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Impact of the Global Financial Crisis on the Cambodian Economy at Macro and Sectoral Levels

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Over the decade and a half up to 2008, Cambodia experienced remarkable growth through improvement in garment, tourism, construction and real estate sectors supported by stable agricultural sector performance. Driven by export market demand, the garment industry contributed around 80 percent of the country's total exports in the past decade, making the country one of the biggest garment exporters. Likewise, Cambodia's tourism industry was making steady headway with the number of arrivals increasing constantly overtime. Construction and real estate sectors experienced a sudden boom prior to 2008 due mainly to huge capital inflows, especially from China and Korea.

Nonetheless, the global financial crisis that struck the world economy in late 2008 hit Cambodian core industries very hard, causing overall growth to plummet to 0.1 percent in 2009 (ADB 2012). The country fared just slightly better than Brunei, Malaysia and Thailand, which all faced negative growth. Remarkably, Laos achieved the highest growth (7.3 percent) followed by Myanmar, Vietnam and Indonesia, while the Philippines's growth rate of 1.1 percent was almost on a par with ASEAN's average growth of 1.3 percent. Further adding to economic difficulty, the extensive flooding in 2011 that destroyed tens of thousands of hectares of cultivated land has taken its toll on the economic and social wellbeing of many Cambodians, particularly those in rural areas. Resultant damage and loss could hinder agricultural sector growth, undermine poverty eradication efforts and threaten national food security, though government has given assurances that Cambodia can still export rice.

There is no evidence of the global economic downturn having adverse impacts on the banking and financial sector, though reports suggest that many foreign investors have withdrawn investment capital from banks in Cambodia, which to some extent manifests a setback in the banking sector. Some economists point out that because Cambodia's banking and financial sector is not linked to the world financial system, it was insulated from the effects of the crisis. The financial crisis was however a wake-up call for the Cambodian government to review and rearrange its banking and financial policies to avoid a recurrence of the credit crisis that stalled the construction sector. For example, there are reports of real estate investors who stymied by sudden tightening in credit experienced bank foreclosure.

The trend in FDI inflows (asset approvals) shot up after 2004, reflecting the dramatic increase in investments in garments, hydropower and services sectors, and peaked at USD866 million in 2007. The number of FDI approvals began to drop in 2008 and continued to decline in 2009 due to the

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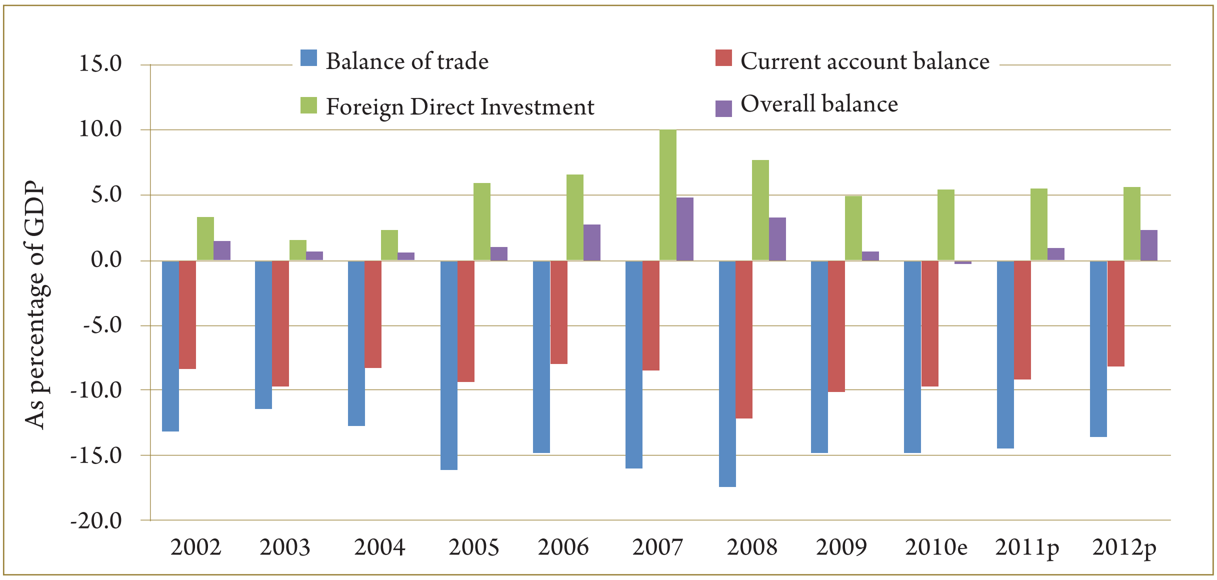
Figure 1: Balance of Payments 2002-2012



Source: Ministry of Economy and Finance (2012)

global economic downturn. However, the value of FDI inflows increased to USD553 billion in 2010 and even higher in 2011 as world and Cambodian economies began to recover from the crisis.

In terms of trade performance, Cambodia has been able to maintain steady growth in both import and export sectors. However, the trade deficit has continued to widen because Cambodia needs to import more goods than it can export (Figure 1). Imports include inputs for garment manufacturing and electronics, other capital goods such as machinery, and food - especially from neighbouring countries. Because the country's export largely relies on garment and textile products, a drop in garments export has a pivotal effect on total export values.

Current account growth has been negative over the 10 years from 2001 to 2012. Overall balance growth, however, was modest and positive in all years bar 2009.

Rural households commonly send family members to seek employment in garment factories and construction sites in urban areas, especially Phnom Penh. When the GFC hit Cambodia in late 2008, these groups of workers were the most affected. They had to either return to their hometowns or find jobs in other sectors such as tourism and services. A study conducted by the Cambodian Institute for Development Studies (2009) estimated that income losses due to the global financial crisis would likely affect 93,000 households (470,000 people) in 2008 and 217,000 households (more than 1 million people) by the end of 2009.

The UNDP warned that retrenched workers from garment factories, construction and tourism industries would return to their rural villages, putting pressure on agricultural resources. Migrant workers, numbering around 200,000 and mostly working in Thailand and Malaysia, were highly likely to come back to Cambodia. The concern was that unless the government devised bold policy to create jobs and provide a social safety net, the number of laid-off workers and new entrants to the labour market would create a heavy burden on government, widen social inequality, and push people back into poverty.

To respond to the economic slowdown, the government of Cambodia has provided incentives to attract more foreign investors. It also implemented macroeconomic measures to stabilise the economy by tackling inflation that otherwise would have further burdened already stressed livelihoods. Other fiscal measures include tariff exemption on products used in agriculture and construction, subsidised import tax on petroleum products, and tight public spending control. Rice price speculation was curbed by government intervention that released around 300 tonnes of rice to local markets at prices well below the current market price.

Alongside other policies, the government adopted a social protection safety net that with assistance from development partners should help the poor and other vulnerable groups to recover from the crisis or prevent them from falling deeper into poverty. Supports include Health Equity Funds, Food Emergency Programmes, Food for Work and Mother and Child Health Programmes implemented by the World Food Programme, school feeding schemes and targeted secondary education scholarships (especially for girls) for poor households in selected provinces, the National Social Security Fund and pre-paid health insurance scheme.

Strategy to accelerate economic diversification is imperative for sustained pro-poor economic growth. The government has identified other sectors that have potential in broadening the country's economic growth base. Those sectors include electronics, car assembly, food processing, and oil and gas and minerals extraction. The national vision is for Cambodia to become one of the leading rice exporters in the near future. To this end, government has renewed efforts to modernise the agricultural sector, especially through attracting private sector investment to not only production, but also to processing, including rice milling, and domestic linkages in packaging and quality finishing so as to increase local value-added. A lot remains to be done before such vast potential can be realised, particularly in terms of human resource planning to develop the capacity and skills of the labour force. The common ASEAN market will allow free labour movement between ASEAN member countries from 2015. This is another call for the government to prioritise skill development.

Meanwhile, the present debt crisis in the Eurozone is hindering EU countries' recovery from economic recession and risks stalling the world economy. This poses a serious concern for Cambodia. The country has benefitted from preferential market access to the EU, which has since become the major export destination for its garment and agricultural products, especially rice. The challenge is a timely prompt and should stir Cambodia to seek opportunities and integrate itself in more diverse export markets, both within the region and further afield.

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