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SURVIVING THE GLOBAL FINANCIAL AND ECONOMIC DOWNTURN

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- Agricultural Trade in the Greater Mekong Subregion
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SURVIVING THE GLOBAL FINANCIAL AND ECONOMIC DOWNTURN

The Cambodian Experience

**Hossein Jalilian,
Sothorn Kem, Glenda Reyes and Kimsun Tong**



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LIST OF ACRONYMS AND ABBREVIATIONS

3mma	3-month Moving Average
ADB	Asian Development Bank
AFP	Associated Fee Press
AFTA	ASEASN Free Trade Area
ASEAN	Association of Southeast Asian Nations
ATC	Agreement on Textiles and Clothing
BFC	Better Factories Cambodia
CARD	Council for Agriculture and Development
CCSEAS	Canadian Council for Southeast Asian Studies
CDC	Council for the Development of Cambodia
CDRI	Cambodia Development Resource Institute
CMT	Cut-Make-Trim
CPP	Cambodian People's Party
CRDB	Cambodian Rehabilitation Development Board
CSES	Cambodia Socio-Economic Survey
DFID	Department for International Development (UK)
DTIS	Diagnostic Trade Integration Strategy
EBA	Everything But Arms Initiative
EIU	Economist Intelligence Unit
EU	European Union
FAO	Food and Agriculture Organisation
FCD	Foreign Currency Deposit
FDI	Foreign Direct Investment
FGD	Focus Group Discussion
FSN	Food Security and Nutrition

FUNCINPEC	Front Uni National pour un Cambodge Indépendant, Neutre, Pacifique, et Coopératif
GDCC	Government-Donor Coordination Committee
GDP	Gross Domestic Product
GFEC	Global Financial Economic Crisis
GHI	Global Hunger Index
GMAC	Garment Manufacturers Association of Cambodia
GNI	Gross National Income
GSP	Generalised System of Preferences
H1N1	Swine influenza virus
IFC	International Finance Corporation
IFPRI	International Food Policy Research Institute
ILO	International Labour Organisation
IMF	International Monetary Fund
IRRI	International Rice Research Institute
ISDR	International Strategy for Disaster Reduction
MAFF	Ministry of Agriculture, Forestry and Fisheries
MFA	Multi-fibre Arrangement
MFI	Microfinance Institutions
MoC	Ministry of Commerce
MoEF	Ministry of Economy and Finance
MoRD	Ministry of Rural Development
MoT	Ministry of Tourism
MPDF	Mekong Private Sector Development Facility
NBC	National Bank of Cambodia
NGO	Non-governmental Organisation
NIS	National Institute of Statistics
NPL	Non-performing Loans
NSDP	National Strategic Development Plan
OECD	Organisation for Economic Cooperation and Development
PDS	Poverty Dynamics Study
PFMRP	Public Financial Management Reform Programme
RCA	Revealed Comparative Advantage
RGC	Royal Government of Cambodia
RHS	Rural Household Survey
ROR	Rules of Origin Requirement
SAM	Social Accounting Matrices

SSI	Semi-structured Interview
TATA	Trade Agreement on Textiles and Apparel
UN	United Nations
UNCTAD	UN Conference on Trade and Development
UNDESA	UN Department of Economic and Social Affairs
UNESCAP	UN Economic and Social Commission for Asia and the Pacific
UNICEF	United Nations Children’s Fund
UNSCN	United Nations Standing Committee on Nutrition
UNTAC	UN Transitional Authority in Cambodia
UNWTO	United Nations World Tourism Association
US	United States
USAID	United States Agency for International Development
USD	United States Dollar
USDA	United States Department of Agriculture
USEIA	United States Energy Information
US ITC	US International Trade Commission
VWS	Vulnerable Worker Survey
WB	World Bank
WDI	World Development Indicators
WEF	World Economic Forum
WEO	World Economic Outlook
WFP	World Food Programme
WHO	World Health Organisation
WTO	World Trade Organisation
y-o-y	Year-on-year

FOREWORD

Following a decade of strong economic growth, socio-economic development, and poverty reduction, the Global Financial Crisis (GFC) and associated regional economic downturn in 2008–09 had a severe impact on Cambodia's economy, exposing its vulnerability due to the narrowness of its economic base and its reliance on European and North American export markets. While annual GDP growth has now recovered to levels of 6–7 per cent, the vulnerability remains, with a shared imperative by the Cambodian government, the private sector, investors and development partners to work together for the diversification of the economy. The experiences of 2008–09, despite their severity, also provided useful lessons for policy-makers. I am pleased to introduce this volume which provides an independent analysis of the impact of the crisis on Cambodia and a deeper understanding of the Cambodian economy, its strengths and weaknesses, and policy challenges for the future.

Since 1993, the Cambodian economy has undergone a dramatic and rapid transformation. The traditional economy, based on agriculture, is now driven increasingly by the industrial and the tertiary sectors. With the return of peace and stability in the late 1990s, a sense of confidence and pride pervades the country. All Cambodians now share a common vision of sustained economic growth with employment and a secure future for all. The government's strategy is to help realize this vision by reinforcing Cambodia's comparative advantages both regionally and internationally. In the era of globalization the fortunes of all countries in the world are intertwined; autarchy is not an option for sustained high economic growth for a small sized economy as Cambodia. Hence Cambodia's continued economic success will depend on full

market access for its products and the cooperation of its development partners.

Cambodia had to rebuild itself virtually from scratch after the defeat of the Khmer Rouge regime. At the very outset, the country had to face the harmful consequences of the international economic embargo imposed in 1979. The annual rate of economic growth did not exceed 3.4 per cent during 1988–91, even though average annual growth in the manufacturing sector reached 6.3 per cent. Growth has been particularly strong since the early 1990s, with the implementation of macroeconomic reforms and the normalization of economic and trade relations with countries in the region. An annual average rate of growth of 6.3 per cent was achieved during 1994–98, despite the upheaval caused by the Asian financial crisis of 1997–98.

It was only after the successful implementation of the “win-win” policy put forward by Samdech Hun Sen in 1998 that the government was able to dismantle the politico-military organization of the Khmer Rouge, thus re-establishing peace throughout the Kingdom and achieving the physical and political unification of the country. The government could then take steps to strengthen the spirit of national reconciliation. The elections of 1998 created conditions for political stability that allowed the government to focus on macroeconomic management.

Following the July 1998 elections, the government adopted the Triangular Strategy with the objective of promoting sustainable development in Cambodia. The strategy aimed at the restoration of peace and stability, as well as the maintenance of security for the country and its people. The strategy was by and large successfully implemented and the process of robust economic recovery initiated.

At the opening meeting of the Council of Ministers on 16 July 2004, Prime Minister Hun Sen launched the “Rectangular Strategy for Growth, Employment, Fairness and Effectiveness in Cambodia”. The successful implementation of the strategy depends on establishing a conducive environment in four critical areas: (i) peace, political stability and social order; (ii) partnership for development, particularly partnership with the private sector, donor community and civil society; (iii) economic and financial stability; and (iv) integration of Cambodia in the region and in the world. The strategy was reviewed and reinforced after the elections of 2009 and is currently under implementation.

During the 1990s, the Cambodian economy was transformed from a centrally planned to a market economy. Reforms and policies intended to encourage private sector development were adopted in 1989–90. Government liberalized the economy by dismantling price controls and encouraged private sector development including foreign investment. Growth during this period was achieved mainly from the manufacturing and services sectors. Agricultural production, on average, remained lower than population growth. Since 1999, Cambodia has been working towards accelerating development based on market principles and private sector development. Growth was 11.9 per cent in 1999 and recorded annual average rate of 8.8 per cent during 1999–2003. Growth performance was consolidated further during 2004–08. In the decade ending 2010, GDP rose at an average annual rate of 9.3 per cent. Growth in the last decade was based on the strong performance of garments and tourism. From the policy side, sound macroeconomic management, in particular a prudent fiscal policy and tight monetary management supported by structural reforms, contributed to this performance.

In 2005 questions arose about the capacity of Cambodia to sustain high growth due to loss of competitiveness. The Multi-Fibre Agreement (MFA), which allowed World Trade Organization member countries, primarily China, to export clothing on a worldwide basis with no quotas imposed, expired in December 2004. It was anticipated that while the larger and more efficient textile manufacturers in Cambodia would be able to survive global competition, the smaller ones would perish as they would be unable to compete. The GFC had a crushing impact on Cambodia and growth slowed down sharply in 2009. The country had to rethink and reformulate its development strategy.

Moreover, the economic success of recent years has been accompanied by rural and agricultural stagnation, growing inequality between urban and rural sectors, social problems of landless farmers, and the growing pressure of finding productive employment for youth who are swelling the labour force day by day. Cambodia, with an annual per capita GDP of US\$700 in 2010, remains a least developed country (LDC). Cambodia's economic future depends on how effectively it will be able to address the following challenges:

First, political stability, governance and respect for law and order must be strengthened and law enforcement must be guaranteed. Cambodia has adopted systems of governance appropriate for its culture and

history. Elections are organized regularly and transparently. Individual and collective freedoms are assured. Political parties, labour unions, and the press function freely in this young democracy. Cambodia has also signed and ratified most of the international agreements on human rights protection. Education of citizens about their rights and responsibilities is an important area of government responsibility. However, the pursuit of political liberties should not derail political and social stability achieved after decades of turmoil and bloodshed by overstretching the capacity of the fragile political, social, and governance institutions of the nascent democracy. Also, the fruits of development must be shared equitably between the rich and the poor for preserving social stability.

Seccond, much remains to be done to correct social injustices. The press, including the foreign press, enjoys great freedom in Cambodia and several non-government organizations, both national and foreign, are working in the country in diverse areas of social development. Although their activities have helped to increase awareness of social ills prevailing in the community, social equity remains a distant goal. In particular, human trafficking in women and children and the deprivation of landless farmers are serious concerns.

Third, the capacity to implement policy must be improved. Several institutional and policy reforms were undertaken during 1993–2010. Much more effort is needed to ensure that institutions function effectively, and that concrete actions follow approved strategies and policies. The top priorities are the implementation of an employment-oriented and market-responsive education policy along with the provision of technical and vocational training, improving access to good quality healthcare and swiftly propagating the latest advances in information and communications technology to the public to serve the cause of progress.

Fourth, protecting and developing natural resources will be crucial for sustaining development. Fair and equitable access to resources must be ensured to sustain social stability. Government policies and actions in technical, financial, cultural and academic sectors as well as in institutional coordination must reflect the political will to protect the environment. A transparent mechanism must be put in place to implement the sub-decree on social concessions to address the problem of landless farmers.

Fifth, in the area of capital accumulation, emphasis must be put on domestic resource mobilization and the selection of efficient investment projects. For augmenting human capital, human resource development at all levels should be encouraged. Skilled entrepreneurs and administrators and technical knowledge are key factors of production and no less important than physical capital. Cambodia's business community needs to improve its institutional and technical capacity. Investments for raising labour productivity and the introduction of improved technology should be given priority. A middle class has emerged in recent years; this welcome development will contribute to social stability. The middle class should strengthen Cambodia's capacity to benefit fully from the opportunities of development.

Sixth, Cambodia needs to attract private investment and mobilize broad-based international support for its development effort. In particular, international cooperation must be enhanced in the areas of (i) official development assistance; (ii) direct foreign investment; and (iii) foreign trade. The activities and outcomes of the Cambodian Development Forum (CDF), cooperation with the Asian Development Bank, International Monetary Fund, World Bank, and other donors of bilateral funds, along with deliberations in ASEAN, ASEAN Plus Three, and the World Trade Organization will provide important policy inputs to the government. Cambodia is committed to cooperating with these agencies.

The GFC had a largely indirect impact on the Cambodian economy. Cambodia's commercial banks did not have direct exposure to subprime loans, and the banking sector, while small, has grown healthily through responsible governance by the National Bank of Cambodia. However the crisis severely impacted on the real sectors, particularly export of garments. Cambodia's GDP growth fell from 10.2 per cent in 2007 to 6.7 per cent in 2008 and 0.1 per cent in 2009, but bounced back to 6 per cent in 2010 and is projected at 6.4 per cent in 2011. The Cambodian economy is expected to grow at about 7–8 per cent per annum over the next several years, but growth will likely accelerate after oil production commences on a commercial scale, expected in 2012. The high growth seen in the last decade was partly a post-conflict "catch up" phenomenon. As Cambodia confronts stiffer competition from globalization, the high cost of doing business — characterized principally by high energy and transport costs — could also become a

binding constraint. As a result growth could become less buoyant. In the near term, the economy will likely continue to be led by tourism, garment industry, and construction, with agriculture providing periodic but volatile spurts of growth depending on weather conditions. However, there are already promising signs that investors from the Asian region, China, Japan and South Korea are leading the way in the diversification of the economy through investment in light industrial manufacturing and agri-business.

This volume not only makes a timely and useful contribution to analysis of the past and present challenges faced by Cambodia and its economy, but also reflects the valuable role played by CDRI as Cambodia's leading independent development policy research institute, widely respected by government, the private sector, the research community and civil society for the quality and objectivity of its research. CDRI's initiation of the GMS Development Series in partnership with ISEAS Singapore provides an important new platform for the dissemination of quality development policy research on Cambodia and Its Greater Mekong Subregion.

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