



Cambodia's Economic Transformation

Scoping Roundtable Report

Alberto Lemma

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A joint SET (ODI) and CDRI event, supported by DFAT. This initial scoping roundtable was held on the 26th of February 2019 at the Raffles Hotel Le Royal, Phnom Penh, Cambodia.



Summary

- ODI and CDRI convened a roundtable meeting on 26th February 2019 attended by key government staff, experts, private sector and donor agencies. Its aim was to scope new activities to be undertaken by the SET programme in 2019. Presenters and participants discussed a range of key facets of Cambodia's transformation and suggested a number of avenues for further analysis.
- Cambodia needs to diversify its export base, move up the value chain and create jobs for the 70% of the population that is below the age of 30.
- Economic transformation is needed for sustained job creation and poverty reduction in the long run. It is a long-term process, which requires partners at the table to tackle some urgent issues.
- Cambodia cannot depend on primary agriculture and needs to move to the next level i.e. agro-processing and diversified exports, but there are many barriers.
- Cambodia has scored a 'hat-trick' over the last two decades. Its strong growth rate has reduced poverty and inequality dramatically.
- Cambodia has seen a shift away from agriculture since 2014, moving towards the industrial and service sectors, however the level of FDI in the industrial sector is still relatively low. A new push towards manufacturing is needed.
- Development efforts need to be more socially orientated, providing protections to the disadvantaged, pursuing balanced growth on the economic, social and environmental fronts.
- The Government needs to become more confident and see itself as a leader in the innovation space.
- We need to make choices on how economic transformation will work in Cambodia, think about what to focus on and what the next possible steps will be.
- The discussions placed emphasis on the quality of education and skills, e.g. through sectoral skills councils, on the challenges and opportunities in the digital economy, and on policy making.

Prospects for Cambodia's Economic Transformation

Introductory Remarks

Dr Chhem Rethy (Executive Director of CDRI) opened the discussion, stating the importance and need for economic transformation (ET) in Cambodia. The country needs to move further up the value chain, create jobs for the 70% of the population that is below the age of 30 and diversify its export base. It will be difficult, but the paradigm needs to shift and the government of Cambodia is working hard to ensure that this happens.

Dr Dirk Willem te Velde (ODI and Director of the SET programme) followed by arguing that economic transformation is needed for sustained job creation and poverty reduction in the long run. It is a long-term process, which requires partners at the table to tackle some urgent issues. There are concerns that if developing countries do not act to move towards the digital economy, they could stagnate – hence countries need to prepare for a Digital Economy. We should also think about inclusive economic transformation – a broad based transformation is needed to sustain transformation in the long term. The Supporting Economic Transformation programme has helped governments in Nepal, Myanmar and countries in Africa tackle these concerns.

Mr Lim Sovannara (Senior Research Officer of DFAT) stated that the Australian Government has increased its focus on economic growth in the South-east Asian region. Substantial engagement will begin in 2020. This meeting can help inform these activities and their supporting vision. He stressed the importance of ODI considering views of organisations such as CDRI to incorporate local aspects. There is growing bilateral engagement between Cambodia and Australia. It

emphasises the importance of a resilient economic strategy- which is key for economic diversification. It is imperative that Cambodia moves up the value chain and upgrades its technological know-how.

Finally, His Excellency Dr Phan Phalla, the Undersecretary of State for the Ministry of the Economy and Finance (MEF), presented the keynote speech. Dr Phan stated that the Ministry of the Economy and Finance leads on finance and approves disbursements to programmes especially when they can show they positively contribute to the Cambodian economy. The MEF is dealing with the practical issues of helping Cambodia move up the value chain, which means that it could take forward the findings of the project, even at this initial scoping stage.



Dr Phan expected Cambodian growth in 2019 to reach approximately 7% – although the agricultural growth rate has slowed down considerably, from 4%~5% in 2010/11 to about a 1.1% average growth rate over the last five years. Industry has grown at approximately 11% per year and so have services, around 7.3% per year. Some diversification in manufacturing has occurred, for example in the beverages, electrical components and automobile parts sub-sectors. Dr Phan stated that this was therefore a timely discussion as Cambodia cannot depend on primary agriculture and needs to move to the next level i.e. agro-processing and diversified exports. Dr Phan asked what industries, sectors and value-added chains need to be pursued for Cambodia in the next 20 years?

Dr Phan stated that as there is currently no clear path to move forward, it would be useful to address the question of 'how' to move ahead. Whilst the Cambodian garment sector has been a strong contributor to growth over the last 20 years, the question is 'what will be the next growth sector?' Cambodia has formulated several policies, like its industrial policies, that now need to be translated into practice. The important question isn't so much 'what' but more about 'how'. For example, the government knows that SMEs are important but there are no clear strategies in place to support them, whilst a clear roadmap is needed to ensure that the tourism sector moves up the value chain. Finally, Dr Phan mentioned that the Cambodian government is working hard to understand what the digital economy & industrialisation 4.0 would mean for Cambodia, looking to set up a future strategy to embrace such opportunities and harness the digital economy for Cambodia's benefit.

Presentation Session

Dr Dirk Willem te Velde discussed the [background note](#) 'Cambodia's Economic Transformation – scoping new activities'. There is significant potential for economic transformation, particularly in countries such as Cambodia. Cambodia's economic structure has changed a little over time. However, the share of the manufacturing sector, where labour productivity is higher than the national average, in the overall economy has remained the same in the last 2 decades. This is significant considering the premature de-industrialisation occurring in many other developing countries.

Cambodia has scored a 'hat-trick' over the last two decades. Its strong growth rate has reduced poverty and inequality dramatically. However, the concentration of manufacturing activities in the garments sector could cause vulnerability in the economy. Some diversification has occurred but not as much as we thought. If Cambodia is capable of diversifying into sectors (into the dense

part of the Product Space), it is much easier to diversify across other sectors, which could reduce vulnerability.

Te Velde discussed a range of options for further research. Cambodia is expected to graduate out of LDC status (sooner or later), which means losing a 12% margin for garment exports. There is, therefore, some policy urgency to tackle the loss of preferential trade agreements. The question then becomes how to coordinate actions effectively to respond to changes in the external policy environment, for example diversifying export markets. Diversification into higher value manufacturing and services is also important.

ODI analysis suggests that change is coming, hence Cambodia needs to prepare for the digital economy. Competitiveness can be enhanced by harnessing the digital economy. Getting the business environment right, and getting skills right - these are preconditions to successfully harnessing the digital economy. Corridor development is important since you still need a good transport system to move goods within and out of the country, even if you move towards a digital economy. The promotion of agro-processing is important, linking the rural sectors to economic transformation – and the role of non-tariff measures to promote agricultural exports. The final option is improving the quality and coordination of policy actions. This can help distinguish successful from less successful countries – making sure that you are able to provide effective leadership.

Dr. Ouch Chandarany from CDRI presented her [work](#) 'Prospects for Cambodia's Economic Transformation: Scoping new activities'. Cambodia started a shift away from agriculture from 2014, moving towards the industrial and service sectors, however the level of FDI in the industrial sector is still relatively low. Breaking down FDI by sub-sector, it is possible to note emerging investments in electrical components, auto parts and food processing activities. In terms of employment, ILO estimates of employment by sector show a shift away from agriculture into service sectors, with employment in the service sector now accounting for more than 40% of total employment in Cambodia. Data from Cambodia's Socio-Economic Survey shows a similar trend with employment decreases in agriculture and increases in services, however there has been little change over time in the proportion of skilled and professional sector workers in the country.

In terms of export diversification, there has been a slight increase in light manufacturing and agricultural product exports, but exports remain concentrated in garments. Thailand has concentrated more on light manufacturing and agriculture, whilst Vietnamese exports are more diversified. Hence the Vietnamese diversification model would provide a better example for Cambodia. There are several areas that Cambodia could focus on. One priority is that the country should produce a higher skilled workforce, focussing on STEM education, building university and industry linkages and building partnerships between the private sector and education. The second priority is that as R&D expenditure is low in the country, more focus should be placed on technology and innovation. Technological adoption by firms is still very low, this needs to increase to increase productivity. The third priority area is the policy & regulatory framework. The lack of coordination between government departments is an issue and they should learn how to improve their coordination processes and monitoring over time.

Open Discussion

The event proceeded with an open discussion amongst private sector, senior government officials, experts and donor agencies. The discussion opened with Ms Eng Sopheap (CAMFEBA) highlighting the skilled workforce issue. CAMFEBA is forming four Sectoral Skills Councils for the light manufacturing, electrical components, construction and automobile component sectors. One of the roles of the councils is to link students with industry, with more focus on work-based learning. The initiative should be able to begin addressing the skills mismatch. A key priority will be skills development, understanding what the private sector wants and what is currently being provided by the schools.

HE Tuon Thavrak (Ministry of Planning) agreed that in order to realise economic transformation, Cambodia should make the best use of prevailing opportunities. Development efforts need to be more socially orientated, providing protections to those that are disadvantaged and vulnerable. In addition, it is also important to pursue balanced growth on the economic, social and environmental front i.e. meeting the SDG challenge to ensure that development efforts are sustainable. Inclusive growth needs to be ensured so that everyone is given the opportunity to participate in the development process and so that everyone has the chance to benefit from growth.

Ms Eng Socheath (CDC) shared some ideas. The first was about the alignment between policy, coordination and monitoring, which is a consistent problem, for example, the alignment between the government and the private sector or/and civil society. She also shared ideas on the effectiveness and efficiency of the policy implementation process – coordination is needed when ministries have their own policy priorities. The world is currently at the 'Industry 4.0' stage, hence it is important to move discussions forwards on what investors and government think of the current industrialisation process, with emphasis on how to move from 'Industry 2.0' to 'Industry 4.0' in Cambodia. What will be the critical factors that will trigger economic transformation in Cambodia?

Mr Narin Sok (UNIDO) continued the discussion, noting that there needs to be inclusion of programmes that develop the entrepreneurial spirit of Cambodians i.e. how to overcome the lack of 'soft skills' amongst the Cambodian work force. On the policy coordination and monitoring level, there are always tendencies to focus at the national level but the implementation of policies is at the sub-national level (i.e. provincial) hence more focus needs to be placed on how sub-national actors can implement policy. It may also be useful to provide attention on building backward/forward linkages (reflected in government IDP policy). We are still struggling to understand what these are and how to go about it as there still seems to be a lack of interaction between local and foreign companies in terms of how local companies could supply goods to foreign companies. Better access to markets for Cambodian products needs to be supported by enhanced infrastructure. There is currently under-investment in quality standards infrastructure, for example ISO accredited laboratories.



Mr. Chan Sophal (Center for Policy Studies) argued that when Cambodia starts producing something, it must be as competitive as its neighbours, Vietnam and Thailand, given how porous its borders are. This is a challenge. In the past 20 years, agricultural investment has been more about pro-poor growth, however this may not have contributed sufficiently to economic transformation as it does not target productivity. Agriculture needs to become more commercial

but the policies to support this are not in place yet as the government needs to improve its understanding of what modern inputs are required for agriculture and reduce its tax burden accordingly. The transport system also provides a challenge, it is expensive to export from the country. Finally, Cambodian branding is also limited, and more support needs to be provided.

Mr Nick Beresford (UNDP) mentioned three important issues. Policy documents have not been as effective as required. There is a need to move from writing policy to action and experimentation to ensure more learning by doing. A balanced model is important i.e. health, education, the environment so we need measurement systems that are more balanced to see if ET works for all people or only for a few people in Cambodia. Industrial policy used to be taboo, but we now have a much more practical discussion where the Government is a central player, however it needs to become more confident and see itself as a leader in the innovation space and partner to the

private sector. It is a matter of working with the existing institutions, and experimenting, rather than waiting for ideal institutions. Social protection is an important tool to build the base on which a prosperous middle class can emerge in Cambodia. It should be perceived as an investment rather than a hand-out.

Ms Yong Sarah Zhou (IMF) stated that the objective is to achieve strong sustainable and inclusive growth in Cambodia. Cambodia has made progress but what are the next steps? Cambodia can learn from other South East Asian nations. Industrial diversification and export led growth are key. No economy can move away from low incomes without industrialisation. If productivity increases so does per capita income, hence the country needs to move towards higher productivity sectors like industry. Cambodia's industrial share is not declining but it is stagnant and it is still a low skill society. Industry needs to be able to absorb jobs, otherwise per capita incomes will not grow. Globalisation means that capital is mobile, so Cambodia needs to create the basis for capital to move into the country i.e. skills. Cambodia also needs to address binding governance constraints.

Finally, the World Bank (Miguel Sanchez) mentioned that the high cost of formalisation in Cambodia is creating a dual economic system, informal domestic SMEs and formal large foreign companies.



Closing Remarks

DFAT took the floor, thanking everyone on behalf of DFAT. DFAT is proud to work with CDRI and ODI. When looking at economic transformation, it is important to not just consider the economic aspect but also look at how benefits accrue to people across the economy. What does this mean for sectors where the poor work? There are still less than 2/3rd of people in poverty so the question we need to look at is who will be the beneficiaries of economic transformation?



Dr Ouch added two more points. The first is that when we talk about the comparative advantage of Cambodia, it is well known for its low labour costs, hence we should think about how we should support a new comparative advantage for Cambodia. The second point is that 65% of the population is under the age of 30, hence the country still has 20 years where its youth can contribute to growth and transformation. Hence the country needs to take advantage of this labour 'boon' and point the labour force towards work in more productive sectors.

Finally, Dr te Velde stated that the discussion covered a range of issues, including inclusive and sustainable growth, multiple sectors and the factors that drive competitiveness, barriers to formalisation and a focus on skills. Now is when we need to make choices on how economic transformation will work in Cambodia, hence we need to think about what overlapping areas to focus on e.g. the quality of policy making, the institutional framework and what the next possible steps will be.

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