

Cambodian Economy

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Cambodian Economy

Charting the Course of a Brighter Future
A Survey of Progress, Problems and Prospects

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Foreword

To assess the economic situation in Cambodia, we need to have a clear understanding of its past. Cambodia has moved in stages, many traumatic, from a position as a war-torn, conflict-ridden, isolated country to one of stability, which is underpinned by a gradual progress to a market economy. Notwithstanding the significant progress that has been made since 1993, when the UN-supervised elections were held, the country still faces many daunting challenges in its efforts to improve the livelihood of its people. In a larger sense, Cambodia's contemporary economy is the legacy of its troubled past and political conflict, during which the foundations for growth and development — physical, social, economic, and human — have been devastated.

After the Paris Peace Agreements were signed on 23 October 1991, Cambodia moved swiftly to integrate itself into the international community. Cambodia's membership in ASEAN, WTO, and the East Asia Summit, as well as cooperation within the framework of the Greater Mekong Sub-Region (GMS) provided great opportunities to reform the investment and foreign trade regime. This was done by focusing on the liberalization and decentralization of the decision making process, reducing impediments to investments, implementing reform programs and initiating the modernization of the national economy and upgrading its competitiveness to the regional and international standards.

The book entitled *Cambodia Economy: Charting the Course of Brighter Future, A Survey of Progress, Problems and Prospects*, written by HE Dr Hang Chuon Naron, Secretary of State, Ministry of Economy and Finance of the Royal Government of Cambodia, provides useful accounts about the current economic landscape and emerging challenges facing Cambodia that has evolved over the years.

This book also assesses rigorously the stage-by-stage evolution of all the important economic sectors of the country and the emerging vulnerabilities that the Cambodian economy has experienced since 1993, and as the result of the global economic and financial crisis starting in 2008. It also provides rich analysis of the economic policy making process as well as policy formulation and implementation, and a sharper focus on the priorities which should be addressed for Cambodia's future competitiveness and sustainable growth.

As Cambodia takes its place on the international stage, it also grows more susceptible to the economic shocks affecting the rest of the world. This book will serve as a strong catalyst to help move Cambodia forward smoothly, and to earn its rightful place in the process of economic integration. It also discusses the new risks and new opportunities that Cambodia will face in the future. It is a useful book for businessmen who seek more information in order to do business in Cambodia, or for the general reader who might wish to update himself on the development that has occurred over the past two decades.

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July 2010

Preface

The overthrow of Prince Sihanouk by the Lon Nol coup d'état on March 18, 1970, plunged Cambodia into the horrors of war, genocide, and unbridled violence. The two decades that followed dramatically transformed the society and economy of Cambodia. The seizure of power by the Khmer Rouge on April 17, 1975 set Cambodia on course of genocide and self-extinction of its people. Cities were evacuated, hospitals emptied, schools closed, factories shut down, currency abolished, monasteries sealed off, and libraries destroyed. Life in Cambodia remained this way for three years, eight months, and twenty days. Cambodia's human resources were decimated. The Cambodian people were first kidnapped, and then besieged. The Khmer spirit was broken; its points of reference vanished.

The day of national redemption arrived on January 7, 1979, when the Front uni national de salut du Kampuchea (National United Front for the Salvation of Kampuchea), assisted by Vietnamese forces turned the tide against the Khmer Rouge. For many Cambodians this date celebrates the resurrection of Cambodia.

The Front immediately proclaimed the advent of the People's Republic of Kampuchea. The Cambodian people redoubled their efforts to reconstruct the country, organize the economy, set up the school system, reopen hospitals, and train management level staff. The first school to reopen its doors was Chaktaumuk, followed by Phnom Daun Penh (now Sisowath) Secondary School. The generation of my parents and parents-in-law worked ceaselessly to restore the educational system and save the Khmer culture. Furthermore, Fortunately many university students had left to continue their higher education abroad, especially in Eastern Europe. Many of them have returned to participate in rebuilding the nation.

Cambodia had to endure an economic embargo following the demise of the Khmer Rouge regime. The country had no access to international financial institutions; its currency was not convertible. Foreign aid from the Soviet Union, Viet Nam, and other countries of the Soviet bloc, as well as from some fifteen Western non-government organizations enabled the People's Republic of Kampuchea to begin the reconstruction of the economy and society. Despite these efforts it was not possible to fill the immense void in human resources caused by the Khmer Rouge regime. The first priority, in development was provision of training. The formation of the People's Republic of Kampuchea (PRK) in 1979 marked a new stage in the rehabilitation and reconstruction of the country in all sectors.

Even after the Khmer Rouge regime ended in 1979 civil strife continued. After a series of meetings on October 23, 1991, in Paris, 18 governments along with the

four Cambodian factions signed the Agreement on a Comprehensive Political Settlement of the Cambodian Conflict, with France brokering the peace deal. However, even after the general elections of 1993 following the peace agreement, unrest continued. The prerequisites for any serious development had yet to be established. A sense of insecurity prevailed in the country. The Khmer Rouge were routed but were still a presence in many parts of the country. The “win-win” policy of national reconciliation in 1997 initiated by Prime Minister Hun Sen finally ended the Khmer Rouge regime and dismantled its political and military organizations.

Nonetheless, Cambodia has paid a heavy toll for war and international isolation. In particular, the social costs have been heavy. In the early 1990s, Cambodia had the highest infant mortality rate in the world; the mortality rate for pregnant women and women in childbirth was double that seen in Africa and India. Cambodia also had the highest rate of disabled people in the world and the highest incidence of tuberculosis. Only 12% of the rural population had access to potable water. In some rural areas, barely 30% of the population had been enrolled in school.

In order to promote sustainable economic growth and rapid alleviation of poverty, the Royal Government of Cambodia (RGC) has given priority to investments in agriculture, physical infrastructure, with a special focus on transportation and telecommunications, electrical energy, human resources development, labor-intensive industries, as well as to manufactured exports and tourism. The goal of this policy is to lay the foundations for sustainable development.

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, a sense of confidence and pride pervades the country, a feeling that bodes well for bright prospects for economic growth and job creation and a concrete vision of a promising future. The government strategy is to help realize this vision by reinforcing Cambodia’s comparative advantages both regionally and internationally.

The RGC attaches great importance to private investment for laying the foundation for economic takeoff. The government’s strategy aims to make Cambodia a focal point for foreign investment and encourage the export of goods and services. This will enable Cambodia as a nation to shape its economic destiny by responding to market forces. The Cambodian people are capable of achieving this goal provided they are not denied market access and the government and other development partners are supportive,

Proud of its glorious past and recent achievements, Cambodia is managing to find the strength and will to undertake the decisions and actions necessary to speed up development. The Cambodian people are determined to fulfill their inherent

potential and make their dreams come true. No single individual or group can make development happen; development has to be a collective effort, through concrete contributions of all members of the society. If all work together, Cambodia can win the fight against poverty and achieve progress.

With the restoration of peace economic results have improved dramatically. During the last decade GDP rose at an average annual growth rate of 9.3%, thanks to prudent budgetary policy, healthy monetary management, and appropriate structural reforms. Though Cambodia has made much progress, the reform effort must be sustained and strengthened in key areas in order to promote sustainable development.

Cambodia, with annual per capita GDP of US\$700, remains one of the least developed countries. Much remains to be done in order to ensure strong and lasting economic growth in the future in a global and regional climate increasingly fraught with challenges. 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 challenge of a young population in search of employment.

It is essential that all stakeholders in Cambodia agree on common objectives for pursuing their development and reform efforts. First, political stability, governance and respect for public order must be strengthened and law enforcement must be guaranteed. In the area of democracy and the promotion of human rights, Cambodia has adopted systems of governance appropriate for its cultural and historical heritage. Elections are organized regularly and with transparency and fairness. Individual and collective freedoms are assured. Political parties, labor 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 action. However, the pursuit of political liberties should not be at the cost of risking political and social stability achieved after decades of turmoil and bloodshed and should not lead to overstressing the capacities 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.

Second, much remains to be done to correct social injustice despite the great freedom enjoyed by the press, including the foreign press, total freedom of worship, and the latitude given, in many respects exceptional, to the multitude of non-government organizations both national and foreign that are working in diverse areas. The top issues are human trafficking in women and children and the deprivation of landless farmers.

Third, the capacity to implement policy must be improved. Several institutional and policy reforms were undertaken during 1993-2008. Much more effort is needed to ensure that institutions function effectively and concrete actions emerge from approved strategies and policies. The reforms must strengthen the efficiency of the State's political and economic institutions. The top priorities are the implementation of an effective education policy along with provision of technical and vocational training, improving access to good quality health care and swiftly propagating the latest advances in information and communications technologies to the public in such a way that they can serve the cause of progress. The RGC is committed to identifying and implementing strategies and programs in these areas.

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. Measures in technical, financial, cultural and academic sectors as well as in the area of political and institutional cooperation must reflect the political will to achieve sustainable development through protection of 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 should be put on domestic resource mobilization and in the selection of efficient investment projects. Human resource development at all levels needs to be encouraged. Skilled entrepreneurs and administrators and technical knowledge are key factors of production and are as important in the production mechanism as physical capital. Investments for raising labor productivity and introduction of improved technology should be given priority. Cambodia has seen a middle class emerge in recent years; this is a welcome development which will contribute to social stability. The middle class should strengthen its capacity to benefit fully from the opportunities of development. The capitalist class of Cambodia needs to catch up with its comparators in the rest of the region as far as institutional and technical capacity is concerned.

Sixth, globalization and foreign economic relations must support development through: (i) official development assistance; (ii) direct foreign investment; and (iii) foreign trade. The activities and outcomes of the Cambodian Development Forum (CDF), advice of the IMF, World Bank, Asian Development Bank, and other donors of bilateral funds, along with deliberations in ASEAN, ASEAN Plus Three, and the World Trade Organization (WTO) must also be duly considered. Cambodia is committed designing projects, conducting debates or negotiations, and concluding agreements within these mechanisms which is conducive to economic takeoff.

Reports and analyses of the performance of economic and social infrastructure, public services such as education, health, transportation, communications, water and energy supply, irrigation and drainage systems, and favorable assessments of the

quality of institutions, and good governance, play a pivotal role in attracting private investment and mobilizing broad based international support for Cambodia's development effort.

This book attempts to take a broad look at Cambodia's struggle to promote sustainable development and shared prosperity, the strategies and policies for reform in essential sectors which underpin them, and the results they have produced. The emphasis is on Cambodia's achievements in the last decade and the problems that must be addressed in the future.

The book is organized on the following major themes: (i) an overview of Cambodia's geography and climatic conditions; (ii) Cambodia's demographics; (iii) the macroeconomic framework; (iv) agriculture and rural development; (v) industry and development of the private sector; (vi) the non financial service sector; (vii) infrastructure; and (viii) human resources development (ix) financial sector (x) Public Finance (xi) international economic relations. The book concludes with a discussion of issues in institutional and human capacity building which is the immediate challenge facing Cambodia.

I have had the personal satisfaction of having been intimately involved in Cambodia's development process almost since inception. This has given me insights which I have attempted to reflect in the book. I remain convinced that the motivation for the development of Cambodia at the grass roots level must come from the people of Cambodia. It is thus essential that they are fully informed of the achievements of their country and the challenges that remain. This book is a contribution to improving the information on Cambodia so that Cambodian public could better prepare itself to confront the challenges of development.

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HANG CHUON NARON

Phnom Penh, December 2009

INTRODUCTION

“Development is by definition a process of change. The increase in productivity and intensification of agriculture, the abandoning of farming activity in favor of employment in industry and services, and the consequent rural exodus, are all decisive factors in this process.”

Nicholas Stern

After more than three decades of civil war, Cambodia has experienced relative peace since 1998 and has been rebuilding its infrastructure, economy, and social fabric, and thereby enabling the country to redirect its resources and strengths toward sustained, equitable development. The country's achievements during the 20 years of reconstruction from January 1979 onward show what the Cambodian people are capable of doing when they put their talents and ingenuity to work for a peaceful cause. Cambodia is now back on track to achieve its destined place in the vanguard of the community of nations.

Three significant phases in the recent economic history of Cambodia can be discerned: A period of rebuilding from 1979-1990, a transition and reconstruction phase from 1991-1998, and a development phase beginning in 1999. Cambodia's economy grew steadily in all the three phases.

Cambodia had to virtually start from the scratch to rebuild the country after the defeat of the Khmer Rouge regime. At the very outset, the country had to face the harmful consequences of the economic embargo imposed in 1979. The annual rate of economic growth did not exceed 3.4% during 1988-1991, even though average annual growth in the manufacturing sector reached 6.3%.

Growth has been particularly strong since the early 1990s, with the implementation of macroeconomic reforms and normalization of economic and trade relations with the countries of the region. An annual average rate of 6.3% was achieved during 1994-1998, despite the upheaval caused by the Asian financial crisis of 1997-1998.

Since 1999, Cambodia has been working towards accelerating development. Growth was 11.9% in 1999, although slowing to 6.6% in 2002, with an annual average rate of 8.8% for the five-year period of 1999-2003. This growth is attributed to two flourishing sectors: garments and tourism. Despite this record, in 2005 questions arose on the capacity of Cambodia to sustain high growth due to its lack of competitiveness. The Multi-Fiber Agreement (MFA) expired in December 2004, which allowed WTO member countries, primarily China, to export clothing on a worldwide basis with no quotas imposed. It was anticipated that while the larger and more efficient textile manufacturers in Cambodia would be able to survive the global competition, the smaller ones would perish as they would be unable to compete.

From the early 1980s until 1991, Cambodia's economy was centrally planned. There were some attempts at reform in 1985, but economic deregulation effectively commenced after 1992. During the 1990s, Cambodia underwent a transition from a command economy to a market economy. Reforms and policies intended to encourage development of the private sector adopted in 1989 and 1990, liberalized the economy by dismantling price controls and encouraged private sector development including foreign investment. During this period, growth was achieved mainly from the production and service sectors. Agricultural production, on average, remained lower than population growth.

During 1993-1998, the RGC of Cambodia (RGC) had not yet been able to bring together the political and security conditions necessary for a stable, unified government. The Khmer Rouge were still a viable military force, a menace weighing heavily upon the security of the country, and the political fabric of the country was still fragile. Moreover despite government efforts growth slowed in 1997-1998 owing to political events and the Asian financial crisis.

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

Following the July 1998 elections, RGC adopted the triangular strategy with the objective of promoting sustainable development in Cambodia. Restoration of peace and stability, as well as maintenance of security for the country and its people—the first axis of the “triangle”—are now accomplished facts. The integration of Cambodia into the region and the normalization of its relations with the international community—the second axis of the “triangle”—had also been substantially achieved. Cambodia had regained its seat at the United Nations, which had been lost following the armed confrontations of July 1997, and became the tenth member of the Association of Southeast Asian Nations (ASEAN). The country joined the World Trade Organization (WTO) in October 2004. The third axis of the government's “**Triangular Strategy**” was to promote socio-economic development through an extensive reform program addressing public administration, decentralization, remobilization of the military, legal and judicial reform, gender equality, public finance, eradication of corruption, and sustainable management of natural resources. The triangular strategy was by and large successfully implemented as seen in higher growth and investment, improved monetary and fiscal policy management resulting in lower inflation and strengthened

foreign exchange reserves, larger inflows of foreign official transfers and private capital; and faster private sector development.

Nevertheless, Cambodia found itself at a crossroads at the conclusion of the second political mandate of the government in 2003. Following the elections of 2003 the country clearly wanted to proceed faster on the path of modernization. At the opening meeting of the Council of Ministers on July 16, 2004, Prime Minister Hun Sen launched the “**Rectangular Strategy for Growth, Employment, Fairness and Effectiveness in Cambodia.**” The core of the strategy is good governance. 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 four sides of the rectangle addressing reform are: (i) eradicating corruption; (ii) legal and judiciary reform; (iii) public administration reform, including decentralization and deconcentration; and (iv) reform of the armed forces, notably demobilization. Finally the four sides of the rectangle for creating growth are: (i) promotion of the agricultural sector; (ii) development of the private sector and job creation; (iii) rehabilitation and reconstruction of physical infra-structure; and (iv) capacity building and human resources development.

Cambodia must prove its ability to reform. The country has committed to a significant decentralization reform. These reforms were undertaken to allow the Cambodian people to live in a modern civilized society with basic amenities. The government is in the process of reforming the education and health sectors to ensure social justice and improve the quality of life of all Cambodians. These reforms are necessary so that Cambodian society can face the future confidently.

Cambodia must not only overcome impediments to growth through the reform process, but must also create the conditions for sustainable growth through equitable distribution of costs and benefits of development. For a start business costs, costs that weigh upon employment are being cut down. The country must map out a clear strategy and implement it in order to enhance its attractiveness as an investment destination.

Stability and prosperity depend upon the ability of Cambodians to strengthen good governance. The promotion of transparency, fairness, efficiency, and accountability requires first of all an updating of the government’s agenda of liberalization, globalization, and building partnerships within the country and at the international level.

The agenda for achieving growth in Cambodia is clearly defined in the Rectangular Strategy. But the challenge lies in making growth the process work for the poor.

Poverty reduction requires appropriate measures, such as: (a) a public finance policy that will raise revenue in an equitable manner and incomes through pro-poor public expenditures; (b) maintaining macroeconomic stability; and (c) formulation and implementation of appropriate sector policies including increased investments in health and education, addressing gender issues, development of ethnic minorities, land reform, sustainable management of fisheries resources and protection of the environment.

While commune councils could move forward with the identification and resolution of the causes of poverty at the local level, sustainable poverty reduction requires increased investment in the economy. The development strategy must give high priority to attracting foreign investment by creating and maintaining a favorable environment. Cambodia has taken significant measures for improving the investment climate but it should ensure that its incentive structure is competitive with its neighbors and comparators in the region..

The RGC has strengthened economic and financial management with the help of its development partners and is working to accelerate the momentum of the reform process by improving services in tax and customs administration, budget and public treasury management, central bank transactions, economic statistics, and development of the legislative framework for monetary and financial reforms. For accelerating social development, the RGC has allocated a large part of the budget to the education, health, agriculture, and rural development sectors, which have huge payouts by way of social benefits. Over the last five years, the government has more than tripled budgetary spending for health, and almost doubled public expenditure on education. But much remains to be done to improve the efficiency of public expenditures and the quality of public services. More importantly, Cambodia must ensure that the increase in budget funding is accompanied by improved performance in the concerned sectors.

The RGC has been working on an effective strategy for improving transportation infrastructure, in particular roads and bridges—the very foundation of the national economy—for creating a more extensive and operational road network allowing Cambodia to promote economic and tourist activities, facilitate the movement of goods and services, promote local and foreign investment, and open up the potential of the rural economy. Reducing the cost of transportation will encourage private business investment and employment.

Cambodia has made giant strides in development in the last decade. In particular, under the Rectangular Strategy of the second mandate of the government, Cambodia has achieved a profound transformation of the Cambodian society. But with each stage of development accomplished, new challenges arise. Cambodia's economic performance has been severely affected since late 2008 by the yet

unresolved global economic crisis. The government has acted swiftly to counter the social impact of falling incomes and employment from declining garment exports, tourism and construction pursuant to the crisis. Over the long haul, economic reforms have to be accelerated to build greater resilience in the economy to withstand external shocks. The country has to be firm in its resolve to achieve progress and bring about better living conditions for the people. There is yet a long way to go, and no one knows this better than Cambodians themselves.

Symbols and abbreviations

ACLEDA	Association of Cambodian Local Economic Development Agencies
ADB	Asian Development Bank
ADD	Accelerated District Development
AFD	Agence française de développement (French Development Agency)
AFTA	ASEAN Free Trade Area
ASEAN	Association of Southeast Asian Nations
BDR	Bank of Rural Development
BOT/BOO	Build, operate, transfer / Build, own, operate
CAR	Council for Administrative Reform, Council of Ministers
CARDI	Cambodian Agricultural Research and Development Institute
CDAF	Council for the Demobilization of the Armed Forces, Council of Ministers
CDC	Council for the Development of Cambodia
CDRI	Cambodia Development Resource Institute
CDV	Village Development Committee, Ministry of Rural Development
CG	Consultative Group
CIB	Cambodian Investment Board
CRDB/CDC	Cambodian Rehabilitation and Development Board of the Council for the Development of Cambodia
EDC	Électricité du Cambodge
EU/ EC	European Union/ European Commission
FAO	Food and Agriculture Organization of the United Nations
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
GMS	Greater Mekong Sub-region
GSP	Generalized System of Preferences
HRMIS	Human Resources Management Information System
IPP	Independent Power Producer
IIPP	Integrated Investment Priorities Program
ILO	International Labor Organization (United Nations)
IMF	International Monetary Fund
MAFF	Ministry of Agriculture, Forestry and Fisheries
MDG	Millennium Development Goals
MEF	Ministry of Economy and Finance
MEYS	Ministry of Education, Youth and Sports
MFIs	Microfinance institutions
MFN	Most-Favored Nation
MIME	Ministry of Industry, Mines and Energy
MLMUPC	Ministry Land Management, Urban Planning and Construction
MoE	Ministry of Environment
MoH	Ministry of Health
MoP	Ministry of Planning
MoPT	Ministry of Posts and Telecommunications
MoPWT	Ministry of Public Works and Transport
MoRD	Ministry of Rural Development
MoWRM	Ministry of Water Resources and Meteorology
MoWVA	Ministry of Women's and Veterans' Affairs
MPA	Minimum Package of Activities, Ministry of Health
MW	Megawatt
NAA	National Audit Authority
NBC	National Bank of Cambodia
NGOs	Non-government Organization

NPAR	National Program for Administrative Reform
NPRDC	National Program for the Rehabilitation and Development of Cambodia
NR	National Road (Highway)
OD	Operational District, Ministry of Health
ODA	Official Development Assistance
OECD	Organization for Economic Cooperation and Development
PAP	Priority Action Program
PEP	Public Expenditures Program
PIMS	Public Investment Management System
PIP	Public Investments Program
PMG	Priority Missions Group
PSI	Pre-shipment inspection
RCAF	Royal Cambodian Armed Forces
RGC	Royal Government of Cambodia
RH	Referral Hospital (Ministry of Health)
SEDP	Socio-economic Development Plan 1996-2000
SEILA	Khmer word for “foundation”, a government rural development program
SMEs	Small and Medium-size Enterprises
SWAP	Sector-wide Approach
TOFE	Tableau des Opérations Financières de l'État (Table of Government Financial \ Operations)
UN	United Nations
UNAIDS	United Nations Fund for Aids Prevention
UNDP	United Nations Development Program
UNESCO	United Nations Educational, Scientific and Cultural Organization
UNFPA	United Nations Fund for Population Activities
UNICEF	United Nations Children's Fund
VAT	Value-Added Tax
WB	World Bank
WFP	World Food Program
WTO	World Trade Organization