



Economic transformation in Cambodia

Prospects, challenges and avenues for further analysis

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Executive summary

Cambodia has been the sixth-fastest growing country in the world over the past two decades and it has reduced poverty and inequality significantly. It graduated to lower-middle-income country (LMIC) status in 2015. It has achieved remarkable growth in exports of garments, attracted record numbers of tourists, expanded agricultural land leading to significant exports of rice, benefited from high commodity prices and recently witnessed a construction boom. It has also shown signs of diversification into bicycles, footwear and, to some extent, maize, vegetables, sugar and palm oil. Special economic zones have played a crucial role in kickstarting manufacturing.

However, Cambodia currently also faces major challenges to its hitherto successful growth model in the form of expected graduation from least developed country (LDC) trade preferences; limits to the natural asset base; vulnerability to shocks; and lack of high-quality governance capacities. Cambodia also faces new prospects and challenges owing to automation and digitalisation. These factors provide a more uncertain and potentially threatening context for Cambodia's future economic transformation, which requires appropriate action for transformation and diversification.

Scholars and institutions agree on a range of *economic* constraints to transformation:

- *Physical capital.* The investment to gross domestic product (GDP) ratio is around 20%, compared with 30% in the Asian tigers.
- *Human capital.* There are low secondary completion rates (54% in Cambodia in 2017, compared with 77% in LMICs) and negative perceptions of technical and vocational education and training and tertiary education.
- *Competitiveness.* The country is weak on investment climate indicators related to formalisation and business start-up; and electricity access (51%, the lowest in the Association of Southeast Asian Nations (ASEAN)) and prices (35% higher than in Vietnam, Thailand and Myanmar).
- *Vulnerability.* Exports are concentrated in a few sectors, such as garments (70% of goods exports), rice and cassava and tourism (70% of services exports), raising vulnerability. Export complexity has been increasing gradually but not as fast as in Thailand or Vietnam. Foreign direct investment (FDI) is dominated by a few Asian countries, especially China, and Cambodian exports are concentrated to the EU, the US and Japan.
- *Governance.* Corruption is among the highest in the world, and coordinating mechanisms around certain policies are not very effective.
- *Others.* There are high levels of vulnerable employment; social protection is limited; industrial relations are volatile; graduation from LDC preferences and rapidly rising wages are a challenge; agricultural productivity is low because of low irrigation, mechanisation and fertiliser use; and internet subscriptions and digital adoption at firm level are limited.

Studies also suggest a range of governance, implementation and *political economy* constraints.

- Many policy instruments lack accountability and coordination and are poorly targeted.
- There are unclear and unexpected practices in informal payments (which are needed to obtain government licences and permits); formal legal instruments to counter this have not resulted in major gains.
- Sector initiatives help some groups and some sectors but not others.
- There have been changes and new dependencies in the international political economy. There is major dependence on EU and US trade preferences. Only five of these countries take 50% of Cambodian exports, and ten countries take 75%. There is increased dependence on China, which is responsible for more than 50% of FDI. ASEAN has lost in importance, responsible for 9% of Cambodia's trade in 2017, but 13% in 2009.
- Sustainability in the political settlement is weak.

While the constraints to transformation (defined as moving resources from low- to high-productivity activities), and the measures to overcome constraints (human capital, infrastructure, governance), are well known, the question often left unanswered is how to make the next step.

This scoping paper introduces a number of options for further immediate policy analysis:

1. *improving competitiveness in the context of graduation and loss of trade preferences*
2. *targeting diversification into sectors beyond the currently successful activities*
3. *preparing for a digital economy: job creation, manufacturing and a digital economy*
4. *developing corridors*
5. *linking agriculture to the transformation: agro-processing*
6. *improving the quality and coordination of policy actions*

Our discussions on Cambodia's future transformation paths centred on the quality of skills (including quality and completion in secondary education; issues on science, technology, engineering and mathematics; industry–university linkages); the impact of the digital economy on transformation models based on manufacturing; and the quality and implementation of policies.

We conclude that a crucial concern commonly expressed at present relates to gaining a better understanding of the role of appropriate and good quality education and skills in preparing for a digital economy. A set of activities around the following issues would significantly help advance discussions on digitalisation and inclusive ET in Cambodia at this time:

- *Development models in a digital economy.* What are the implications of the digital economy for Cambodia's development model? Which type of jobs in which sectors and activities are promising and which ones are under threat?
- *Political economy and inclusion in the digital economy.* What population groups would benefit and lose from advances in the digital economy and how would they be able to affect decision-making to prepare for a digital economy? For example, what would be the effects on the 700,000 young women in garments; what are the opportunities for those with non-routine cognitive skills; and what are the incentives for policy-making?
- *Quality skills for the poorest and young and the digital economy.* What skills are needed for a future inclusive digital transformation, and what does Cambodia need to do to get there?
- *A policy framework for the digital economy.* What would be a comprehensive policy agenda through which Cambodia can support ET and job creation?

Acronyms

ADB	Asian Development Bank
ASEAN	Association of Southeast Asian Nations
CDRI	Cambodia Development Resource Institute
CPAN	Chronic Poverty Advisory Network
CPP	Cambodian People's Party
DFQF	duty-free quota-free
EBA	Everything But Arms
ECI	Economic Complexity Index
ESID	Effective States and Inclusive Development Research Centre
ET	economic transformation
EU	European Union
FDI	foreign direct investment
GDP	gross domestic product
GNI	gross national income
GSP	Generalized System of Preferences (US)
GSP+	developing country component of EU Generalised System of Preferences
ICT	information and communication technology
ILO	International Labour Organization
IMF	International Monetary Fund
ITC	International Trade Centre
JICA	Japan International Cooperation Agency
LDC	least developed country
LMIC	lower-middle-income country
NEA	National Employment Agency
NTM	non-tariff measure
ODI	Overseas Development Institute
SET	Supporting Economic Transformation
SEZ	special economic zone
SSEZ	Sihanoukville Special Economic Zone
TVET	technical and vocational training and education
UK	United Kingdom
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Programme
UNIDO	United Nations Industrial Development Organization
US	United States
WTTC	World Travel & Tourism Council

1 Introduction

Over the past two decades, Cambodia has achieved remarkable growth and reduced poverty and inequality significantly. It graduated to lower-middle-income country (LMIC) status in 2015. It has achieved remarkable growth in exports of garments, attracted record numbers of tourists, expanded agricultural land to export rice, benefited from high commodity prices and recently witnessed a construction boom.

But Cambodia also faces challenges to its growth model in the form of expected graduation from least developed country (LDC) trade preferences (this is expected to happen in 2024 with a three-year transition phase); dependence on a few sectors (such as garments and tourism) and countries (such as China); automation and digitalisation; limits to the natural asset base; and lack of high-quality governance capacities. This sets a difficult context for Cambodia's future economic transformation (ET).

This scoping paper examines current experiences and promising sectors for ET (Section 2); ET (Section 3); policies to enhance ET (Section 4); options for further analysis (Section 5); and conclusions, including suggestion for further analysis (Section 6). The Appendix includes supplementary statistical analysis and other relevant information. A Cambodia Development Resource Institute (CDRI)–Overseas Development Institute (ODI) roundtable on 26 February 2019¹ discussed the ideas contained in this scoping paper, and we have taken comments into account.

2 Current experiences and promising sectors for economic transformation

This section reviews key messages from existing reports and data analysis.

2.1 Transformation experiences so far

We discuss transformation experiences by reviewing a variety of sources and by presenting a limited set of new analyses.

The World Bank (2017) argues that Cambodia has seen some remarkable achievements. Average growth was 7.6% per year over 1994–2015 (the eighth-fastest growing country in the world). Poverty rates (national definition) fell from 47.8% in 2007 to 13.5% in 2014, although two thirds remain living under \$5.5 a day. The Gini coefficient fell from 40 in 1997 to 29 in 2012 (IMF, 2018).

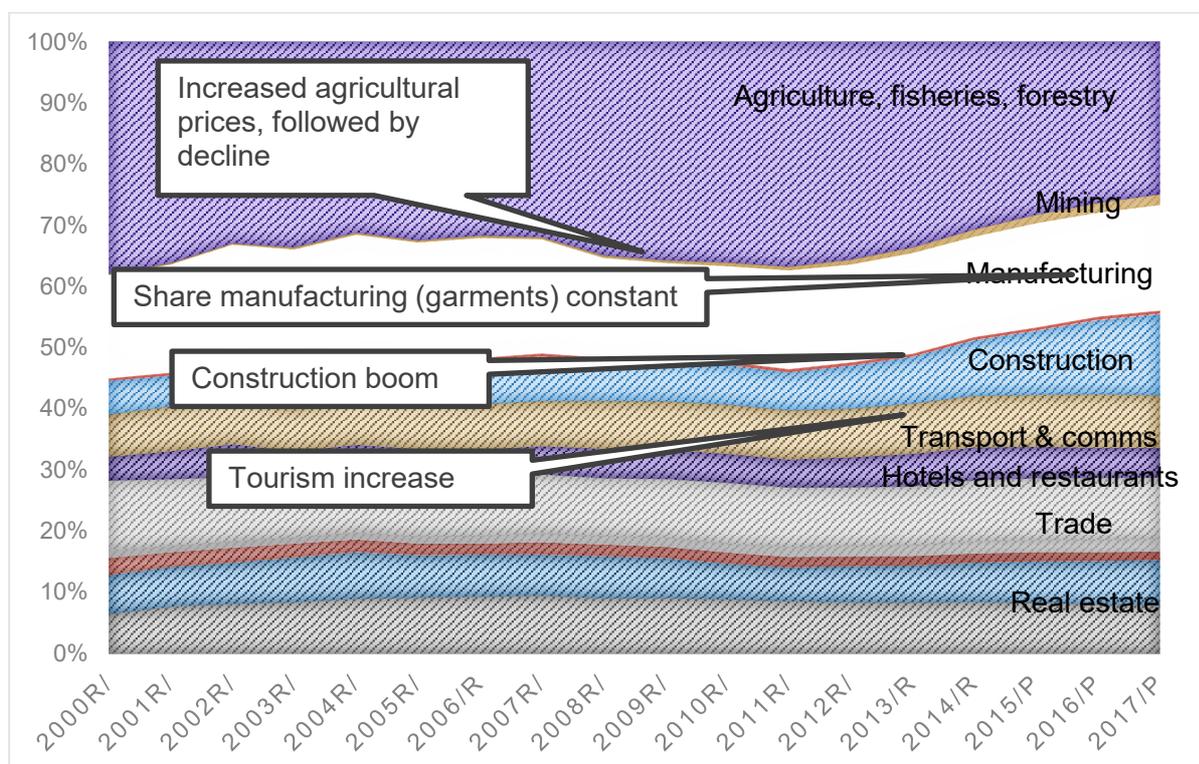
Cambodia's exports grew faster (18% per year) than those of Vietnam or Bangladesh. Gross national income (GNI) per capita tripled from \$300 in 1994 to \$1,070 in 2015 (when it became an LMIC). The country created 3.6 million new net jobs in industry and services and 0.7 million

¹ For a workshop report and background note, see <https://set.odi.org/february-2019-prospects-economic-transformation-cambodia-scoping/>

in agriculture over 1994–2015. It achieved 3.5% annual labour productivity growth between 1993 and 2014, although this is lower than that of Vietnam (4.7%). Cambodia’s female labour force participation (79% in 2014) is among the highest in the world.

Despite these remarkable achievements, Cambodia’s economic structure has shifted only marginally over the past two decades, though with a few notable developments (Figure 1). The share of agriculture in GNI (at factor prices) declined from 38% in 2000 to 25% in 2017 but increased in the period immediately after 2008, when commodity prices kept high (which supported poverty reduction). The share of the manufacturing sector, and that of garments within it (which now employs some 800,000 people), has remained constant at 17% over time. The share of construction in gross domestic product (GDP) has doubled, from 6% in 2011 to 13% 2017. The share of most other services sectors has remained constant in the past few decades (with the exception of tourism, which has also increased dramatically).

Figure 1: Cambodia’s economic structure, 2000–2017



Source: Cambodia National Statistics

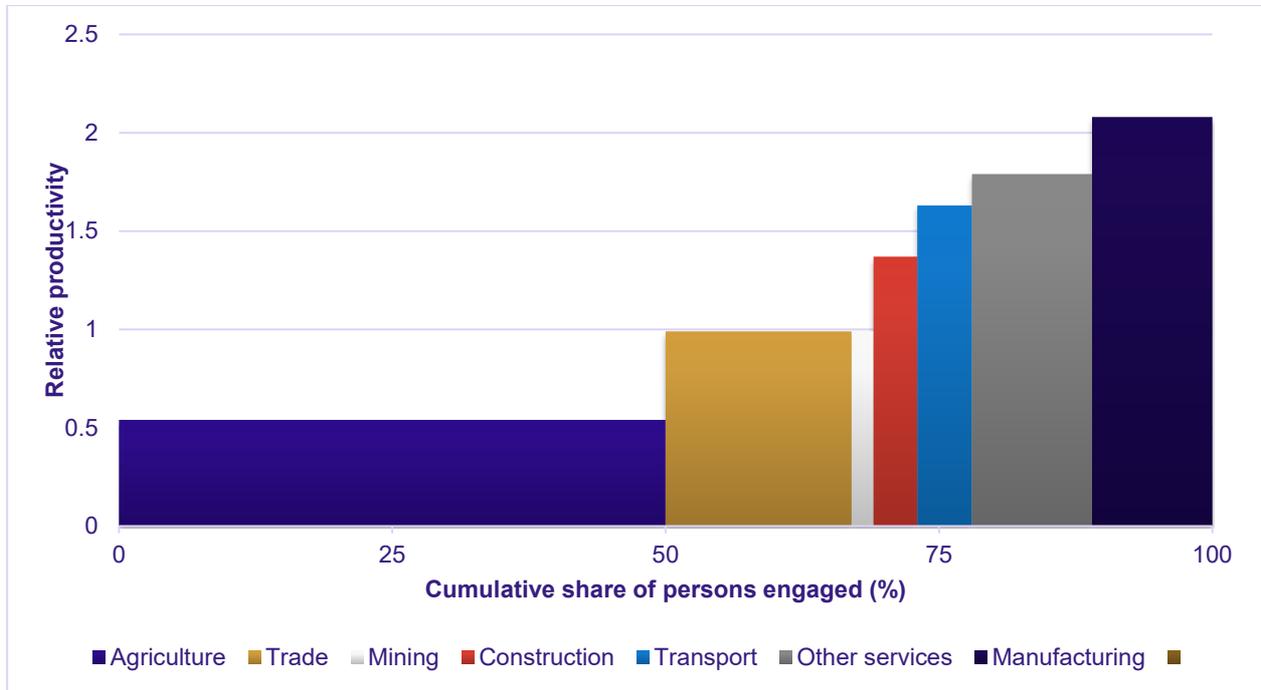
There is much opportunity in moving resources from low- to high-productivity sectors. For example, productivity in manufacturing is four times higher than in agriculture (Figure 2). Shifting resources away from low- to high-productivity sectors is one way to pursue transformation. It is also important to support within-sector productivity change, for example by moving to high-value crops and beyond rice.

Initial data do not suggest major movements in the skilled share of employment, though there has been movement from one type of unskilled to another type of unskilled workers. Figure 3 shows that employment in agricultural occupations has decreased but in services and clerical workers it has increased. But there has not been a marked change in professional, technical and managerial occupations.

Figures A3 and A4 in the Appendix show the concentration of Cambodia’s goods export basket in garment products. There is also concentration in foreign direct investment (FDI) (see Table A1). Some 90% of FDI inflows are from Asia, especially from China in recent years (see Box 1).

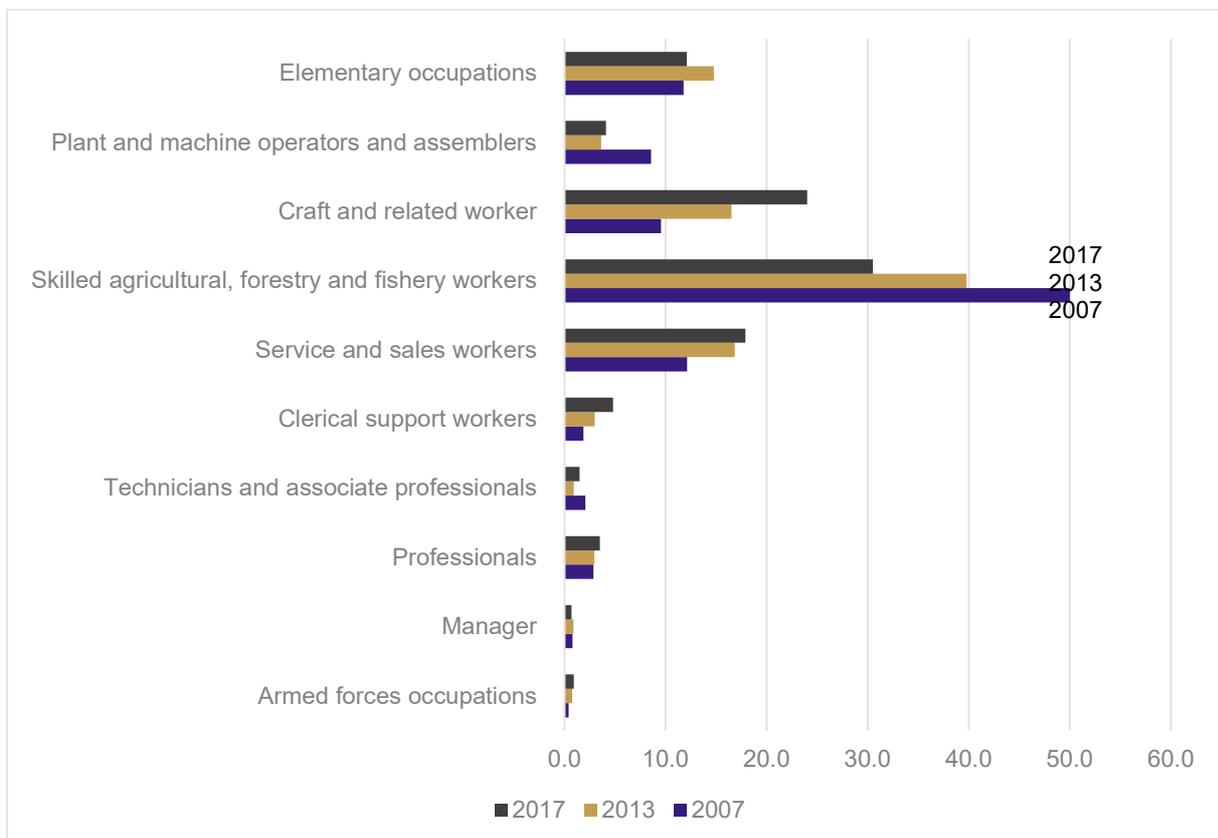
The share of manufacturing FDI has declined, while inflows into banking and construction have increased (Figure A5). Fortunately, the real effective exchange rate has remained stable in the past four years, as shown in Figure A6 (IMF, 2018).

Figure 2: Cambodia’s economic structure, 2013



Source: SET

Figure 3: Employment by occupation, 2007, 2013 and 2017



Source: SET and Socio-Economic Survey 2017

Figure A1 in the Appendix further shows that Cambodia's product space has become more complex, but it has some way to go to reach that of Vietnam and Thailand. Cambodia's value on the Economic Complexity Index (ECI) is also much lower (Figure A2). It is important for Cambodia to diversify into a more diversified set of products, particularly not only those products that are already exported by a large range of other countries.

Box 1: China's role in transforming Cambodia – Sihanoukville

There is a long history of involvement of China in Cambodia, but more recently there has been a step-up. This is most notable in the Sihanoukville area. China has been active in building, developing and populating the Sihanoukville Special Economic Zone (SSEZ) which has already attracted 160 firms (mainly from China, but also others, such as from Ireland), with plans to have 300 firms in the coming few years. There are plans to replicate the Shenzhen Special Economic Zone. Data for 2018 suggest SSEZ is responsible for some \$400mn worth of exports (and \$1bn of investment),¹ especially in garments and furniture exports. China has also invested heavily billions of dollars in the construction of hotels and casinos, which have rapidly transformed Sihanoukville into a large hotel resort area dominated by Chinese investment.

While China's involvement brings major opportunities for Cambodia, there are also concerns. For example, while the SSEZ provides excellent insights into how to build up a successful SEZ in less than 10 years, there are also worries that Chinese (and other) firms invest in SSEZ only to use low-cost labour without any incentives to upgrade the workforce or build meaningful linkages with the rest of the economy. One Chinese-owned garment firm expanded much faster in Myanmar than in Cambodia when Cambodia's minimum wages increased rapidly.

Chinese investment has fuelled a construction boom, and Chinese FDI is by far the main source of inward FDI. This construction investment has led to Chinese-owned hotels and casinos, Chinese immigration and tourism. Much investment is private investment rather than loans to the public sector. Chinese FDI in construction has also increased local prices and the cost of living and fostered insecurity around the gambling sector. The area has become very dependent on trade and investment with China and on Chinese managers and workers. This may lead a discrepancy between the current profile of Chinese investments and Cambodia's long-term objectives, in the absence of complementary actions to link Chinese FDI more with an upgrading of the local economy.

Source: Interviews in Sihanoukville

2.2 Promising sectors

There are various ways to examine promising sectors for the future (McMillan et al., 2017), such as revealed comparative advantage, product space analysis, multiplier analysis and productivity analysis. Some of these have been undertaken for Cambodia, but not all.

Several studies discuss promising sectors. For example, Chhair and Ung (2016) suggest the following are sunrise industries: mining, textiles, food, non-metallic manufacturing and electricity, gas and water. Wood and paper industries and construction are considered sunset industries. Of course, this may not account for recent Chinese investment in construction. There has also been a rapid increase in investment in casinos in Sihanoukville and Phnom Penh. Recent news suggests NagaCorp is planning a new casino worth \$3.5 billion, or a sixth of Cambodia's GDP, to cater for the rapid increase in Chinese tourists to 2 million in 2018 (Turton, 2019). Not all construction investments will help Cambodia's ET.

ODI and the United Nations Development Programme (UNDP) (2009) focus on agriculture (including rice, cassava, rubber, palm oil and vegetables), garments, tourism, information and communication technology (ICT) and construction.

The World Travel & Tourism Council (WTTC) (2018) finds that tourism in Cambodia contributes 14.1% of GDP in 2017 and 13.6% of total employment directly. Visitor exports generated 29% of total exports (goods and services) in 2017.

The World Bank and the Asian Development Bank (ADB) (2015) argue that Cambodia remains concentrated in rice, garments, tourism and construction. Some diversification has happened into bicycles, footwear and, to some extent, maize, vegetables, sugar, palm oil and plywood. Cambodia already exports a number of promising products, such as machinery, metallurgy, chemicals and furniture (as revealed by product space analysis).

The United Nations Conference on Trade and Development (UNCTAD) (2017) argues there are significant opportunities for e-commerce in Cambodia. Cambodia has the highest internet connectivity growth in the Asia-Pacific region and a very young population. Enhanced connectivity will continue to provide opportunities for Cambodian businesses to reach new consumers. By 2017, the potential clientele was already 15,000 consumers for most e-commerce ventures. The International Trade Centre (ITC) (2018) suggests that e-commerce demand is growing faster in Cambodia (and Bangladesh) than in Laos, Myanmar or Nepal. Beauty and personal care products feature prominently in Cambodia. Interestingly, while garments accounted for 70% of its goods exports, they accounted for only 2% of e-commerce. The number of Alibaba e-commerce users increased five times faster than GDP growth.

More detailed analysis is required to have a full assessment of promising sectors for economic transformation and employment. However, this quick overview already suggests a reasonable consensus on promising sectors around non-traditional agriculture, value-add manufacturing and selected services. Other relevant questions centre around the constraints to developing these sectors further.

3 Constraints to economic transformation

The literature discusses a range of common economic constraints and political economy issues.

3.1 Economic challenges

The World Bank (2017) discusses a range of challenges faced by Cambodia, including graduation from LDC status, which will reduce trade preferences and donor funding; rapidly rising wages, which is causing challenges for labour-intensive sectors; and a relatively low gross fixed capital formation/GDP ratio at 20%, lower than that of neighbours or Thailand in the boom years. There is also concentration in a few activities such as garments (70% of merchandise), exports and tourism (70% of services exports); weak competitiveness on indicators such as formalisation and business start-up; electricity prices that are 35% higher than in Vietnam, Thailand and Myanmar; low secondary completion rates (43% in 2013 compared with 71% in LMICs); negative perceptions of technical and vocational training and education (TVET) and tertiary education; and bribery that is among the highest in the world.

ODI and UNDP (2009) discuss general and specific factors (we have incorporated some of these in Table 2). The World Bank and ADB (2015) summarise the constraints as follows: infrastructure remains inadequate and unreliable, education attainment and skills are subpar,

governance is weak and savings rate are still low. The first constraint is human capital and decent employment, covering early childhood development, low secondary completion rates, low expenditure on education and failure to upgrade technical skills. Second, infrastructure is a constraint: there is low access to electricity (the lowest in the Association of Southeast Asian Nations (ASEAN), at 51% coverage for households), tariffs are high and supplies are unreliable. Rural roads need upgrading, railways are weak and there is a low rate of rural access to sanitation. There is also a lack of diversification, with Cambodia highly dependent on a few export sectors and few changes in Cambodia's rudimentary export basket.

ADB and the International Labour Organization (ILO) (2015) undertake an employment diagnostic and highlight inadequate fiscal space to finance infrastructure and human capital; low domestic investment, at 20% of GDP (against 30% in the Asian tigers) and heavily depending on FDI; quality problems in education; demographic shifts; inadequate skills in the workforce; low agricultural productivity because of low irrigation, mechanisation, fertiliser use and low-value rice; and high levels of vulnerable employment, limited social protection, improving industrial relations.

On ICT challenges, the World Bank (2018b) finds that, while mobile penetration has surged in Cambodia in recent years, it lags behind in internet subscriptions (especially fixed broad band). Digital adoption at firm level is also low, with only a quarter of firms having a web presence. Digital government is fragmented. UNCTAD (2017) argues that e-commerce remains limited so far, and Cambodia ranks 119 out of 137 on the 2016 UNCTAD Business-to-Consumer E-Commerce Index, as e-commerce is hampered by small market size, payment issues, poor logistics and low internet penetration in rural areas. ITC (2018) finds that Bangladesh introduced online banking in 2009 but Cambodia only in 2016.

3.2 Political economy

There are a number of relevant discussions around the quality of policy-making for inclusive development and the institutional framework supporting it.

For example, the World Bank (2009) reviewed sector strategies and suggests that many instruments lack accountability and coordination and are poorly targeted. ADB (2015) highlights failures in governance and suggests that improvements are required around informal payments (which are needed to obtain government licences and permits), as the formal legal instruments to counter this have not resulted in major gains.

Chhair and Ung (2016) argue that sector initiatives could play a useful role. The 1994 law on investment was followed by the establishment of the Council for the Development of Cambodia and an increase in FDI inflows. The Garments Manufacturers Association in Cambodia has provided good enough governance in garments, but other sectors, such as rice and food processing, have not enjoyed this, though the rice export policy helped later on. The government has established a Government Private Sector Forum.

The Industrial Policy Plan 2015–2025 is an important policy document aimed at steering Cambodia's efforts to industrialise and transform. There are some good advances, but some aspirations are overly optimistic. There are also discussions around who should implement many of the actions and whether Cambodia can develop a body that has the same powers as, for example, the Economic Development Board in Singapore.

Kelsall and Heng (2014) argue that, between 1998 and 2013, Cambodia's political settlement was based on a balance between technocrats and rent-seekers in Hun Sen's governing coalition, with the former facilitating employment-generating export-oriented industrialisation whereas the latter channelled political rents to the ruling class, some of which were

subsequently used for fighting elections. Although this arrangement enabled rapid growth, relatively high levels of social development and successive Cambodian People's Party (CPP) election victories, a combination of population displacement, underemployed educated youth and a more united political opposition was rendering it increasingly untenable.

Post 2015 saw the CPP working harder to neutralise the political opposition while pivoting more definitively towards China. Growth and poverty reduction have continued apace while some of the wilder aspects of Cambodian capitalism, such as economic land concessions, appear to have been partially tamed. However, what the shift has done for Cambodia's longer-term transformational prospects needs to be investigated more thoroughly. In particular, it remains to be seen whether Cambodia has the wherewithal to escape the middle-income trap that is so prevalent in the region, under which the dynamic potential of the largely foreign-owned exporting sector fails to spread convincingly throughout the domestic economy because of the political connections of domestic firms and the lack of foreign firms to link with the domestic economy.

Prime Minister Hun Sen and the CPP were re-elected in July 2018, as the Supreme Court dissolved the opposition party. This has led the EU to threaten to withdraw trade preference on human rights grounds. The government of Cambodia has taken some action to improve the situation.

4 Policy suggestions

A number of common policy options to help transform Cambodia emerge from existing reports.

ODI and UNDP (2009) include policy suggestions at the national and sector level. At the national level, Cambodia needs to consider four areas. First, it needs a more pro-active human resources policy, which is more coordinated with the private sector. Second, it needs to rethink industrial policy using a more targeted approach in investment policy (including the use of SEZs). Third, it needs targeted infrastructure policy. And finally, it needs an appropriate regulatory framework, with non-discretionary implementation of rules, more efficient laws, and clearer *Prakas*.

ADB (2015) discusses a range of policy options, including fostering human development (healthcare, nutrition; quality secondary education and completion; TVET accreditation), infrastructure development (electricity generation, rural roads and rural sanitation); and improving governance (strengthening the anti-corruption unit, improving legal capacity to settle commercial disputes).

The World Bank (2017) discusses four pathways and associated policy suggestions. The first is to aim for export competitiveness and diversification for sustained growth and jobs. Policies include reducing the cost of firm establishment and operation (e.g. Single Window for trade facilitation, business environment); public and private investment in infrastructure and machinery (develop manuals and bond markets); regulation and supervision of the financial sector (bank supervision and financial safety net); and agricultural modernisation (knowledge throughout value chains, managing product quality).

The second pathway is around creating human assets for increased mobility and shared prosperity, through skills (secondary and higher education, including accreditation issues); nutrition in the early years; and protecting households from shocks. Third, it could foster sustainable growth by investing in natural capital, which includes issues such as urban planning and decentralised sanitation. Finally, it could address cross-cutting issues such as public administration and financial management.

The World Bank (2018b) argues that, in order to benefit from the digital economy, Cambodia needs to invest in infrastructure and complementary regulations, skills and institutions. More specifically, it should (i) enhancing spectrum reallocation and infrastructure sharing among mobile providers; (ii) design and implement a digital skills ready strategy; (iii) implement laws in e-commerce, cybersecurity and data protection; and (iv) build a digital government strategy. Cambodia has a long way to go in each of these areas, but it has to take this issue seriously as the rest of the world is not going to stand still.

We summarise the numerous policy suggestions in Table 1 according to whether they are general enabling or target and specific (columns) and whether they support structural change or are mainly within sectors.

Table 1: Cambodia’s public actions for economic transformation: illustrative examples

	General enabling factors	Targeted interventions (sector-specific)
Public actions to support structural change	<ul style="list-style-type: none"> Reducing cost of firm establishment and operation (e.g. Single Window for trade facilitation, business environment) An appropriate regulatory framework with non-discretionary implementation of rules, more efficient laws and clearer <i>Prakas</i> Regulation and supervision of financial sector (bank supervision and financial safety net) Public administration reforms Strengthen anti-corruption unit, improve legal capacity to settle commercial disputes. Laws on e-commerce 	<ul style="list-style-type: none"> Rethink industrial policy using a more targeted approach in investment policy (and SEZs) Public and private investment in infrastructure and machinery (develop manuals and bond markets) Digital skills ready strategy Industrial relations and skills for garments Internet exchanges Targeted investment promotion
Public actions to support within-sector productivity growth	<ul style="list-style-type: none"> Pro-active human resources policy, which is more coordinated with the private sector Skills, secondary and higher education (accreditation) Electricity, rural (access) roads and sanitation 	<ul style="list-style-type: none"> Agricultural modernisation (improve knowledge throughout value chains, manage product quality) Land titling for agriculture Comprehensive construction code Open skies Vocational training for trades (electricians, etc.) and professional training (architects, etc.)

Source: Current scoping work based on categorisation in McMillan et al. (2017)

5 Options for further analysis

Over the past two decades, Cambodia has grown fast, reduced poverty significantly and reduced inequality. It has also shown signs of diversification and has established a large garment manufacturing base. But there are some immediate and long-term challenges to Cambodia's ET pathways, which require policy action.

The SET programme aims to support countries in their efforts towards ET. Some constraints and measures to overcome them are well known, but the question is how to make the next step. This means making choices.

We discuss six options for further policy analysis (for a summary of the workshop findings see Box 2).

Box 2: Summary of CDRI–ODI Scoping Workshop, 26 February 2019, Phnom Penh

- CDRI and ODI convened a roundtable meeting on 26 February 2019 attended by key government staff, experts, the 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.
- ET is needed for sustained job creation and poverty reduction in the long run. It is a long-term process that requires partners at the table to tackle some urgent issues.
- Cambodia cannot depend on primary agriculture and needs to move to the next level – that is, agro-processing and diversified exports – but there are many barriers.
- Cambodia has scored a 'hat-trick' over the past 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 services 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 oriented, 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 ET will work in Cambodia and 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, for example through sectoral skills councils, on the challenges and opportunities in the digital economy and on policy-making.

5.1 Improving competitiveness in the context of (immediate) graduation and preference loss

Garments support 700,000–800,000 mostly female low-skilled jobs. Anything that affects the garment sector has direct implications for inclusive ET. Exports such as garments and bicycles currently enjoy trade preferences in the EU, US and some other markets. However, they face

immediate² removal of trade preferences, if, for example, the EU decides to withdraw Everything But Arms (EBA) from Cambodia in the coming year over human rights considerations (and this could be followed potentially by the US). Over the medium term, Cambodia faces graduation out of LDC preferences (some Asian LDCs such as Bangladesh are scheduled to graduate in 2024). Most-favoured nation tariffs in the EU are 12% on garments and between 8% and 17% for footwear. Cambodia's exports to the EU make up two fifths of total goods exports.

While previous analyses have indicated the challenges preference erosion presents (and a literature exists on forthcoming graduation in Bangladesh, see Bhattacharya, 2018), the current situation in Cambodia potentially requires immediate action to improve competitiveness by enhancing skills, improving infrastructure and streamlining regulation and licences. What institutional and policy arrangements can help overcome the key constraints? Our interviews in SSEZ suggest that preferences are not as important as previously considered, at least in the short run.³ If firms can absorb a change in minimum wages from \$60 in 2010 to \$182 per month currently, they may also be able to absorb the (smaller) changes in preferences. However, it is likely that a loss in preferences would lead to lower growth than would otherwise have been the case. The European Parliament (2019) argues that Sri Lanka lost 10,000 jobs or 4% of the garment workforce, and 1% of GDP, when it lost access to the EU developing country component of the Generalised System of Preferences (GSP+) between 2010 and 2017.

5.2 Targeting diversification into specific sectors

Cambodia has seen too little diversification compared with other countries (as the product space analysis shows), while existing sectors such as rice and tourism are limited by environmental constraints. What steps can Cambodia make to diversify into a few high-productivity activities? How can this be done – for example, how can it attract lead investors (see e.g. ADB, 2015)? One added complication is that investors that use low wage as a major attractor (e.g. Chinese investors in the garments sector) have few incentives to upgrade. Diversification therefore has to come from attracting new higher-value-added investment. This requires new attention to skills development and innovation.

5.3 Preparing for a digital economy: job creation, manufacturing and a digital economy

The digital economy is advancing rapidly globally, and low- and lower-middle-income countries will not be excluded. As CDRI (2018) notes, Cambodia aims to become a digital economy but this may take sometime. Rather than fearing the labour impact of digitalisation on labour-intensive SEZs and garment activity, Cambodia needs to harness the digital economy for its competitiveness (see also World Bank, 2018b for Cambodia and similar analyses for African manufacturing in Banga and te Velde, 2018a, 2018b). One core element in this is the importance of ensuring the appropriate skills are available (especially cognitive skills to undertake non-routine tasks) (see Banga and te Velde, 2018).

While there is some discussion around specific aspects of digitalisation, such as on the potential of e-commerce, our consultations suggested there is no agreed policy framework within which

² The European Parliament (2019) notes that the EU launched the procedure to suspend the country's EBA's preferences on 11 February 2019. This will be followed by a six-month monitoring period until August 2019 and a report by the European Commission by November 2019, with a decision by February 2020, coming into effect by August 2020.

³ Prime Minister Hun Sen downplayed the role of EU preferences (Chheng, 2019a) and Adidas argued the EU needs to consider all possible impacts before progressing (Chheng, 2019b). Unions and employers in Cambodia are concerned and have issued statements.

to consider how Cambodia can prepare for a digital economy in a comprehensive way. This confirms recent discussions by ILO, UNDP and the United Nations Industrial Development Organization (UNIDO) on Industry 4.0 in Cambodia (Lopez-Gomez, 2018). Cambodia needs to consider the future of specific sectors and activities; who would be the main gainers and losers from this; how skills can be developed to prepare for a digital economy; and especially how the poorest can also benefit from digitalisation. Interviews with manufacturing firms suggest there is still little awareness of the changes that may come sooner rather than later.

Prime Minister Hun Sen recently held a speech at a CDRI conference on digital transformation (Hor, 2019). He argued that actions to date include the development of the Cambodia ICT Masterplan 2020, the drafting of the Cambodia e-Government Master Plan, the establishment of a Data Management Centre and the promotion of a legal framework for the digital ecosystem. But there are also challenges, such as building infrastructure to support the digital sector; developing an e-payment system and logistics network; creating a digital platform and developing an ecosystem; and promoting government digitalisation, entrepreneurship, digital literacy and open data. The Supreme National Economic Council has established a working group to formulate a digital economy policy framework. Skills for a digital future require much further attention (see Box 3).

Box 3: Skills development for the digital economy in Cambodia, some examples

Banga and te Velde (2018) discuss skill needs for a digital economy, especially cognitive non-routine skills. Attention to skills in Cambodia's digital economy has only just begun. Here are some examples.

The World Bank (2018a) analyses the ways in which Cambodia can maximise the benefits from the digital economy. The note details a policy development strategy that supports Cambodian development of digital skills. However, there is little detail on the skills gaps.

ILO (2016) discusses how technology is changing job and enterprises. Many women in Cambodia are employed in garments, which are also susceptible to automation. One estimate puts the share of employment in the garments and footwear sector at risk of automation at 88%, and 71% in retail.

Richardson (2009) developed a case study detailing the outcomes of an international development project that trained Cambodian teachers in basic ICT skills.

The Sasakawa Peace Foundation (2017) outlines analyses on how governments, foundations and the private sector can increase the employment of women in Southeast Asia through the development of mechanisms to support women's ICT skills development.

Latchem (2017) outlines case studies showcasing the use of ICT and new forms of open, flexible and technology-enhanced learning in TVET. The study includes case studies from the Asia-Pacific regions: Australia, Cambodia, New Zealand and Sri Lanka.

Hun Sen's speech at CDRI on 26 March 2019 highlighted actions so far and challenges ahead for the digital economy. However, more skills are needed to make this a success (The Phnom Penh Post, 2018).

In the Cambodia Job Outlook 2018, the Labour Ministry's National Employment Agency (NEA, 2018) argues that IT professionals are becoming increasingly important in the labour market owing to the rise of digitalisation.

Konrad-Adenauer-Stiftung (2018) contains a number of perspectives on Cambodia in the digital economy, and considers policy frameworks and the role of women and small and medium enterprises.

5.4 Developing corridors

There is not much discussion around developing corridors. There is interest in developing the road between Phnom Penh and Sihanoukville, where traffic has slowed down considerably. The other main corridor, Phnom Penh–Bavet–Vietnam, seems more dynamic, and several SEZs have emerged around the Vietnamese border. Corridor approaches have focused and helped coordinate action in other countries (e.g. those in East Africa) but there does not appear to be a major impetus in this region.

5.5 Linking agriculture to the transformation: agro-processing

A range of licences, non-tariff measures and basics constrain agricultural development. The World Bank is focusing on this issue. The consultations pointed to a range of factors that negatively affect the competitiveness of the entire agricultural value chain. Much more emphasis is needed to modernise and transform agriculture. This should also cover the role of facilitating imports of modern inputs. Agriculture is a large area and requires substantial attention, especially in the context of inclusive ET, but it is not clear whether a SET study could make a major change and what the entry point would be.

5.6 Improving the quality and coordination of policy actions

The quality and level of implementation of public policies remains a cross-cutting issue. Each of the proposed solutions above needs to be evaluated not just in technical but also in political-economic terms. Investors need to be provided credible commitments that government actions will be supportive rather than extractive; coordination problems need to be solved; and in some cases investors need to be given both positive and negative incentives to enter more sophisticated areas of production. All these imply second-order collective action problems of government discipline, monitoring and enforcement. There is an important role for a programme such as SET to examine the political-economic dimensions of structural change, identifying the most realistic areas for the creation of coalitions in support of change, such as around preparing for a digital economy or helping the country diversify. At the same, the analysis should also consider how the poorest are included in decision-making.

A practical example is around the 2015–2025 Industrial Policy Plan and how it can best be implemented, which is an issue into which UNIDO is looking. The policy has all the appropriate elements, but the consultations also suggested there was a lack of implementation, compounded by a lack of clear leadership by specific agencies. One concern, for example, is around diversification and moving away from informal trade of agricultural commodities into more formal agro-processing. This requires licences and compliance with standards, which leads to the involvement of various agencies, all of which have incentives to take a share of the proceeds. One idea would be to promote better coordination and support measures through, for example, sector initiatives, such as that in the rice sector, which seems to have been effective to some degree.

Table 2 summarises the six areas of interest, the link to inclusive transformation, the link to policy, a sample of existing studies and selected views from the workshop and consultations.

Table 2: Options for further analysis

Area	Link to inclusive ET	Link to policy	Relevant studies	Selected views from workshop and consultations
1. Fostering competitiveness in context of rapid trade preference erosion	Manufacturing; 700,000 female garments jobs; rural–urban migration; poverty reduction	Policy urgency; EU DFQF, US GSP, US–China trade war, LDC status	Not on current shocks	No-one else is examining, clear policy link, but some debate on importance of preferences for ET
2. Diversification into high-value manufacturing/ services	Reduces vulnerability; productivity; future job creation	Industrial Development Policy 2015–2025	ADB, UNDP, UNIDO, CPAN	Long-run important focal area, the question is what would be new?
3. Preparing for a digital economy	Digitalisation changes; development models; competitiveness and inclusion	New digital economy task force; skills	CDRI World Bank ITC UNCTAD	Very relevant issue, as there is a lack of comprehensive and well-informed policy approaches, especially around the inclusiveness of digital change
4. Developing corridors and clusters	Ability to trade goods and services crucial for competitiveness	Attention to Sihanoukville and Bavet	JICA China	Much attention to SEZs, especially building on the successful SSEZ, but much less to corridors
5. Promoting agro-processing	Linking (rural) agriculture to ET	NTMs; rice; rural infra	World Bank CPAN	Key concern, but large topic
6. Improving quality and coordination of policy actions	Effective leadership, targeted coordination, state–business relations crucial for ET	Sector initiatives (garments, rice); business climate/licences	ESID	Important cross-cutting issues, including the role of the poorest in decision-making

6 Conclusions

Cambodia has been the sixth-fastest growing country in the world over the past two decades and it has reduced poverty and inequality significantly. It graduated to LMIC status in 2015. It experienced high growth in a few activities: garments, tourism, 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 related to 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.

This paper suggests there are six areas of concern related to Cambodia’s ET that require further discussion: (i) Improving competitiveness to address loss of trade preferences; (ii) diversification; (iii) preparing for a digital economy; (iv) developing corridors; (v) agro-processing; and (vi) improving the quality and coordination of policy actions. Decision criteria include contribution to inclusive ET and link to policy. We analysed the issue and current interests and knowledge.

Three issues were central to our discussions on Cambodia's future transformation paths:

1. quality of skills (including quality and completion in secondary education; issues in science, technology, engineering and mathematics; industry–university linkages) including for diversification
2. impact of the digital economy on transformation models based on manufacturing, with few having brought the issues together in a practical policy agenda and
3. quality/implementation of policies (around diversification into higher-value-added activities).

A crucial issue common across papers and consultations appears to relate to gaining a better understanding of the role of appropriate and good quality education and skills in preparing for a digital economy. The following analytical questions are crucial

1. **Development models.** What are the implications of the digital economy for Cambodia's development model (which type of jobs in which sectors and activities are promising and which ones are under threat)?
2. **Political economy and inclusion.** What population groups would benefit and lose from changes in the digital economy (and how would they be able to affect the decision-making to prepare for a digital economy)? For example, what would be the effects on the 700,000 young women in garments, what are the opportunities for those with non-routine cognitive skills and what are the incentives for policy-making?
3. **Skills, including for the poorest and young.** What skills are needed for a future inclusive digital economy, and what does Cambodia need to do/change to get there?
4. **Policy framework.** What would be a comprehensive policy agenda through which Cambodia can support ET and job creation?

A number of activities around these issues would be able to advance discussions around digitalisation and inclusive ET in Cambodia.

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Appendix: Cambodia’s product space, merchandise exports and investment

Cambodia’s product space has become more complex, but it has some way to go to reach that of Vietnam and Thailand. The ECI is also much lower.

Figure A1: Cambodia’s product space, 2000 and 2017

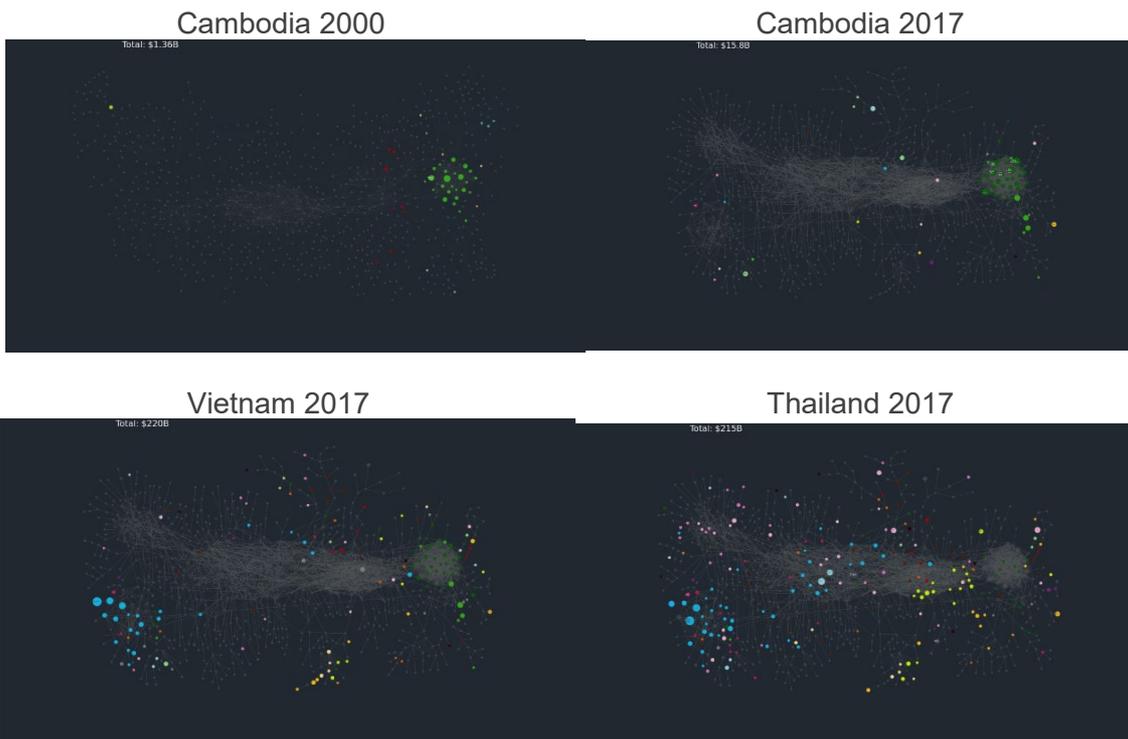


Figure A2: Economic Complexity Index in Cambodia, Thailand and Vietnam

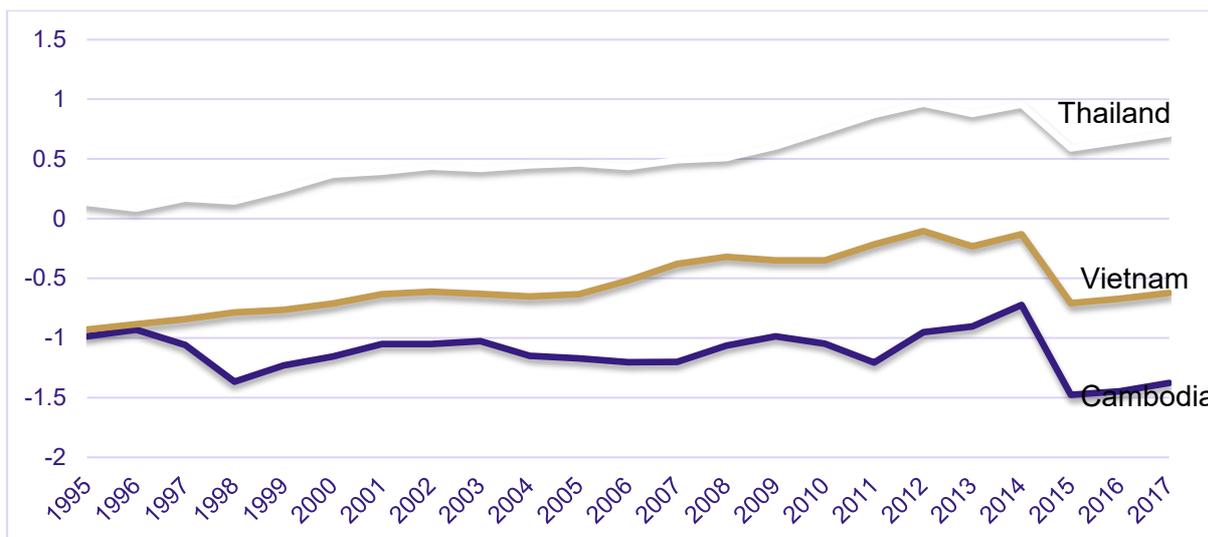
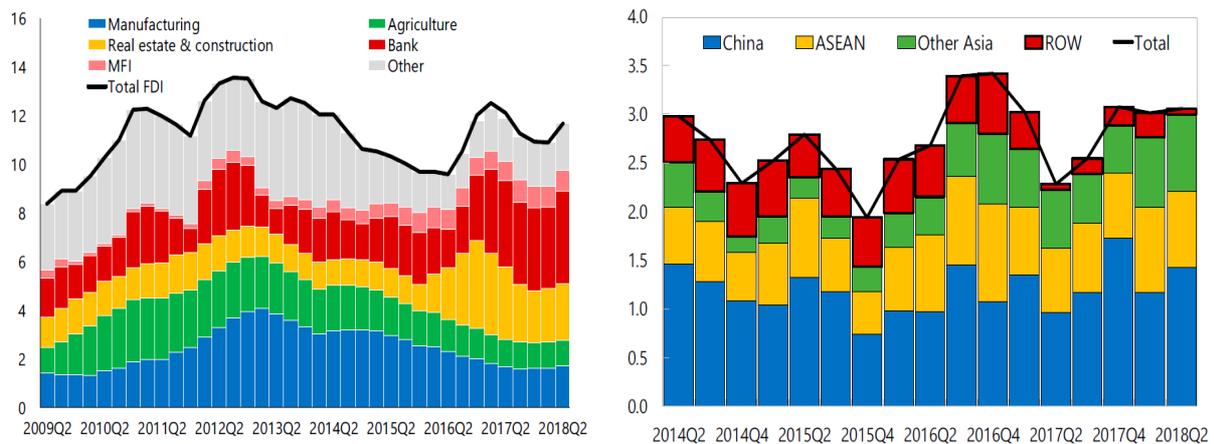


Table A1: Committed investment in Cambodia

	2012		2013		2014		2015		2016	
Total	\$2.9bn		\$4.9bn		\$3.9bn		\$4.6bn		\$3.6bn	
Rank	Country	%								
1	Cambodia	42.08	Cambodia	66.8	Cambodia	64	Cambodia	69.28	China	29.92
2	China	20.69	China	15.68	China	24.44	China	18.62	Cambodia	27.55
3	Korea	9.89	Vietnam	6.1	Malaysia	2.18	UK	3	Japan	22.78
4	Japan	9.15	Thailand	4.37	Japan	1.72	Singapore	2.18	Thailand	4.61
5	Malaysia	6.04	Korea	1.76	Korea	1.66	Vietnam	1.92	Korea	4.59
6	Thailand	4.53	Japan	1.59	Vietnam	1.26	Malaysia	1.61	US	3.38
7	Vietnam	2.89	Malaysia	1.04	UK	1.13	Japan	1.28	Singapore	3.03
8	Singapore	2.59	Singapore	1.03	Singapore	0.89	Thailand	1.18	Vietnam	2.45
9	UK	0.51	UK	0.43	Thailand	0.88	Korea	0.21	Korea	0.21
10	US	0.42	France	0.27	Australia	0.51	Canada	0.19	India	0.55
11	Others	1.21	Others	0.93	Others	1.33	Other	0.53	Others	0.54

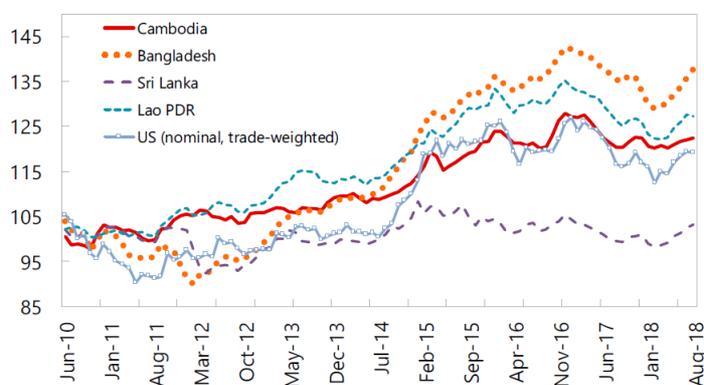
Source: Adapted from <http://www.cambodiainvestment.gov.kh/why-invest-in-cambodia/investment-enviroment/investment-trend.html>

Figure A5: FDI inflows in Cambodia by sector and source, 4 quarter moving average sum, average (% of GDP)



Source: IMF, Cambodian authorities

Figure A6: Real effective exchange rate (2010=100)



Source: IMF, Cambodian authorities