CAMBODIA 2040

ECONOMIC DEVELOPMENT

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Chapter 3 | Fiscal Policy

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Dara has recently relocated the headquarters of his digital marketing company to Phnom Penh. Encouraged by the growth of industry in the kingdom, the move was largely motivated by the low level of corporate taxation when compared to his previous base in the region. This additional revenue for the company has been instrumental in the firms' recent success. The ability to invest in the latest software and training has led to a reputation for quality that is now in high demand: so high that the team has doubled in personnel. Thankfully the national e-payroll system is streamlined to reduce the burden on companies. One code per company, one code per resident, easy to track for Dara, and easier to collect for the administrative system.

I. Fiscal Policy: The Ideal Scenario

As a result of extensive and progressive reforms by the Royal Government of Cambodia (RGC) to enhance tax administration procedures and the fiscal system, fiscal policy in the kingdom has seen a remarkable transformation in operating efficiency and institutional systemization.

Of particular note is the impressive addressing of tax revenue collection. Collected tax revenue now averages 86% of total national revenue, with more traditional means of income, such as foreign aid, now contributing only a small proportion of total government revenue streams.

As well as having significantly developed its tax revenue mechanisms, Cambodia has created a smart tax system designed to insulate against shocks and work

toward the equitable redistribution of national income to meet development goals and provide public sector security.

A resilient tax system is one designed in such a way that it can rebound from benign influences and/or external shocks to recover tax revenues quickly (Miranda 2015). Such a system also ensures adaptive capabilities in response to unexpected changes in circumstance and the consistent evolution of societal patterns across areas including advances in investment portfolios, saving patterns, and technology (ibid).

Revolution 4.0 will create further opportunities for Cambodia to generate greater tax revenues. The digital economy will create further business interaction, thereby increasing productivity and competitiveness. Changes in the way people do business, think, and behave will positively impact revenue collection as awareness of the benefits of tax compliance increases.

Yet with thousands of traditional jobs likely lost due to the Fourth Industrial Revolution and new high-skilled roles in strong demand, it will be necessary to have measures in place to mitigate the impact thereof, such as the provision of training for low-skilled workers and the creation of other opportunities for those individuals.

With targeted fiscal procedures and system development, domestic tax revenues will have grown to become the primary source of government funding in Cambodia by 2040. This will have been enhanced by the declining costs of tax collection, becoming on par with global standards. A more efficient taxation system has worked to address previous asymmetries and to command a stable, predictable revenue stream.

The main objectives of Cambodian fiscal policy in 2040 will be to keep the rate of inflation at between 2% and 3%, and to stabilize the kingdom's macroeconomic environment. Predictability is paramount to maintaining productivity and progress under the institutionalized approach. Taxation is utilized as the main tool of fiscal funding and contributes an average of 86% to the total national budget. Government spending is focused on meeting national development objectives and the pursuit of equitable redistribution.

Accordingly, it has seen year-on-year increases as the system ensures a more consistent stream of domestic income. Foreign debt still remains a feature underpinning national spending, but this has levelled out at around $ 5 billion. The primary shareholder of this debt is China, with around 40% attributed to targeted infrastructure investment programs in the kingdom.

Five key factors will ultimately determine the path of development as regards fiscal reform:

1. The RGC will have increasingly pursued a systematic process for ensuring tax collection. Individuals and organizations that have remained noncompliant are subject to tax levies on personal income, luxury products, and corporate tax.
2. A reduction in the corporate tax rate of around 15% will have been utilized to lure more Foreign Direct Investment for the country.
3. National treasury bonds will be issued to raise public finance internally. This is enhanced, when necessary, by holding foreign assets, and finance procured from international financial institutions such as the World Bank, the Asian Development Bank, or the Asian Infrastructure Investment Bank.
4. The implementation of a comprehensive tax reform package to increase government spending and stabilize the macroeconomy.
5. Taxes and government expenditure will be seen as key strategic fiscal tools for pursuing government objectives.

Through these five key factors, the future of Cambodian fiscal funding will have been strongly reformed to target taxation and foreign borrowing to offset government spending and deficit funding. Taxation remains a key instrument of fiscal funding and the capability of the government in responding to rapid global economic, societal geopolitical changes, resilience to the shock is questionable for the next 20 years.

The world economy in 2040 has changed as well as the regional and national level. In the context of Cambodia, government spending remains continuous to meet spending demands on public goods desired by its citizens – noting here the increased percentage of elderly Cambodians not in the active labor force.

As evidence, government spending in 2018 was 24.2% of GDP, while revenue was 22.3% of GDP (World Bank 2019). This makes fiscal funding more challenging and policy objectives toward an inclusive economic growth will not be easy to achieve. There might also be questions as to how to structure taxation and whether central or local government mobilizes revenues.

Tax revenue is one of the main revenue sources available to the government to fund its expenditure, accumulated year on year. The stimulation of economic growth with macroeconomic stability, full employment, and low inflation is the main objective for economic policymakers.

Taxation has been used as one of the key instruments for the government to mobilize funds. The simplification of the tax system, reducing tax erosion and tax evasion are challenges for every country. Some countries have done far better than others in modernizing and comprehensively reforming their tax system to lure foreign investors.

However, many have lost significant revenue from tax erosion and evasion because of weaknesses in the tax system and its administration. To overcome these challenges, having clear tax policy objectives, good governance in revenue administration, and global tax system integration are crucial for all countries.

The globalization of the tax system remains a subject of debate among states. Both developed and developing countries continue to face violations of their laws. A unified and globalized tax system could help countries eliminate tax evasion and Base Erosion and Profit Shifting (BEPS).

Carnahan (2015) states that the nature of economics has changed due to globalization, with tax authorities facing challenges in raising income as individuals and multi-cooperative companies allocate profits and arrange their affairs so revenues can be hidden. The Automatic Exchange of Information (AEOI) seeks to address these issues; however, the extent of members' awareness is still insufficient to act on this initiative (ibid). This means developing countries need to invest more in human and physical capital to meet the standards required by developed countries, investing in technology, standardized regulations, and cybersecurity platforms, which represents an expenditure burden for such countries.

II. Scenario Space and Key Factors for Fiscal Policy

Cambodia's economic development post-conflict has seen progressive and measured change since 1993. Not only has the form of the structural economy changed, the political system also shifted from communist to democratic principles. From step to step, there have many mechanisms and stakeholders involved underpinning the government's economic development policies. Some argue that Cambodia's rapid growth has been both unusual and volatile (Hal & Jayant, 2014). This could point to implications in development, including landscaping, people replacement, and natural resource distortion.

The stages of Cambodia's development can be summarized in the form contained in Table 1 Below.

Table 1. Stages of Cambodian Development

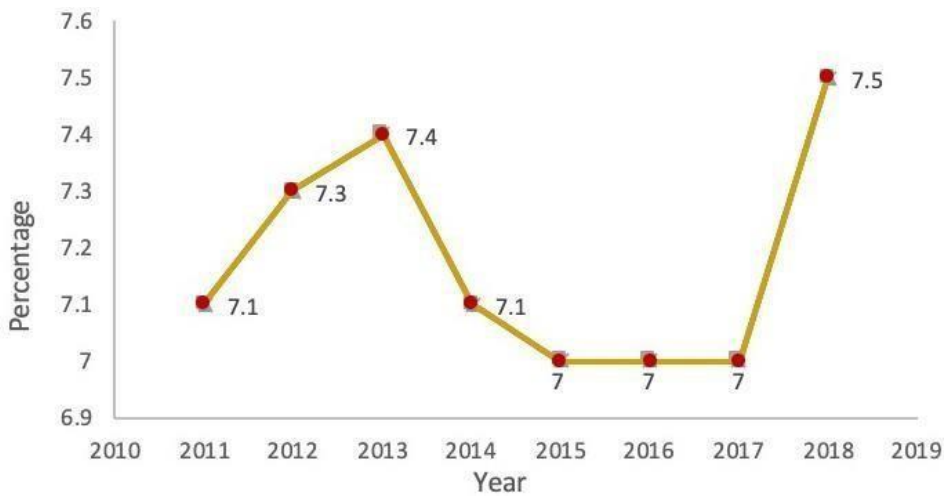
Year	Structural Economy	Fiscal Policy Implementation
1993-2013	Agricultural-based economy	Expansionary
2013-2018	Agricultural & labor-intensive industry	Expansionary
2018-2030	High value-added industry	Expansionary
2030-2050	Knowledge-based economy	?

Shifting from a labor-intensive to a high value-added or knowledge-based economy can be challenging and an unrealistic goal if clear directions are not outlined and policy objectives not critically defined. It requires the government to invest greater capital to modernize and improve physical infrastructure and human resource development through skills training and job creation.

Cambodia's unprecedented growth has relied on conventional economic drivers, i.e., construction, agriculture, garment manufacturing, and tourism, with a small threshold from service industries. While the global economy becomes more competitive with a race for technology, it is not realistic for these to continue contributing such a large proportion to national income in the future. However, shifting the structural economy from agrarian to high value-added is not simple.

Reviewing key indicators of economic achievement, Cambodia has achieved economic growth of around 7% annually since 2011. In a preliminary estimate by the World Bank Group (2019), real growth reached 7.5 per cent in 2018, an increase on previous years (see in figure 1).[1] Crucially, individual household income per capita has gradually increased to $1,230 in 2017 from $750 in 2010 (see figure 2).[2]

Figure 1. Annual GDP Growth (2010 – 2019).

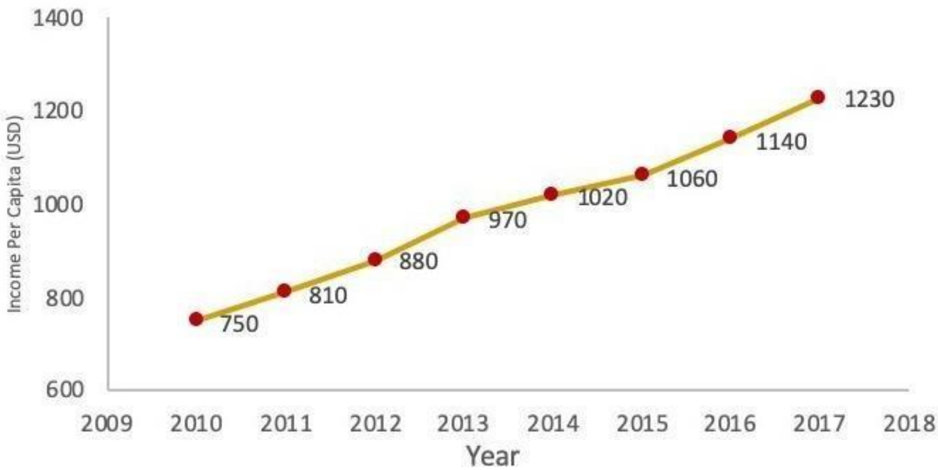


[1] Recent Economic Development and Outlook, Cambodia Economic Update, World Bank Group May 2019

[2] GNI per capita, Atlas method (current US$), retrieved from https://data.worldbank.org/indicator/NY.GNP.PCAP.CD?end=2017&locations=KH&start=2010

Even with an annual average growth rate of seven percent, income per capita has been lower than that in other countries in the region. According to the country's strategic plan, the current government aims for Cambodia to reach upper-middle income ($3,956 to $12,235)[3] status by 2030, before becoming a high-income country by 2050 (>$12,235). Driving the economy to meet the 2030 and 2050 objectives requires credible and strategic economic policies and comprehensive public service administrative reforms.

Figure 2. Household Income Per Capita (2009 – 2018).



From 2010, it took Cambodia only seven years to move from low to lower-middle income country status. However, it is questionable whether there will be sufficient time for the kingdom to meet the ambitious 2030 and 2050 goals. Income per capita would have to increase three-fold in the thirteen years from 2017 to 2030 and nine times in the next thirty-three years.

Tax revenues have gradually increased over the past decade. This has been driven by reforms in tax administration and registration procedures and improving the ability of individual tax officials to mobilize tax revenues. In percent of GDP, the share of tax revenue has increased from 12% in 2013 to

[3] World Bank Data Team, July 2017, Retrieved from https://blogs.worldbank.org/opendata/new-country-classifications-income-level-2017-2018

16.9% in 2017, with 17.2 per centprojected for 2019 (IMF Report 2018). Despite significant progress, achieving fiscal sustainability requires modernizing revenue administration and strategic policies to underpin the economy and improve equity and efficiency (ibid).

Efficiency in tax collection is one of the key performance indicators for tax administration, and a major factor in determining the realities of Cambodian fiscal policy in 2040. In this context, efficiency means maximum tax revenues with minimum tax expenditure. Miranda (2014) states that under the global standard, efficiency in tax collection means that only one US dollar is spent to collect one hundred dollars of tax revenue.

In theory, tax revenue and GDP growth are both positive correlations. However, these are decoupling in some countries, mainly due to a rise in tax expenditure (OECD, 2016). In this respect, transparency in tax revenue and expenditure is crucial to improving efficiency in tax collection. Tax collection targets in Cambodia can be overestimated or underestimated, while tax expenditure has never been publicly disclosed.

Despite increasing tax revenues, government expenditure has also increased annually. In the IMF report, public sector expenses are accumulating, with a large proportion of government spending going on the compensation of employees (IMF 2018). This continues to grow year-on-year in tandem with projected GDP growth.

This means government operations are less efficient, which needs to be tackled by focusing on cost control rather than cost-cutting. The government budget should be spent on priority sectors that align with the strategic development policies of the country-budget policy linkage. Therefore, all stakeholders need to be more engaged to prepare for what lies ahead and to overcome difficulties, especially as global economic competition intensifies.

An imbalance between government revenues and expenses creates challenges for policymakers in making decisions regarding the design of asymmetric policies between the budget and sectoral priorities of the government.

In 2018, public external debt was around 31% of GDP, close to the borrowing ceiling as stated in the budget law. This debt has increased unprecedentedly recently, and it is likely to further climb with the government needing additional funds to cover expenditures.

Grants also contribute to government revenues -- around 1.5% of GDP. These are predicted to gradually decline to less than 1% of GDP from 2020 onward (IMF, 2018). Grants and public debt moving in the opposite direction creates concern regarding the future of the kingdom's fiscal funding.

In addition, the equilibrium of the global economy has been threatened by the world's two principal powers competing in a trade war; a fragile liberal trading system; democratic recession; the rise of populism in developed countries; fast-growing information and communications technology (ICT); changing demographics; and climate change.

As described by Karl Marx, global or domestic political struggles result from a conflict of economic interests as each economy competes to gain more and more economic benefits (Francis, 2018). These demands force the development of economic policies that not only focus on macroeconomic stabilization but also on resilience to shocks. With future uncertainties, economic policies should focus on balancing growth and sustainability objectives (IMF, 2019).

There are additional key factors that result in uncertainty as regards the 2040 scenario outlined above. Slowing growth in developed countries is likely to have an impact on emerging economies -- most of them export-oriented countries. Moreover, rapid urbanization and changes in the structural economic sector in low and middle-income countries has depleted natural resources and resulted in the dislocation of the free flow of labor and goods that are the main inputs of the industrial sector. All of these factors make it harder for developing countries to achieve inclusive growth.

Burkhardt & Bradford (2017) comment that governments are too slow in responding to economic and societal changes, with most decisions being made without consulting other stakeholders. Governmental responses are often made by individual departments and fragmented by the levels of government and different departments (ibid).

Whether the current government's ambitions of Cambodia become an upper- middle income country by 2030 and reaching high-income status by 2050 are realistic or not depends on successful governance and economic reforms by the state.

III. Policy Initiatives to Achieve the Ideal Scenario

The key factors in the pursuit of Cambodian fiscal policy reforms are: (i) maintaining a sustainable fiscal balance; (ii) increasing budget allocation for the social and economic sectors; (iii) limiting rationalized public expenditure; (iv) preventing revenue leakage; (v) maintaining price stability in the dollarized economy; and (v) ensuring a level of government spending in line with macroeconomic stability (CDC 2019).

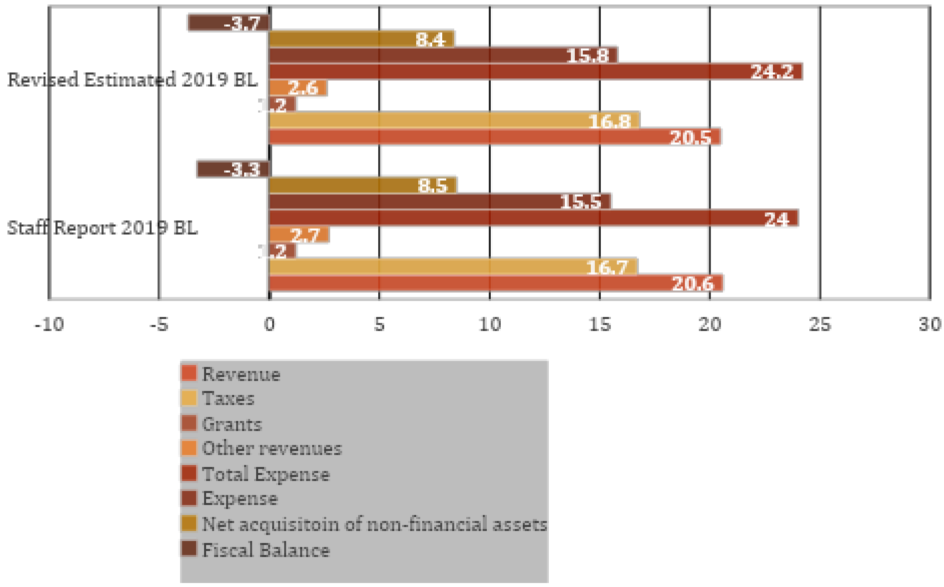
To further support economic growth, an expansionary fiscal policy remains important to ensure the success of reforms. In the 2019 budget, expenditure is still spent on the increasing public wage bill, improving human capital, and infrastructure (IMF 2018). With tax administration reforms in progress, the authorities remain optimistic that the budget deficit will be neutralized thanks to strong revenue collection.

However, public debt remains around 30% of GDP, alerting fiscal risk and drawing greater attention from the public and civil society. Even though that threshold is lower than that of other developing and developed countries, the contingence of liability should be monitored and well managed to avoid any potential debt trap. To mitigate this and going forward, strengthening fiscal governance and modernizing the tax collection system and the customs and excise administration with fiscal transparency are pragmatic measures for the government to adopt.

Through recent tax administration reforms, revenue has been accumulating progressively. The Ministry of Economy and Finance (MEF) has been implementing the Revenue Mobilization Strategy (RMS) for 2018 -2023, with the General Department of Taxation (GDT) a key stakeholder to ensure its responsible execution (IMF 2018).

In 2017, Cambodia's tax revenue to GDP was 17.2%, which is comparable with other countries in the region. Since 2012, the GDT has met 71 of 86 RMS measurements, while the remaining 15 are in active progress (ibid). Authorities expect revenue collection fiscal to remain strong in 2019, mostly from indirect taxes and property tax. This will help to narrow the government's fiscal deficit.

Figure 3. Cambodia 2019 Budget Law (% of GDP)



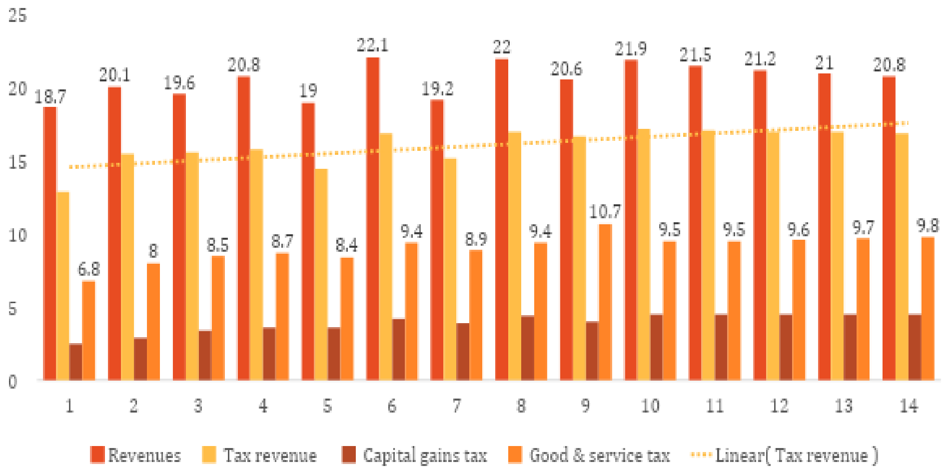
The figures show that tax revenues contribute a major share of total government revenues. The budget deficit also looks relatively positive, remaining under 5% annually. However, the reduction in grants from development partners may have unintended consequences that hurt taxpayers. To overcome this, the tax structure needs to be simplified and clearly defined, and have clear objectives.

For instance, notions of taxing more or taxing better will be the most important considerations going forward. Moreover, broad-base taxes with lower rates are clearly preferable to narrow-base taxes with high rates, and the tax structure should not support "pro-rich" policies through the provision of special treatment such as unfair tax incentives.

Cambodia has made significant achievements in improving tax revenues in recent decades thanks to progressive reforms of the tax administration and the diversification of revenue sources, which will support reaching the ideal outcome. Total revenue had increased to 22% of GDP in 2018 from 15.1% of GDP in 2014, with average growth of 1.4% of GDP.

In May 2019, the RGC launched a new revenue mobilization strategy for the period from 2019 to 2023. This will act as the roadmap for inter-related ministries to follow in order to strengthen revenue collection efficiently and effectively, with integrity and credibility. The strategy aims for sustainable economic growth and optimum revenue levels, ensuring justice for taxpayers. It also aims to ensure social justice by easing the tax burden for the poor and a commitment to provide welfare and to ensure environmental protection (RGC, 2019).

Figure 4. Key Sources of Government Revenue (2013 – 2023)



With historic achievements in tax mobilization over the past five years, in the next twenty, three different trajectories are likely for raising greater revenues to fund government expenditure, which has grown annually, in order to achieve the ideal 2040 scenario.

Trajectory 1: Levying personal income tax, taxing luxury products, and a corporate income tax

The purposes of taxation are efficiency, effectiveness, equity, and simplicity. This means tax is for economic growth, social justice, and minimizing inequality. Thomas (2015) states that households have different sources of income: wages, self-employed, pension funds, income transfer, and capital income. The tax system should address the income gap between rich and poor.

However, it is difficult to tax more while people might shift their income to other jurisdictions that have a lower rate or tax havens. Thus, in this scenario, a levy on income tax and corporate income tax might not be practical in the next 20 years. However, levying more taxes on luxury products might help reduce inequality in society.

Trajectory 2: Reducing corporate income tax (CIT)

In the digital economy, a country with less attractive corporate income tax rates might find it hard to lure foreign investors and lose revenue due to capital outflows from the economy. Many countries have decreased the CIT rate to attract further FDI and offered other form of tax incentives (GGGI 2018). Some incentives are provided for a one-off period, and some are temporary (ibid). As a consequence, tax competition might hurt countries that have poor tax administration and unattractive tax rates. This could undermine the common interests of people and the liberal trading system. However, this form of tax is commonly used in many countries, both developed and developing. Other ASEAN countries as well as Cambodia are to reduce the rate of CIT to below 20% in the near future.

Trajectory 3: Diversified sources of government revenues, tax and non-tax revenues, and shifting tax collection from narrow-base to broad-base collection

The diversification of revenue sources is key to preparing for the next possible economic downturn. In terms of private sector practice, it is not a good risk management framework for an entity/corporation to heavily rely on a single source of revenue or financial supporter. While this can apply to countries, generally tax revenues contribute a large proportion of a na tion’s total revenue.

For Cambodia, grants are at present still crucial for social and infrastructure development. In 2016, grants contributed to 2.5% of GDP. However, this has gradually decreased to below 1% as per IMF estimates (IMF, 2019). In 2023, it is estimated that grants will be reduced to 0.5% of GDP, while non-grant remains residual at around 17% of GDP. Therefore, the diversification of revenue sources is a crucial ingredient in preparing to react swiftly to local, regional, and global trends.

The final trajectory is the most likely over the next 20 years in Cambodia. To mobilize more funds for government expenditure, broad base tax collection is the most useful tool with which to reach at least 90% of taxpayers.

James, Michael, and John (2006) are of the view that with a country needing more revenue in the future, it is necessary for it to have a tax system that can supply it. Broadening taxes with lower rates could involve reducing revenues from a specific form of tax revenue, income tax, for instance, but other forms of tax might offset the loss (ibid). The authors add that the first policy approach in preserving some sense of fairness in tax collection is to reform income tax by lowering the rate, removing distortions as broadly as possible, and broadening the tax base.

To reach the ideal scenario for 2040, there are two possible factors, internal and external, that need to be taken into account. Internal factors include reforms to the tax system and a commitment by inter-related ministries to promote a tax-compliant culture, ensuring accountability and integrity among officials, and strengthen governance between institutions and taxpayer. As the world changes, a tax system needs to be adaptable to changes in investment, employment and saving patterns and the way people do things, and advancements in technology (Miranda, Andre, Peter, and Quentin 2015).

First, broadening the tax base will help the country mobilize more revenues, but it needs sophisticated tax registration procedures and simplicity in its tax system to achieve revenue maximization. Generally, the tax base normally takes from the principal production factors in the economy, such as labor, capital, and land. From these economic factors, the country can charge three tax bases: income, consumption, and wealth. Income and wealth taxes are the main targets over the next 20 years as the economy becomes more advanced.

Income and wealth taxes not only help a country to mobilize more revenue, but it also minimizes inequality, helping prevent the rise of populism and disorder when the gap between rich and poor grows. Miranda, Andre, Peter, and Quentin (2015) opine that the fair distribution of economic reward is essential for a country to maintain social wellbeing and cohesion, and be accepting of the political and social institutions. Income tax is the single largest source of government revenue in Australia, contributed more than 10% to the GDP (ibid). Drawing from this, it is crucial for Cambodia to restructure its current form of personal income tax to minimize tax evasion and erosion by those in the top 10% income bracket.

Property tax may be the second target for the 2040 vision. The objectives are to turn vacant land into productive land and cool unprecedentedly rising prices resulting from speculation by local and foreign property developers. While activity in the property market brings in short-term revenue for the government, high property prices will not help the economy in the long term. The government should introduce a flat rate for commercial and rental properties, and make this rate progressive over the next 20 years. Doing so would see property prices come down and ensure rational behaviour.

Company income tax (CIT) contributes the largest proportion of tax revenue, as a single source, in Cambodia. The current CIT rate is 20% which sits at the average rate across Asia, and below the OECD average of 24% (Tax Foundation, 2018). Despite its seemingly reasonable level, the rate has been identified as a hindrance to optimal investment wherein it serves to reduce the attractiveness of Cambodia among investors and large multinational corporations (PWC 2018). Using a reduced CIT rate, the government seeks to induce a greater level of investment and subsequently add value to the economy through technology, the creation of jobs, and the transfer of skills.

However, this requires strong tax administration and regulations, with officials able to ensure efficiency by collecting more revenue with less expenditure. Another mechanism is raising awareness among taxpayers of the advantages of paying tax to the government. This needs a simple payment procedure, with taxpayers willing to pay their obligation to the government, and investment in technology and an ICT platform for the tax administration.

Second, external factors including uncertainty surrounding the global balance of power, fragile trading systems, and an unpredictable international political economy. These factors may have an indirect impact on Cambodia's economy as a whole and could distort the ideal fiscal policy scenario in 2040.

Global politics remains uncertain with competition between the two major powers, the United States and China. Cambodia has been labelled a Chinese client state. This could make Western investors less willing to do business in the kingdom.

Moreover, economists have predicted that the Chinese economy will slow over the next five years. This slowdown could have negative impacts on Cambodia's economy as China is one of its biggest investors, particularly in the real estate sector. The drying up of capital inflows from China into the kingdom would have seriously hurt the Cambodian economy.

The trading system is under attack from rising protection and international political economy is unpredictable. The liberal trading system, in the form of WTO, remains fragile, while most industrialized nations have turned from multilateral strategic trading approaches to bilateral agreements, ignoring the post-World War II consensus. Moreover, international political economy has seen challenges from rising populism across Europe, "Brexit" – the United kingdom leaving the European Union – the escalation of disputes over the South China Sea, and the rise of protectionism. Whether positive or negative, these developments will definitely have a major impact on the mobilization of revenues.

IV. Fiscal Policy Under the Baseline Scenario: Business as Usual in 2040

Consistent with current practice, revenue compared to GDP will remain residual between 2019 and 2020 as per forecasts. On average, revenue is increasing 0.01% annually, which remains low. Without further intervention, revenue is expected to increase around 0.03% annually in 2040. If we look at expenditure, current figures show a slight increase due to greater administrative reforms and budget expenditure on priority areas aligned with the development policies of the Cambodia-budget policy linkage. If current practice and trends remain consistent, government spending in 2040 may not see big changes; perhaps an average 2% increase by 2040.

Table 2. Cambodian Fiscal Projections (2016 – 2021).

Fiscal	2016	2017e	2018e	2019f	2020f	2021f
Revenue (% of GDP)	20.7	21.4	22.3	21.2	21.6	22.0
Expenditure (% of GDP)	22.1	23.1	24.2	23.9	23.6	23.6
Overall Fiscal Balance (% of GDP)	-1.4	-1.6	-1.9	-2.6	-2.0	-1.6
Primary Fiscal Balance (% of GDP)	-1.0	-1.2	-1.5	-2.1	-1.5	-1.1
General Government Debt (% of GDP)	29.1	30.3	30.6	30	30.1	31.1

Source: (World Bank 2019, Recent Economic Developments and Outlook Selected Issue: Investing in Cambodia's Future, page 53)

Serious attention should be paid to the level of general government debt to GDP. The proportion is considered as residual from 2019 until 2021 as forecast. However, the baseline scenario is that government debt will reach 40% of GDP in 2040 without targeted fiscal intervention.

This will be compounded by the emergence of industry 4.0 practices which will necessarily influence the economy of Cambodia and the region, in addition to incurring costs of transition. This will require a huge level of capital and physical investment, an investment that the government will not be able to carry out alone. Therefore, either borrowing or grants will be useful tools for Cambodia to be ready for the Fourth Industrial Revolution.

Maintaining a sustainable fiscal balance is another challenge for Cambodia to overcome by 2040. There may be many changes, including to the societal and demographic structures, political institutions, and the structural economy. With government spending rising continuously, economists, policymakers, and international development partners for years worked on a resilient fiscal policy for sustainable growth.

However, unexpected future changes may prove to be the hardest work yet in designing a practical and resilient fiscal policy. Lee, Kim and Park (2017) state that emerging economies in ASEAN have been improving their social fund transfers – mainly for the growing elderly population – and their generous fund transfer policy is proof of an unsustainable fiscal balance.

In 2040, Cambodia's population structure may have seen huge changes, with resultant effects on government revenues and expenditures. The level of spending in the public sector may be higher than the current baseline year 2019 and be one of the bottlenecks in achieving a sustainable fiscal balance. Lee, Kim and Park (2017) estimate that government expenditure will reach 21.4% of GDP in 2040 and tax revenues making up around 15% of GDP. This prediction appears more conservative than the World Bank forecast that government expenditure will be around 23.6% in 2021.

When a country reaches middle to high income status, public spending increases and puts a burden on government revenue shared with other key economic sectors. In theory, government spending on social fund transfers has a slight effect on economic multipliers (Peter 2010). From this perspective, fiscal policymakers need to think strategically in designing a plausible policy that works for everyone and balances social and economic benefits.

In 2040, limiting rational public expenditure and preventing revenue leakage will be the priority for the relevant ministries as they monitor and control government expenses. This means that a prioritized public sector might absorb more of the budget than non-prioritized sectors in any particular year.

The budget will be allocated by alignment with the prioritized sectors as set by the government in every mandate. To do so, budget allocation will target sectors set by the national grant strategic policy known as "Budget Policy Linkage". It is envisioned that alignment between policy and government spending is a key measure in helping the government balance revenues and expenditures. One area in particular that will remain problematic is the level of CIT. In the absence of the targeted intervention to encourage business investment, CIT is likely to see a moderate decrease but will fall short of encouraging significant investment.

Ensuring macroeconomic stability, with internal and external balance, is an economic policy objective for every country. In Cambodia, the government is undertaking deep reforms in all sectors to ensure the economy remains strong and resilient to unpredictable shocks and the continued strong functioning of the economic sector.

Two significant sectoral reforms have been seen recently: tax administration reform and trade facilitation. These two reforms have tremendously aided foreign investors doing business in Cambodia. However, the kingdom will be unable to end the dollarization of its economy in the next 20 years, with the dollarization circular in the economy reported at around 86% in 2013 (Kubo 2017). The trend of de facto dollarization is in sharp contrast with other ASEAN member countries, where dollarization has been declining in a stable trend (ibid).

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