



# Cambodia Outlook Brief\*

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## Delivering Sustainable Growth in a Changing Global Economy: Cambodia in 2012<sup>1</sup>

“Cambodia and our region have changed dramatically. Our Asian region is now at the centre of the global economy, with East Asia, and ASEAN at its core, the main driver of growth and economic prosperity.”

*Samdech Akka Moha Sena Padei Techo HUN SEN,  
Prime Minister of the Kingdom of Cambodia*

The 2012 Cambodia Outlook Conference yielded some of the most positive perspectives of recent years on the current state of Cambodia's economy and its potential for future development, and highlighted key areas that the government and the private sector must address if Cambodia's latent potential is to be realised.

Cambodia has made a confident start to 2012. The IMF has predicted that GDP will grow 6.5 percent in 2012, indicative of growing confidence in the economy as it emerges from the crash of 2008/9. The outlook for the medium term sees growth maintaining a robust 6 – 7 percent.

In 2012 Cambodia takes the ASEAN Chair - a valuable platform to further its vision of harmonious and equitable regional growth. But at the helm, it must navigate the region through some tricky waters ahead; the structure of the global economy still presents real dangers for Asia.

### Asia and the Global Economy

Global GDP growth in 2011 remained unbalanced and slow; global growth has since been revised

<sup>1</sup> This is a summary of the 2012 Cambodia Outlook Conference presentations by H.E. Dr Hang Chuon Naron, Secretary of State, Ministry of Economy and Finance, Permanent Vice Chairman, Supreme National Economic Council, Royal Government of Cambodia; Mr Faisal Ahmad, IMF Representative, International Monetary Fund (IMF), Cambodia; Mr Aninda Mitra, ANZ Head of Economics, Southeast Asia; and relevant extracts from the speech of Samdech Akka Moha Sena Padei Techo HUN SEN, Prime Minister of the Kingdom of Cambodia.

downwards by the IMF to a disappointing 4.3 percent, principally because of the poor recovery in advanced economies.

The Eurozone in particular looks frail. Sovereign credit risks in Greece, Italy and others as well as high debt ratios across the region have spelt instability and uncertainty.

Policy responses have been inadequate and uncoordinated, and have so far failed to remedy the situation and provide the conditions for banks to recapitalise. The focus has been on cutting spending, but austerity alone will not work – growth and more burden sharing among European states is crucial if the region is to recover from the current crisis. Thankfully a major catastrophe looks unlikely; nevertheless, deep restructuring can be expected across the Eurozone over the next few years.

Across the Atlantic the US recovery is far from assured: the housing sector holds the key to turnaround over the coming years but at present a troubling 1 in 5 homeowners are in negative equity, which has constrained spending and resulted in low rates of consumption. A flagging labour market is inflaming these tendencies. Decisive mitigating action from government has not been forthcoming; fiscal policy is stuck in a quagmire between stimulus and austerity.

The dire state of affairs in the US and Europe could spell trouble for an increasingly interlinked global economy. Asia in particular is dependent on external demand driven largely by European and North American consumers. Financial contagion from Europe and the US through capital market exposure, especially bond markets, is also a possibility.

The good news for Asia is that many of its economies are relatively sturdy and will likely be able to fend off contagion. The region spent the last decade strengthening economic fundamentals in the wake of the 1997 crash: balance sheets are relatively healthy, financial sector reforms have reduced exposure through slashing both private sector and government debt.

Decisive policy interventions across the region have been crucial in decreasing unemployment and managing inflation. This lends the region leverage to boost domestic demand if demand from advanced economies decreases further.

Asia has also seen a marked increase in capital inflows resultant of liquidity provisioning in Europe and its reputation as a comparatively safe place to invest. But there is some uncertainty about the longer-term sustainability of these inflows, which could be quick to disappear if conditions change. A further concern is that inflows in tandem with rising commodity prices will result in increased inflationary pressures.

But the emerging trend in Asia is a move away from dependence on Europe and the US and towards a future that incorporates regional powerhouses as drivers of growth.

China already stands out as a key force. Its economy looks strong – exports to the US have once again picked up, inflation seems to have peaked and stabilised and most importantly, domestic demand particularly for intermediary goods is increasing. Asian intra-regional trade is already deeply affected by increases in China's consumption, which per percentage point has approximately the same impact as changing consumption trends in the US.

### Cambodia's Ascendance

Mirroring the fortunes of Asia, Cambodia has developed remarkably over the past decade largely due to its stable government, prudent macro-economic policies, development of regulatory and policy frameworks and consistent efforts to increase institutional capacity. Today as it takes ASEAN leadership, the country has changed beyond recognition since 2002, the year when the Royal Government last assumed the ASEAN rotating Chair.

Macroeconomic indicators exhibit a stable outlook (Table 1). Inflation was 5.5 percent in 2011, while International reserves increased from USD2.7 billion in 2010 to USD3.0 billion in 2011. The current account deficit was projected to narrow to 11.9 percent of GDP

**Table 1: Key Macroeconomic Indicators**

	2009	2010	2011	2012
GDP nominal (USDm)	10400	11634	<b>12937</b>	14231
Real GDP (% growth)	0.1	6.0	<b>6.9</b>	6.5
- Agriculture (share)	33.5	33.9	<b>34.0</b>	33.6
- Industry (share)	21.7	21.9	<b>22.6</b>	23.1
- Services (share)	38.8	38.3	<b>37.8</b>	37.7
GDP per capita (USD)	753	830	<b>909</b>	984
Inflation (%)	-0.6	4.0	<b>5.5</b>	5.0
National savings (% of GDP)	21.1	24.7	<b>23.0</b>	22.8
Domestic revenue	11.9	13.2	<b>13.2</b>	13.4
Budget expenditure	20.5	21.3	<b>18.2</b>	18.5
Overall deficit	-6.4	-8.7	<b>-6.1</b>	-6.1
Investment expenditure	9.1	10.3	<b>8.1</b>	8.6
Domestic investment	13.3	13.9	<b>13.9</b>	14.1
Private investment	16.4	16.2	<b>16.2</b>	16.2

Source: H.E. Dr Hang Chuon Naron's Cambodia Outlook Conference presentation, 16 February 2012

in 2011, and having posted a surplus of USD143.2 million in 2010, the balance of payments surplus continued in 2011.

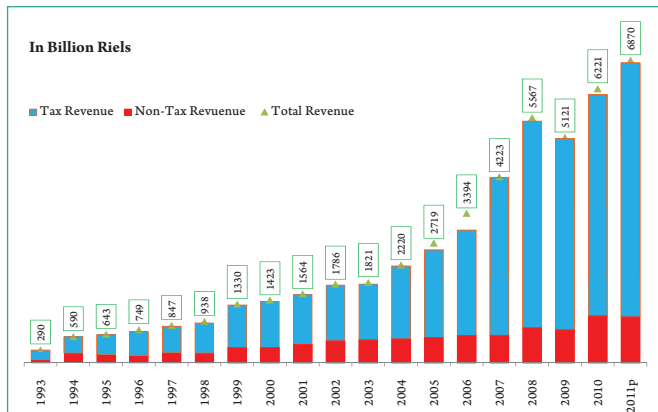
This stability has paid dividends in the form of increased FDI, up from USD533 million in 2010 to USD632 million in 2011. In addition, financial deepening has continued with bank deposits increasing by 19 percent from USD4 billion in December 2010 to USD4.8 billion in November 2011. Meanwhile, credit to the private sector has increased by 28 percent, from USD3.3 billion in December 2010 to USD4.2 billion in November 2011.

Cambodia's key sectors look robust. Agriculture grew a solid 3.3 percent in 2011, strong though slightly lower than the 4 percent in 2010. Total paddy rice production is estimated to increase to around 8.4 million tonnes in 2011 from 8.24 million tonnes in 2010. Rice exports increased to 170,000 tonnes worth USD104 million in 2011, compared to USD35 million in 2010. This huge increase was due to the EU's "Everything But Arms" initiative, which resulted in an exemption on import tax.

Rubber exports increased 125 percent in 2011 to USD200.6 million (46,100 tonnes), compared to USD34.7 million (23,800 tonnes) in 2010, reflecting increased demand for rubber for car tyres, particularly from the Asian region.

Industry grew 14.3 percent in 2011 compared to the negative growth of -9.5 percent in 2009 and positive growth of 13.6 percent in 2010. Garments performed particularly well with exports increasing by 30.7 percent from USD3.0 billion in 2010 to USD3.9 billion in 2011. The industrial sector is expected to

**Figure 1: Revenue Collection**



Source: H.E. Dr Hang Chuon Naron's Cambodia Outlook Conference presentation, 16 February 2012

grow in 2012 and textile exports are projected to further increase, also as a result of the EU's "Everything But Arms" initiative.

The services sector expanded to 5 percent of GDP in 2011, supported by good performance in the tourism sector; tourist arrivals increased by 15 percent in 2011 to around 2.88 million. The sector is projected to grow by around 5.7 percent in 2012, much of which is attributed to the increasing number of visitors from the Asian region.

There are signs that the real estate market is beginning to stage a recovery. Construction permit approvals by the government increased in 2011 and imports of construction materials more than doubled to USD560 million. Some 1980 construction projects worth USD1.6 billion were approved, compared to 2000 projects worth USD655 million in 2010.

The government has also made strides in increasing fiscal space by improving revenue collection (Figure 1). Domestic revenue performance in 2011 was strong and is expected to have remained unchanged from 2010 at 13.2 percent of GDP. Revenue collection by the General Department of Taxation saw a marked improvement, increasing by 12 percent to 2330 billion riels (USD575 million) in 2011.

### Policy Priorities for a Shared Economic Future

It is clear that the Cambodian economy is built on strong foundations, but the changing dynamics of regional and global economies means that it will have to adapt if it is to thrive.

Four interconnected policy outcomes are necessary to ensure Cambodia's sustainable economic future: deeper regional integration, which in the context of weakened demand from advanced economies and growing demand from Asia, is essential to increasing trade and investment; economic diversification so that

Cambodia's economy is strategically prepared to benefit from a growing Asia; increased productivity across all sectors to capitalise on integration and diversification; and inclusive development – not only a moral imperative but a critical facet of a healthy and stable economy.

Deepening regional integration and interconnectivity has been a priority for the Cambodian government, and it has participated enthusiastically in ASEAN and other regional organisations.

With development partners' support, the government has spent the last decade bringing itself into alignment with other countries in the region, both in terms of policy reforms and upgrading physical infrastructure. Notable in this regard, the Asian Development Bank's Greater-Mekong Sub-region initiatives have focused on developing policy, institutions and infrastructure to enable increased economic integration within the region. Key infrastructure such as road and rail networks, shipping and the electricity grid have all been upgraded, eliminating barriers between Cambodia, its neighbours and global markets.

ASEAN membership, and specifically implementing the roadmap to a single market ASEAN Economic Community by 2015, has spurred the government to make the requisite policy reforms to ensure Cambodia meets the criteria for inclusion. On the "ASEAN Economic Community Scorecard", which quantifies how member states have implemented institutional and regulatory reforms to aid integration, Cambodia has achieved more than 70 percent of the key deliverables required, ranking third behind Singapore and Malaysia.

Strides are being made in key areas in the computerisation of cross-border trade and customs transactions to achieve further compliance. However, work still needs to be done in strengthening the institutional capacity of agencies responsible for the administration and good governance of cross-border trade, transport and people flows.

Harnessing the power of trade and investment to diversify the economy through both targeted and cross-sectoral reform has been a core aspect of the government's overall economic strategy. Economic diversification is crucial to the future sustainability of the economy; it is inextricably linked to regional integration, and government strategy should reflect this in order to maximise gains and pursue appropriate partnerships and regional policy agendas.

At present there is an overreliance on garment exports which are highly dependent on North American and European demand. It is crucial that the economy diversifies into new areas such as energy and light manufacturing, and expands into new markets. Already

there are signs of new sectors emerging. For example, Kratie province is becoming a centre for gold mining. It is especially important to develop sectors that can benefit from a growing demand for intermediary goods from China and integrate into regional supply chains.

Diversification into new sectors should be accompanied with increased productivity and diversification within sectors to include new types of products and processes, and to penetrate new markets. To achieve this, the government must focus on enhancing productivity across the economy by targeted policies that remove constraints to the export potential of key sectors, and that encourage increased investment in them.

Within the agricultural sector, there is huge untapped growth potential and endowment. To make sure these are realised, policy needs to focus on agricultural exports, enabling movement up value chains and breaking into new markets. Trade policy that aids rice export growth is particularly important, as well as microfinance and extension services that reduce the costs and increase the productivity of small rice farms.

There is also scope for diversification within the traditional garment and tourism sectors. More efficient manufacturing processes could move Cambodia into better quality and more expensive apparel. Crucially, industry needs to seize opportunities offered by a growing China – there is potential for investment from garment manufacturers in China. Cambodia, with an established garment sector and competitive labour costs, could benefit from increased Chinese investment in the sector.

Tourism can be diversified from cultural to beach and eco-tourism. The development of islands south of Sihanoukville shows great promise in this regard and has attracted significant foreign and domestic investment.

There has been a dearth of research into sector-specific binding constraints to diversification. This needs to be addressed with thorough empirical research and fed back into government policy, so that constraints can be effectively and efficiently removed as they emerge.

At the same time, broad-based cross sectoral policy must augment policy targeting specific sectors. In particular, Cambodia's business environment must be further strengthened to encourage longer-term and diversified investment. This will benefit a wide range of agricultural and industrial practices, both big and small, and spread benefits across all sections of society.

Some familiar issues need addressing. Chief among them is the institutional capacity to implement the country's regulatory and policy frameworks. Anti-corruption initiatives and increasing institutional capacity to implement law and policy are key to increasing long-term diversified investment.

Another cross-sector binding constraint to diversification and increased productivity is the mismatch between labour market skills and private sector needs. Policy must encourage small and medium enterprises (SMEs) and mobilise investment to provide jobs for young people entering the labour market. Much has been done in reforming Higher Education Institutions (HEIs) and developing Technical and Vocational Education and Training (TVET) schemes with development partner assistance, but more work is needed to ensure that educational institutions are responsive to industry needs. Greater cooperation between the public and private sectors is required as well as best practice models that draw on past successes.

There is also a need for policies that directly attack inequality and promote inclusive growth. It is a worrying reality that the Asian region has been traditionally characterised by increases in inequality despite growth. Cambodia has not bucked this trend and irrespective of overall reductions in poverty, has performed modestly in this regard.

Inequitable development can adversely affect growth through the route of political economy. Political stability and harmonious growth is extremely important for investment and fostering a general spirit of entrepreneurialism.

To promote equitable development, Cambodia's growing fiscal space needs to expand further through improving rates of revenue collection. Fiscal space needs to be augmented with policy frameworks that extend benefits across society, chiefly through improving the productivity of agriculture and SMEs and creating social safety nets that protect the poor and vulnerable from economic shocks. In addition, substantial investments in education, that will pay dividends in the future, are urgently required.

Tradeoffs between growth and the environment should be managed to ensure that growth is environmentally sustainable. Again, this necessitates research into the environmental aspects of Cambodia's development so that future policy ensures growth, but also preserves the country's resources for future generations.

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