

**KEY POINTS
OF THE ROYAL GOVERNMENT'S MEASURES IN THE CONTEXT OF THE
INTERNATIONAL FINANCIAL CRISIS AND
THE GLOBAL ECONOMIC DEFICIT**

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I. Introduction

- The current global economy is undergoing a serious downturn. According to the IMF's forecast, the global economy will decrease by 0.5% in 2009, the lowest growth in the last 60 years. This global decline has resulted in deficits everywhere, in particular in the US and the European economies. Indeed, no continent or country can avoid this calamity.
- Since Cambodia is now in the mainstream of economic globalization, it is also affected by this serious downturn, but the impact has not become a crisis. Whether the impact will be of long or short duration depends upon external factors. When the world economy recovers, Cambodia's economy will also pick up.
- Overall, the current global financial and economic crisis means some risk for the Cambodian economic and financial system; in particular, a decline in the sources of capital flow for private investment, a decrease in demand for Cambodia's major commodities, and a drop in the number of tourist visits to Cambodia. The sectors most seriously affected are the garment industry, tourism, and construction and real estate.
- In 2008, according to preliminary calculations by the National Institute of Statistics, economic growth may achieve a rate of 6.8% despite the external negative impact since the end of 2007.
- According to judicious forecasts, the 2009 economic growth may be only 1% - 2% compared with the 6.5% forecast predicted in the preparation of the Law on Financial Management for year 2009. The 2009 average inflation will fall to around 4% and in 2010, about 5% as compared to inflation of 12.5% at the end of 2008.

II. The Royal Government's Measures

The Royal Government's measures are set forth in the implementation package of the "**Rectangular Strategy, Phase II**". These measures address the sustainability of both the system and employment, and also respond to the uniqueness of phases of the situation and to sartorial needs. The Royal Government's measures are multifaceted, managerial and flexible, and constitute a movement focusing not only on stabilizing the situation, but also on foregrounding Cambodia's comparative advantage. These measures are as follows:

1. Measures concerning monetary policy and the management of private finance

- To decelerate credit to non-productive sectors in order to weather the inflationary pressure that began to rise in 2007, the Royal Government, in April 2008, through the National Bank of Cambodia, introduced measures for banking and financial

institutions, including (1) increasing reserve requirements from 8% to 16% for monetary deposits, and (2) establishing a credit ceiling of 15% for the real estate sector.

- Since the global economic deficit has increasing negative impacts on the Cambodian economy while inflationary pressure has subsided, the Royal Government adopted the following measures in January 2009: (1) decreasing reserve requirements from 16% to 12% for monetary deposits and promoting credit to productive and agricultural sectors, and (2) abolishing the ceiling of 15% for the real estate sector and instructing banks to strengthen appropriate risk management of the property sector.
- The National Bank of Cambodia has strengthened and expanded the monitoring and supervisory mechanisms of the banking institutions. Similarly, the Ministry of Economy and Finance has tightened the supervisory mechanisms of non-banking financial institutions such as insurance companies.

2. Measures calling for the intervention of public finance

2.1. Measures for mitigating the impact of inflation on civil servants and the armed forces

- In 2008, the Royal Government took measures to mitigate the impact on civil servants and the armed forces of the sharply rising prices of goods by (1) continuing to raise their base salaries by 20%, (2) increasing teaching premiums by 10% for teachers, (3) providing livelihood support of 20,000 riel per person per month from July to December 2008, and (4) taking measures to facilitate salary and function premiums for the armed forces.
- In 2009, the Royal Government continued measures to increase the base salary by 20% and continued to implement measures for providing function premiums to the armed forces. The total salary budget package was increased to 120 billion Riels per month.

2.2. Measures for implementing tax and excise policies for the private sector

- In order to maintain the price of strategic goods, i.e., fuel, for sustaining economic growth and the well-being of the people, the Royal Government has quietly subsidized an estimated proportion of about US\$300 million in 2008 in order to set a tax base unchanged since 2004.
- In 2008, the tax and excise on imports for which the State is responsible in order to support investment in both manufacture and infrastructure was equivalent to about US\$490 million. Moreover, the Government has conceded financing equivalent to about US\$18-29 million through 2 years of continued income tax exemption for investment firms in garments for export since 2005. In addition to this incentive, the Royal Government allowed 40 support industries or contractors to implement 0% of value added tax for supplying products or services to serve for exporting of the garment, textile, and footwear industries. As a result, the Government lost a cash flow equivalent to about US\$13 million. Since 2007, in order to facilitate the cash flow of the garment industry, the Royal Government has exempted it from the monthly profit tax of 1%, resulting in a loss of cash flow equivalent to about US\$13 million in 2008.

- In order to develop the SMEs, the Royal Government has reduced the tariff on a number of raw materials and on production equipment, an amount of import and excise tax equivalent to about US\$5 million.
- In order to develop agriculture, the Royal Government has reduced the tariff rate to zero percent, and has made the State responsible for value added tax on raw materials and agricultural production equipment, an amount of import and excise tax equivalent to about US\$8 million.

2.3. Budget policy measures related to the macro-economy

- The Royal Government remains committed to ensuring a stable overall macro-economic environment favourable to growth, particularly through the execution of a support budget policy and the promotion of growth in a way that does not cause negative effects on macro-economic stability, especially the control of inflation.
- The 2009 national budget package as stated in the Law on Financial Management for year 2009 was designed to have a general national budget deficit, excluding grant financing which is equivalent to over US\$500 million or about 3.2% of the GDP. This is a well thought out preparation, given the need for supporting and promoting growth as well as the need and ability to maintain macro-economic stability.
- In the 2009 budget expenditure policy, the Royal Government continues to focus mainly on increasing public investment capital in physical infrastructure, including transport, irrigation, improvement in agricultural productivity to reduce production costs, and the implementation of some social safety net programs.
- At the same time, the Royal Government set out **revenue management measures**, notably efforts to mobilize enough revenue according to or exceeding the plans and including **expenditure rationalization measures** such as cutting the current budget for expenditures and diverting the funds saved to the highest priority and most urgent areas of the Royal Government, i.e., the need to safeguard social safety and to invest in the enhancement of productivity.

3. Measures to attract and use cooperation financing

- For the 2009 meeting of the “**Second Cambodian Development Cooperation Forum**”, the Royal Government succeeded in mobilizing cooperation assistance resources of about US\$1 billion, the highest figure in nearly 10 years. In fact, in the current context, this cooperation assistance is a crucial leverage in reducing the impact that Cambodia is suffering from the international financial crisis.
- The Royal Government has made efforts to attract and use official development assistance (ODA) in the right directions and with the greatest effectiveness for both the ODA for public investment financing and the ODA for budget support as well as increasing Cambodia’s maximum ODA absorbing capacity to support growth.
- The Royal Government has been implementing a number of projects, such as the promotion of much “**net resource transfer**” to Cambodia, and the expediting of project implementation to quickly attract large disbursements of financial resources into the Cambodian economic system.
- The Ministry of Economy and Finance has sought to coordinate with all ministries/agencies that are carrying out projects, as well as some development partners such

as the World Bank, the Asian Development Bank, and IFAD in order to increase the effectiveness of project implementation, to encourage rapid execution and disbursement, and to strengthen the cooperation between the Royal Government and development partners in the spirit of equal partners with mutual responsibilities.

4. Sectorial interventions and strengthening and expanding of human and institutional capacity

- The Royal Government has already made maximum tax and excise concessions within the existing legal framework and regulations. There remain only measures to be taken within the framework of business facilitation and investment climate improvement.

4.1. Agricultural improvement in both productivity and product processing

- In 2008, the Royal Government, through the Rural Development Bank, provided special financing of US\$12 million to private rice millers to buy rice for local supply and signed a US\$ 18 million contract to continue this work in 2009.
- The Royal Government established the "**Agriculture Support and Development Fund**" of 72 billion Riels, incorporated into the draft law on the amendment of the Law on Financial Management for year 2009, which was adopted by the Council of Ministers on 3 April 2009. The establishment of the Fund will provide short-term credit concessions for purchasing rice from farmers at a decent price in order to maintain price stability and to ensure food security. It will also provide medium-term loans to rice processing firms, aimed at expanding storage capacity, drying machines, and processing machines. In addition, it will provide medium and long-term loans for expanding the scope of use of the fund to other non-rice subsectors.
- At the same time, the Rural Development Bank will make a financial contribution of US\$ 2 million from its capital to the Government's **Agriculture Support and Development Fund**.
- The Royal Government is giving additional fiscal incentive to the agricultural sector by allowing income tax exemption for a period of 3 years for qualify investment projects in agriculture and agro-industry with an investment capital of 4 billion Riels or more, whether the projects are short, medium, or long-term. The provision for this incentive was included in the draft law on the amendment of the Law on Financial Management for year 2009, which had already been adopted by the Council of Ministers.
- The Royal Government is reviewing the amendment of the sub-decree on the implementation of the Law on the Amendment of the Law on Investment in order to give more incentive to investment projects for processing wood products using raw materials from trees grown locally, investment in storage and rice processing for export, and investment in irrigation serving agriculture with an investment capital of US\$ 200,000 or more..
- The Royal Government is encouraging partnership between small land holders and large agricultural corporate farms and between economic land concessionaires and social land concessionaires. In particular, it is encouraging the establishment of

communities and partnerships between these farmer communities and companies that buy, process, distribute, and export rice products.

- The Royal Government is continuing to minimize rice export procedures and to gradually strengthen rice export management mechanisms while making efforts to increase local capacity in purchasing, processing, distributing, and exporting rice.

4.2. Saving the garment industry through links to a social safety net

- In order to alleviate the difficulties and to facilitate the cash movement of garment and footwear firms, the Royal Government has extended the suspension of monthly profit tax of 1% for another two years (2010-2011), and has contributed to the coverage for occupational hazard risk, or 0.3% of a worker's wage, on behalf of the manufacturers, for a period of two years (2009-2010).
- The Royal Government is introducing measures to improve trade facilitation through the introduction of ASYCUDA and is reducing procedures to cut down unnecessary costs, both formal and informal.
- The Royal Government has introduced measures to improve industrial relations in the spirit of tolerance and responsibility on the part of all actors within the legal framework, and has developed a law on trade unions.
- The Royal Government is taking additional administrative measures, such as preventing the theft of garments from factories for sales at markets.
- In order to solve social issues and increase work productivity in the garment sector and in Cambodian society generally, the Royal Government has prepared a budget of about US\$6.5 million to set up a special scholarship fund for short-term vocational training for about 40,000 laid-off and unemployed workers in agriculture, industry, technology, handicraft, and services.
- At the same time, the Royal Government has set aside a budget of about US\$ 1 million for the "**fund for self-created occupations**," which is managed by the National Training Committee, in order to provide micro credit to trainees who have completed training and who are considered to have sufficient motivation and reliability to create occupations by themselves.

4.3. Saving tourism

- The Royal Government will pay considerable attention to strengthening the tourism industry for the short, medium and long term through the rigorous assurance of peace, security, political stability, social order, and the personal safety of tourists, construction of additional infrastructure, improvement of legal framework and institutional capacity, development of human resources, and diversification of tourism markets, etc.
- The Royal Government is encouraging foreign tourism through the facilitation of access to the Kingdom of Cambodia. It is also streamlining procedures for obtaining the Angkor visitor's pass.
- At the same time, the Royal Government is ready to intervene to help the tourism industry by, for example, exemption of visa fees if the results of the study on expenditure structure show that doing so will indeed attract more tourists to Cambodia and will profit Cambodia economically.

4.4. Saving the construction and real estate sector

- In order to prevent the construction and real estate sector from being affected by the international financial crisis and the global economic deficit, the Royal Government is studying the businesses of pawning, buying and selling non-cash property as collateral in exchange for cash for urgent short-term needs. This is a short-term capital circulation outside of the banking system, and can also help encourage movement of capital as collateral for use in the economic system.
- The Ministry of Economy and Finance will develop temporary management of the aforementioned businesses in collaboration with relevant ministries/agencies. Meanwhile, the Ministry of Economy and Finance will study the experience of other countries as a basis for managing this sector in a clear manner and in accordance with international standards.

4.5. Implementation of mobilization of actors

- The Royal Government's Committee for Economic and Financial Policies has helped solve problem packages in relevant sectors, such as tourism and the garment industry through mobilisation of four kinds of actors, namely, sectorial owners, Royal Government's ministries/agencies, commercial banks, and development partners, based on the principle that "**each party is a winner**".
- The Royal Government believes that action through the mobilization of the various parties will alleviate to an extent the negative impact on the garment, tourism, and other sectors.

4.6. Continuation of structural reforms

- The Royal Government is committed to continuing all reform and development efforts. In this regard, the Government-Donor Coordination Committee (GDCC) will meet to review the 19 work efforts on 28 April 2009.
- The Private Sector Development Steering Committee, the three sub-committees and the mechanisms of the eight Government-private sector working groups of the Government-Private Sector Forum are continuing their respective tasks on an ongoing basis to solve all issues related to private sector development; in particular, investment, business, trade facilitation, SMEs, and the participation of the private sector in building infrastructure within the legal framework on concessions.

III. Conclusion

The Royal Government believes that the measures described above will not allow Cambodia's economic situation to fall into a bad deficit vacuum.

The Royal Government will continue to monitor and manage the situation in a careful and ongoing basis, and will encourage the introduction and flexible implementation of new measures as called for by the situation on the ground. The Royal Government remains eager to achieve an economic growth target of about 7% and poverty reduction by 1% per annum in accordance with the **Rectangular Strategy Phase II**.