

# Cambodia: A Macro View from 2007 to the Medium Term–Key Indicators for Growth, Development and Shared Prosperity

*Eng Netra and Phim Runsinarith summarise and synthesise the presentations made by speakers from the Ministry of Economy and Finance, the International Monetary Fund and CDRI.\**

Cambodia has enjoyed relative peace and stability over the past decade. It has embarked on many initiatives, including economic liberalisation, institutional reforms and political reforms responding to the changes of its political economy. It conducted and managed elections and put in place state institutions, and recently has successfully held the second election of commune councils, part of the process of decentralising power.

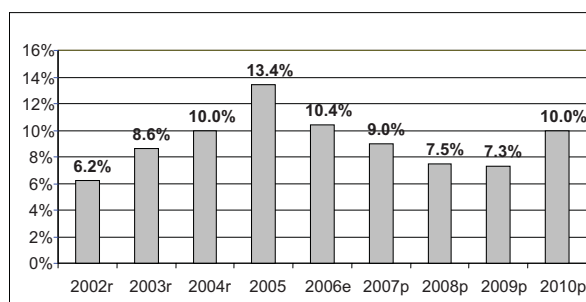
Major social services have also been improved, including health, education, rural infrastructure and irrigation. Economic performance has been remarkable; however, poverty reduction, natural resource management and governance remain challenging. Drawing from the first session presentations at the Cambodian Outlook Conference in 2007 presented by Ministry of Economic and Finance, International Monetary Fund and CDRI, this article synthesises and summarises major development achievements and challenges, ranging from economic growth to governance.

\* This article is based on speeches by Dr Hang Chuon Naron, secretary general of the Ministry of Economy and Finance, Mr John Nelms, IMF resident representative in Cambodia, and Ms Eng Netra, research manager at CDRI, at the 2007 Cambodia Outlook Conference. Mr Phim Runsinarith is a research associate at CDRI.

## Macroeconomic Developments: Recent Performance and Medium-Term Outlook

*The presentation of Dr Hang Chuon Naron, secretary general of the Ministry of Economy and Finance, paid specific attention to important economic issues facing Cambodia, including macroeconomic performance, fiscal developments, financial sector performance and the outlook for overall economic growth 2007–15. The following is a summary of those issues.*

**Figure 1: Economic Growth Rate 2002–10**



*r = revised; e = estimate; p = predicted.*

*Source: Hang Chuon Naron*

Cambodia has achieved remarkable macroeconomic stability and progress, with robust growth averaging 8.7 percent per year during the past decade. Gross domestic product (GDP) grew by 10.4 percent in 2006 in real terms (Figure 1). This robust growth was underpinned by the expansion of garment exports, tourism and construction. Cambodia's garment exports increased by 20 percent in 2006, reaching USD2.5 billion and providing 334,000 jobs. The US is the dominant buyer of the product, followed by the EU and Canada (71, 23 and 4 percent respectively). Tourism and construction also remained strong in 2006. The number of tourist arrivals, which contributed significantly to GDP growth climbed to 1.7 million. The number of new apartments built in Phnom Penh is increasing by 8000 to 10,000 annually, and a new town project at Boeng Pong Peay started in 2006. The number of companies registered with the Ministry of Commerce totalled 11,584, of which 1600 were newly registered in 2006.

The country's fiscal performance improved in 2006, with better revenue mobilisation and expenditure rationalisation. The current budget surplus increased to 1.8 percent of GDP, and the overall budget deficit declined to 1.7 percent of GDP. Total revenue increased from USD660 million in 2005 to USD832 million in 2006, reflecting increased tax and non-tax collections. Total expenditure increased from USD853 million in 2005 to USD959 million in 2006; infrastructure development was the priority area, being allocated about USD45 million. The strong economic growth

and investment in infrastructure, especially rural infrastructure, also led to significant improvement in social sectors such as a decline in infant mortality rate and an increase in literacy.

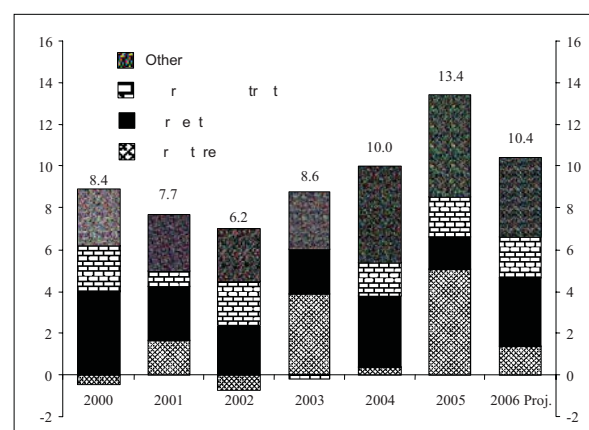
The country's financial sector developed well in 2006. Broad money grew robustly, by 38 percent, up from 16 percent in 2005, reflecting greater confidence in the banking system as a result of banking reform. Foreign currency deposits increased by 45 percent, and bank credit to the private sector rose by 51 percent. The development of micro-finance has also been remarkable. Micro-finance loans grew by 40 percent to USD56 million in 2005. FDI inflows are projected at USD394 million in 2006, up from USD381 million in 2005. The Council for the Development of Cambodia approved 88 investment projects, amounting to USD3.8 billion, which are expected to create 154,000 jobs if fully implemented.

The outlook of Cambodia's economy is very bright. In the medium term, GDP is expected to grow at 9 percent in 2007 and at 7–8 percent in 2008–09 with tourism, garments and construction remaining the pillars of growth and agriculture playing supporting role. In the longer term, GDP is anticipated to expand at 9–10 percent in 2010–15. Revenue from oil will become a new source of growth from 2010, and this will play a crucial role in sustaining a high growth rate. While garments, tourism and construction will continue to drive growth, Cambodia needs to diversify the sources of growth to new industries to make growth more broadly based.

However, there is a need for comprehensive policy reforms to make investment in Cambodia more attractive. Reduction of the costs of infrastructure, electricity, port fees and informal fees should be addressed to facilitate trade activities, and economic processing zones should be created to attract foreign investment. Reform of idle economic concessions, land reforms to prevent encroachment on land of ethnic minorities, policies to increase farmers' access to extension services, good seeds and micro-finance, electricity and irrigation are crucial for agricultural development. Moreover, to sustain growth in this sector, product diversification, outsourcing promotion in certain categories of machinery products and services such as back office operations in banking, accounting and so on, encouragement of agricultural processing and establishment of farmer organisations will also be important.

*Mr John Nelmes, the IMF resident representative in Cambodia, also shared his views on Cambodia's recent macroeconomic developments and the outlook for 2007 and the medium term. The contents of his presentation can be summarised as follows.*

**Figure 2: Composition of real GDP growth rate**



Source: John Nelmes

Cambodia's economic growth, though narrowly based, was robust in 2006, while inflation was low. GDP growth was much faster than that of the world as a whole and of developing Asia. Garment exports remained strong, tourism continued to expand, and agriculture and fisheries also posted positive growth (Figure 2).

These developments were supported by the government's prudent fiscal policy. Progress has been made in boosting overall government revenues over the past few years. Stronger enforcement of customs and tax collection, along with

collection of tax arrears and privatisation receipts, has more than offset a continued shortfall in non-tax revenues. Nevertheless, revenue performance remains well below that achieved in other countries.

Domestic economic activity continued to expand thanks to the prudent monetary policy and a deepening of financial intermediation by the banking sector. Small businesses previously operating in the informal sector are increasingly registering and seeking bank finance, with vigorous construction activity reflecting a broadening of investment demand for real estate.

The medium-term macroeconomic outlook remains bright. The economy is expected to grow by around 9 percent in real terms in 2007, with continued expansion

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of garment exports, tourism and domestic economic activity. In the medium term, growth is expected to be sustainable at 7–8 percent. Despite this promising perspective, Cambodia needs additional revenue collection efforts to raise its historically low revenue to GDP ratio in order to finance higher spending to help realise its Millennium Development Goals and the objectives of the National Strategic Development Plan. Further, to maintain macroeconomic stability, critical reforms are needed. In line with higher government revenues, more spending should be allocated to well-targeted and productive physical infrastructure projects, health care and education, to improve livelihoods and strengthen productivity. Equally importantly, Cambodia should make the economic environment more conducive to private sector activity and foreign investment through continued efforts to facilitate trade and reduce excessive public administrative burdens.

### **CDRI Outlook on Cambodian Development and Challenges**

*Ms Eng Netra, research manager at CDRI, presented the findings from four research programmes. The findings can be summarised as follows.*

#### *Poverty Reduction Makes Progress But Inequality Rises*

Despite impressive overall macroeconomic growth, over the past decade Cambodia has achieved only about one percent per annum poverty reduction. CDRI poverty studies suggests that growth is not equitably distributed, and the gaps between rich and poor, and between rural and urban areas, have increased. Women's economic role and contribution continue to broaden as a result of the changing economic base, although more of the poorest women sell labour, migrate for work and undertake "male" responsibilities in addition to their domestic role.

#### **Natural Resource Management Is Declining**

More of the poor and very poor are increasingly dependent on natural resources, especially forest and fishery products; however, their access to these natural resources is decreasing significantly. CDRI studies show that governance of natural resources is critical and must be sustainably managed for poverty reduction because they are primary assets for the poor. In his opening address, the prime minister said that land management

is one of his priorities to tackle poverty reduction. Security of land tenure is one of the most important issues for Cambodian poor. More and more poor people are losing land because of "distress sales", health shocks and land grabbing. CDRI strongly supports the land-titling effort, but this effort should be accelerated and targeted at areas where the impact on poverty reduction can be optimal.

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benefited better off households, and outsiders (such as national level officials and businessmen). Our research suggests that central management of natural forests without involvement of local people has potentially significant

negative economic impacts on communities. New community-based forestry management alternatives are necessary in order to provide more equitable access. Challenges facing natural resource management are (i) unclear and conflicting mandates and authority, exacerbated by poorly demarcated jurisdictions, and (ii) local corruption that prevents enforcing of rules and regulations on access to and control over natural resources.

#### **Significant Institutional Reforms Achieved, But Weak Accountability Remains**

The government has succeeded in ensuring political and macroeconomic stability over the past decade and is currently performing quite well in reducing poverty and improving social services. However, overall, the government has not been able to establish the rule of law and to combat corruption, establish an environment likely to attract investors or institute mechanisms of accountability. While the technical capacities of government staff are undoubtedly strengthening, the state apparatus remains fragmented. Reliance upon directives from the top is high; formal accountability mechanisms are weak; and effective intra- and inter-ministerial coordination is minimal.

CDRI studies also show that sub-national administrations remain highly centralised and politicised. Centralised control and lack of resources weaken sub-national government and make local personnel management, planning and expenditure management futile. The result is that local managers cannot hold their staff accountable, and their staff are constantly drawn to outside interests and accountabilities. This has a negative

impact on the economy and citizens, and particularly disadvantages the poor and small businesses. Also inadequate is the capacity of institutions to facilitate the participation of women in decision making at all levels and to respond to demands from vulnerable groups such as the poor and women.

Commune councils have provided some hope of improved basic governance. CDRI studies show that commune councils work effectively in areas such as rural infrastructure—construction of roads, irrigation systems and bridges. The poor have also benefited from the collaboration between NGOs and councils. Due to the fact that commune councils have very limited resources and authority, especially when dealing with natural resources or problems involving higher level and powerful external actors, they are not capable of defending democratic politics, effective services or key natural resources. This points to the critical importance of effective provincial administrative and deliberative capacity, which will be targets of a forthcoming organic law, and to the importance of central-local relations and the interaction between formal and informal governance.

Some of these challenges will be addressed by major government reform initiatives such as decentralisation and deconcentration

(D&D), public finance management (PFM) and public administrative reform (PAR). D&D is progressing, with good lessons from the commune councils, but provincial and district challenges remain, and related sectoral deconcentration reforms are needed to complete D&D. The PFM reform programme over the last two years has begun to make significant headway in reforming the country's public spending and revenue management. It opens possibilities for more effectively and efficiently directing public expenditure towards poverty reduction. PAR is slowly progressing but posing major challenges, especially in defining clear functions for public institutions and their staff, creating incentives for performance and accountability and establishing meritocracy and professionalism among civil servants.

### Summary and Conclusion

These are four major conclusions and the relevant policy questions:

- Economic growth is remarkable, but a medium- and long-term strategy is needed, particularly to diversify sources of growth and develop agriculture as the third engine of growth. What are the possibilities for sharing increased prosperity? How can the private sector make a more effective contribution to

economic growth and influence policy?

- Poverty reduction is marginally achieved, but inequality and other poverty dynamics (such as landlessness, risk behaviour of men and female-headed households' poverty challenges) are emerging. How will economic growth be translated into poverty reduction? How can the reach of public programmes and initiatives be extended to the poor and vulnerable, including women?
- Natural resources are increasingly degraded and threatened by the lack of implementation of policy and legal framework in place and the weak capacity of local actors. How can natural resources be managed and protected to promote sustainable access by the poor?
- Governance and institutional reform have not been making sufficient progress to accelerate opportunities for growth and development. Passing of the anti-corruption law and organic law is critical, as are political commitment and community support for government reforms. How can institutional

reforms be implemented to achieve the government objectives? How do members of Cambodian society understand their status as citizens? How do we build national pride and civic responsibility in order

to promote and sustain civic engagement?

CDRI's visions for Cambodia are: (i) sustainable economic growth and equitable distribution of the benefits of growth; (ii) achieving the MDG of halving poverty by 2015; (iii) sustainable use of land management and natural resources; (iv) integration into the region and international trade and governance systems; and (v) strong and effective governance institutions that are responsive to citizens' needs. We at CDRI believe that the way to achieve this vision is to have government, the private sector, civil society and development partners working together for the future of Cambodia.

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