

# Economic Transformation in Cambodia

## *Experiences, challenges and scoping future activities*

Background note for CDRI-ODI workshop, 26<sup>th</sup> February 2019, Phnom Penh, Cambodia

### Key messages

- Over the past 2 decades, Cambodia was the 6<sup>th</sup> fastest growing country in the world and has reduced poverty and inequality significantly. It graduated to lower middle-income status in 2015. It experienced high growth in few activities: garments, tourism and rice exports and construction. There are a few limited signs of diversification into bicycles and footwear, but Cambodia's economic structure has largely remained constant.
- Cambodia faces major challenges through expected trade preference erosion (possibly soon), limits to the natural asset base, vulnerability to shocks, low physical and human capital, automation and digitalisation, weak competitiveness in specific areas, and lack of high-quality governance capacities.
- The SET programmes could support Cambodia's Economic Transformation by focusing on one or a combination of: (i) *Improving competitiveness to address loss of trade preferences*; (ii) *diversification*; (iii) *preparing for a digital economy*, (iv) *developing corridors*, (v) *agro-processing*, or (vi) *improving the quality and co-ordination of policy actions*. Decision criteria include: contribution to inclusive economic transformation and link to policy.

### Introduction

Cambodia was the 6<sup>th</sup> fastest growing country in the world growing 7.6% per year over 1994-2015. IT graduated to lower middle-income status in 2015. Poverty rates (national definition) fell from 47.8 per cent in 2007 to 13.5 percent in 2014, but two thirds living under USD 5.5 a day. The Gini coefficient fell from 40 in 1997 to 29 in 2012 (IMF, 2018). It achieved remarkable growth in garments exports and tourism, expanded agricultural land for rice, benefited from high commodity prices, and has witnessed growth in construction. It has seen some diversification into eg bicycles, footwear electronics and some higher value agriculture. Special Economic Zones played a key role in kickstarting manufacturing.

Cambodia also faces major challenges in the form of expected graduation from LDC trade preferences, automation and digitalisation, limits to the natural asset base, vulnerability to shocks, and lack of high quality governance capacities. This provides a more uncertain and potentially threatening context for Cambodia's future economic transformation which requires appropriate action for transformation and diversification.

### Current experiences and promising sectors for economic transformation

Figure 1 shows Cambodia has had limited economic transformation in over the past 2 decades, although manufacturing has remained substantial. Productivity gaps exist throughout economy (Figure 2) suggesting avenues for further transformation.

Fig 1: Economic structure (sector % of GNI), 2000-2017

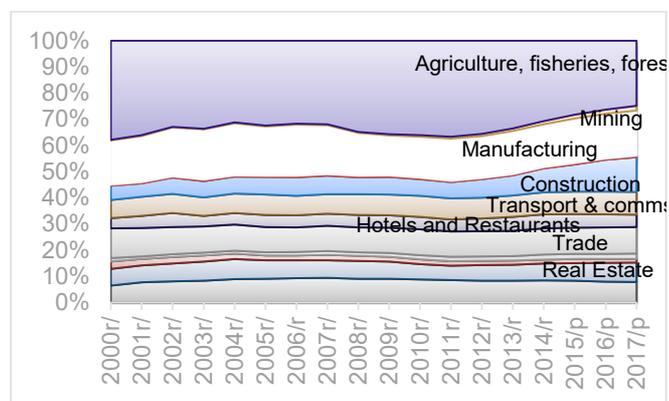
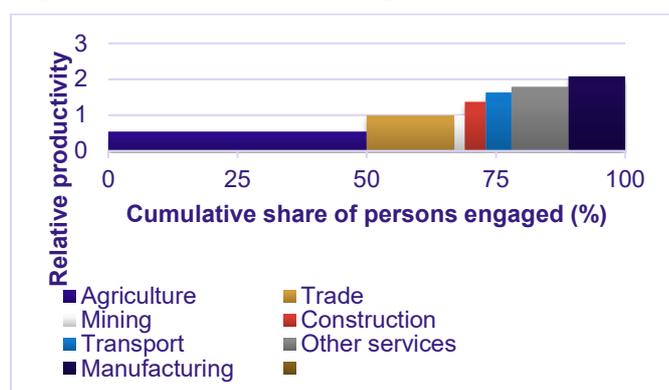


Fig 2: Labour productivity gaps, 2013



Source: SET, ILO, Cambodia National Statistics

## Constraints to economic transformation

The ADB, World Bank, ILO, UNDP and others have discussed a range of *economic* constraints, examples include

- **Physical capital.** Investment to GDP ratio is around 20%, compared to 30% in Asian Tigers.
- **Human capital.** Low secondary completion rates (43% in Cambodia in 2013, compared to 71% in LMICs), negative perceptions on TVET and tertiary education;
- **Competitiveness:** e.g. weak investment climate indicators on formalisation and business start-up; electricity access (51% lowest in ASEAN) and prices (35% higher than in Vietnam, Thailand, Myanmar).
- **Vulnerability.** Exports concentrated on a few sectors such as garments (70% of goods exports), rice and cassava, and tourism (70% of services exports), raising vulnerability. Export complexity gradually increasing, but not as fast as Thailand or Vietnam. FDI concentrated in a few Asian countries, exports to EU, US and Japan.
- **Governance:** bribery amongst highest in the world
- **Others:** high levels of vulnerable employment, limited social protection, volatile industrial relations; graduation from LDC status and rapidly rising wages; low agricultural productivity because of low irrigation, mechanisation, and fertilizer use; internet subscriptions and digital adoption at firm level low.

Studies have also suggested a range of governance, implementation and *political economy* constraints, e.g.

- Many policy instruments lacked **accountability and co-ordination and are poorly targeted.**
- Unclear and unexpected practices in **informal payments** (which are needed to obtain government licenses and permits); formal legal instruments to counter this have not resulted in major gains.
- Importance of **sector initiatives** help some groups but not others
- Changes in **international political economy**, e.g. EU/US trade preferences (5 countries take 50% Cambodian exports, 10 75%), role of China (responsible for 50% of FDI worth 1.5% of GDP), ASEAN (9% of trade in 2017, but 13% in 2009).
- Dynamics and sustainability in the **political settlement.**
- The **Industrial Development Policy 2015-2025** is an illustrative example of an important policy document; some aspirations are optimistic and require more specific follow up.

## Future focus? Six options

The SET programme employs analysis, convening and public affairs to support countries in their efforts towards inclusive economic transformation. Some constraints and measures to overcome constraints are well understood. The question is how to make the next step. This means making **choices**.

Table 1 highlights six options for further policy analysis. It includes broad links to inclusive economic transformation (ET), examples of current policy issues, and examples of existing studies. We seek guidance on where to focus.

Table 1: Options for further analysis

Area	Link to inclusive ET	Link to policy	Relevant studies
1. Fostering competitiveness in context of rapid trade preference erosion;	Manufacturing; 800.000 female garments jobs; rural-urban migration; poverty reduction	Policy urgency; EU DFQF, US GSP, US-China trade war, LDC status	Not on current shocks
2. Diversification into high value manufacturing / services;	Reduces vulnerability; productivity; and future job creation	Industrial Development Policy 2015-2025)	ADB, UNDP, UNIDO, CPAN
3. Preparing for a digital economy,	Digitalisation changes development models; competitiveness and inclusion;	New digital economy task force Skills	CDRI World Bank
4. Developing corridors & clusters	Ability to trade goods and services crucial for competitiveness	Attention to Sihanoukville and Bavet	JICA China
5. Promoting agro-processing	Linking (rural) agriculture to ET	NTMs; Rice; Rural infra	World Bank CPAN
6. Improving the quality and co-ordination of policy actions	Effective leadership, targeted co-ordination, state-business relations crucial for ET	Sector initiatives (garment, rice); business climate /licenses	ESID

## References

ODI and CDRI (2019) *Economic Transformation in Cambodia..Experiences, challenges and scoping future activities, Forthcoming SET Report.* ODI

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