 pandemic on the economy and tax relief provided to affected firms, Cambodia's domestic revenue collection growth rate was able to rebound almost to the pre-COVID level, thanks largely to the country's efforts to improve tax collection and administration and a broad-based economic recovery.

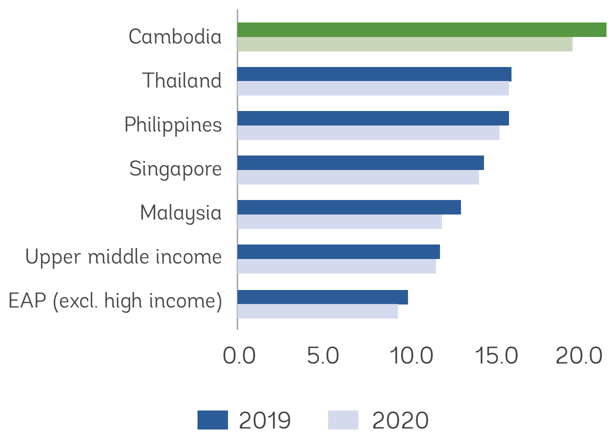
Figure S.2 Government overall revenue and expenditure increase, 2011–22

Panel A. Government overall revenue increase: Domestic revenue (% of GDP)



Source: Cambodian authorities.

Panel B. Tax revenue (% of GDP), 2019–20



Source: World Development Indicator

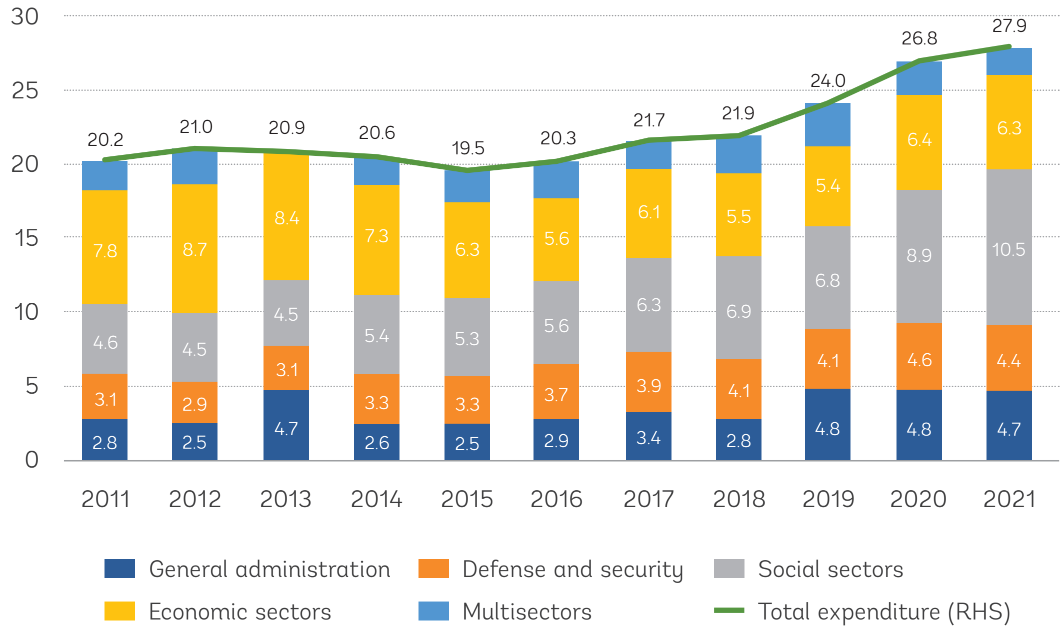
17 Although growth was strong, reaching 7.1 percent in 2019, the COVID-19 pandemic caused sharp decelerations in most of Cambodia's main engines of growth in the first quarter of 2020.
18 World Bank 2022.

Availability of fiscal space enabled higher spending, especially in social sectors

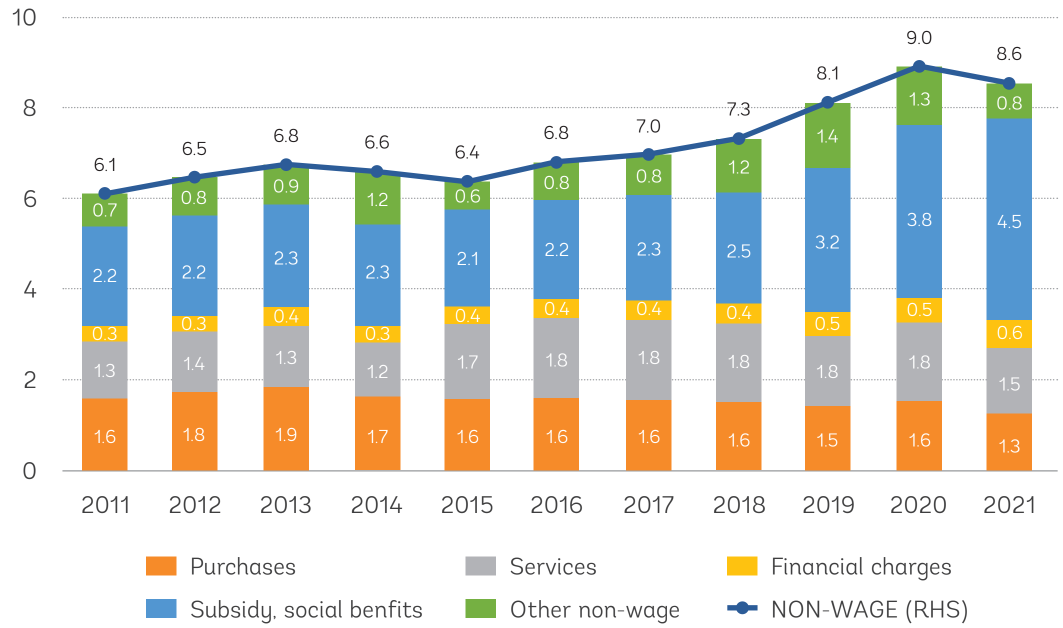
Increased fiscal space allowed the government to boost total planned spending. Planned expenditure increased from 20.2 percent of GDP in 2011 to 27.9 percent in 2021. In line with the government's public expenditure policy, which prioritized human capital accumulation and increased spending in the healthcare and education sectors, the share of social sector spending increased to 10.5 percent of GDP in 2021 from 4.6 in 2011 (figure S.3, panel A). However, Cambodia's budget allocation boost was driven partly by across-the-board salary increases. The public sector wage bill grew quickly during the past several years before the pandemic. Non-wage recurrent allocation increased at a slower pace, from 6.1 percent of GDP in 2011 to 8.6 percent in 2021 (figure S.3, panel B).

Figure S.3 Government overall budget increased between 2011 and 2022

Panel A. Government expenditure, by sector grouping (% of GDP), 2011–21



Panel B. Non-wage recurrent budget allocation, by economic classification (% of GDP), 2011–21

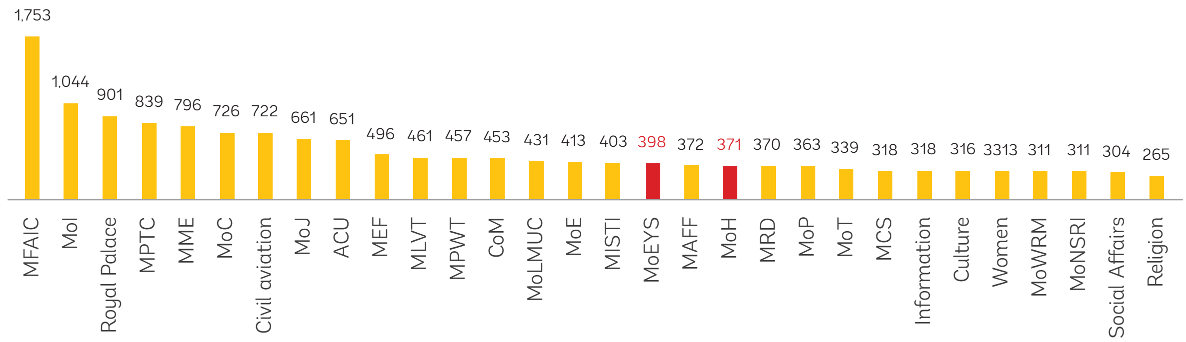


Sources: Budget Settlement Law; World Bank staff.

After a decade of compensation reform and salary increases, the average public sector wage now exceeds the average private sector wage

Cambodia's public expenditure boost was driven partly by across-the-board salary increases for its civil servants. Between 2011 and 2021, the public sector wage bill as a share of GDP almost doubled, reaching 7.2 percent of GDP in 2021, up from 4.4 percent of GDP in 2011. This represented a tripling of civil servants' minimum wage compared to 2013, having reached the target of 1 million riels a month by 2018. Further, while the government increased the average monthly take-home pay per civil servant, administrative sectors benefited the most from the increase (figure S.4).

Figure S.4 Monthly average pay of Cambodian civilian civil servants, 2021



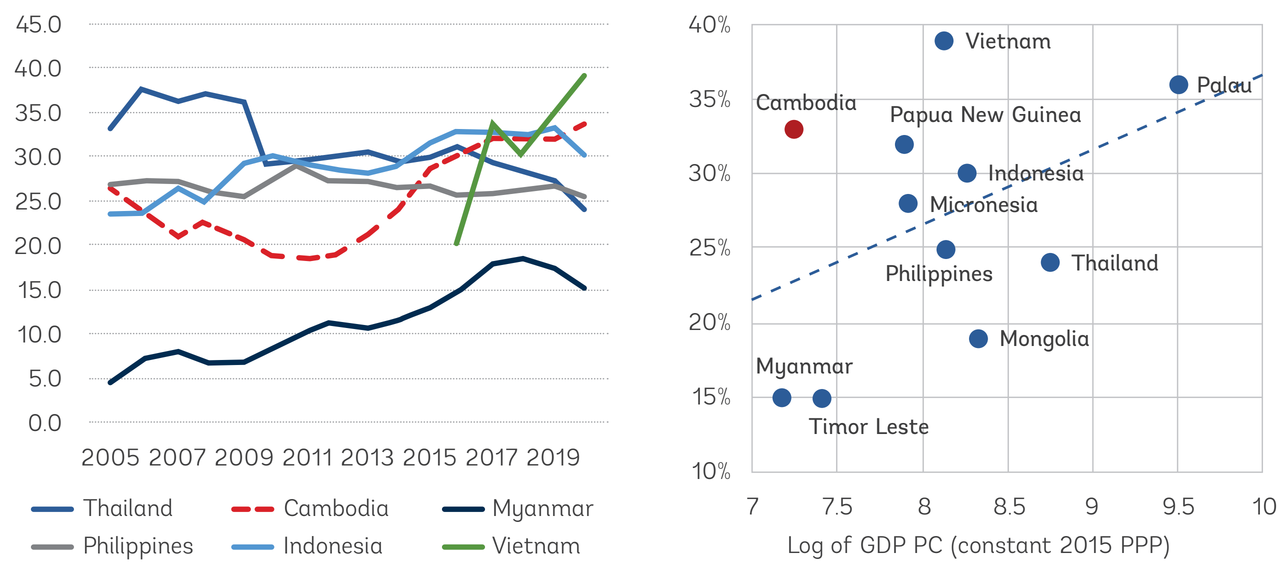
Source: Cambodian authorities (2021 Budget Settlement Law).
Note: Actual spending under chapter 64 for all ministries (except for MoH which is for 2020) and 2022 civilian civil servant statistics (MCS).

The increase in the public sector wage bill places Cambodia among those countries that spend a large share of government revenues on public wages, especially compared to regional peers (figure S.5). All regional peers except Vietnam and Palau (both of which have higher per capita income levels) spend less than Cambodia on their wage bill (figure S.5, panel A), and in fact Cambodia is among the countries spending the highest share of general government revenues on the public wage bill (figure S.5, panel B).

Figure S.5 Footprint of the public wage bill

Panel A. Wage bill (as % of public expenditure), 2005–19

Panel B. Wage bill and GDP % in the EAP region

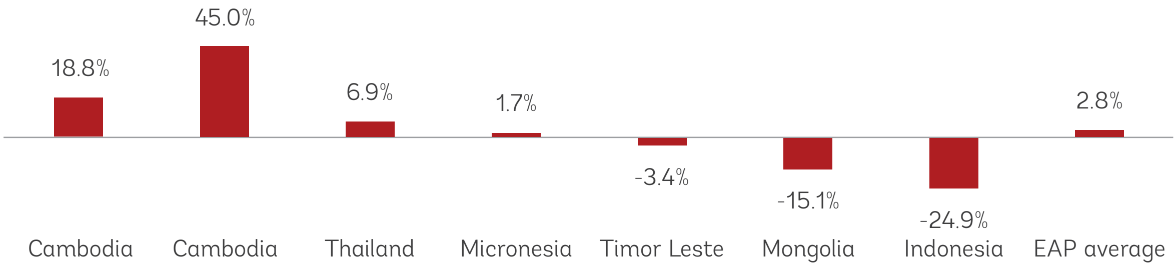


Source: World Bank Worldwide Bureaucracy Indicators based on IMF data.

Cambodia's public sector workers currently earn a higher average salary than their private sector counterparts.[19] Average monthly public sector pay reached 1.50 million riels in 2019, compared to 1.25 million riels for the private sector. Cambodia's public sector wage premium relative to private sector wage employees (even after accounting for observable characteristics such as experience, educational qualification, gender, and location) was 18.8 percent in 2019 (figure S.6).[20] This positive wage premium experienced by public sector workers is higher than the regional average of 3 percent and is among the highest compared to all its peers, with only the Philippines being higher. Furthermore, the results hold in the education and health sector, where the wage premium for working in the public sector is also positive and significant in the country (6 percent in healthcare and 17 percent in education).

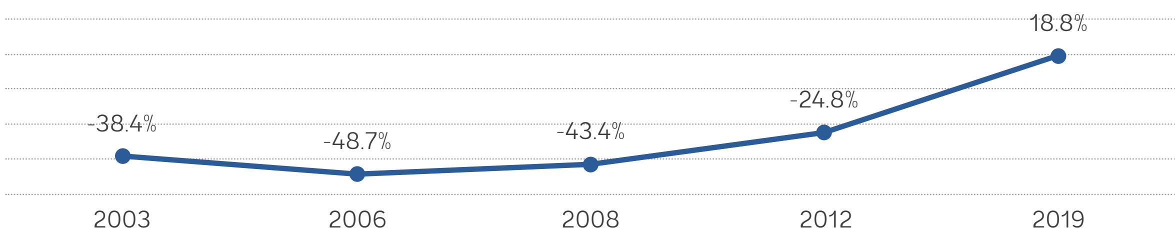
Average public sector wage was 18.8 percent higher than the private sector wage in 2019. This represents a major improvement from the 2003 level, when the public sector wage was 38.4 percent lower than the private sector counterpart (figure S.7). During 2003–12, because of the low wages offered by the government (compared to those in the private sector), government jobs were unattractive to the newly graduated and other skilled workers. This led to problems among government employees, such as moonlighting, while other young skilled workers left the government for more generous private sector jobs, thereby adversely affecting government efficiency.[21] After 2013, compensation reform under the National Program for Public Administration Reform resulted in a restructuring of the salary scale and this, together with continuous annual across-the-board salary increases, resulted in substantial improvement in basic civil servant salaries. This higher compensation of public sector workers made room for a more competitive wage for the public workforce.

Figure S.6 Public sector wage premium (compared to all private sector workers)



Source: World Bank's Worldwide Bureaucracy Indicators

Figure S.7 Cambodia's public sector wage premium over time



Source: World Bank's Worldwide Bureaucracy Indicators

19 While public sector wage levels are an important determinant of personnel motivation and of state capacity, they also have important consequences for expenditure efficiency, fiscal sustainability, and equilibrium outcomes in the entire labor market. However, answering the question "does the public sector pay too much or too little" naturally requires an appropriate comparator. Comparing the wages of public and private sector workers is analytically useful given that the most likely outside option to employment in the public sector is the private sector.

20 These wage differentials do not take additional sources of compensation like allowances and in-kind transfers into account, which are likely higher in the public sector. Therefore, if anything, these estimates may be underreporting the wage premia. However, the lack of such information on the household surveys affects the ability to perform this additional analysis.

21 Oudom 2012.

The difference in pay between the public and private sector varies by level of education. Public sector workers with tertiary education earn 7.5 percent more than their private sector counterparts. However, public sector workers with no education make 16.4 percent less than their private sector counterparts.[22] The wage gap between public and formal private sector workers is highest among workers with secondary education, at 14.7 percent in favor of public sector workers (figure S.8). A high wage premium among highly educated workers, together with a larger representation of these workers in the public sector relative to the private sector, suggests potential skilled labor shortages for the private sector, with big implications for public sector wage bill sustainability.

Technical occupations enjoy a higher premium in the public sector than senior managerial occupations. In Cambodia, public sector technical specialists enjoy 40.4 percent higher pay than private formal workers, mainly driven by the high proportion of police officers and public sector administrative officers. All other occupations in the public sector pay a wage penalty, and the highest penalty is observed among senior officials (65 percent), as seen in figure S.9. This is usually observed in other countries, where premiums are higher for entry-level civil servants than senior civil servants, which may be particularly disruptive to the overall labor market. Given these high premia among specialists, it will not be surprising to see a massive demand for these public sector jobs, with hundreds of applicants for each vacancy.

Figure S.8 Wage premium by education level (Compared to private formal workers)

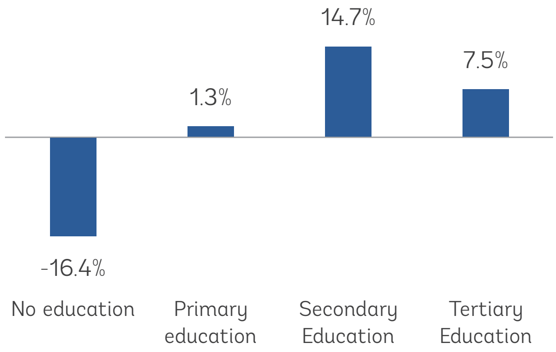
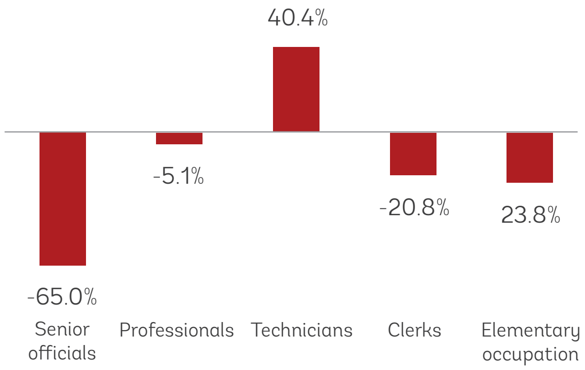


Figure S.9 Public sector wage premium by occupational group (Compared to private formal workers)



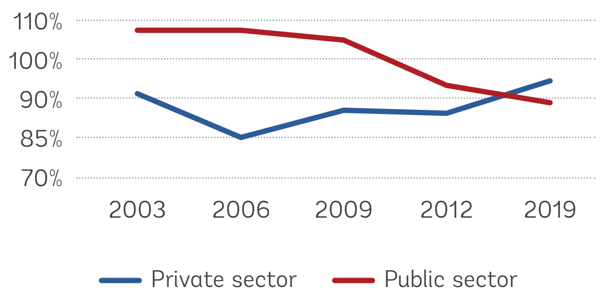
Source: World Bank's Worldwide Bureaucracy Indicators

22 This heterogeneity in the wage gaps by education level could be caused by many factors, and it is impossible to identify these factors without data from household surveys. It may stem from different productivity gaps in the public sector that vary across occupations, such as stronger union bargaining power of lower-skilled employees.

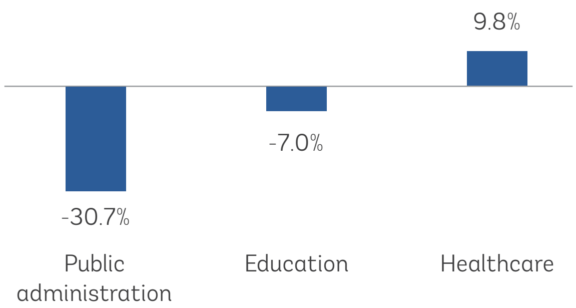
Female workers in the public sector suffer a significant gender wage gap in many segments of the public sector workforce. Globally, women often earn significantly less than men for doing the same work in both the public and private sectors. In Cambodia, females earn 94 percent of the wage of males in the private sector and 89 percent of the wage of their male counterparts in the public sector, and this wage gap observed in the public sector has increased over time (figure S.10, panel A). Moreover, women in Cambodia perform most tasks in the public sector education and healthcare sectors, but their participation is mostly confined to lower-paid occupations. Women working in the education industry face a wage penalty of 7 percent compared to their male counterparts working similar jobs with similar hours (figure S.10, panel B), even after accounting for differences in age, educational qualifications, and location. In public administration, women experience a wage penalty of 30.7 percent. However, women in healthcare earn almost 10 percent more than men in the same industry. While the wage penalty experienced by women is observed globally, in Cambodia, the size of these penalties is higher. The average global gender wage penalty is 3 percent for education and 2 percent for public administration industries, respectively.

Figure S.10 Gender wage gap in Cambodia

Panel A. Female-to-male wage ratio by sector of employment



Panel B. Public sector gender wage premium by industry

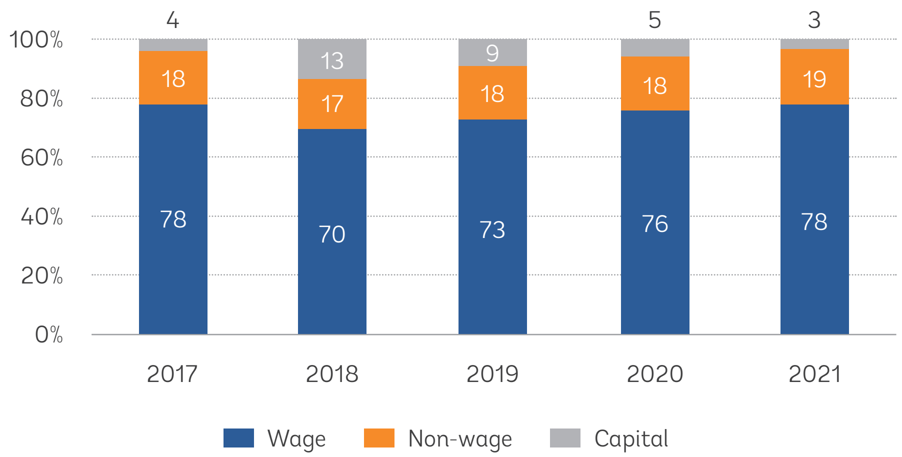


Education spending increased but has yet to translate into better learning outcomes

Putting emphasis on human capital development in the Cambodian government's national development strategy, the Rectangular Strategy[23] Phase 4, government spending for social sectors increased significantly. Cambodia had increased spending on education, but that budget increase centered on the wage bill, which occurred before COVID-19, and was driven mainly by a rise in salary for the large number of education staff. To improve the standard of living for education staff, especially teachers, the government has been increasing salaries since 2014. Starting salaries for upper secondary teachers doubled between 2014 and 2020 due to a rise in both base salary and functional allowance. In addition, the total number of educational staff increased by 6 percent during the same period, from 107,395 in 2014 to 114,170 in 2020. Therefore, wage bill increases have squeezed out budget space for capital expenditures. For example, wage expenditure as a share of total Ministry of Education, Youth and Sport (MoEYS) expenditure reached nearly 80 percent in 2021, up from 70 percent in 2018. Non-wage expenditures as a share of the total MoEYS budget slightly increased during the same period. However, the budget allocation for capital expenditure has dropped significantly, declining from 13 percent in 2018 to only 3 percent of the total MoEYS budget in 2021 (figure S.11).

While average public sector pay is higher than private sector pay, human resources management remains a challenge. The education sector continues to face difficult challenges, particularly in terms of shortages and an uneven distribution of teachers. At the national level, the total number of teachers is generally adequate. However, class size remains relatively larger than in Cambodia's ASEAN peers. Cambodia had the highest student-teacher ratio for primary school from 2013 to 2018. For secondary school, the student-teacher ratio remains high, but just lower than in Thailand and Myanmar for the same period. The larger class size in Cambodia is mainly attributable to the inefficient distribution of teachers. At the national level, based on MoEYS' 2018 norm on student-teacher ratios, Cambodia had an overall shortage of 12,305 teachers in 2021. There was a teacher shortage of 4,833 in preschool and 9,959 in primary school. However, there was a surplus of teachers at the lower secondary and upper secondary level for the same year.

Figure S.11 Economic classification of MoEYS budget (% of total budget expenditure)



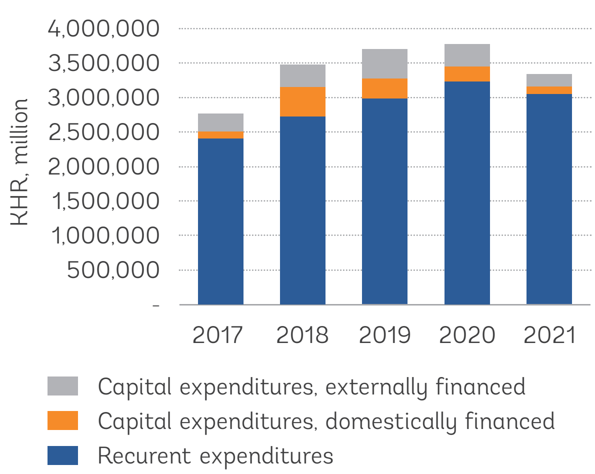
Sources: Budget Law 2017-2022 and World Bank staff.

23 Cambodia's Rectangular Strategy was formulated "to guide the implementation of the agenda of the Royal Government." Phase IV specifically addresses Growth, Employment, Equity and Efficiency.

Education infrastructure expenditure relied mainly on development partner (DP) capital allocation. Between 2017 and 2021, the DP-funded budget as a share of MoEYS' budget was around 1.5 to 3.3 times MoEYS' planned expenditures during the same period. Education infrastructure investment has declined, driven by a decrease in the DP-funded budget and MoEYS' capital budget. Planned capital expenditures funded by DPs as a share of MoEYS' budget represented 6 percent in 2021, a steady decline from 10 percent in 2017. MoEYS' capital expenditures budget dropped three times, from 12 percent of the budget in 2018 to only 3 percent in 2021 (figure S.12, panels A and B).

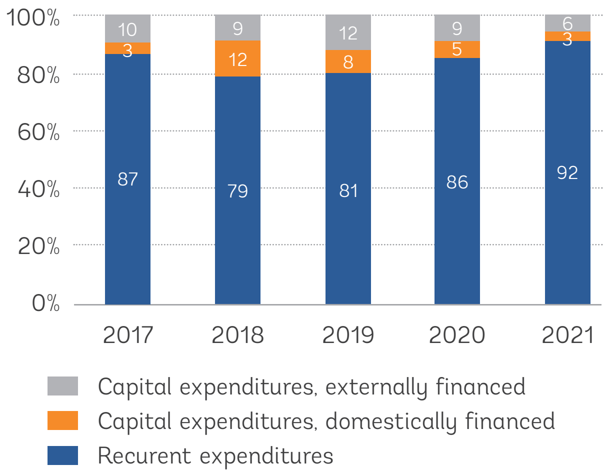
Figure S.12 MoEYS recurrent and capital expenditures, 2017–21

Panel A. MoEYS' budget by category, 2017–21



Sources: Budget settlement law and WB staff.

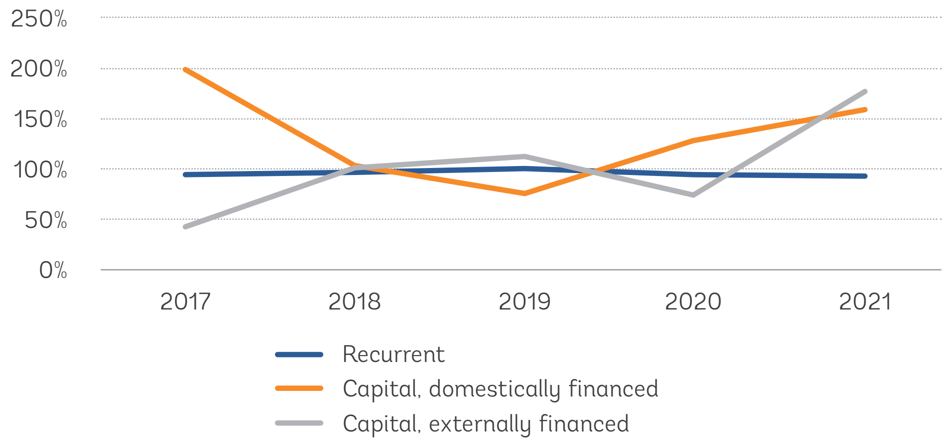
Panel B. MoEYS' budget by category (% of total), 2017–21



Sources: Budget settlement law and WB staff.

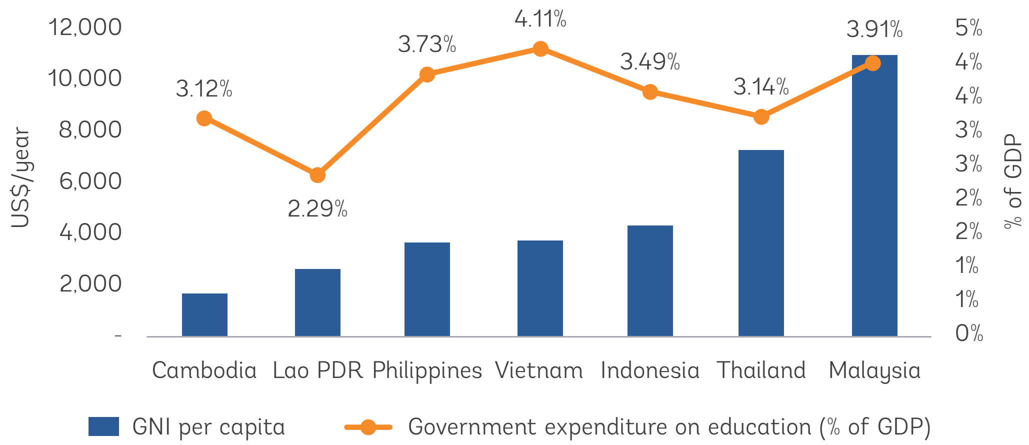
Budget execution for recurrent expenditures is in line with budget plans. However, budget outturns for capital expenditures—both domestically and externally financed—significantly fluctuated (figure S.13). This suggests weaknesses in planning and execution of capital expenditures. Making public investment projects more comprehensive and aligning public investment projects with the budget process could strengthen the planning of investment projects.[24] While Cambodia's gross national income per capita is the lowest compared to regional neighbors, Cambodia's education spending of 3.12 percent of GDP is relatively high—higher than Lao PDR, on par with Thailand (3.14 percent of GDP), and slightly lower than Indonesia (3.49 percent of GDP), the Philippines (3.73 percent of GDP), and Malaysia (3.91 percent of GDP) (figure S.14).

Figure S.13 Planned capital spending and budget outturn
MoEYS' budget outturn, 2017–21



Sources: Left: Budget settlement law, MEF and WB staff; Right: PIMA 2019.

Figure S.14 Government expenditures on education: Percent of GDP compared to gross national income per capita, 2021



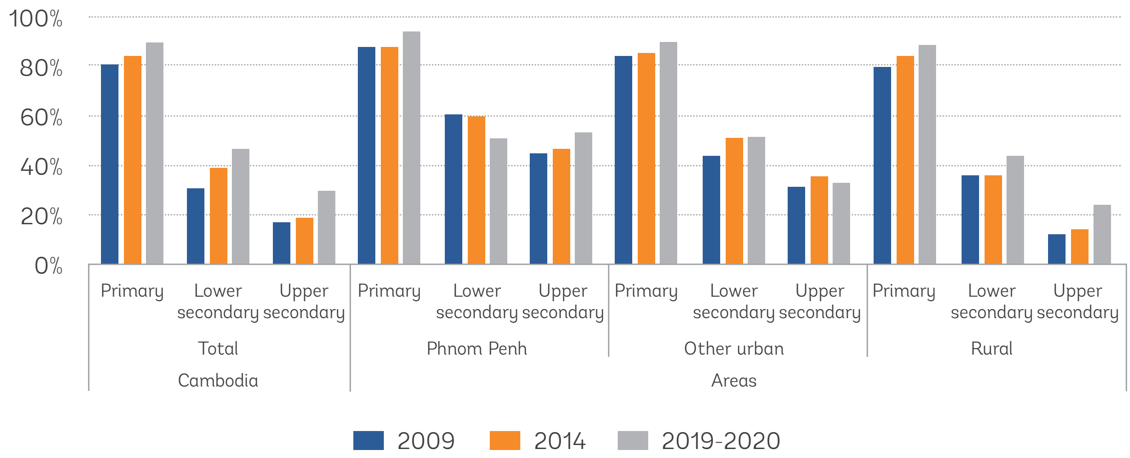
Source: WDI

24 IMF, Cambodia Public Investment Management (PIMA) 2019.

Education outcomes have improved over the last decade, but the gap between urban and rural areas remains. Between 2009 and 2019, net enrollment rates for primary education increased from 81 percent to 90 percent, for lower secondary from 31.5 percent to 47.5 percent, and for upper secondary from 17.9 percent to 30.9 percent. The literacy rate for population aged 15 and above increased from 73.9 percent to 81.9 percent over the same period. However, there is a big difference between urban and rural areas in terms of net enrollment and literacy rate. Although Cambodia has reduced the percentage of people with no schooling, the completion rate for primary and secondary remained flat. Figure S.15 shows that net enrollment rates were higher in urban than rural areas, particularly after primary education.

Despite the improvement, Cambodia lags behind its ASEAN peers in education outcomes, including literacy rates (figure S.16). Completion rates are also lower than in most ASEAN countries, suggesting that more work needs to be done to retain students in secondary education. Also, dropout rates at primary school remained the highest in the ASEAN region. On the positive side, those with no schooling dropped from 28 percent in 2009 to 18 percent for the 2019/20 school year.

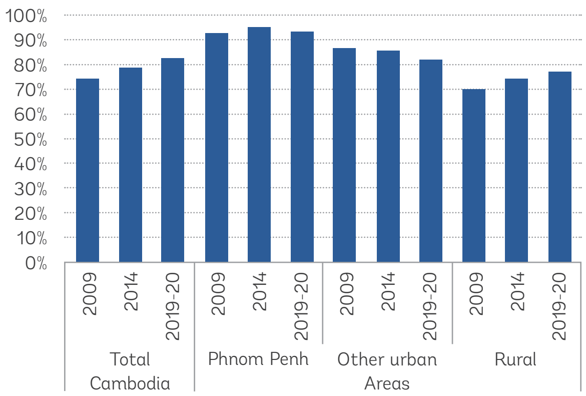
Figure S.15 Net enrollment rate, urban and rural areas, 2009–2019/20



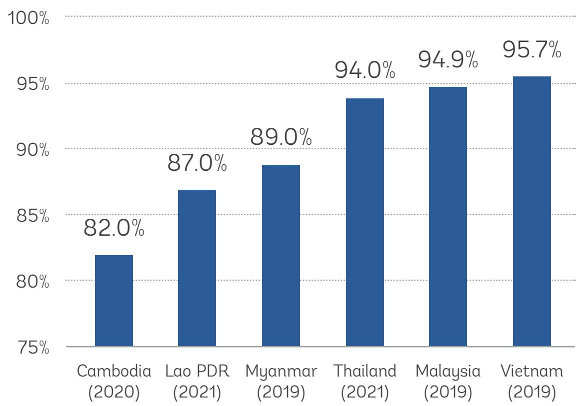
Sources: CSES 2014 and CSES 2019-2020.

Figure S.16 Cambodia literacy rate, and compared with its ASEAN peers

Panel A. Cambodia literacy rate, 2009–2019/20



Panel B. Cambodia literacy rate compared to other ASEAN countries

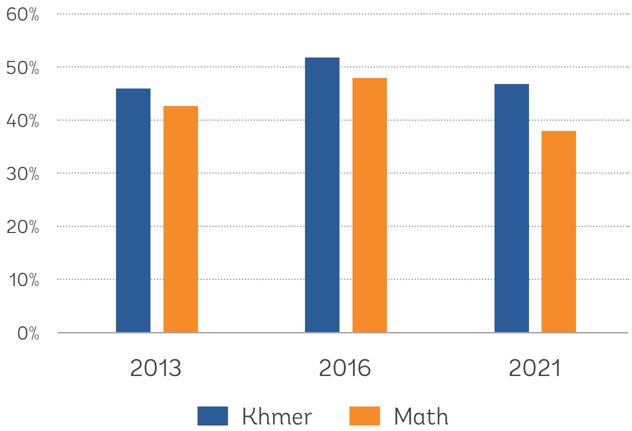


Sources: Panel A: CSES 2014 and CSES 2019–20; panel B: Cambodia extracted from CSES 2019–20 and other countries sourced from *World Development Indicators* (WDI) (extracted in March 2023).

The increase in spending on education has not yet translated into learning outcomes. Learning outcomes for students in Grade 6 and Grade 8 are still low. Between 2013 and 2021, an average student in Grade 6 could answer less than 52 percent of Khmer questions correctly. Student learning outcomes for mathematics were even poorer; on average, Grade 6 students answered less than half the questions correctly—43 percent in 2013, 48 percent in 2016, and 38 percent in 2021 (figure S.17). The deterioration of 2021 test results were due to the negative impact of the COVID-19 pandemic. Similarly, 36 percent, 19 percent, and 52 percent of students in Grade 8 performed below basic proficiency levels for math, Khmer reading, and physics, respectively, in 2017 (figure S.18).

Figure S.17 Learning outcomes for Grade 6, 2013–21

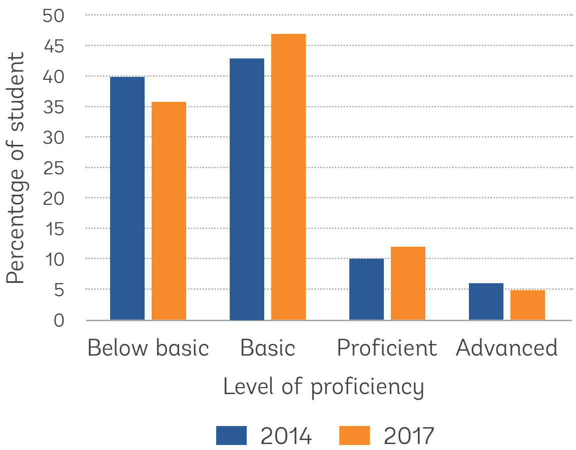
Percentage of questions correctly answered



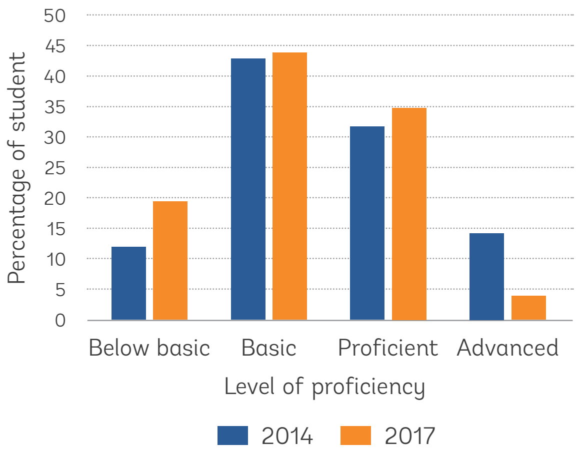
Source: MoEYS.
Note: Scaled score were converted with a mean of 500 and standard deviation of 100.

Figure S.18 Percentage of Grade 8 students proficient in Khmer reading and mathematics, 2014–17

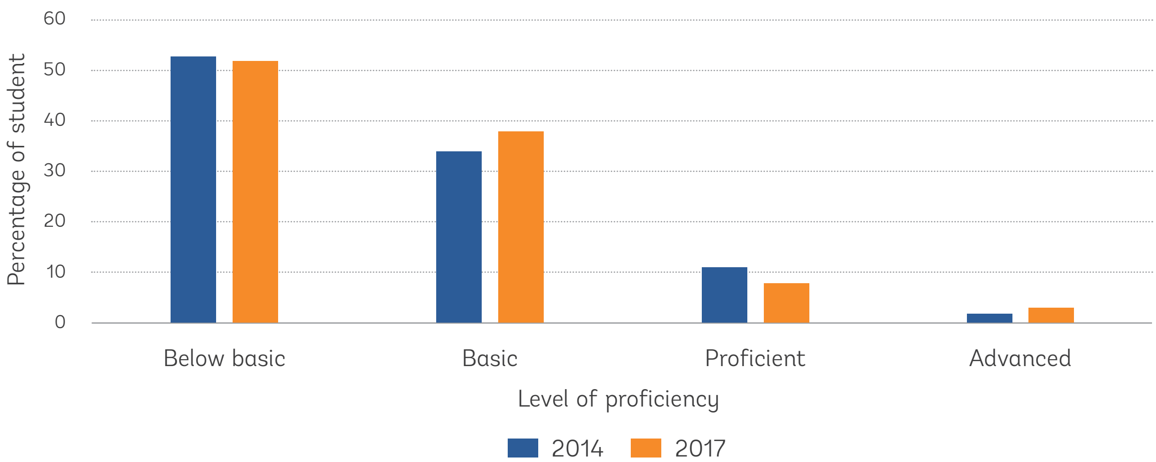
Panel A. Proficiency of Grade 8 students in math



Panel B. Proficiency of Grade 8 students in Khmer reading



Panel C. Proficiency of Grade 8 students in physics



Source: MoEYS.
Note: Scaled scores were converted with a mean of 500 and a standard deviation of 100.

A study on Cambodia's experience in the Program for International Student Assessment for Development (PISA-D) found that the performance of students in Cambodia was yet to reach the level at which they were expected to learn. A low percentage of Cambodian students at age 15 achieve a minimum level of proficiency—8 percent in reading and 10 percent in mathematics. Students in Cambodia performed below the average score for other participating ASEAN countries (Indonesia, Singapore, Thailand, and Vietnam) in three domains: reading, mathematics, and science. On average, Cambodia scored 321 for reading, 325 for mathematics, and 330 for science on the PISA-D, which is lower than the ASEAN average scores of 430 for reading, 435 for mathematics, and 439 for science. Less than 2 percent of students in Cambodia showed an ability to perform at the average competency level of Organisation for Economic Co-operation and Development (OECD) countries. In reading, they performed significantly lower than the PISA-D average (346 score points).[25]

Public health policy effectiveness is limited by low public health spending, low utilization rates of public health facilities, and high levels of out-of-pocket spending

Overall public health spending mainly goes to public health administration, medical supplies and equipment, and other necessities for frontline services to keep public health facilities operational. The use of public facilities requires applicable user fees. Part of the public funds also finance Health Equity Funds for the poor to access public facilities.

Prior to the COVID-19 outbreak, Ministry of Health (MoH) budget allocations had been gradually decreasing, from 8.6 percent of the total government budget in 2017 to 7 percent in 2020. In response to the pandemic, however, public resources allocated to the MoH increased by 58 percent, from 1,729,987 million riels (1.9 percent of GDP) in 2017 to 2,724,907 million riels (2.5 percent of GDP) in 2021 (figure S.19).

Capital expenditures at the MoH are mainly financed by DP-funded capital allocation. Between 2017 and 2022, planned government capital investment allocation as a share of total budget allocation accounted for 4 percent or less, except in 2021, when planned government capital expenditures reached 18 percent (figure S.20), as a part of a broader COVID-19 response. Finances for capital expenditure mainly come from external funds (development partners).

Figure S.19 MoH budget expenditures, 2017–22

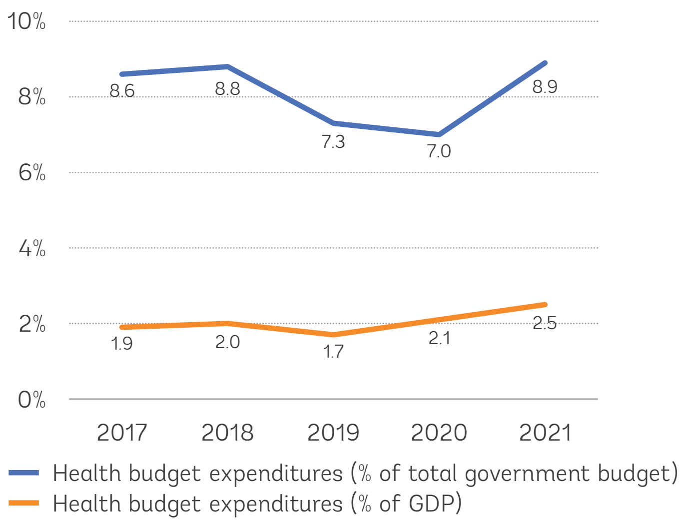
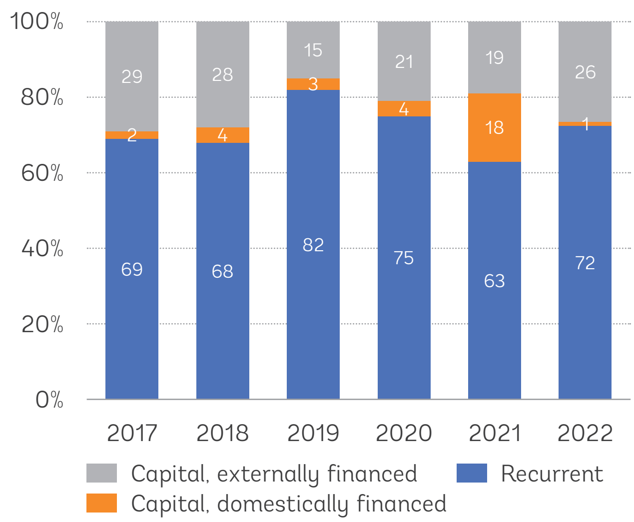


Figure S.20 MoH budget, by category (% of total), 2017–22

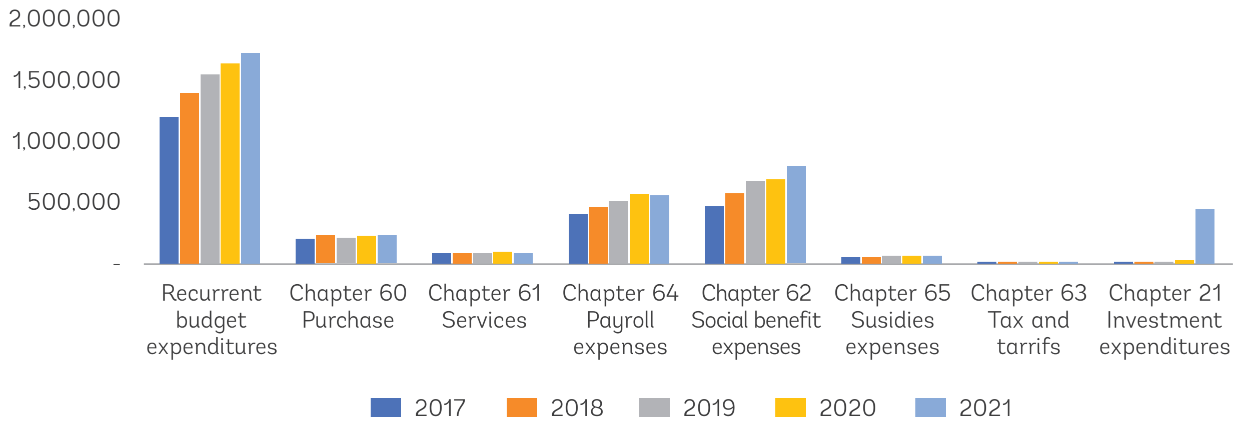


Sources: MEF and World Bank staff
Note: MOH = Ministry of Health; MEF = Ministry of Economy and Finance; KHR = Khmer Riel. Recurrent expenditure budget includes expenditures other than infrastructure such as wages, drugs, medical supplies, and other operating expenses. Capital expenditures budget is used to acquire infrastructure fixed assets such as hospitals or health center buildings.

25 MoEYS 2018.

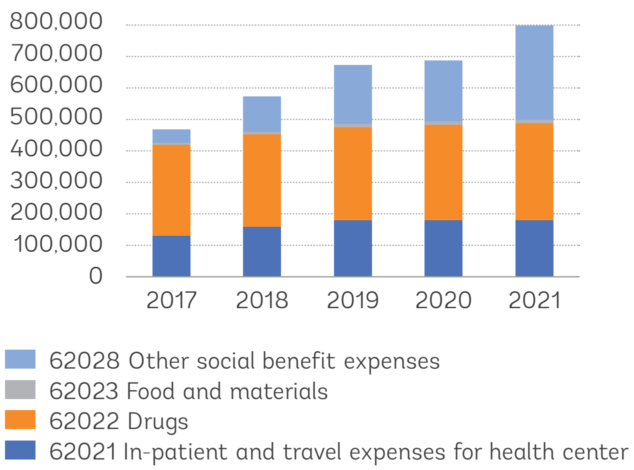
The increase in the MoH recurrent budget in nominal terms between 2017 and 2021 was driven by social benefits expenses and wages[26] (figure S.21). Social benefits expenses (Chapter 62) support health service delivery and include inpatient and operational expenses at health facilities, drug purchases, and medical supplies (box 2). Between 2017 and 2021, the budget for nominal social benefits expenses (Chapter 62) increased by 71 percent—from 469,459 million riels (0.5 percent of GDP) to 801,031 million riels (0.7 percent of GDP), driven by a rise in subsidies to informal sector Health Equity Fund (Chapter 62028) and drug expenditures (Chapter 62022). Planned domestically financed capital expenditure (Chapter 21) was modest in 2017 (1,199 million riels or 0.001 percent of GDP), with an increase in 2020 (20,370 million riels or 0.01 percent of GDP) (figure S.22 and box S.1).

Figure S.21 MoH recurrent budget, by economic classification (Riels, million), 2017–21



Sources: MEF
Note: MEF = Ministry of Economy and Finance, Actual spending on COVID-19 was excluded from social benefit expenses (Chapter 62)

Figure S.22 MoH budget on social benefits expenses, by economic classification (Riels, million), 2017–21



Source: MEF Note: MEF = Ministry of Economy and Finance; KHR = Khmer Riel, Actual recurrent spending was based on MEF data, which does not include payroll expenses at the provincial level in 2021. Actual spending on COVID-19 was excluded from other social benefit expenses (Chapter 62028)

Box S.1. Spending under Chapter 62 (Social benefits expenses)

Chapter 62021 (inpatient support and operational expenses for health center): This chapter covers expenses related to (i) operational expenses (water, electricity, telephone, office supplies, and others), (ii) government expenditures on HEF, and (iii) contribution to Kunthea Bopha Fund.

Chapter 62022 (drugs): The expenses in this chapter include drugs, oxygen, alcohol, and vaccines.

Chapter 62023 (food and materials): Subsidies to blood donors, food for inpatients, food for newborns at National Matronal and Child Health Center, safety cloth, etc.

Chapter 62028 (other social benefit expenses): Subsidies to NSSF for female workers delivering at health facilities, subsidies to NSSF for former public officials, subsidies to poor pregnant females and infants under 2 years of age, government expenditure on informal sector HEF.

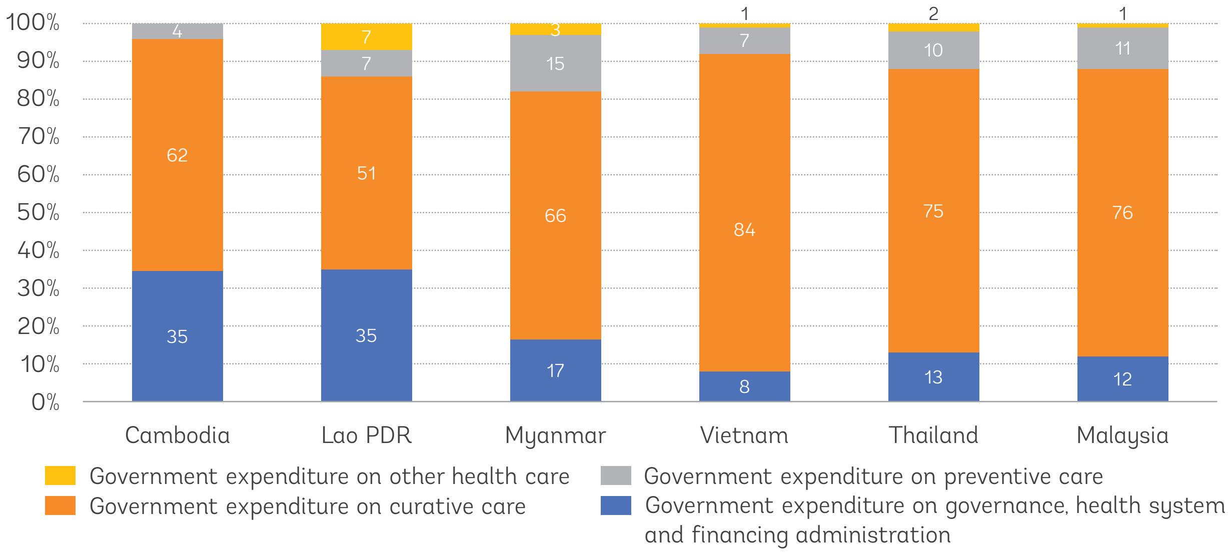
Note: Chapter 62028 excluded COVID-19 expenses from MoH general health spending. HEF = Health Equity Fund; MoH = Ministry of Health; NSSF = National Social Security Fund.

26 Social benefits expenses (Chapter 62) include inpatient travel expenses to a health center, drug purchase expenses, and medical supplies.

Spending on health system administration remains high compared to other ASEAN countries, while spending on health service delivery (particularly preventive care) remains very low as a total share of public expenditures. In 2019, Cambodia's spending on health system administration as a share of government health expenditures (34.5 percent), was twice as high as in Myanmar, more than four times higher than in Vietnam, and nearly three times higher than in Thailand and Malaysia (figure S.23). As a share of government health expenditures, Cambodia's public spending on curative care (61.9 percent) is second lowest only to Lao PDR, and lower than Myanmar (65.5 percent), Vietnam (84.4 percent), Thailand (74.6 percent), and Malaysia (75.9 percent). When expenditure on preventive care is measured as a share of government health expenditure, Cambodia was the lowest. The share of government spending on preventive care is the lowest among comparator countries. There should be a transition toward higher prioritization for preventive care, including introducing policies to increase targeted prevention measures where health spending is high, and institutionalizing incentives for people to seek preventive services is desirable.

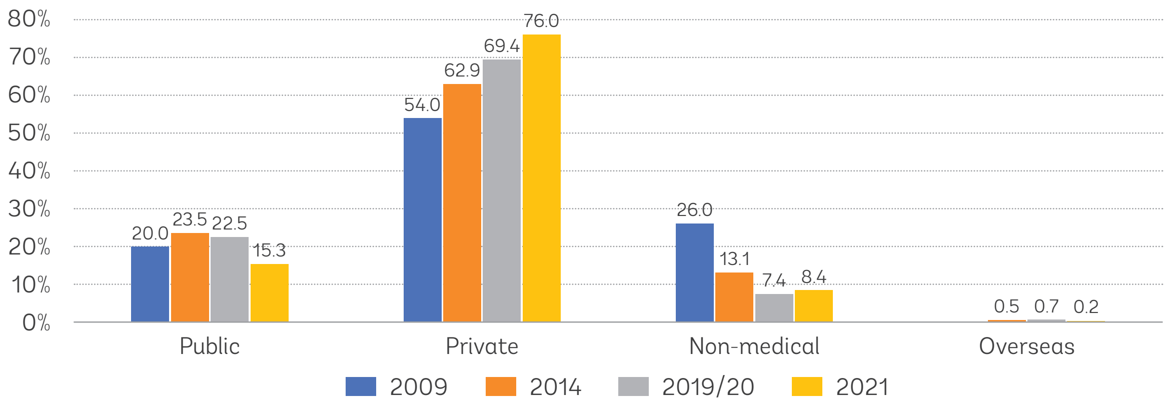
Utilization of health care services provided by public health facilities is relatively low (figure S.24). In 2021, more than three-fourths of sampled household members sought care for illness and injury from a private healthcare provider in the last 30 days, 15.3 percent sought care from a public healthcare provider, 8.4 percent from a nonmedical provider, and 0.2 percent sought healthcare overseas. Low utilization of public health services means that public expenditure has not achieved its fullest potential.

Figure S.23 Cambodia's health spending compared to its ASEAN peers, by health care function, (% of government health expenditure), 2019



Sources: WHO-Global Health Expenditure (2022) and World Bank staff
Note: MoH = Ministry of Health. Government health expenditures from 2016 to 2019 (graph a) are PPP-adjusted nominal values. Other healthcare includes rehabilitative care, long-term healthcare, ancillary services, medical goods, and other healthcare services.

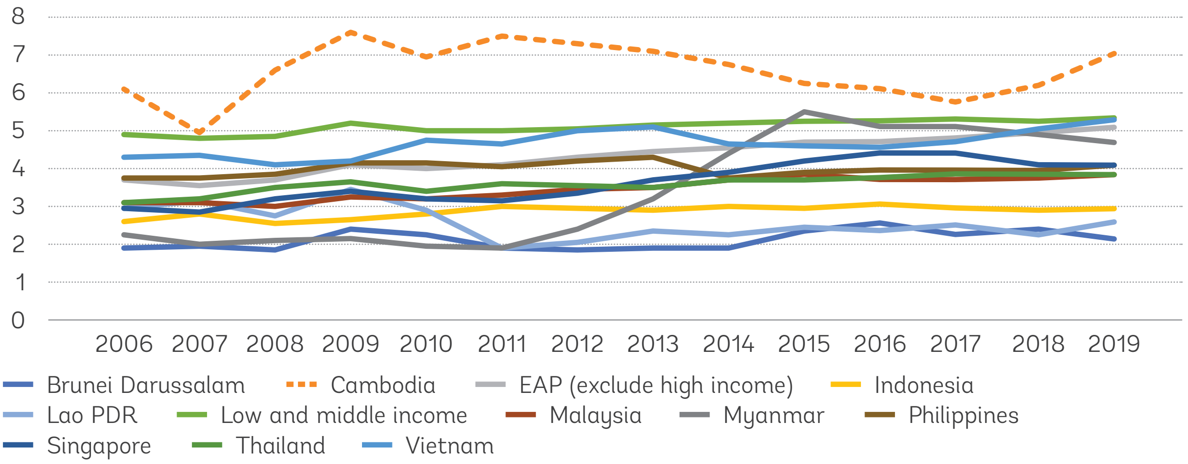
Figure S.24 Type of health provider consulted first



Source: Draft report: *Analysis of Financial Risk Protection in Cambodia's Health System using CSES (Cambodia Socioeconomic Survey) Data: 2009–2021*. GIZ (2023, forthcoming)
*Option for overseas treatment is not included in the 2009 CSES data.

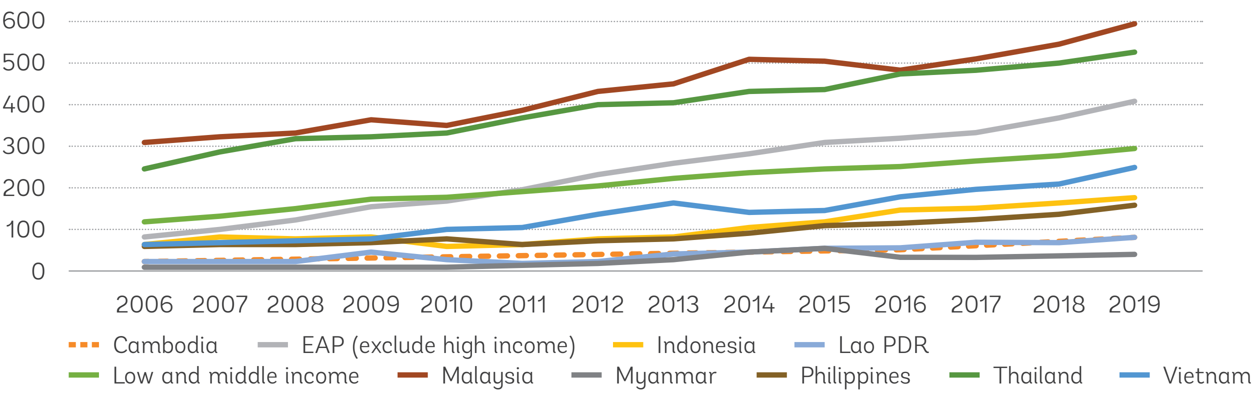
Cambodia spends more on health care than all its neighbors, despite low levels of government spending. Cambodia spent more than 5.7 percent of its GDP on healthcare from 2009 to 2019, which is consistently higher than any of its ASEAN neighbors for over a decade (figure S.25). This level of spending persists despite relatively low levels of government spending on healthcare in both per capita terms (figure S.26) and as a share of the government budget (figure S.27), with both lower than nearly all other countries in the region. This means the remainder is financed by external (DP) financing and out-of-pocket spending.

Figure S.25 Health expenditure (% of GDP)



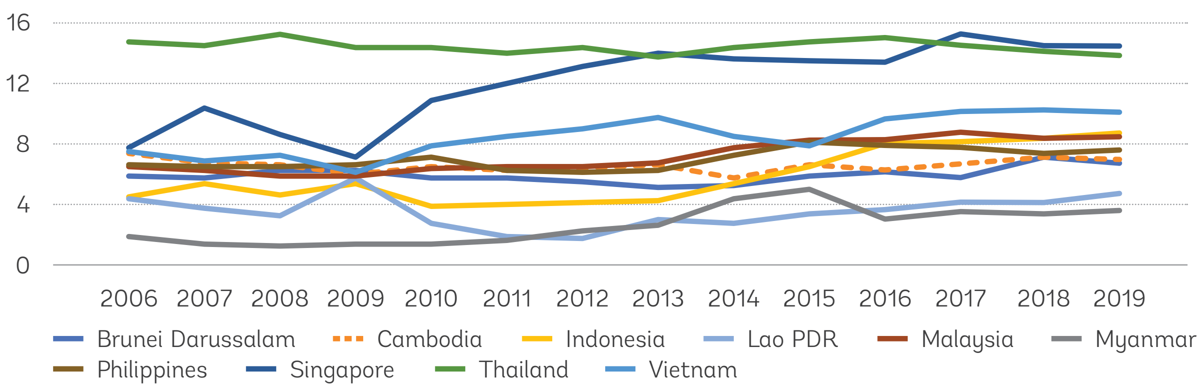
Source: WDI

Figure S.26 General government health expenditure per capita, purchasing power parity (current international dollars)



Sources: WDI

Figure S.27 Domestic general government health expenditure (% of general government expenditure)



Sources: WDI

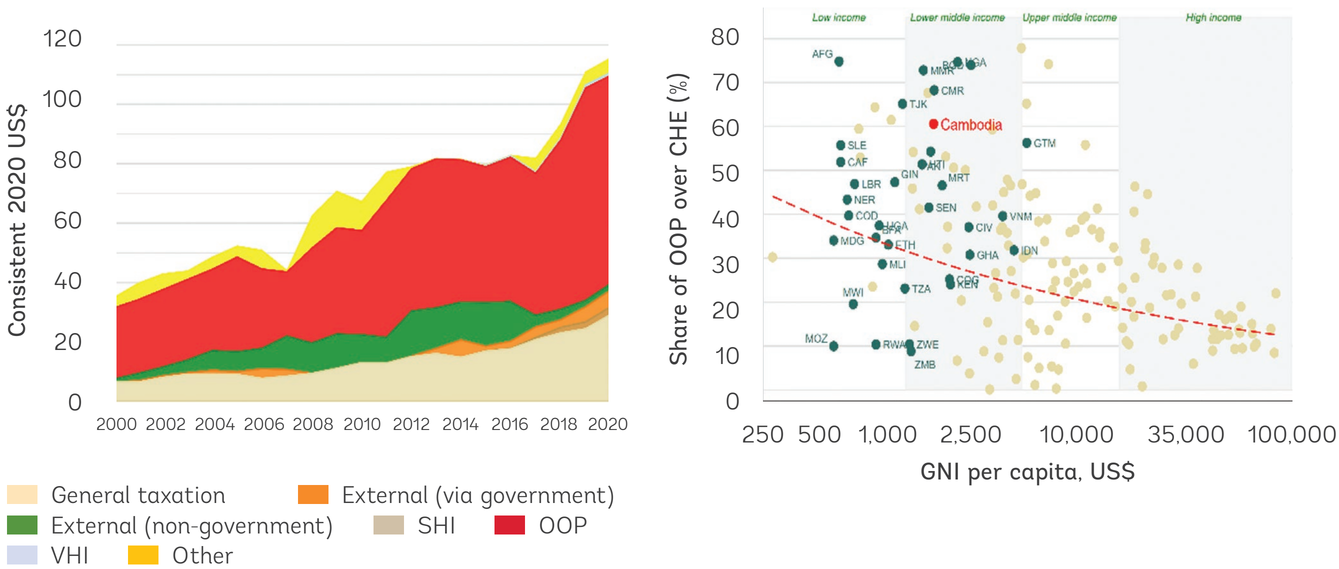
The volume of financing for health in Cambodia is consistent with what other countries are spending at similar income levels, but the composition of health financing is overly dependent on private out-of-pocket (OOP) expenditures. OOP financing is neither an efficient nor equitable way to achieve universal health coverage. Total health expenditure per capita increased in real terms from about US$35 per year in 2000 to about US$115 in 2020. Countries transitioning from low- to middle-income status typically also achieve a health financing transition whereby (i) the volume of financing invested in health increases, and (ii) the composition of health funding transitions from external and OOP dependence to predominantly prepaid mechanisms, such as public health financing or some form of health insurance. In Cambodia, however, while the share of external financing has decreased since 2015, OOP expenditure remains the main financing channel for the sector (figure 28, panel A), and the share of OOP financing (60 percent in 2020) is well above what is observed on average for countries at similar income levels (about 30 percent) (figure S.28, panel B).

High out-of-pocket spending means the poor are more vulnerable to income shocks and are less likely to have access to health services. In 2013 the highest quintile of income (richest) spent 16 times more on healthcare than the lowest quintile (poorest), being more able to afford to pay for healthcare services owing to larger disposable non-food income.[27]

Figure S.28 Cambodia health financing and reliance on OOP expenditures, 2000–30

Panel A. Volume of health financing

Panel B. Overreliance on OOP



27 WHO 2015.

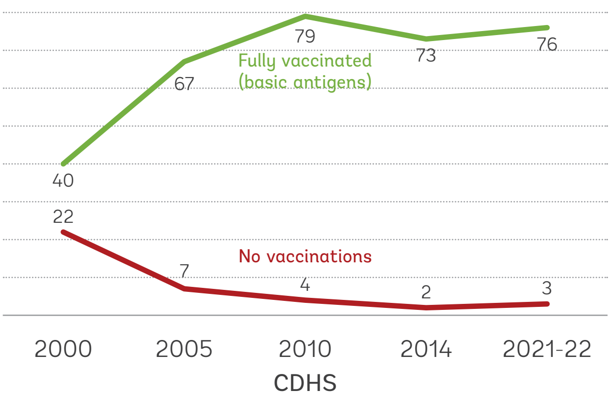
Against the backdrop of a declining MoH budget (unrelated to COVID-19), low utilization of public facilities, and a preference for private sector services, which contribute to high out-of-pocket expenditure, Cambodia has significantly improved health outcomes over the last two decades. Cambodia has seen substantial increases in immunization coverage and declines in unvaccinated children (figure S.29, panel A). It has also seen large reductions in childhood mortality, with under-five mortality dropping from 124 per 1,000 births in 2000 to 16 in the 2021–22 health survey (figure S.29, panel B).

Despite the improvement in health outcomes, Cambodia lags behind most of its ASEAN peers in life expectancy and child mortality rates (figure S.30, panels A and B). Over the last two decades, life expectancy increased from 57 years in 2010 to 68 years in 2019. However, Cambodia's life expectancy was higher than only Lao PDR, but remained lower than in the rest of its ASEAN peer countries. In addition, Cambodia's infant and under-five mortality rate was around three times higher than in Thailand and around one-third higher than in Vietnam.

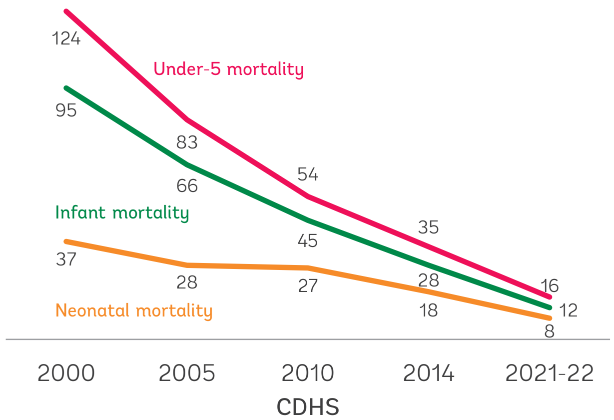
Figure S.29 Trends in immunization coverage and childhood mortality

Panel A. Immunization coverage, 2000–2021/22

Percentage of children age 12-23 months



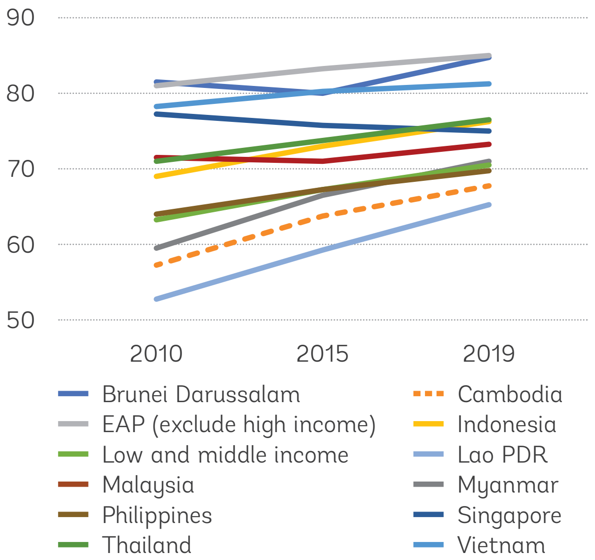
Panel B. Childhood mortality, 2000–2021/22



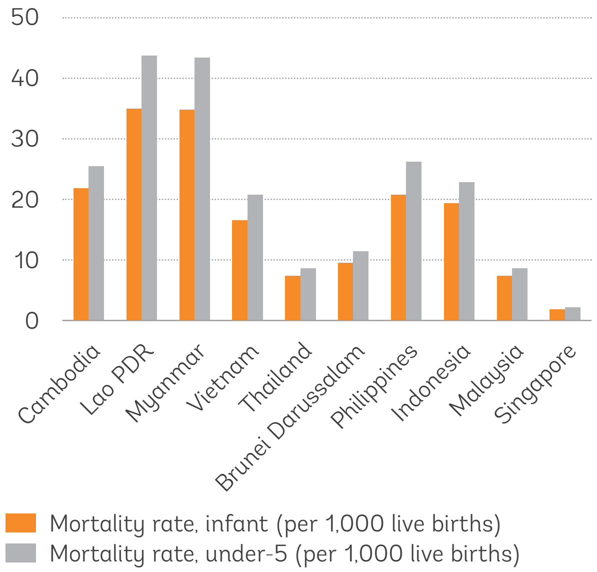
Source: Cambodia Demographic and Health Survey (CDHS) 2021-22 Key Indicators Report, June 2022.

Figure S.30 Life expectancy and child mortality rates, Cambodia compared to ASEAN peers

Panel A. Life expectancy compared to regional peers



Panel B. Child mortality rate compared to regional peers, 2020

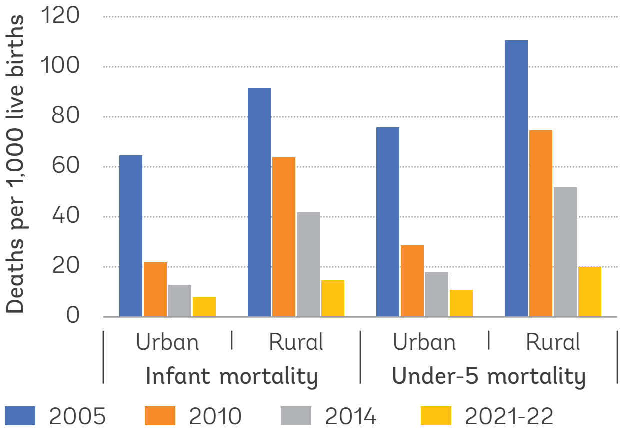


Source: World Bank Development Indicators, 2022.

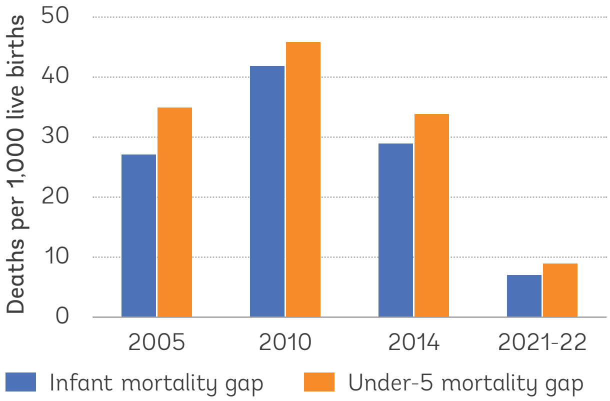
The disparity in health outcomes in rural and urban areas and among wealth quintiles is likely to remain a challenge. Between 2005 and 2021, infant and under-five mortality for urban and rural areas significantly declined, but the urban and rural gap remained. Infant mortality and under-five mortality in rural areas were, respectively, 7 and 9 deaths per 1,000 live births, higher than in urban areas by 2021 (figure S.31). The richest and poorest gaps in infant mortality and under-five mortality declined, as well, during the same period. However, the gap between the poorest and richest in infant mortality and under-five mortality persists. In 2021, the poorest infant mortality and under-five mortality rates were, respectively, 16 deaths per 1,000 live births and 21 deaths per 1,000 live births, higher than the richest infant mortality and under-five mortality (figure S.32). The evaluation of targeting quality is hindered by data availability constraints, which prevent the inclusion of more up-to-date health outcome data, as well as data at the district and commune levels to evaluate the equity of access within provinces.

Figure S.31 Infant and under-5 mortality, urban compared to rural

Panel A. Infant mortality rate and under-5 mortality rate, by residence areas (deaths per 1,000 live births), 2014–2021/22



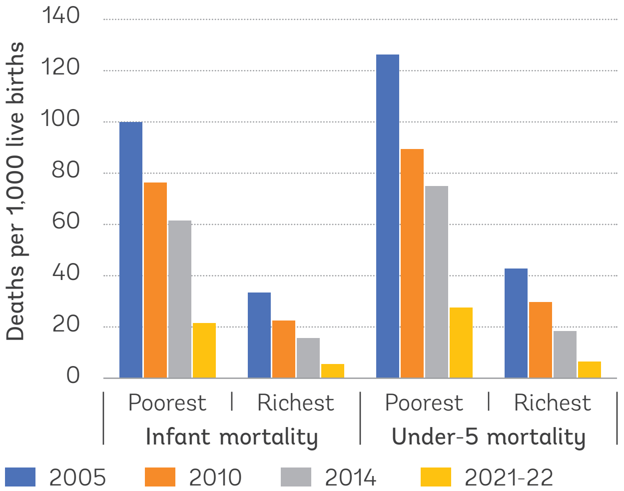
Panel B. Child mortality gap, infant and under-5, between urban and rural (deaths per 1,000 live births), 2005–2021/22



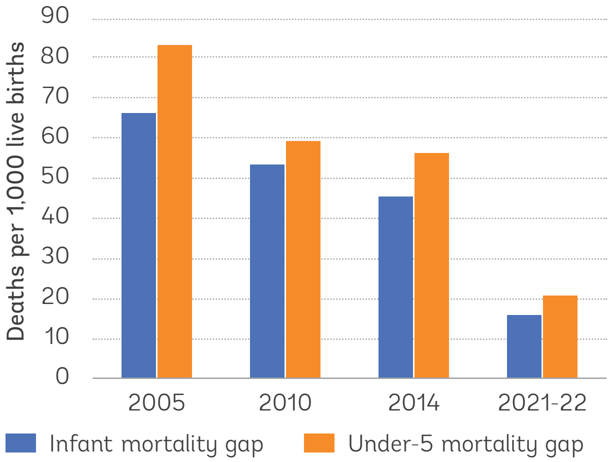
Sources: CDHS 2005, CDHS 2010, CDHS 2014, CDHS 2021-22
Note: CDHS=Cambodia Demographic and Health Survey, Infant mortality: the probability of dying between birth and the first birthday. Under-5 mortality: the probability of dying between birth and the fifth birthday. Child mortality gap=rural mortality rate-urban mortality rate. The higher the figure, the wider the gap.

Figure S.32 Infant and under-5 mortality rates, richest compared to poorest quintile

Panel A. Infant mortality rate and under-5 mortality rate, by wealth quintile (deaths per 1,000 live births), 2014–2021/22



Panel B. Child mortality gap, infant and under-5, between poorest and richest (deaths per 1,000 live births), 2005–2021/22



Sources: CDHS 2005, CDHS 2010, CDHS 2014, CDHS 2021-22
Note: CDHS=Cambodia Demographic and Health Survey, Infant mortality: the probability of dying between birth and the first birthday. Under-5 mortality: the probability of dying between birth and the fifth birthday. Child mortality gap=rural mortality rate-urban mortality rate. The higher the figure, the wider the gap.

Conclusions and Recommendations

The Government of Cambodia has been able to enlarge fiscal space, maintain fiscal sustainability, and increase budget allocations to social sectors in the country. Thanks to improved domestic revenue mobilization, the government has been able to support civil service compensation reform and finance COVID-19 relief packages.

Social sector expenditure significantly increased from 4.6 percent of GDP in 2011 to 10.5 percent in 2021, while spending in other sectors was stable. Key social sectors, including education and health, saw substantial increases in budget allocations. The increase in spending is broadly in line with the government expenditure policy, which prioritized the social sector. Across the sectors, capital expenditures relied mainly on external funding. More domestic financing for the capital budget is necessary, as external funds for infrastructure have tended to decline. Improvement in public investment management is necessary to achieve quality from public spending.

Expanded spending was significantly driven by salary increases for government officials across the board. The wage bill as a share of GDP increased over the last decade from 4.4 percent of GDP in 2011 to 7.2 percent in 2021. Average monthly public sector pay is higher than private sector pay, reaching 1.50 million riels in 2019, compared to 1.25 million riels for the private sector. Without the introduction of performance measurements, salary increases cannot ensure improved performance and, hence, quality, of spending.

The government needs to address the gender wage gap to improve gender equity in the workforce. Female workers in the public sector suffer a significant gender wage gap in many segments of the public sector workforce. Cambodian females earn 94 percent of the wage of males in the private sector and 89 percent in the public sector.

Improvement in human resource management and the introduction of performance-based management and accountability mechanisms could help improve technical efficiency and quality in public spending. The education sector continues to suffer from an uneven distribution of teachers and an inability to address teacher surpluses and shortages, impacting the quality of education. Without an accountability framework in place, student learning outcomes deteriorated despite the significant increase in teacher salary.

Low utilization of public health facilities and preference for private sector facilities, which contributes to high out-of-pocket expenditure, reflects the limited effectiveness of public health policy and the general perception of the quality of public health facilities. Major challenges for the sector include (1) health services quality remained inadequate due to limited resources, specifically in terms of number of health professionals, diagnostics, and treatment; (2) inadequate capacity of the public health system to deal with diseases and illnesses; (3) investments in health infrastructure, including technology and information systems, remained limited; and (4) inappropriate healthcare-seeking behavior of the population, especially those in rural or remote areas who delay seeking healthcare and who self-medicate.[28]

The quality of spending needs to be improved. The outcomes from public spending in both the education and health sectors suggest a need for further improvement in both the effectiveness of investment and quality of outcomes. This will require a stronger focus on strengthening both allocative efficiency and operational efficiency.

28 National Voluntary Review 2019.

Table S.1 Summarizes these recommendations.

Table S.1. Summary of recommendations

Sector	Challenges	Short-term recommendations (1–3 years)	Medium-term recommendation (3–5 years)
Across all sectors	Linking government spending with performance outcomes	• Revisit and refine Budget Strategic Plan to define realistic outcome indicators and performance information that is comparable across the reporting period • Provide program directors greater authority over resources allocation and hold them accountable for performance outcomes • Review and restructure program budgets across the sector to support link between budget allocation and performance outcomes	• Fully implement performance-based budgeting
	Introducing performance-based management and linking salary increase to performance	• Introduce performance-based management for mid-management level (general department and department level) across all sectors	• Introduce performance-based management for all civil servants
Health sector	Shifting from a (heavy) reliance on out-of-pocket spending to increasing and efficiently using public spending on health	• Improve efficiency of public health spending with more resources allocated for preventive and curative care and less on health administration • Improve availability of resources including health professionals, diagnostics, and treatment to encourage use of public health facility • Increase government health expenditure for Health Equity Fund (HEF) service payments	• Revisit the benefits packages included in current social health protection schemes to improve the protection of these schemes to avoid financial hardship • Increase health coverage by building on existing social health protection schemes
	Increasing equitable access to health services for the poor	• Rebalance resource allocation to point-of-service delivery at the district level, with a focus on poorer provinces with lagging health outcomes	• Integrate all existing social protection schemes, which includes (i) establishing an administration and governance body to oversee a unified health protection scheme, (ii) harmonizing health benefits packages of all health protection schemes, and (iii) ensuring sufficient budget to finance healthcare under the unified health scheme
Education sector	Improving human resources governance	• Improve information on teacher surpluses and shortages for management purposes • Improve teacher recruitment and deployment to ensure that newly recruited teachers will stay at their assigned workplaces with low transferring rates • Introduce redundancy (termination) for teachers in subject matters not in demand and early retirement for those not teaching the minimum required number of hours	• Delegate authority to schools that meet school effectiveness standards to hire contractual teachers and allocate resources for it • Introduce teacher licensing that requires renewal every specific number of years, and that requires mandatory service in remote locations
	Enhancing accountability framework	• Establish effective performance management systems that set out clear expectations and goals for teachers and education staff and provide regular feedback and evaluations by the use of technology • Introduce performance-based salary raise and career promotion for teachers and education staff • Continue to build capacity of teachers	• Fully implement school-based management and strengthen accountability • Enforce teacher standards

Annex 1: Cambodia – Selected Indicators

Selected Indicators*	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023F
Income and Economic Growth																
GDP growth (annual %)	6.7	0.1	6.0	7.1	7.3	7.4	7.1	7.0	6.9	7.0	7.5	7.1	-3.1	3.0	5.2	5.5
GDP per capita growth (annual %, real)	4.9	-1.4	4.4	5.5	5.8	5.8	5.7	5.5	5.5	5.6	6.2	5.8	-4.2	1.8	4.0	4.4
GDP per capita (US$, nominal)	741.3	734.7	810.0	889.6	949.4	1030.1	1105.1	1183.2	1281.3	1397.0	1527.3	1667.8	1583.9	1624.7	1768.1	1913.6
Private Consumption growth (annual %)	12.7	-0.2	8.8	10.4	4.6	5.8	4.5	9.4	5.8	3.7	6.8	5.9	-4.0	-0.7	9.5	20
Gross Investment (% of nominal GDP)	17.3	20.1	16.2	16.0	17.4	18.7	20.9	21.4	21.7	21.9	22.6	23.4	24.0	25.8	30.9	32.8
Gross Investment - Public (% of nominal GDP)[2]	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Money and Prices																
Inflation, consumer prices (annual %, EOP or MRV)[1]	12.5	5.1	2.9	4.6	2.3	4.5	0.9	2.8	3.8	2.1	1.5	3.0	2.8	3.7	5.5	2.5
Inflation, consumer prices (annual %, period average)	12.3	3.1	2.6	5.5	3.0	2.9	3.9	1.2	3.0	2.9	2.5	1.9	2.9	2.8	5.5	2.5
Broad Money (% of GDP)	28.3	37.7	41.6	39.1	50.1	55.5	67.1	72.4	79.2	88.2	100.7	116.3	137.2	152.6	148.3	146.7
Domestic Credit to the Private Sector (% of GDP)	23.5	24.6	27.6	28.3	38.7	52.0	62.7	74.3	81.7	86.7	99.6	114.2	139.6	-	-	-
10 year interest rate (annual average)[1]	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Nominal Exchange Rate (local currency per USD)	4060.0	4140.0	4044.0	4016.0	4033.0	4027.0	4030.0	4025.0	4058.0	4062.0	4067.0	4070.0	4077.4	4100.0	4150.0	4110.0
Real Exchange Rate Index (2015=100)	91.3	90.8	98.0	94.3	93.3	92.6	94.9	100.0	101.9	101.8	98.5	99.2	99.2	92.7	95.7	87.0
Fical																
Revenue (% of GDP)	16.4	15.9	17.7	17.6	17.7	18.2	20.0	19.7	20.9	21.9	23.8	27.0	23.8	22.0	23.2	23.5
Expenditure (% of GDP)	16.1	20.5	21.0	23.0	21.9	21.4	21.9	20.2	21.1	22.7	23.4	25.5	28.8	29.1	27.9	29.9
Interest Payments (% of GDP)	0.2	0.2	0.3	0.3	0.5	0.7	0.7	0.3	0.4	0.4	0.4	0.4	0.6	0.5	0.5	0.6
Non-Interest Expenditure (% of GDP)	15.9	20.3	20.7	22.7	21.4	20.7	21.2	19.9	20.7	22.3	23.0	25.1	28.2	28.5	27.4	29.3
Overall Fiscal Balance (% of GDP)	0.3	-4.6	-3.3	-5.4	-4.2	-3.2	-1.9	-0.5	-0.2	-0.8	0.4	1.5	-4.9	-7.0	-4.7	-6.4
Primary Fiscal Balance (% of GDP)	0.5	-4.4	-3.0	-5.1	-3.7	-2.5	-1.2	-0.2	0.2	-0.4	0.8	1.9	-4.3	-6.5	--4.2	-5.9
General Government Debt (% of GDP)	27.8	29.1	28.7	29.7	31.6	31.3	31.8	31.2	29.1	30.3	28.3	28.1	33.9	35.2	33.7	35.6
External Public Debt (% of GDP)[2]	24.6	26.4	27.2	27.0	30.5	31.6	31.5	31.2	29.1	29.7	28.5	27.9	33.9	35.1	-	-
External Accounts																
Export growth, G&S (nominal US$, annual %)	20.2	-24.4	22.9	11.4	16.0	16.8	10.3	7.5	9.0	9.4	12.3	8.5	2.1	11.2	31.9	19.0
Import growth, G&S (nominal US$, annual %)	11.3	-17.0	19.1	11.4	14.2	16.9	8.8	7.6	9.0	7.8	9.3	17.4	5.7	46.1	37.8	9.2
Merchandise exports (% of GDP)	49.4	33.9	38.3	38.8	41.6	44.6	45.4	45.4	45.5	45.2	46.0	46.0	51.8	62.8	70.2	71.8
Merchandise imports (% of GDP)	58.2	46.8	50.4	50.5	53.7	57.5	57.5	57.3	56.9	55.6	55.1	54.6	65.7	92.4	91.4	93.5
Services, net (% of GDP)	6.5	6.2	6.8	6.3	7.3	7.8	7.7	7.5	7.0	7.0	7.4	1.8	4.1	-5.8	-26.9	-18.9
Current account balance (current US$ millions)	-622.3	-1120.4	-1165.3	-1309.3	-1390.7	-1489.3	-1899.7	-1680.6	-1756.5	-2140.5	-2180.1	-4107.7	-3221.0	-11492.8	-7798.4	-6256.3
Current account balance (% of GDP)	-6.0	-10.8	-10.0	-10.1	-9.9	-9.6	-11.3	-9.2	-8.8	-9.7	-8.9	-15.2	-12.4	-42.6	-26.3	-19.3
Foreign Direct Investment, net inflows (% of GDP)	7.6	8.8	11.8	11.8	14.0	13.0	10.6	9.5	12.0	12.1	12.6	13.2	13.5	12.6	-12.6	-13.5
Multilateral debt (% of total external debt)[2]	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-

Selected Indicators*	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023F
Population, Employment and Poverty																
Population, total (millions)	13.9	14.2	14.4	14.6	14.8	15.0	15.2	15.4	15.6	15.8	16.0	16.2	16.4	16.6	16.8	16.9
Population Growth (annual %)	1.7	1.5	1.5	1.5	1.5	1.4	1.4	1.4	1.3	1.3	1.2	1.1	1.2	1.2	1.1	1.1
Unemployment Rate[2]	0.8	0.6	0.8	0.6	0.5	0.4	0.7	0.4	0.7	0.1	0.1	0.1	0.3	0.6	-	-
Inequality - Gini Coefficient[2]	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Life Expectancy[2]	66.5	67.4	67.7	68.4	68.9	69.3	69.7	69.9	70.2	70.5	70.6	70.7	70.4	-	-	-
Other																
GDP (current LCU, millions)	41968385.4	43056731.7	47047985.2	52068692.7	56616800.5	62219524.1	67740449.6	73422701.6	81241866.0	89830524.8	99544274.8	110014048.2	105891753.0	110505915.9	123036850.5	133448611.2
GDP (current US$, millions)	10337.0	10400.2	11634.0	12965.3	14038.4	15450.6	16809.0	18241.7	20020.2	22114.9	24476.1	27030.5	25970.2	26952.7	29647.4	32469.3
GDP per capita LCU (real)	2055920.0	2026907.2	2116702.2	2233632.6	2362497.2	2500274.8	2641674.7	2787803.8	2941584.8	3106427.6	3297922.6	3490805.5	3343715.1	3405004.0	3542598.8	3688869.9
Human Development Index Ranking[3]	145	145	147	148	147	147	146	148	148	147	148	147	148	146	-	-
CPIA (overall rating)[2]	3.3	3.3	3.4	3.4	3.5	3.4	3.4	3.4	3.4	3.4	3.4	3.4	3.4	3.5	-	-
Economic Management[2]	3.8	3.8	4.0	3.8	3.8	3.8	3.8	4.0	4.0	4.0	4.2	4.2	4.2	4.2	-	-
Structural Policies[2]	3.3	3.3	3.3	3.5	3.7	3.7	3.7	3.5	3.5	3.3	3.3	3.3	3.3	3.5	-	-
Policies for Social Inclusion and Equity[2]	3.3	3.3	3.4	3.5	3.5	3.4	3.4	3.4	3.4	3.4	3.4	3.5	3.5	3.6	-	-
Public Sector Management and Institutions[2]	2.7	2.7	2.7	2.8	2.8	2.8	2.8	2.7	2.7	2.7	2.6	2.6	2.7	2.8	-	-

Notes: ".." indicates not available. E = estimate, F = forecast. Data from MFMOD unless otherwise noted.
1/ World Bank GEM database; MRV = Most recent value.
2/ World Development Indicators Database and World Bank Staff Estimates.
3/ The HDI ranking in 2001 is in relation to 175 countries and in 2010 in relation to 169 countries. Methodological enhancements in HDI calculations have resulted in notable improvements in the countries' rankings.
Sources: MFMOD Database, World Bank WDI and GEM databases, IMF.

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