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ABSTRACT

With a rapidly growing commercial economy that requires a sound financial system to sustain growth, Cambodia is committed to the long-term development of the financial sector, channeling financial resources to productive investments, and managing the inherent risks to achieve sustainable economic growth over the long term and contribute to poverty reduction. Financial Sector Development Strategy 2011–2020 reflects Cambodia's achievements to date, provides an assessment of current challenges and constraints to financial sector development, the long-term goals, and a prioritized set of action plans for the next decade. Said strategy will enable Cambodia's financial sector to integrate into the regional financial system and support her long-term economic development agenda. This paper reviews the theoretical and empirical literature on the role of financial sector development, with a view to deepening understanding of the rationale of development assistance to the financial sector of developing countries. The review leads to the following broad conclusions: there are convincing arguments that financial sector development plays a vital role in facilitating economic growth and poverty reduction, and these arguments are supported by overwhelming empirical evidence from both cross-country and country specific studies; there are however disagreements over how financial sector development should be sequenced in developing countries, particularly the relative importance of domestic banks and capital markets and, in developing the banking sector, the relative importance of large and small banks; while broadening the access to finance by microenterprises, small and medium-sized enterprises (SMEs), and vulnerable groups is recognized as critically important for poverty reduction, it is also widely believed that microfinance and SME credit programs need to be well designed and targeted to be effective. In particular, these programs need to be accompanied by other support services such as provision of training and capacity building, assistance in accessing markets and technologies, and addressing other market failures; and financial sector development and innovation will bring risks, and it is therefore essential to maintain sound macroeconomic management, put in place effective regulatory and supervisory mechanisms, and carry out structural reforms in developing the financial sector. There are benefits to dollarization, such as limited exchange rate movements that promote growth in foreign investment and provide a stable environment for the implementation of prudent fiscal policy. However, the loss of seignior age and constraints on the wider use of market-based instruments in implementing monetary policy, such as open market operations3 and foreign currency interventions, raise serious concerns over how well a crisis would be handled, should one occur. This is exacerbated by the limited ability of the NBC to act as the lender of 2 Association of Southeast Asian Nations plus the People's Republic of China, Japan, and the Republic of Korea. 3 When the riel becomes the dominant currency and a broad-based government.