



The United States and Cambodia: Bilateral Relations and Bilateral Debt

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Mr. Chairman, Ranking Member Manzullo, and Members of the Subcommittee, thank you for inviting me here today to testify about the growing U.S.- Cambodia bilateral relationship and, in particular, Cambodia's outstanding bilateral debt to the United States.

The bilateral relationship between the United States and Cambodia has been steadily improving, especially over the course of the past two years. Although Cambodia continues to undergo a difficult transition to democratic governance, we have seen positive developments in several key areas, including the strengthening of civil society and democratic processes, rapid economic growth, improvements in the fight against trafficking, support for democratic reforms in Burma, and increasing religious tolerance. While longstanding problems in the electoral process persist, which we are working to address through our democracy assistance programs, Cambodia's April 2007 commune-level elections were peaceful and generally positive. National elections are scheduled for July 2008.

U.S. - Cambodia cooperation in a number of areas is growing and moving our bilateral relationship forward. In 2007, Cambodia hosted two U.S. Navy ships – the first to visit in over 30 years – and inaugurated a Peace Corps program. With U.S. encouragement and support, Cambodia has taken increasingly responsible positions on the world stage, including sending de-miners to participate in a UN peacekeeping mission to the Sudan and instituting a parliamentary caucus on Burma. We share good cooperation with the Cambodian military on counterterrorism and POW/MIA accounting.

Despite this progress, weak rule of law, rampant corruption, and weak institutions remain major challenges to Cambodia's democratic development and sustained economic growth. While the political opposition plays a role in the country's political affairs, the ruling party dominates all branches of the government. Cambodia's leaders continue to occasionally use its weak and easily-influenced judiciary to pursue legal cases against critics and the political opposition. Land disputes and forced evictions, often accompanied by violence, continue to be a high-profile problem. Cambodia's health and education system were largely decimated during the reign of the Khmer Rouge (1975 – 1979), and this legacy continues to hamper the country's social and economic development.

In Cambodia's efforts to deal with the legacy of the Khmer Rouge, the U.S. strongly supports bringing to justice senior leaders responsible for the atrocities committed under that regime. We applaud the progress made by the Extraordinary Chambers in the Courts of Cambodia (ECCC), a Cambodian government and UN hybrid tribunal created in 2004 to try those individuals most responsible for the crimes committed under the Khmer Rouge regime in which nearly two million Cambodians were killed. The investigative phase of the tribunal is now underway and five former Khmer Rouge senior officials have been charged with war crimes and/or crimes against humanity. The U.S. has not in the past provided direct funding to the ECCC, due to congressional and Administration concerns about the tribunal's quality, and in particular that the tribunal is not capable of meeting "international standards of justice." However, in light of the Court's progress during the past year, the Department is currently reviewing the tribunal and its operations, including whether or not it is capable of meeting international standards of justice, in order to make a decision regarding future funding.

Economy and Trade

Cambodia has taken a number of important policy measures recently to improve its business climate and promote economic growth. Cambodia joined the World Trade Organization in 2004 committing to implement global trading rules and opening its economy to foreign investment and trade. Implementation of these WTO commitments and other economic reforms have resulted in annual GDP growth rates in the 8 – 10 percent range over the past two years. Despite these impressive results, Cambodia remains a poor country: per capita income is only \$590 per year; education levels are lower than in most neighboring countries; and infrastructure remains inadequate. Economic opportunity and competitiveness continue to be retarded by corruption and lack of legal protections for investors, and there are significant questions regarding the sustainability of recent high economic growth rates.

Cambodia's largest trading partner is the United States. Garments dominate Cambodia's exports, especially to the U.S., and accounted for over \$2.6 billion in 2007. The garment industry employs roughly 350,000 workers, mostly women. Cambodia has developed a good labor record in the garment sector, built through close cooperation with the International Labor Organization and the U.S. Government, which has attracted socially conscious buyers in the United States. Since the end of the WTO's Multi-Fiber Agreement in 2004, Cambodia has defied expectations that its garment industry would shrink significantly. In fact, exports have grown by nearly 20 percent, due in part to safeguards placed on imports of apparel from China. The U.S. safeguards on Chinese textiles will expire at the end of 2008, and under WTO rules cannot be renewed. The U.S. will continue to help accelerate economic opportunity and competitiveness in Cambodia by encouraging policy reform, implementing measures to reduce and eliminate corruption, and strengthening the legal framework for investors.

In July 2006, the U.S. and Cambodia signed a bilateral Trade and Investment Framework Agreement (TIFA), and the first round of discussions took place in Cambodia in February 2007. The on-going bilateral TIFA dialogue is focused on creating a cooperative mechanism to deepen and expand bilateral trade and investment ties, and supporting Cambodia's efforts to implement its WTO commitments and other domestic economic reforms. Our engagement with Cambodia under this dialogue has been highly successful. In November 2007, Ambassador Susan Schwab led the bilateral dialogue, becoming the first U.S. Trade Representative to visit Cambodia.

U.S. Assistance to Cambodia

Cambodia is the third-largest recipient of U.S. foreign assistance in the East Asia and Pacific region. In 2007, Cambodia received \$62 million to cover a broad array of important issues, including HIV/AIDS and maternal health, demining and professionalizing the military, strengthening good governance and human rights, and promoting economic development (see Appendix 1). U.S. assistance also supports programs to reverse the current culture of impunity, while strengthening civil society's ability to address legal and judicial reform, land tenure, rights of workers and children, and prevention of trafficking in persons. The U.S. also encourages expanded political participation by youth and women in elections and political processes. The USG provides assistance to improve the quality of and access to education, teacher training, assisting school directors to measure performance, and strengthening the leadership of the education system. We hope to increase the number of Cambodians studying in the United States under Fulbright and Humphrey Fellowship programs beyond the current twenty. U.S. assistance also helps preserve Cambodia's rich natural resources, by building increased transparency in natural resources management.

From 1997 to 2007, legislative restrictions limited direct funding to the central government of Cambodia. Current assistance programs started since the restrictions were removed are carefully targeted to ensure funds are being used effectively to promote reform.

U.S. Policy on Restructuring Official Foreign Debts

Debt relief can be an important means of achieving U.S. goals of promoting economic growth, well-functioning financial markets, and economic reform abroad. Longstanding U.S. policy is to coordinate sovereign debt restructuring internationally, primarily through the Paris Club group of official creditors. This multilateral approach is a good value for the U.S. taxpayer because it increases recoveries from countries that are not paying their debts to the U.S., while maximizing benefits of debt relief for

heavily-indebted, low-income countries that are unable to meet their payment obligations.

The United States provides debt cancellation only under limited circumstances, for example, as a Paris Club creditor in the Enhanced Heavily Indebted Poor Countries (HIPC) Initiative. This approach provides budgetary resources to pay for the cost of debt relief for debtor countries that are in debt distress. These debtor countries commit to implement economic reforms aimed to reduce poverty and help avoid a new build-up of unsustainable debt before having debt relief. In evaluating requests for debt cancellation, the U.S. and other major official creditor countries rely heavily on International Monetary Fund (IMF) and World Bank assessments of a debtor country's financial need for debt relief and willingness to undertake reforms. Congress has reinforced this need-based approach to debt relief by enacting statutes such as the Special Debt for the Poorest authorization (enacted this year as Section 662 of the Department of State, Foreign Operations and Related Program Appropriations Act, Division J of P.L. No. 110-161) and the Enhanced Heavily Indebted Poor Countries Initiative (Title V of Appendix E of H.R. 3425, as enacted into law by Section 1000(a) (5) of P.L. No. 106-113). These statutes authorize the Executive Branch, under specific circumstances, to reduce or otherwise restructure sovereign debts, which are considered U.S. Government assets.

Cambodia's External Debt

Cambodia's public debt is almost entirely external, of which roughly one-third is owed to the United States and Russia. At the end of 2006, Cambodia's debt was 31 percent of its GDP. According to the World Bank and the IMF, Cambodia's debt is on a sustainable path and the risk of debt distress is judged "moderate," an improvement from the 2006 assessment that Cambodia's risk was "high," thanks to higher-than-expected GDP growth and additional large-scale concessional financing from creditors such as China and South Korea. IMF and World Bank data indicate that, in 2007, Cambodia's debt-to-exports ratio was 32 percent and its debt-to-government revenues ratio was 188 percent (net present value terms). In comparison, the threshold levels of indebtedness needed to qualify for debt relief under the Enhanced Heavily Indebted Poor Countries (HIPC) Initiative are 150 percent (debt-to-exports) and 250 percent (debt-to-revenues). Simply put, Cambodia does not qualify for debt relief under Enhanced HIPC applying the usual criteria, which were designed to identify the most heavily debt burdened poor countries. Based on the Multilateral Debt Relief Initiative's different eligibility criteria, Cambodia benefited from \$82 million in IMF debt relief in January 2006.

Cambodia's Debt to the United States

Cambodia's bilateral debt to the U.S. Government stems from shipments of U.S. agricultural commodities, such as cotton, rice, and wheat flour, financed with low interest-rate loans by the U.S. Department of Agriculture (USDA) under Title I of the Agricultural Trade Development and Assistance Act of 1954 (P.L. 480). The U.S. and Cambodia signed three "P.L. 480 agreements" in 1972, 1973, and 1974, during the Vietnam War and Cambodia's turbulent Lon Nol era. The United States accepted significant payments in local currency under a "Currency Use Payment" provision commonly included in such agreements; the remainder of the debt was to be paid in dollars. The Lon Nol regime never consolidated its hold on the country and ultimately Cambodia fell to the Khmer Rouge in 1975, which ceased servicing this debt. Arrears and late interest accumulated over the next three decades.

In 1995, the Paris Club group of creditor nations and Cambodia reached an agreement to restructure Cambodia's debt on "Naples" terms – then the most generous treatment in the Paris Club's "toolkit." At the time, the U.S. was by far Cambodia's largest Paris Club creditor. Cambodia benefited from a 67 percent reduction of certain non-concessional debts, and a long-term rescheduling of certain concessional debts. Since all of Cambodia's debt to the U.S. was contracted on concessional terms, at below-market interest rates, the Paris Club agreement called on the U.S. to consolidate arrears and future payments scheduled between January 1, 1995 and June 30, 1997 into a new loan payable over 40 years following a 16-year grace period. Debt service falling due on or after July 1, 1997 was to be paid according to the original schedule. Cambodia eventually signed debt agreements with France, Germany, Italy, and Japan to implement the 1995 Paris Club debt treatment, and began paying those countries normally. The United States and Cambodia never concluded a bilateral implementing agreement, in part because the Cambodian government refused to accept responsibility for debts incurred by the Lon Nol regime and, in part, because of a disagreement at the time over the amount of debt owed.

After several years of deadlock, negotiations resumed over the 2001-2005 period, with the active involvement of the State Department, the U.S. Treasury Department, USDA, and U.S. Embassy Phnom Penh. After carefully examining the available legal authorities, the U.S. negotiating team's offer to the Cambodian government showed significant flexibility on the amount of debt owed. In December 2005, the Treasury Department affirmed that, for legal and policy reasons, this was the final, best offer the U.S. could make.

In February 2006, the Cambodian Finance Minister indicated that Cambodia agreed with the U.S., in principle, with the amount of principal it owed. Based on this understanding, the United States drafted a bilateral agreement that retroactively implemented the 1995 Paris Club agreement, including USDA's concessions, and presented it to the Cambodian government in the summer of 2006. If the agreement is implemented in 2008, Cambodia's total debt to the U.S. totals approximately \$339 million using data calculated as of December 31, 2007. About \$154 million of that amount, arrears that have accumulated because regular debt service payments were to have resumed in 1997, would be due immediately. The United States has repeatedly communicated to Cambodia that, should Cambodia agree to the proposed bilateral agreement, the U.S. stands ready to support a new debt treatment in the Paris Club to reschedule these arrears.

To date, the Cambodian government has been unwilling to sign the draft bilateral agreement and now seeks additional concessions, such as a lower interest rate. Longstanding U.S. debt policy, in keeping with Paris Club principles and U.S. budget rules, is to retain the same interest rate of the original loans in any rescheduling of those loans. The proposed U.S.-Cambodia bilateral debt agreement would reschedule the consolidated P.L. 480 debt at the original interest rate of 3 percent – a highly-concessional interest rate given the interest rate environment of the early 1970s. Offering a lower interest rate would be an unauthorized form of debt reduction. Cambodian officials have also indicated that domestic political obstacles still make the government reluctant to accept responsibility for debts incurred by the Lon Nol regime. Although Cambodian observers may consider this debt illegitimate, the U.S. has on its side the international law principle that governments are generally responsible for the obligations of their predecessors. The government of Iraq accepted the debts incurred by Saddam Hussein. The civilian government of Nigeria accepted responsibility for debts accumulated by military governments that ruled the country in the 1980s and 1990s. Similarly, Afghanistan accepted the heavy debt burden left by decades of foreign occupation and civil war. There are many other examples.

Senior U.S. government officials have repeatedly encouraged Cambodia to live up to the 1995 Paris Club agreement it signed with the United States and other creditors, and urged it to sign the pending U.S.-Cambodia bilateral agreement without further delay. However, Cambodia may be reluctant to accept the current proposal to settle the bilateral debt issue if it believes there are good prospects of converting a significant amount of the debt service it would otherwise pay to the United States into a form of increased U.S. assistance.

We understand Cambodia has expressed an interest in a debt-swap program similar to debt-for-assistance measures that were enacted for Vietnam in 2000. Observers often compare Vietnam and Cambodia for geographic and historical reasons, but several distinctions about the treatment of the debts these countries contracted with the United States are worth highlighting. In 1993, Paris Club creditors provided Vietnam a debt rescheduling on terms similar to Cambodia's 1995 Paris Club debt agreement. Vietnam signed a bilateral implementing agreement with the U.S. in 1997, resumed making scheduled payments, and was in good financial standing when Congress created the Vietnam Education Foundation, which will refund to the Foundation's programs about 40 percent of Vietnam's total debt payments to USAID and USDA. The same cannot be said of our current situation with regard to Cambodia debt.

The Administration's position is that Cambodia's economic and financial situation does not merit debt reduction, because the country is neither heavily indebted nor experiencing an external balance of payments crisis. The Administration is concerned that creating a special debt reduction program for a country that is unwilling, rather than unable, to pay its debts, sets a poor precedent for other countries in similar circumstances and sends the wrong message about prudent debt management. Cambodia has accumulated arrears to the U.S., while paying other creditors on time, and in at least one case, early. Every year, both within and outside of the Paris Club context, the U.S. Government reviews and declines similar requests for debt-for-assistance swap arrangements from debtor countries that are both current on their debt service and may owe billions of dollars of debt.

Congress has also expressed its view on the importance of maintaining orderly creditor-debtor relations in a number of statutes, including Section 620(q) of the Foreign Assistance Act of 1961 and the Brooke Amendment (enacted this year as Section 612 of the Department of State, Foreign Operations and related Programs Appropriations Act, Division J of P.L. No. 110-161). These statutes provide for an automatic cutoff of U.S. economic assistance to a country that is in default on certain loans for certain periods of time. Although Cambodia's USDA debts are not subject to these default sanctions, these statutes reflect Congress's expectation that countries

repay their debts to the United States in a timely manner.

Another concern about funding foreign assistance programs through the principal and interest payments of debtor countries is that it circumvents normal budget rules. Congress passed the Federal Credit Reform Act of 1990 requiring U.S. creditor agencies to make realistic estimates about recoveries when calculating the true cost of lending programs. This approach saves U.S. taxpayers money by creating transparent incentives for agencies to manage credit programs efficiently and effectively. Accordingly, the Administration requests and Congress annually appropriates, funds to be used to pay the U.S. budget cost of cancelling a country's debt obligation or providing a debt swap. The Cambodian proposal circumvents this congressional budget oversight mechanism.

In sum, Cambodia's prompt agreement to resolve U.S. debt claims would eliminate this long-standing dispute in a scenario of otherwise improving bilateral relations; it would also enhance Cambodia's creditworthiness and Cambodia's ability to access international capital markets. Other countries following this path have benefited enormously.

Mr. Chairman, I appreciate this opportunity to appear before you and welcome any questions you may have. Thank you.

Appendix 1

	FY 2007
(\$ in thousands)	Actual
TOTAL	62,020
Child Survival and Health	32,989
Development Assistance	7,710
Economic Support Fund	14,850
Foreign Military Financing	990
Global HIV/AIDS Initiative	1,600
International Military Education and Training	101
Nonproliferation, Antiterrorism, Demining and Related Programs	3,780

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