

Increasing the Inclusiveness, Resiliency and Sustainability of ECONOMIC GROWTH IN CAMBODIA



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Cambodia's New Growth Strategy
An Assessment of Medium and Long-term Growth for
Resilient, Inclusive, and Sustainable Development

Background Paper 3

Increasing the Inclusiveness, Resiliency and
Sustainability of Economic Growth in Cambodia

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List of acronyms and abbreviations

ADB	Asian Development Bank
ASEAN	Association of Southeast Asian Nations
BRI	Belt and Road Initiative
CDS	Country Diagnostic Study
EU	European Union
FDI	Foreign Direct Investment
FTA	Free Trade Agreement
GFC	Global Financial Crisis
GDP	Gross Domestic Product
IMF	International Monetary Fund
LDC	Least Developed Country
MOP	Margin of preference
MFN	Most-Favoured-Nation
MSME	Micro, small and medium enterprise
OECD	Organisation for Economic Cooperation and Development
PISA	Programme for International Student Assessment
PV	Photovoltaic
RGC	Royal Government of Cambodia
TVET	Technical and Vocational Education and Training
UNDP	United Nations Development Programme
UNICEF	United Nations Children's Fund

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ដើម្បីសម្រេចបានតាមបំណងប្រាថ្នានូវគោលដៅអភិវឌ្ឍន៍របស់ខ្លួន ប្រទេសកម្ពុជាត្រូវបន្តឆ្ពោះទៅរកកំណើនប្រកបដោយបរិយាបន្ន ចីរភាព និងភាពធន់។ នេះគឺជាប្រភេទកំណើនដែលបង្កើតការងារប្រកបដោយចីរភាព នៅក្នុងវិស័យកម្មន្តសាល និងសេវាកម្ម ហើយផ្តល់ផលចំណេញដោយសមរម្យ និងជាប់លាប់ សម្រាប់ស្វ័យនិយោជិត នៅក្នុងវិស័យសេដ្ឋកិច្ចក្នុងប្រព័ន្ធនិងក្រៅប្រព័ន្ធ។ ឧបសគ្គសំខាន់សម្រាប់កំណើននេះ គឺកង្វះការធ្វើពិពិធកម្មនៅក្នុងសេដ្ឋកិច្ច ដែលមិនប៉ះពាល់ដល់ល្បឿនកំណើនសេដ្ឋកិច្ចជាប់រហ័សនោះទេ ប៉ុន្តែប៉ះពាល់លើបរិយាបន្ន និងចីរភាពនៃកំណើន។ ដំណាក់កាលដំបូងនៃការធ្វើពិពិធកម្មដែលនាំឱ្យមានការធ្វើចំណាកស្រុកពីជនបទមកទីក្រុង ពីវិស័យកសិកម្ម ទៅវិស័យឧស្សាហកម្ម និងសេវាកម្ម អាចនឹងឈានដល់ដែនកំណត់របស់វា។ ការធ្វើពិពិធកម្មក្នុងវិស័យនេះ នាំមកនូវការបង្កើនផលិតភាពនាពេលអនាគត។ នេះទាមទារឱ្យមានការផ្លាស់ប្តូរតាមខ្សែបញ្ជ្រាងទៅជាផលិតផល និងសកម្មភាពដែលមានតម្លៃបន្ថែមខ្ពស់នៅក្នុងវិស័យនីមួយៗ។

ការធ្វើពិពិធកម្មក្នុងវិស័យ ទាមទារឱ្យមានការដោះស្រាយឧបសគ្គសំខាន់ៗពីរ។ ទី១ គឺភាពខ្វះខាតនៃជំនាញរបស់កម្លាំងពលកម្មនាពេលបច្ចុប្បន្ន ដែលទាមទារឱ្យមានការកែលម្អគុណភាពក្នុងការអប់រំនៅគ្រប់កម្រិត ចាប់ផ្តើមពីបឋមសិក្សា និងមធ្យមសិក្សា រហូតដល់ការអប់រំបច្ចេកទេស និងឧត្តមសិក្សា។ ទី២ គឺការចំណាយខ្ពស់ក្នុងការធ្វើអាជីវកម្ម ដែលបណ្តាលមកពីហេដ្ឋារចនាសម្ព័ន្ធរូបវន្ត និងភស្តុភារកម្មមានកម្រិត តម្លៃថាមពលខ្ពស់ និងការចំណាយហិរញ្ញវត្ថុខ្ពស់។ ដើម្បីដោះស្រាយឧបសគ្គទាំងនេះ កម្ពុជាត្រូវបង្កើនបរិយាបន្នកំណើនសេដ្ឋកិច្ច។ ដើម្បីធានាថាសមិទ្ធផលទាំងនេះមានភាពយូរអង្វែង កម្ពុជាត្រូវដោះស្រាយឧបសគ្គផ្សេងទៀតដែលប៉ះពាល់ដល់ភាពធន់ និងចីរភាព។ ការបង្កើនភាពធន់ រួមមានការដោះស្រាយផលប៉ះពាល់នៃ៖ ១) ការប្រែប្រួលអាកាសធាតុ និងសម្ពាធបរិស្ថានផ្សេងទៀត ២) ការប៉ះទង្គិច ឬរឹបគ្នាហិរញ្ញវត្ថុ សុខភាព និងវិបត្តិផ្សេងៗទៀត និង ៣) ការផ្លាស់ប្តូរនៃបច្ចេកវិទ្យា ជាពិសេសការពន្លឿនឆ្ពោះទៅរកសេដ្ឋកិច្ចឌីជីថល។ ការធ្វើឱ្យប្រសើរឡើងនូវចីរភាពនៃកំណើន និងកត្តាជំរុញរបស់វាទាមទារឱ្យមានការធ្វើពិពិធកម្មលំហូរពាណិជ្ជកម្ម និងការវិនិយោគ។ ការណ៍នេះនឹងកាត់បន្ថយការប្រឈមមុខរបស់ប្រទេសកម្ពុជាចំពោះការប៉ះទង្គិចតាមប្រទេសជាក់លាក់ និងគាំទ្រដោយប្រយោលចំពោះកំណើនសេដ្ឋកិច្ចដែលមានភាពធន់។

Increasing the Inclusiveness, Resiliency and Sustainability of Economic Growth in Cambodia

Abstract

To realise its development goals, Cambodia has to pursue inclusive growth that is also sustainable and resilient. This is the type of growth that generates sustainable jobs in the manufacturing and services sectors, and fair and consistent returns for the self-employed in the formal and informal sector. A key constraint of this growth is the lack of diversification within the economy, which has not affected the rapid pace of the economic growth but only the inclusiveness and sustainability of that growth. The early phase of diversification involving rural-urban migration from the agricultural sector into the industrial and service sectors may be reaching its limit; future increases in productivity must come from intra-sectoral diversification. This involves the vertical shift into higher value-added products and activities within each sector.

Intra-sectoral diversification requires two key constraints to be addressed. First is the limited skillsets of the current workforce, requiring improvements in the quality of

education at all levels, starting with primary and secondary before technical and tertiary. Second is the high cost of doing business, which stems from limited physical and logistical infrastructure, high energy costs, and the high cost of finance. Addressing these constraints should increase the inclusiveness of economic growth. To ensure that these achievements are not short-lived, another set of constraints that affect resiliency and sustainability need to be addressed. Increasing resilience includes addressing the impacts of: (i) climate change and other environmental pressures; (ii) financial, health and other shocks or crises; and (iii) technological change, especially the acceleration towards a digital economy. Improving the sustainability of growth and its drivers involve diversifying trade and investment flows. This will reduce Cambodia's exposure to country-specific shocks and indirectly support resilient economic growth.

1. Introduction

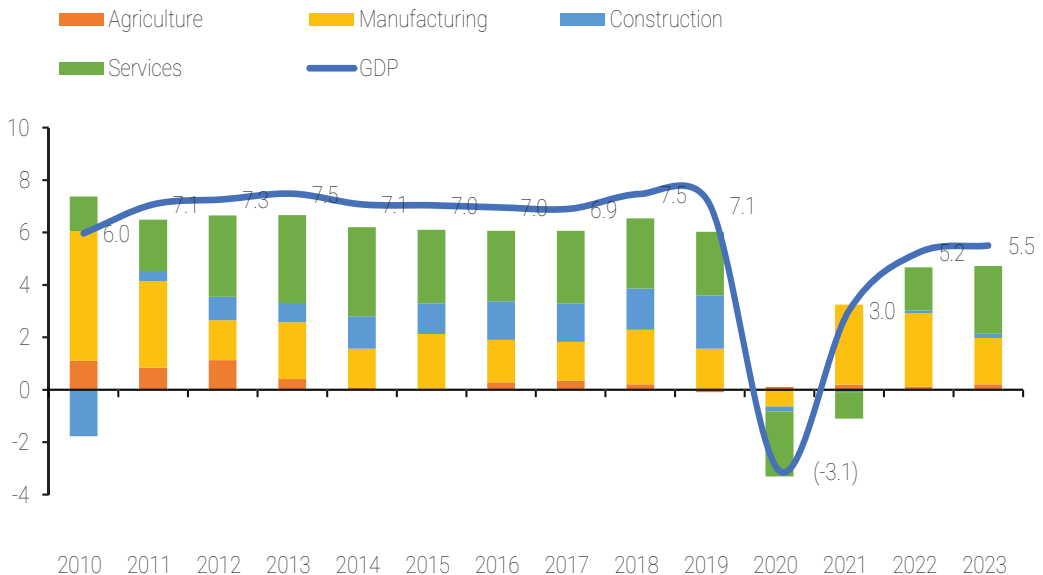
In many ways, Cambodia is Asia's true miracle economy. It was only three decades ago when the Paris Peace Agreements were signed, ending the civil war that ensued following the removal of the genocidal Khmer Rouge regime in 1979. In just over a generation, Cambodia has built up its economy and institutions, almost from scratch, and transformed itself into a modern, thriving economy. Although many challenges remain, these achievements should be recognised and it bodes well for the future, given Cambodia's proven ability to overcome seemingly insurmountable odds.

Despite its tragic history, Cambodia has great aspirations for growth. However, in order to realise these aspirations, Cambodia has to pursue inclusive growth that is also sustainable and resilient. This type of growth

should generate decent and sustainable jobs in the manufacturing and service sectors, and fair and consistent returns for the self-employed, either in agriculture or in the micro, small and medium enterprises (MSMEs) across sectors, formal or informal. To do this, the Kingdom must address a number of constraints.

A key constraint, which is highlighted in the Royal Government of Cambodia's Rectangular Strategy (Phase IV) and the new Pentagon Strategy Phase I, is the lack of diversification of the economy. This was also highlighted in the Asian Development Bank's (ADB) (2014) Country Diagnostic Study (CDS) but continues to be a major limitation. The continued lack of diversification has not affected the rapid pace of economic growth, although it may have hindered the quality of that growth, particularly

Figure 1: Sectoral contributions to GDP growth, 2010–2023 (percent year on year)



() = negative, GDP = gross domestic product.
Source: Asian Development Bank (2024) estimates.

in terms of its inclusiveness and sustainability. Cambodia has been able to grow at above an annual rate of 7 percent since the turn of the century, with the exceptions of the years afflicted by the 2007-8 Global Financial Crisis (GFC) and the 2020-21 COVID-19 pandemic (Figure 1). The high growth rate was mainly driven by trade preferences, tourism centered

around Angkor Wat, and large capital inflows into construction and real estate. If Cambodia grows as anticipated, it will become a victim of its own success with trade preferences and aid flows likely to diminish. Therefore, it will need to pursue new drivers of growth, which will require greater diversification.

2. Defining inclusive, resilient and sustainable growth

Long-term strategic plans such as the Pentagon Strategy and the economic policies that underlie them all aim implicitly or explicitly to support inclusive economic growth. Bottom-up growth through sustainable employment within both the manufacturing and service industries, and self-employed MSMEs, is enabled through upskilling the working-age population by increasing education and skills development and by ensuring equal opportunity to participate in generating growth, irrespective of class, gender, or location.

‘Decent’ jobs are defined as those that provide a fair income, which is at least minimum wage, increased over time to keep pace with the cost of living and productivity improvement. Such jobs must protect labour rights and provide a safe work environment. To enable this, and to ensure equal opportunity and treatment for all, workers must be encouraged and helped to shift from informal to formal employment, and undocumented migrant labour must be regularised to warrant it legal. Sustainable jobs are those that provide safe and secure working conditions that facilitate extended working life in line with longer life expectancy. They are generally found in industries that are shock resilient, be

the shock technological advances, climate change, or other. Sustainability allows workers to be able to respond to change by equipping them with the skills and flexibility needed to migrate from shrinking industries into expanding sectors of the economy.

To ensure that growth is more inclusive not just in the short term but extends into the long term, there is a need to reduce the risk of disruptions while increasing the versatility in managing and responding to all kinds of shocks. Increasing resilience includes addressing the impacts of: (i) climate change and other environmental pressures; (ii) financial, health and other shocks or crises; and (iii) technological change, especially the acceleration towards a digital economy. Improving the sustainability of growth and its drivers involves diversifying trade and investment flows. That is, diversifying export products and markets and import sources, as well as sources of Foreign Direct Investment (FDI) flows, which will reduce risk and increase the sustainability of economic growth.

Understanding inclusive growth requires consideration of how it is linked with several dimensions of diversification and changes in the composition of Gross Domestic

Product (GDP). Moving horizontally into higher-value products or activities must be distinguished from moving vertically up the value chain to products or activities with more value added. The horizontal shift into higher-value products usually entails inter-sector diversification, while the vertical

shift into products with higher value added is intra-sectoral. The implications of intra-sector versus inter-sector diversification are critical to understanding development transitions and their ability to make growth more inclusive. These are considered in more detail below.

3. Inclusive growth and poverty reduction: Historical record

The early phase of diversification or structural transformation, involving rural-urban migration from the agricultural sector into the industrial and service sectors, has been ongoing and has delivered improvements in economic and social outcomes. This process, however, may be reaching its limit. This inter-sectoral transfer is the simplest phase of diversification, requiring minimal government intervention or policy reform, and takes place somewhat naturally with minimal disruption to factor markets (see Kaldor 1967; Herrendorf et al. 2013). The horizontal shift across sectors into higher value products and activities produces a one-off increase in the level of productivity, which raises incomes and living standards, but this increase may not be sustainable.

Nevertheless, the record on poverty reduction and improvements in human development is noteworthy, although significant challenges remain (Hill and Menon, 2011; 2014). Despite strong economic growth leading up to the COVID-19 pandemic, Cambodia remains one of the poorest countries in Southeast Asia, with gross national income per capita at USD1,400 in 2022, as measured in constant 2015 dollars, and USD1,690 in 2024 prices.

The Royal Government of Cambodia (RGC) has implemented programmes and policies to boost economic growth and reduce poverty, particularly in rural areas. These have included cash transfers, rural infrastructure development, and improvements in healthcare and education. The share of Cambodians living below the national poverty line of KHR 4,618 or about USD1.04 per day declined from 33.8 percent in 2009 to 17.8 percent in 2019 (Figure 2). The government aimed to reduce poverty further to below 10 percent by 2023 (Karamba et al. 2022).

Despite notable progress in recent years, poverty is still pervasive, particularly in rural areas of the Kingdom. In 2019, rural areas had a poverty rate of 22.8 percent based on the national poverty line, which was almost double the 9.6 percent rate in urban areas (Figure 2). The same disparity can be seen in food poverty, which has declined across the country but remains much higher in rural areas (Figure 3). While there have been notable achievements in reducing food and extreme poverty, a significant proportion of the population remains vulnerable. ADB estimates that about 30 percent of Cambodians are “near poor” or vulnerable to being pushed into poverty by illness,

natural disasters, or economic shock. Using the higher World Bank poverty line of \$3.20 a day, about a third of the population fall below it (Karamba et al. 2022).

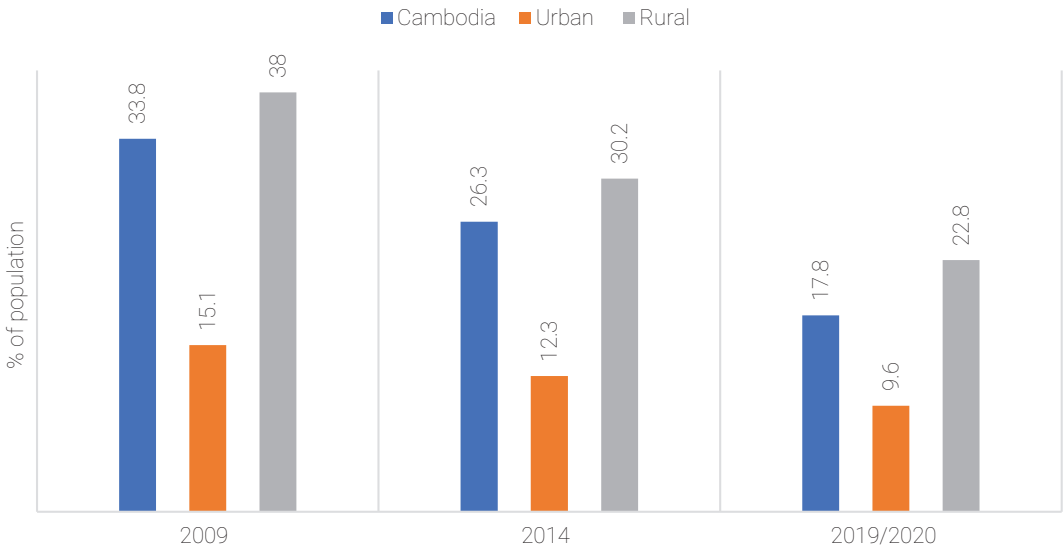
More worryingly, income inequality, as measured by the Gini coefficient, worsened from 29.9 in 2014 to 32.2 in 2019, after remaining fairly stable in the previous 5 years (Figure 4). Further, data on consumption per capita by quintile show that, compared with 2014, average monthly consumption by the bottom fifth increased by only 23 percent in 2019/20, while that of the top fifth increased by 60 percent. This is a drastic reversal from the period from 2009 to 2014, when average monthly consumption by the bottom 20 percent rose by 71 percent and of the top fifth by 28 percent (Table 1). It is likely that asset and wealth inequality is also high and rising, but data on these measures are sparse.

Progress in reducing poverty and improving human development outcomes were

reversed under the COVID-19 pandemic, with an estimated 460,000 people falling into poverty in 2020, raising the poverty rate by 2.8 percentage points. The World Bank estimated that, without government intervention, the pandemic would have increased poverty by 4.7 percentage points in 2020, undoing 3 years of poverty reduction progress.

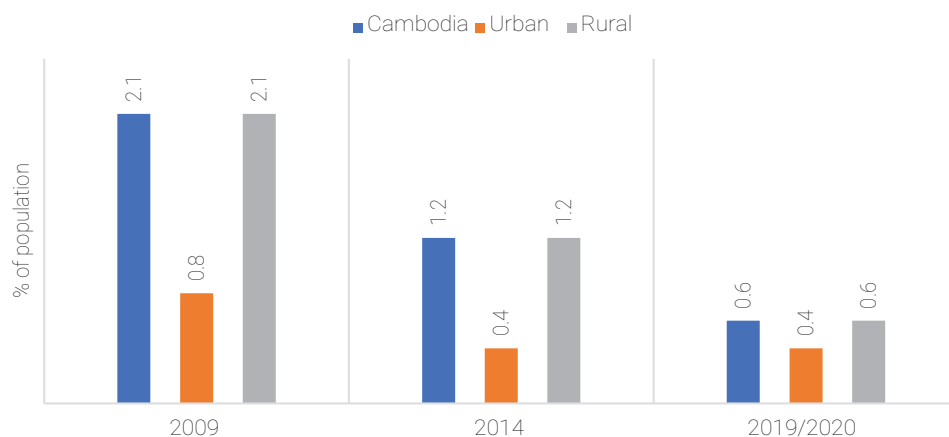
Cambodia's performance on the Human Development Index (HDI) has likewise suffered a reversal in recent years. From 1990 to 2018, the HDI showed a positive trend, increasing from 0.378 to 0.598. However, from 2018 to 2021, it declined to 0.593, categorising Cambodia as a country with medium human development, ranked 146th out of 191 countries in terms of its human capital development. Significant gaps remain in health and education. Cambodia performed poorly in the Global Competitiveness Report 2019, ranking 119th out of 141 economies in terms of overall competitiveness.

Figure 2: Poverty rate, 2009, 2014, and 2019/2020 (percent)



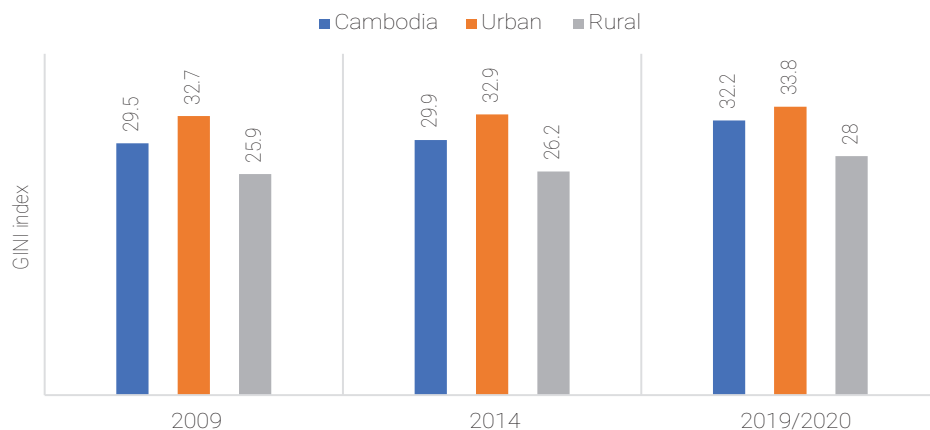
Source: Karamba et al. (2022).

Figure 3: Food poverty, 2009, 2014, and 2019, (percent)



Source: Karamba et al. (2022).

Figure 4: Gini index 2009, 2014, and 2019/2020



Source: Karamba et al. (2022).

Table 1: Consumption per capita, by quintile, 2009, 2014, and 2019

Quintile	KR'000			% of total			% increase	
	2009	2014	2019/2020	2009	2014	2019/2020	2014 vs. 2009	2019/ 2020 vs. 2014
Lowest fifth	97	166	204	8	9	7.7	71	23
Second fifth	144	240	304	11	13	11.5	67	27
Middle fifth	192	309	403	15	17	15.3	61	30
Fourth fifth	269	407	559	21	22	21.2	51	37
Highest fifth	570	731	1,166	45	39	44.2	28	60

Note: Values are monthly averages.

Source: Cambodia Socio-economic Surveys, 2009, 2014, and 2019.

4. Key constraints to inclusive growth

Cross-country comparisons suggest that Cambodia may already have realised most of the benefits from shifting workers across from agriculture into manufacturing or services. While the inter-sector transfer increases productivity, this boost is likely to be a one-off and unable to sustain growth over time. While rice farmers, for example, may increase the value of their output per hour by moving into an electronics factory and assembling wire harnesses, they are unlikely to assemble wire harnesses markedly more efficiently over time.

Future growth in productivity will require a new phase of structural transformation featuring intra-sector specialisation. This second phase is the vertical reallocation of factors to produce goods with more value added within existing supply chains. In Cambodia, this would require greater participation by the private sector to generate new forms of involvement in global supply chains for manufacturing. Unlike the early phase of industrialisation, this upgrading process is unlikely to happen spontaneously but will require government intervention and policy reform. It will also likely require new forms of investment, especially FDI with embedded technologies, and skilled labour will be required to facilitate intra-sector specialisation and upgrading.¹

There are two major constraints that need to be addressed through policy reforms and government support to enable greater intra-sectoral diversification (ADB, 2024). The first is limited human capital and skills mismatches. Second is the high cost of doing business, which limits development of the private sector and domestic and foreign investment. Addressing these two sets of constraints should result in economic growth that is more inclusive. To ensure that these achievements are not short-lived, another set of constraints need to be addressed. These involve measures designed to increase resilience and sustainability, which would otherwise threaten current and future growth.

To address these constraints, there are three accompanying sets of policy reforms and government interventions that are recommended.

4.1. Human capital

Nine out of ten Cambodian workers are employed in elementary or low-skilled jobs (NIS, 2021). This reflects the poor state of human capital in the labour force. There is an urgent need to improve the quality of education at all levels, and not just Technical and Vocational Education and Training (TVET) or tertiary education. TVET and tertiary education can only succeed if students have a strong educational foundation in primary and

¹ The opportunities available to Cambodia to diversify its product mix and export basket through structural transformation can be identified for the short and long run using product space analysis (see Menon and Naqvi, 2024).

secondary schooling.² Results from the 2022 Programme for International Student Assessment (PISA) show Cambodia lagging behind its ASEAN peers in math, science, and reading despite improvement since 2017 (Figure 5). Similarly, Cambodia lags in the share of its labour force with advanced education (Figure 6).

Quality improvements also need to be accompanied by measures to improve access to education and retention rates, which are currently low. For instance, Warr and Menon (2016) found that more than 30 percent of new employees in the Japanese multinational firm, Denso, had never attended school and could neither read nor write, with limited numeracy skills. Although firms like Denso were willing to provide their own tailored on-the-job training, these workers found it challenging and could only be employed to undertake routine manual tasks.³

Cambodia needs to invest in skills development and training in close collaboration with the private sector to avoid skills mismatches. TVET and tertiary education institutions need to align their

curricula more closely with the needs of the private sector. There is also a pressing need to address the various barriers, and push and pull factors, that limit access to formal employment, and strengthen social protection systems.

4.2. Business costs

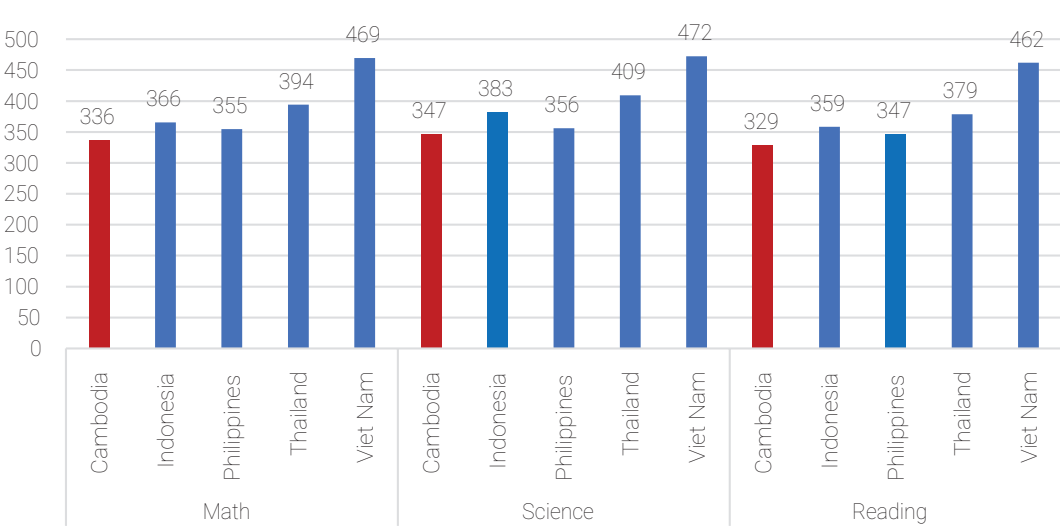
The second constraint is the high cost of doing business. Cambodia has long fared poorly in the World Bank's composite Ease of Doing Business Index (Table 2). Before the index was discontinued in 2020, Cambodia had a low ranking in Southeast Asia, usually performing better than only Laos and Myanmar. The high cost stems from limited physical and logistics infrastructure (Table 3), high energy costs, and the high cost of finance. For a developing economy like Cambodia that is rapidly transforming, transport and related infrastructure needs are a moving target. Despite notable achievements in building infrastructure, a deficit that continues to add significantly to business costs remains. There is a need to prioritise investments both within the transport sector, as well as economy wide. Within transport, chokepoints such as port capacity, high-cost centres such as logistics infrastructure, and inter-modal connectivity should be prioritised. Red tape, inadequate port facilities, and other inefficiencies also undermine trade. Cambodia compares poorly with its neighbors in the time and cost required to export and import (Table 4).

Since infrastructure development relies on foreign involvement, increasingly from China through the Belt and Road Initiative (BRI), there is a need for better vetting of

2 In fact, the problem needs to be addressed even earlier, starting with overcoming malnutrition among infants and children that affect both mental and physical development. Despite progress over the years, UNICEF (2023) reports that almost a third of children in 2022 were stunted. Such effects are largely irreversible and can permanently affect the ability to absorb education and training in future years.

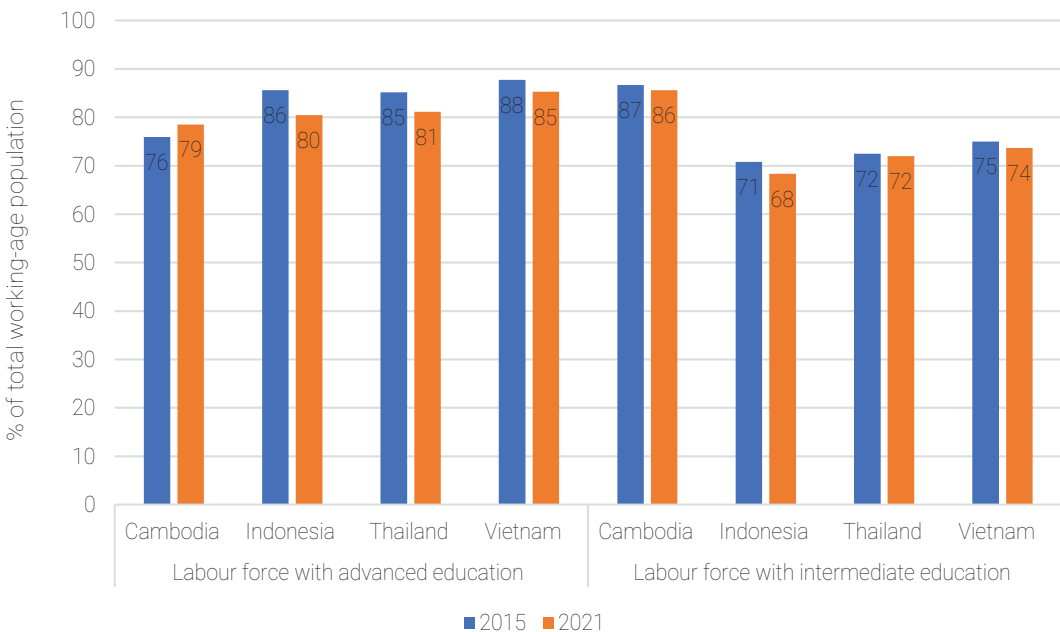
3 These fundamental challenges in the education sector need to be addressed concurrently with the skills development challenges to reverse the COVID-19 pandemic's impact on employment in Cambodia.

Figure 5: PISA scores for mathematics, science, and reading at age 15 comparing Cambodia with regional peers, 2022



Sources: OECD Programme for International Student Assessment (PISA) 2022; PISA 2022 Results, Volume 1, Reader's Guide, and Annex 4.

Figure 6: Labour force educational attainment, 2015 versus 2021 (percent of working-age population)



Source: World Bank World Development Indicators (accessed 11 April 2024).

project proposals through comprehensive cost-benefit analyses conducted by an independent body. The creation of an independent Foreign Investment Review Board, operating as a non-statutory body with inter-ministerial and multi-stakeholder representation, would be useful to assess individual proposals in a purely advisory capacity. Inter-ministerial representation would ensure that sector priorities are considered in the approval process (see Menon, 2023).

The cost of electricity in Cambodia is one of the highest in the region, with a kilowatt hour costing USD 0.14 relative to 0.11 in Thailand and 0.08 in Vietnam. The high cost is limiting vertical upgrades within electronics and automotive supply chains, from labour-intensive assembly activities to higher value added, energy intensive production of parts and components. Greater investment in renewable energy and energy efficiency is required to reduce costs and the reliance on diesel and heavy fuel oil in electricity generation. Investment in grid extension and addressing the fragmented nature of transmission and distribution would reduce the cost of electricity. There is also significant potential to scale up investment in solar energy, which could significantly reduce business costs for MSMEs that are off grid.

The high cost of finance, especially for small scale farmers and MSMEs, perpetuates poverty (Karamba et. al. 2022). Limited access to formal avenues of finance, with more than 70 percent of the population estimated to be unbanked, is closely related to its high cost. The potential for digital innovation, including fintech and blockchain, presents significant opportunities for Cambodia's financial sector to enhance financial inclusion. Increasing digital literacy and access to digital infrastructure, which is still low in rural areas, is required to increase access to finance at a reasonable cost for low-income communities.

There are also a host of long-term development challenges that need to be addressed that will affect trust in the system, and therefore both the access to and the cost of finance. These include issues relating to governance and corruption, the quality of institutions including the legal system, and the development of the finance sector and capital markets.

Table 2: Ease of doing business: Cambodia versus comparator countries, 2015–2019

Indicator	Country	2015	2016	2017	2018	2019
Ease of doing business rank (1 = most business-friendly regulations)	Cambodia	...	...	...	...	144
	Laos	...	...	...	...	154
	Thailand	...	...	...	...	21
	Vietnam	...	...	...	...	70
	Lower-middle income	...	...	...	...	...
Ease of doing business score (0–100, worst to best)	Cambodia	52.9	53.2	53.4	53.8	53.8
	Laos	48.2	49.1	50.0	49.8	50.8
	Thailand	71.9	72.8	78.5	79.5	80.1
	Vietnam	62.6	65.3	67.0	68.6	69.8
	Lower-middle income	52.8	53.7	54.8	56.1	57.4
New business density (new registrations per 1,000 people aged 15–64)	Cambodia	0.4	0.4	0.5	0.7	0.9
	Laos	0.1	0.1	0.1	0.1	0.2
	Thailand	0.9	1.0	1.1	1.5	1.5
	Vietnam	1.1	1.3	1.5	1.6	1.7
	Lower-middle income	0.3	0.3	0.4	0.4	0.4

... = unavailable
Source: World Bank Ease of Doing Business (accessed 25 April 2023).

Table 3: Logistics performance index: Cambodia versus comparators, selected years

Index feature	Country	2010	2012	2014	2016	2018	2022
Overall	Cambodia	2.4	2.6	2.7	2.8	2.6	2.4
	Laos	2.5	2.5	2.4	2.1	2.7	2.4
	Thailand	3.3	3.2	3.4	3.3	3.4	3.5
	Vietnam	3.0	3.0	3.2	3.0	3.3	3.3
	Lower-middle income	2.6	2.5	2.6	2.5	2.6	2.6
Ability to track and trace consignments	Cambodia	2.5	2.8	2.9	2.7	2.5	2.8
	Laos	2.5	2.5	2.2	1.8	2.9	2.4

	Thailand	3.4	3.2	3.5	3.2	3.5	3.6
	Vietnam	3.1	3.2	3.2	2.8	3.5	3.4
	Lower-middle income	2.6	2.5	2.6	2.5	2.6	2.6
	Cambodia	2.3	2.5	2.7	2.6	2.4	2.4
	Laos	2.1	2.5	2.3	2.1	2.7	2.4
	Thailand	3.2	3.0	3.3	3.1	3.4	3.5
	Vietnam	2.9	2.7	3.1	2.9	3.4	3.2
	Lower-middle income	2.4	2.5	2.5	2.5	2.5	2.6
	Cambodia	2.2	2.6	2.8	3.1	2.8	2.3
	Laos	2.7	2.4	2.5	2.2	2.7	2.3
	Thailand	3.3	3.2	3.3	3.4	3.5	3.5
	Vietnam	3.0	3.1	3.2	3.1	3.2	3.3
	Lower-middle income	2.7	2.5	2.6	2.5	2.5	2.6
	Cambodia	2.3	2.3	2.7	2.6	2.4	2.2
	Laos	2.2	2.4	2.4	1.8	2.6	2.3
	Thailand	3.0	3.0	3.2	3.1	3.1	3.3
	Vietnam	2.7	2.7	2.8	2.8	3.0	3.1
	Lower-middle income	2.2	2.3	2.4	2.3	2.4	2.4
	Cambodia	2.8	3.0	2.8	3.3	3.2	2.7
	Laos	3.2	2.8	2.7	2.7	2.8	2.8
	Thailand	3.7	3.6	4.0	3.6	3.8	3.5
	Vietnam	3.4	3.6	3.5	3.5	3.7	3.3
	Lower-middle income	3.2	3.0	2.9	2.9	2.9	2.9
	Cambodia	2.1	2.2	2.6	2.4	2.1	2.1
	Laos	2.0	2.4	2.2	1.8	2.4	2.3
	Thailand	3.2	3.1	3.4	3.1	3.1	3.7
	Vietnam	2.6	2.7	3.1	2.7	3.0	3.2
	Lower-middle income	2.2	2.3	2.3	2.4	2.3	2.4

Note: Ranking is 1–5, low–high. Source: World Bank World Development Indicators (accessed 11 December 2023).

Table 4: Cost and time to export and import: Cambodia versus comparator countries, 2019

Indicator	Cambodia	Laos	Thailand	Vietnam	Lower middle income
Cost to export, border compliance (\$)	375	140	222.6	290	438.7
Cost to export, documentary compliance (\$)	100	235	96.9	139.2	142.1
Cost to import, border compliance (\$)	240	223.5	232.5	373	542
Cost to import, documentary compliance (\$)	120	115	43.5	182.5	211.1
Time to export, border compliance (hours)	48	9	44	55	69.8
Time to export, documentary compliance (hours)	132	60	11.3	50	61
Time to import, border compliance (hours)	7.5	10.5	50.2	56	110.3
Time to import, documentary compliance (hours)	132	60	4	76	71.7

Source: World Bank Ease of Doing Business (accessed 25 April 2023).

5. Long-term inclusive growth: Increasing resilience and sustainability

5.1. Climate change and other environmental pressures

Climate change impacts the livelihoods of millions, as well as threatening longer-term goals. ADB (2023) estimates that Cambodia's GDP could be up to 2.5 percent lower in 2030, and 10 percent lower in 2050, without effective climate adaptation. Improved adaptation policies and practices could reduce the impact by 66 percent by 2050 (MEF and NCSD, 2019).

Economic growth and environmental protection are often considered trade-offs but there can be complementarity. The intersection between the two is green growth, where ecologically sustainable economic growth that fosters low carbon but socially inclusive development is the outcome. Green investments are not only one way to unlock growth potential but also create decent and sustainable jobs for the future. There is significant potential to scale-up investment in renewable energy and energy efficiency using Cambodia's abundant solar energy resources.⁴ Significant parts of Cambodia remain without access to electricity and solar power carries the potential of transforming remote and often poor communities by providing them with affordable, clean energy and the opportunity to improve living conditions.

4 UNDP (2019) estimates that more than USD900 million investment opportunities in solar photovoltaic (PV) exist in Cambodia.

Transitioning away from the heavy reliance on fossil fuels, reducing the rate of deforestation and adopting more sustainable agricultural and fishing practices will be critical in protecting the environment and ensuring the future prospects of these industries.

As green and sustainability aspects of production become increasingly important in business and investment decisions of international firms, reducing Cambodia's carbon footprint would present new growth opportunities that arise from increasing global demand for environmentally sustainable products and services.

5.2. Financial, health, and other shocks or crises

Financial risks

Cambodia will need to strengthen its financial sector's resilience by enhancing regulatory and supervisory frameworks, improving asset quality and risk management practices, and addressing weaknesses in the banking system. There is a need to implement regulations to deal with bank and debt restructuring, and corporate insolvency. Rising private debt following the collapse in the property market has also become a concern that could threaten the stability of the economy and its future growth. The IMF (2024) notes that its share of GDP at around 160 percent is high for a country at its level of development.

With the growth in shadow banking and the increase in non-bank financial institutions, greater regulatory oversight and supervision will be required. Cambodia's authorities will also need to accelerate work on a deposit protection scheme, implement measures to prevent money laundering, and clarify the framework for bank resolution.

Cambodia's authorities will need to carefully monitor the health of banks and microfinance institutions as the forbearance measures are phased out, especially the systemically important banks with high exposure to the construction and real-estate sector. A staged increase in minimum capital requirements could also be used to promote consolidation in the banking and microfinance sectors.

Health crisis

Although Cambodia did remarkably well in managing the COVID-19 pandemic, it highlighted a number of vulnerabilities in the healthcare system that need to be addressed before the next health emergency occurs. Government spending on healthcare needs to be significantly increased in preparation for the next pandemic or major public health outbreak. This was a key limitation in managing the COVID-19 pandemic, requiring more stringent controls than in countries with more robust healthcare systems.

There is great variation in access to quality healthcare in the urban versus rural areas. Increasing both the access and the quality of healthcare in remote regions, that are currently poorly served, are vital to address. Unless there is greater investment to increase the quality and quantity of healthcare services, any future health crisis requiring mass hospitalisation could quickly overwhelm the

healthcare system, inflicting a larger than necessary human and economic toll.

5.3. Technological change, especially the acceleration towards a digital economy

The acceleration towards a digital economy will produce many benefits, but it will also create new challenges. Many low- and medium-skilled jobs may be lost initially, although Artificial Intelligence threatens even highly skilled positions. It will not be easy to redeploy low-skilled workers and reskilling and retraining will be required. Despite the anti-globalisation backlash elsewhere, Cambodia must remain open to importing skills and technology to help catch-up in the short term. In the long- run, the challenges posed by digitalisation and rapid technological change will require a fundamental transformation in systems of education and learning. That is, the digital transition reinforces the need to address the underlying problems associated with human capital and skills development, discussed earlier. Augmenting cognitive skills such as maths and sciences will be critical for the transition to a more innovative, knowledge-based economy. New and innovative approaches to public-private collaboration are also needed, particularly in areas such as research and development.

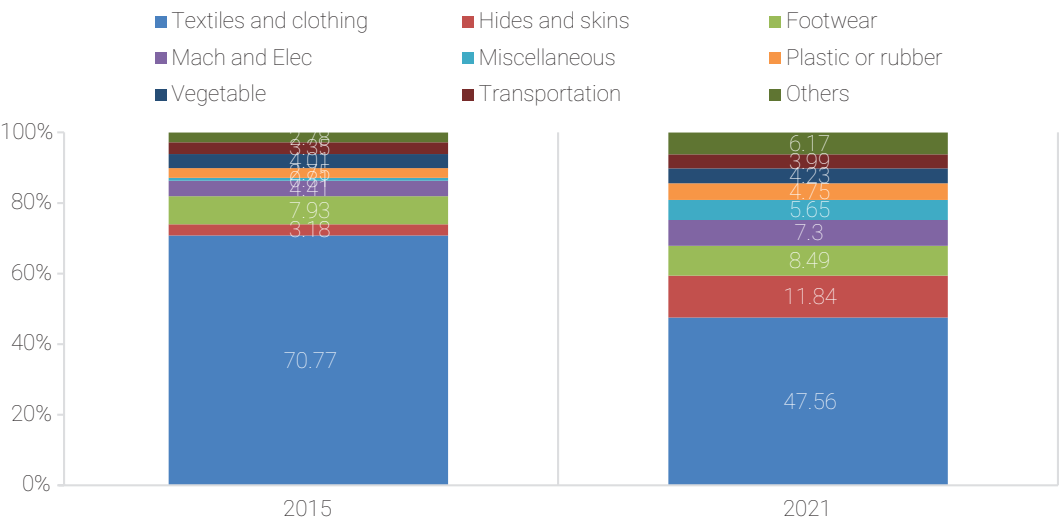
Diversifying export markets and import sources

Cambodia's trade patterns – both the commodity and country composition of its exports and imports – are highly concentrated (see Figures 7, 8, and 9). This raises Cambodia's vulnerability to country- or commodity-specific shocks. As the major

constraints to structural diversification, such as limited human capital and high business costs are addressed, trade and investment flows will also diversify. For instance, if the

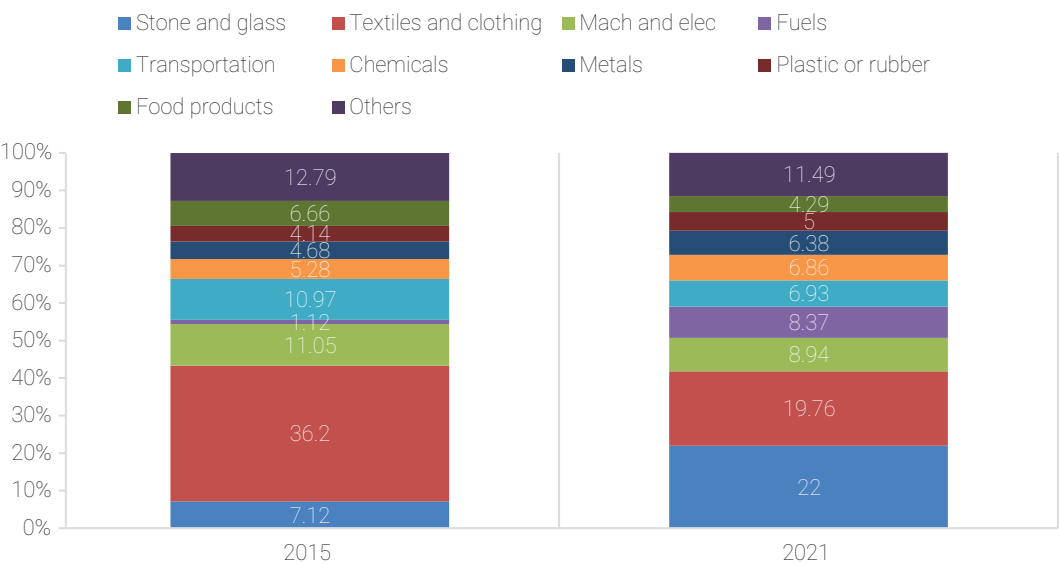
price of electricity could be reduced, this may attract new types of FDI from different source countries, which would result in new outputs, such as electronic parts and components.

Figure 7: Cambodia’s export products, 2015 and 2021 (percent of exports)



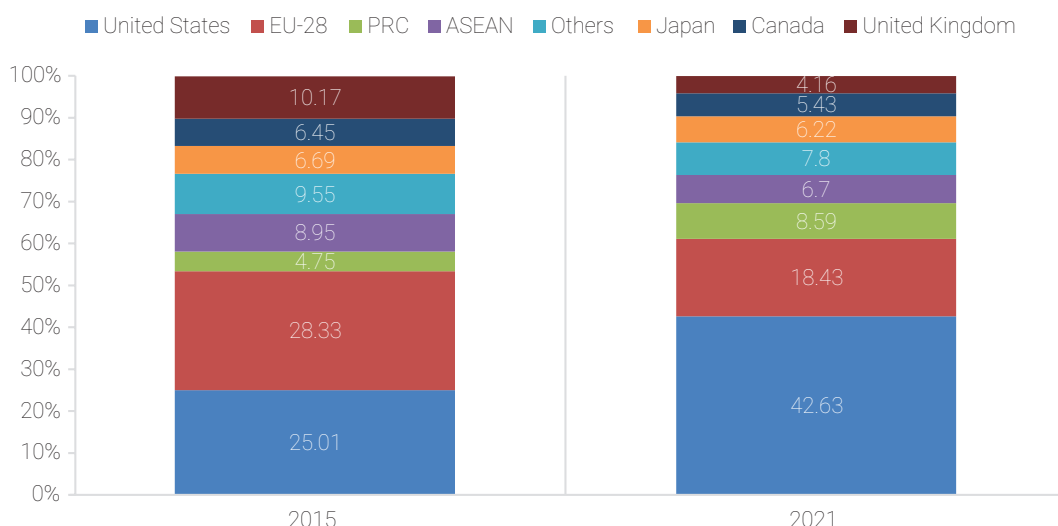
Source: World Bank World Integrated Trade Solution (accessed 11 December 2023).

Figure 8: Cambodia’s import products, 2015 and 2021 (percent of imports)



Source: World Bank World Integrated Trade Solution (accessed 11 December 2023).

Figure 9: Cambodia's export partners, 2015 and 2021 (percent of exports)



ASEAN = Association of Southeast Asian Nations, EU = European Union, PRC = People's Republic of China.
Source: World Bank World Integrated Trade Solution (data downloaded 11 December 2023).

This alters both the commodity and country composition of exports and imports, helping diversify trade and investment patterns. This is one of a number of indirect channels involving policy reform that can affect trade and investment patterns.

There are specific policy changes that can be pursued to deliberately diversify trade and investment flows, and directly improve its sustainability.

Preferences are also present in the many FTAs that Cambodia is engaged in that skew the commodity and country composition of its imports (see Table 5). The margin of preference (MOP) – the difference between preferential and Most-Favoured-Nation (MFN) rates – is still high for many tariff lines and across different FTAs in Cambodia. When MOPs are high, trade patterns can be distorted through trade diversion. It increases the concentration of trade flows by diverting

them from non-FTA partners to FTA partners. Trade diversion is also welfare reducing because imports are no longer sourced from the lowest cost producer. Pursuing open regionalism through multilateralisation of FTA preferences – i.e., offering its preferences to all countries on an MFN basis – is in Cambodia's national interest. It would promote domestic competitiveness and welfare, while reducing the concentration in trade patterns (see Menon, 2022).

Diversifying sources of FDI

Cambodia needs to attract FDI or incur external debt if it is to grow at a rate faster than that determined by its low domestic savings rate. There is a sustainability element associated with both FDI and debt. The need for long-term debt sustainability is widely recognised and better understood than the need to ensure that FDI inflows do not exceed absorptive capacity. The latter is associated

Table 5: Cambodia's 17 free trade agreements and their status

Type	Proposed/under study	Negotiations launched	Signed but Not Yet in Effect	Signed and in Effect
Bilateral			Cambodia–Korea Free Trade Agreement (2021)	Cambodia–People's Republic of China Free Trade Agreement (2022)
Plurilateral	<ul style="list-style-type: none"> • East Asia Free Trade Area (ASEAN+3) (2004) • Comprehensive Economic Partnership for East Asia (2005) • ASEAN-EU Free Trade Agreement (2007) • ASEAN-Pakistan Free Trade Agreement (2009) • ASEAN–Eurasian Economic Union Free Trade Agreement (2016) • Cambodia–Eurasian Economic Union FTA (2017) 	ASEAN–Canada (2021)		<ul style="list-style-type: none"> • ASEAN Free Trade Area (1993) • ASEAN–People's Republic of China Comprehensive Economic Cooperation Agreement (2005) • ASEAN–Republic of Korea Comprehensive Economic Cooperation Agreement (2007) • ASEAN–Japan Comprehensive Economic Partnership (2008) • ASEAN–Australia and New Zealand Free Trade Agreement (2010) • ASEAN–India Comprehensive Economic Cooperation Agreement (2010) • ASEAN–Hong Kong, China Free Trade Agreement (2019) • Regional Comprehensive Economic Partnership (2022)

ASEAN = Association of Southeast Asian Nations, EU = European Union, FTA = free trade agreement.
Source: ADB Asian Regional Integration Center FTA database (accessed 25 April 2023).

with ensuring that external competitiveness of the tradable goods sector is not impaired by a sharp appreciation of the real exchange rate due to massive inflows of FDI, resulting in Dutch Disease type effects. The relevant point here is that an economy like Cambodia should be selective in its choice of projects, whether financed by foreign investment or borrowings,

if it is to grow in a sustainable and inclusive manner. In addition, increasing the share of new investors that can help plug Cambodia into new markets and global manufacturing supply chains will also support domestic structural changes by diversifying sources of growth.

6. Conclusion

To realise its long-term aspirations, Cambodia must pursue inclusive growth that is also sustainable and resilient. A key constraint is the lack of diversification of the economy, which has not affected the rapid pace of economic growth but only the inclusiveness and sustainability of that growth. Future increases in productivity must come from intra-sectoral diversification.

Two key constraints limit the extent of intra-sectoral diversification. First is inadequate human capital, requiring improvements in the quality of education at all levels, starting with primary and secondary schooling. Second is the high cost of doing business, which stems from limited physical and logistics infrastructure, high energy cost, and

the high cost of finance. Addressing these constraints should increase the inclusiveness of economic growth.

To ensure these achievements endure beyond the short term, another set of constraints affecting resilience and sustainability must be addressed. Increasing resilience includes addressing the impacts of climate and technological change, and reducing the risk of financial, health and other crises but, should they occur, mitigating their worst impacts. Improving the sustainability of growth and its drivers involve diversifying trade and investment flows. This will reduce Cambodia's exposure to country-specific shocks and indirectly help with diversification of the economy.

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