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# Cambodia Outlook Brief*

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## Strengthening Key Sectors for Cambodia's Return to Growth, Sustainable Development and Poverty Reduction: Emerging Industries[1]

"[The] diversification of industries from garments and accessories to… new industries is crucial… The corridor of growth [entails]... connecting different parts of the country… [and developing] industrial, commercial and investment zones… along the network."

*Dr Hang Chuon Naron, Permanent Vice-Chairman, Supreme National Economic Council*

### Broader Development, Broader Economic Base

A more broad-based development entails diversifying Cambodia's current economic base. So far, growth has mainly relied on garments, construction, tourism and agriculture. Exports have been limited, with garments accounting for a lion's share of the total. New industries must be cultivated if growth is to become more sustainable and resilient against shocks. Foreign direct investment must be drawn from a bigger pool of sources and new clusters of activities within existing industries must be developed. Cambodia has untapped comparative advantages that can rival the current established industries. The most recent global downturn bears witness to the importance of diversification. In 2009 relative to 2008, while the country's clothing exports plummeted, its less traditional exports increased. Agricultural exports in particular performed well, with the volume of rice exports increasing by more than 150 percent, that of rubber by 125 percent and that of fishing products by about 90 percent (Figure 1). This helped compensate for the loss of earnings due to contraction in the leading export industry, garments.

The government's Rectangular Strategy Phase II placed economic diversification at the heart of its plan for advancing sustainable growth. It called for the development of the following specific emerging industries: export-oriented and labour-intensive industries; food processing industries; petroleum and minerals industries; and information and communications technology. Export industries based on fishing products, rubber, rice, and other agricultural crops also hold a lot of promise. Harnessing the potential of all the above mentioned sectors to become established sources of growth requires creating a climate that is highly conducive to public and private investments.

### Emerging Industries: Constraints to Growth

Cambodia has gone a long way towards making its business climate investor-friendly. However, serious constraints that affect its competitiveness, increase the cost of doing business in the country and ultimately discourage investments, persist. Cambodia currently lags behind Thailand and Vietnam in terms of competitiveness. It ranked 110 out of 133 countries in the Global Competitiveness Index 2009-2010

1 *Outlook Brief 3 summarises the presentations and discussions in session 3A(ii) of the 2010 Cambodia Outlook Conference. Presenters for this session were: Mr Sok Chenda, Minister, Secretary General, Council for the Development of Cambodia, and Mr Stephen Guimbert, Senior Country Economist, World Bank. This Brief also incorporates relevant sections of session 1, presented by Dr Hang Chuon Naron.*

* BASED ON 2010 CAMBODIA OUTLOOK CONFERENCE:
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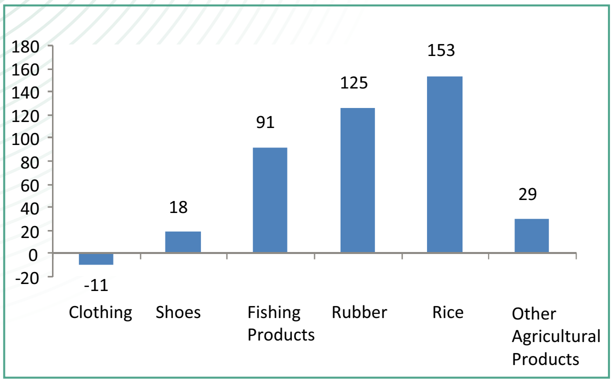
**Figure 1: Annual Export Volume Growth, 2009, percent**




*Source: WB*

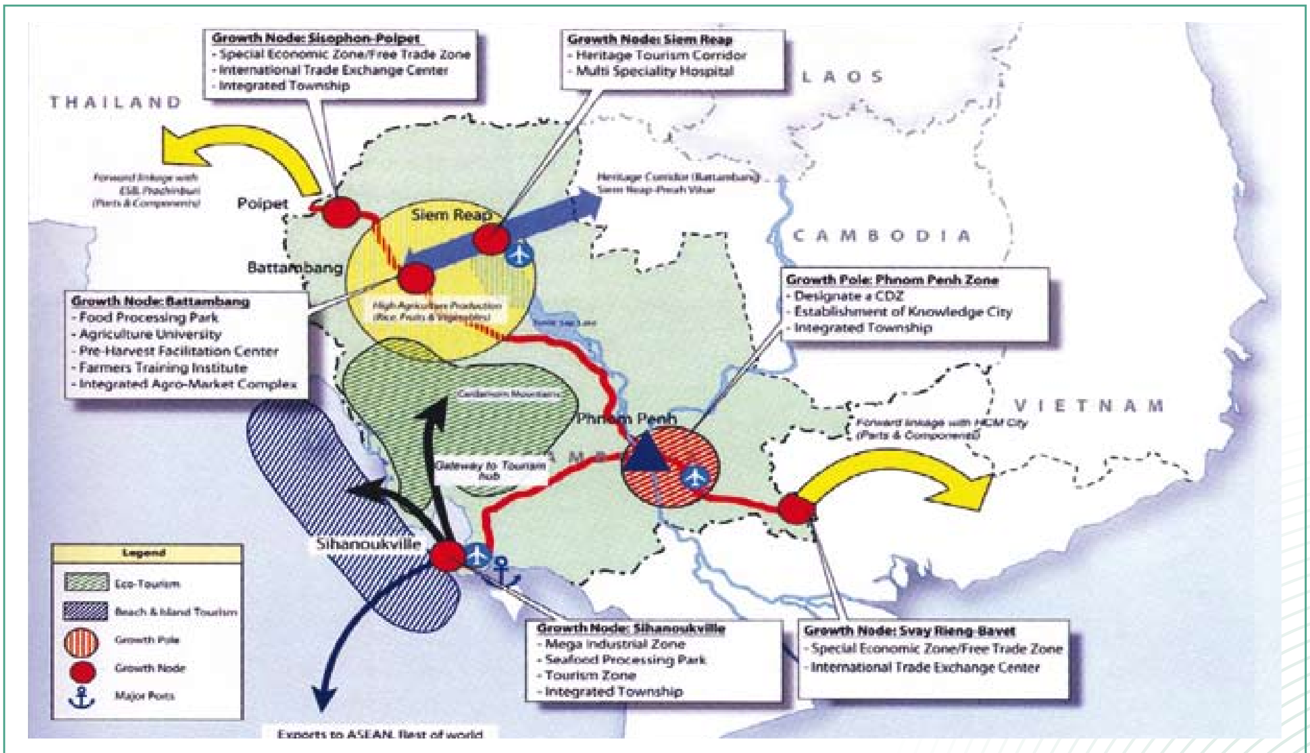
rankings while Thailand landed the 36th spot and Vietnam, the 75th.

Investment climate surveys have consistently identified corruption as the top business constraint in Cambodia, though the severity of the problem seems to have decreased over time. This implies the urgency of resolving governance issues in the country. Macroeconomic uncertainty was identified as the second most serious constraint both in 2008 and 2009, likely reflecting the impact of the food and economic shocks. The most recent survey shows interesting changes. For 2008, the other constraints in the top five were anti-competitive or informal policies, economic and regulatory policy uncertainty, and cost of electricity. For 2009, the other three constraints were crime, theft and disorder, economic and regulatory policy uncertainty, and cost of financing. That crime, theft, and public order moved from being 6th to 2nd in the list of severe business constraints is worthy of note. Cost of financing on the other hand moved two places up, likely reflecting the impact of the financial and economic crisis. Another change of note was the exceptional increase in the severity of the problem relating to customs and trade regulations. This constraint moved from being 17th to 8th in the list, which can be described as unexpected given the government's efforts directed at improving trade facilitation. The lack of coordination of value chains is another pressing problem.

Cambodia's competitiveness has also been harmed by the appreciation of its real exchange rate. Since about the start of the global crisis, its real exchange rate has appreciated faster than its competitors in the global garment industry. When the crisis peaked in 2008, its real exchange rate appreciated by as much as 20 percentage points relative to the average rate in 2007. The appreciation of the riel has made Cambodia's manufactures, particularly garments, more expensive.

How the above constraints hold back economic diversification is reflected in the short life of Cambodia's new exports. Only around 37 percent of said exports are still exported after one year. The

**Figure 2: Proposed Initiatives for MIEC (Cambodia)**




*Source: Presentation by Dr Hang*

survival rates of new exports are way higher in the case of China (64 percent), Thailand (57 percent) and Vietnam (56 percent). The impact of the constraints is also reflected in the low density of firm creation in the country, which was less than one per 1,000 inhabitants in 2007.

## The Corridor of Growth: Network of Special Economic Zones

To achieve a more diversified Cambodian economy, more foreign direct investment, as well as other types of investment, is needed. To attract more investment, the establishment of a corridor of growth, that is a network of special economic zones (SEZs), is one tested strategy that Cambodia must pursue more actively. Building the corridor of growth necessitates connecting various parts of the country and maintaining agricultural, industrial, commercial and technological zones along the network (Figure 2). It requires further development of infrastructure and relevant legal framework.

Currently, there are 21 SEZs in Cambodia, located in the province of Sihanoukville and spread along the country's borders with Thailand and Vietnam. A number of these, however, are inactive. A sub-decree on the creation and management of SEZs exists. Issued in 2005, this sub-decree allows the establishment by the state, a private enterprise or a joint venture between the state and a private company, of an SEZ of around 50 hectares. It created three institutions with the following responsibilities: the Cambodian Special Economic Zones Board which serves as the main agency responsible for the approval, management and development of SEZs; the Special Economic Zone Administration that operates the "One-Stop-Service" mechanism, through which the necessary licences can be obtained; and the Special Economic Zones Troubleshooting Committee which settles issues occurring in the SEZs. Under the sub-decree, SEZs can benefit from such fiscal incentives as exemptions from profit tax, import duties, and value added tax and after-tax profit repatriation. Equally important are non-fiscal incentives such as a simplified legal framework.

One of the inter-regional industrial belts envisioned to become part of the East Asia Industrial Corridor is the Mekong-India Economic Corridor. This corridor seeks to link the Mekong countries, Thailand, Cambodia, Vietnam and Myanmar with India through the latter's eastern coast. As part of this proposed corridor, Cambodia faces the challenge of setting up its own internal corridor that proposedly will run from the coastal area, Sihanoukville, to the capital Phnom Penh, to the provinces, Svay Rieng, Battambang and Poipet.

Sihanoukville, home to the only deep seaport in Cambodia, already hosts a number of SEZs. Many other SEZs are planned to be set up in the area. The industrial potential of the province got a huge boost with the discovery of oil and gas reserves off its coast. It is also an emerging tourist destination. Battambang is a highly populated province that is well connected to Thailand and Phnom Penh. It is a commercial hub and, at the same time, the centre of the country's agricultural belt with its large production of rice, cassava and corn. Svay Rieng is a province bordering Vietnam. Its proximity to the industrial clusters in Ho Chi Minh City and Dong Nai explains its attraction for the several SEZs already established there. With its potential to become a key service centre as border trade with nearby Vietnamese industries deepens, Svay Rieng is expected to host more SEZs. The large parcels of idle land in the area make this industrial expansion feasible. Improved road transport has also strengthened the connectivity of the province to other areas. Poipet likewise has the potential to become a key service centre given its proximity to the industrial clusters in and around Bangkok, the eastern seaboard, and the Cha Choengsao-Prachinburi cluster. It similarly has large tracts of land available for industrial expansion. The huge populations of nearby provinces also give it access to a large pool of labour.

Establishing the internal corridor or SEZs in general requires improvements in power, communications and transport infrastructure. Road, water and railway transport links among the zones will have to be strengthened. The obligations of zone developers in relation to infrastructure provision will have to be clearly set out. Efforts geared at easing trade facilitation must be sustained. It does not bode well that the severity of trade facilitation constraints is found to have increased in 2009 relative to 2008. In any case, pay-off from such reforms as the modernisation of customs (i.e. adoption of the Automated System for Customs data or ASYCUDA and the Single Administrative Document or SAD), joint inspection and issuance of certifications and licences, and enhancement of risk management practices has been seen; thus, these measures must be continued. Further, the adoption of Service Level Agreements, which define the respective roles and responsibilities of concerned line ministries in customs clearance, would contribute to the reduction of processing times and transaction costs. The government must also commit to its plan of joining the ASEAN Single Window by 2012. Pursuing all the above measures would certainly encourage more investment.

Foreign direct investments from Japan and China are particularly promising. Bilateral investment treaties with these two countries have already been signed or are under negotiation.

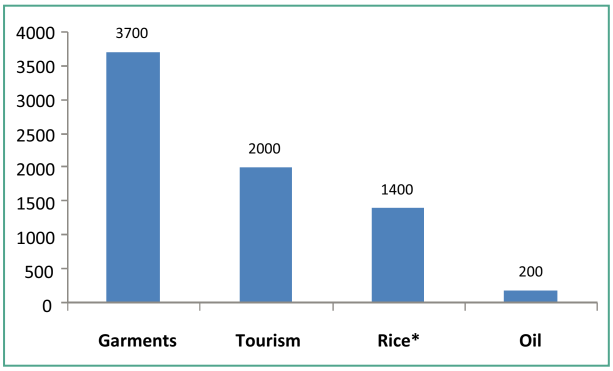
The existing sub-decrees directly and indirectly relating to SEZs are important but can hardly be considered as constituting a sufficient legal framework. Given the vision of building an internal industrial corridor and integrating this into the larger Mekong-India Economic Corridor, the passage of a Law on SEZs gains greater urgency. This law must reflect the principle of extra-territoriality, meaning it must designate SEZs as separate customs territories. It must exempt imports going to SEZs from duties and taxes on the ground that these imports are intended for manufacturing, processing and re-export. Goods such as petroleum products, cars, alcohol and cigarettes should be subject to normal taxation, however.

## Mining for Gold: The Potential of Cambodia's Extractive Industry

Years of conflict prevented Cambodia from developing its mineral industry. As the country stabilised and achieved high economic growth, interest and investment in its rich mineral resources started. Recent years especially have seen greater commitment to investing in this emerging industry. Discovered minerals include such metallic and non-metallic minerals as iron, chromium, manganese and gold and such gemstones as sapphire, ruby and quartz.

Oil and gas are recently discovered wealth of Cambodia, with the first offshore oil discovery having been made in 2004. Six oil blocks off the coast of Sihanoukville have so far been licenced to foreign companies for exploration and resource extraction. Block A, which is being explored by Chevron, Moeco and GS Caltex, has so far turned up with the greatest amounts of recoverable oil and gas. Onshore blocks around the Tonle Sap basin are also being tested for their oil and gas resource potential. While the exact value of the resources cannot be ascertained, the emerging oil and gas industry is expected to become an important driving force of Cambodia's

**Figure 3: Estimated Revenues in 2013, USD million**




*Source: Presentation by Dr Hang*

development in the future. Estimates for 2013, however, indicate that petroleum revenues will still not be able to rival revenues from other sources. Revenues from oil and gas are projected to amount to USD200 million while those from rice are expected to reach USD1.4 billion (assuming a yield of 2.5 tonnes per hectare), garments, USD3.7 billion, and tourism, USD2 billion (Figure 3).

The relevant legal framework is envisioned to include a petroleum law, a law on petroleum taxation and a sub-decree on production sharing agreements. The regulatory framework on the other hand is to set the fiscal regime for the petroleum sector. Oil and gas revenues will be used to pay the cost of recovery, taxes, royalties, and signature payments. The royalties will be shared by the government and the national oil company. Disclosures made to the Extractive Industries Transparency Initiative include signature bonuses totalling USD20.3 million and social fund allocations totalling USD6.5 million for December 2009 and January 2010.

Diversification is easier said than done. Since the crisis, it has become such a buzzword in Cambodia, having been prescribed strongly as one of the key catalysts to recovery from the economic downturn. One clear platform from which this task can take off is the advancement of emerging industries. The raw foundations of these industries are already in place. All they need are policy boosts that can hoist their competitiveness and make them into the established industries that they clearly are meant to be.

**CDRI – Cambodia's leading independent development policy research institute**

☞ 56 Street 315, Tuol Kork, Phnom Penh, Cambodia ✉ PO Box 622, Phnom Penh, Cambodia
☎ (855-23) 881-384/881-701/881-916/883-603/012 867-278 🖷 (855-23) 880-734
E-mail: cdri@wicam.com.kh, Website: http://www.cdri.org.kh