



CAMBODIA DEVELOPMENT REVIEW

A Publication of CDRI—
Cambodia's leading independent
development policy research institute

VOLUME 14, ISSUE 2

APRIL-JUNE 2010

\$4.00

20th
ANNIVERSARY
CDRI 1990-2010

'Returning to a High Growth Economy— Policy Priorities and Action for Growth and Sustainable Development': The 4th Cambodia Outlook Conference¹

The 4th annual Cambodia Outlook Conference, a partnership of CDRI and ANZ Royal Bank, on the theme 'Returning to a High Growth Economy – Policy Priorities and Action for Growth and Sustainable Development', was held in Phnom Penh on 17 March 2010. The opening keynote address to more than 350 invited leaders from government, the private sector, research and civil society organisations, and the international development community, was again presented by Cambodia's Prime Minister Hun Sen.

In his address, Prime Minister Hun Sen said: 'This year's conference is of particular importance because it is the 20th anniversary of the Cambodia Development Resource Institute, CDRI, your co-hosts today, and now Cambodia's leading independent development policy research institute, playing a critical role in providing evidence based development research and policy recommendations to government and other stakeholders in Cambodia's development.... As Cambodia has grown, developed, and changed over those 20 years, so has CDRI grown, developed and changed, but never losing sight of its mandate - to do independent high quality policy relevant research, but also to train and build the professional and other capacities of Cambodians to make a great intellectual contribution to our nation.'

The conference focused on the major factors that will enable Cambodia to return to a sustainable high



Prime Minister Hun Sen viewing the exhibit of CDRI's 20 year history displayed at the 2010 Cambodia Outlook Conference.

growth economy with associated poverty reduction, both in macroeconomic policy, and in key sectors such as agriculture and rural development, emerging industries, infrastructure and energy, and tourism. The conference resolved that sustainable high levels of economic growth for Cambodia will have to be based on a stable well managed macroeconomic

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¹ Larry Strange, CDRI executive director, introduces this special issue of CDR on the 2010 Cambodia Outlook Conference.

Returning to a High Growth Economy: Indicators, Prospects and Policy Priorities

The following piece is based on summary presentations by Mr John Nelmes¹, H.E. Dr Hang Chuon Naron² and Mr Stephane Guimbert³. The collection covers some key macroeconomic indicators, prospects for the future and some policy options to achieve a sustained growth that among others, would ensure continuous and substantial poverty reduction within the country.

Mr Nelmes covered the following broad issues in his presentation:

- The global economy: A multi-speed recovery
- Cambodia's recent indicators: Where are we now?
- Prospects and policy options: Where are we going, and which road to take?

In terms of the global economy, he argued that following a deep recession, global growth is recovering and trade has rebounded. The global recovery is off to a stronger start than was expected earlier, though at different speeds across regions. Regionally, he affirmed that Asia is leading the global recovery, thanks to strong domestic demand and openness to recovering trade. Worldwide, the recovery is supported by an unprecedented easing of monetary and fiscal policy. As far as advanced economies are concerned, they have exited recession but output levels are well below pre-crisis. Furthermore, recovery is expected to be sluggish by historical standards due to high unemployment, weak credit growth as banks repair balance sheets, and high public debt levels. He pointed out that the IMF is supporting its member countries through the crisis and has delivered unprecedented financial assistance.

As far as Cambodia is concerned, he presented a relatively rosier picture of the Cambodian economy than before, arguing that: (a) Decline of

1 Resident Representative of International Monetary Fund in Cambodia

2 Permanent Vice Chairman, Supreme National Economic Council, Secretary General, Ministry of Economy and Finance, and Chairman CDRI Board of Directors

3 Senior Country Economist, World Bank, Cambodia

economic activity was broad based in 2009, but agriculture was a bright spot; (b) Recession appears to have bottomed out late last year, a recovery is now underway; (c) 2009 growth was negative 2.5 percent, earlier IMF estimates anticipated a larger decline; and (d) Inflation is down significantly.

In terms of sectoral and sub-sectoral impacts, Mr Nelmes covered a number of these including garments, tourism, construction, agriculture and finance. As far as the garment sector is concerned, having been hard hit by the fall in US demand, US recovery may help reverse this decline. However, tough regional competition will make for a challenging recovery. In terms of tourism, arrivals are recovering though tourists spent a lot less money last year. The decline in revenue from tourism is mainly explained by the change in composition of tourists' home country; a larger proportion of tourists now come from neighbouring countries and have limited purchasing power, whereas tourist numbers from richer countries have declined.

At the macro level, investment approvals are down sharply, but a shift in the composition bodes well for boosting longer term growth. Construction activity is slowly recovering after a deep downturn, retail trade is also rebounding. Credit growth is inching upwards after a sharp slowdown from excessive expansion. Inflation fell sharply with the contraction in demand, though higher commodity prices and the expansionary budget have exerted upward pressure more recently.

Agriculture still remains a bright spot, due in part to productivity improvements and infrastructure development. Growth in the sector however is not large enough to counter decline in other sectors. All the changes that have taken place are expected to lead to an overall 2009 GDP growth which is estimated at negative 2.5 percent; although agriculture and public spending grew, most other key components contracted, leading to the overall decline in economic activities.

In terms of prospects and policy options, Mr Nelmes went on to suggest that: (a) growth will turn positive in 2010, estimated to be over 4 percent,

supported by the global recovery; (b) modest fiscal consolidation is key for macroeconomic stability; (c) safeguarding the health of the financial system will support access to finance; and (d) deeper structural reforms would boost long-run growth potential.

The prospect for further gains would be there, he asserted, and growth should exceed 4 percent in 2010 if steady agriculture improvements take place, global outlook improves, and domestic demand recovers. Improvement in budget deficit is another factor that would help the economy. The 2010 budget deficit is expected to be 5.25 percent of GDP; he argued that a lower deficit would be appropriate but that financing from the domestic banking system should be avoided. He commended the Royal Government of Cambodia's revenue performance in 2009 and argued that further efforts in 2010 would eliminate domestic financing needs and open space for additional high-priority development spending.

As far as the financial and banking sector is concerned, he argued for a continued strong supervision of the banking sector and enforcement of prudential regulation to ensure stability and facilitate greater access to finance. He pointed out that the banking system now is highly liquid, but profits are being squeezed by negative interest margins. He cautioned banking authorities to avoid another lending boom in order to mitigate the risks of a later bust.

Over the longer run, he suggested, sustained robust growth would enable Cambodia to move up into middle-income status. To ensure sustained growth however, emphasis on raising the quality of infrastructure and human capacity are fundamental to moving up within ASEAN. To outperform neighbours over the long term would also involve a broader strategy to be more competitive. To achieve this goal, the IMF is helping the government in numerous areas including:

- Macroeconomic and financial sector policy advice through IMF surveillance
- Technical assistance such as
 - monetary policy instruments and framework
 - strengthening banking supervision
 - public financial management reform
- Specialised training courses in macroeconomic policy formulation to build human capacity.

The presentation by Dr Naron that followed comprehensively covered all aspects of economic development including: financing of economic

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The 4th Cambodia Outlook Conference

environment that enables and promotes economic diversification, competitiveness and productivity; the strengthening of key export-oriented sectors, along with mobilisation of domestic savings and consumption; human resource development, especially in vocational education and training; and the strategic integration of Cambodia's economy and its key trade and investment relationships in the Greater Mekong Sub-region (GMS), ASEAN, the broader ASEAN, China, Korea and Japan region, and with other targeted international markets.

The programme, presentations and associated conference materials are available on CDRI's redesigned website. A series of Cambodia Outlook Briefs reflecting the major issues and recommendations for policy and action have also been prepared for distribution to conference participants and others in the Cambodian development community. This issue of CDRI's Cambodia Development Review features articles based on the 2010 Cambodia Outlook Conference theme and session presentations.

development; policy priorities for growth, development and poverty reduction; private sector development; and natural resource management. In this paper, a summary of issues that relate to policy priorities for growth, development and poverty reduction are presented.

Dr Naron first summarised Cambodia's growth potential that includes:

- Abundant arable land that offers potential for improving agricultural production and diversification including agro-processing. Increased production, in particular production of a major crop such as rice, could be exported. The EU's policy of Everything, but Arms as well as rice tax-free exports to EU countries provide a potentially lucrative market for Cambodia. In order to realise this potential however, production constraints in the agriculture sector need to be addressed and priority given to further investment in irrigation and provision of extension services in the rural sector.
- Abundant cheap, but low-skilled labour. As in the

case of the garment sector, there is potential to make use of the surplus labour in some industrial production. Long term however, particular attention should be paid to human resources development and management if Cambodia is to attain the goal of achieving an inclusive and sustained growth that would enable the country to catch up with its neighbours in the region.

- Rich cultural heritage and natural bio-diversity that offer opportunities for strengthening the tourism sector and gaining more from international tourism.
- Mining, oil and gas resources that have yet to be effectively tapped and utilised offer substantial opportunity to generate revenues that are badly needed for developing the country, replicating the experience of some of the fast developers in the region.

He offered a six-pronged policy for growth as a way of realising Cambodia's growth potentials. These include: (1) Human resources development; (2) Agriculture development; (3) Tourism (from cultural to beach tourism); (4) Infrastructure (soft and hard); (5) Emerging industries; and finally (6) Processing industries. In order to implement these policies, there are number of priorities at the macro/financial, fiscal as well as firm levels.

At the macro/financial level, priority should be given to revive growth while maintaining stability. Growth revival can come through one or a combination of fiscal stimulus, monetary policy and financial sector supervision. At this level policies should be aimed at supporting competitiveness (exchange rate policy role of tax policy), and mobilisation of domestic savings.

At the fiscal level, policies should be aimed at creating new fiscal space (tax and non-tax, ODA). Spending should focus on agriculture and infrastructure (maintenance) and education. There are issues that relate to the quality of spending and social safety nets that merit careful consideration. There is also a need for public administration reform to improve implementation capacity.

At the firm level, regulatory reform and trade facilitation (in particular in relation to trade with neighbouring countries) should be given high priority. At the policy level, efforts in making industrial policy work should be made. To achieve this, it is important to monitor and evaluate policies implemented in this regard (e.g. SEZs, ELCs, etc) and

introduce new instruments (agri-business investor clearinghouse, standards, sector coordination, etc). Other areas that merit closer inspection and monitoring include the role and nature of foreign direct investment as well as public-private dialogue (e.g. Government Private Sector Forum).

Dr Naron argued that diversification of the Cambodian economy is a key to widening the growth base of the country and ensuring sustainable growth. Besides weak or limited diversification, he went on to argue that Cambodian export also suffers from low sophistication (e.g. simple value chains) and that Cambodia is not well positioned in the international market. According to him, Cambodia's comparative advantage lies in its abundance of land, region and cheap labour; they should be preserved. Diversification should be achieved within existing industries, e.g. through diversification in markets and intensification of intra-regional trade. The role of agri-business as a way of diversification into new products should also be carefully assessed.

Human resource development and management is another key area of policy in order to achieve Cambodia's growth potentials. To be able to compete in an increasingly open and liberalised world, it is important to have the requisite human resources. This can be achieved through establishing professional and vocational training that could respond to market demand. Increasingly due to industrial diversification, it is also important to strengthen existing mechanisms of labour dispute solutions such as the Arbitration Council as well as demonstration and strike solution committees at all levels, training voluntary mediators among local authorities to solve labour disputes peacefully and ensure sustainable employment.

Dr Naron went on to consider the potential for agriculture growth that could be realised through an effective agriculture strategy. The strategy, he argued, should include the following elements:

- Increasing agricultural productivity through
 - investment in irrigation facilities and rural infrastructures
 - increased use of fertilisers vs. organic farming
 - increased research and extension
 - improved access to credit
- Coordinating and connecting Cambodian farmers to global food value chains
- Policies to increase rice and rubber exports

- Clusters of agricultural products e.g. aquaculture linked to fish and animal feed industry.

Covering similar issues, Mr Guibert presented a summary of a recent World Bank study on growth prospects in Cambodia.⁴ He started his presentation with a quotation from Rectangular Strategy Phase II: “In order to ensure sustainable economic growth, which is *sine qua non* for employment creation and income generation, the Royal Government of Cambodia will continue to foster the diversification and strengthen the competitiveness of the Cambodian economy by assuring a highly conducive climate for both public and private (domestic and foreign) investments for the development of the following important sectors: (1) Agriculture, (2) Water and Irrigation System, (3) Transport Infrastructure, (4) Electricity, (5) Human Resource Development, (6) Labour-Intensive Industry and Food Processing Industry for Exports, (7) Tourism, (8) Exploitation of Oil, Natural Gas and other Minerals, (9) Information and Communication Technology, and (10) Trade” (clause 40 of the strategy, p. 28). A summary of issues that he discussed in relation to trade and trade facilitation is presented here.

In terms of trade competitiveness, a number of key factors play a part including changes in real exchange rates relative to competitors as well as market related constraints that traders are faced with. In terms of exchange rate competitiveness, as the following graph shows, Cambodia has lost a bit of

⁴ World Bank (2009): Sustaining Rapid Growth in a Challenging Environment, Cambodia Country Economic Memorandum, 2009.

Figure 1: Growth in Real Exchange Rates

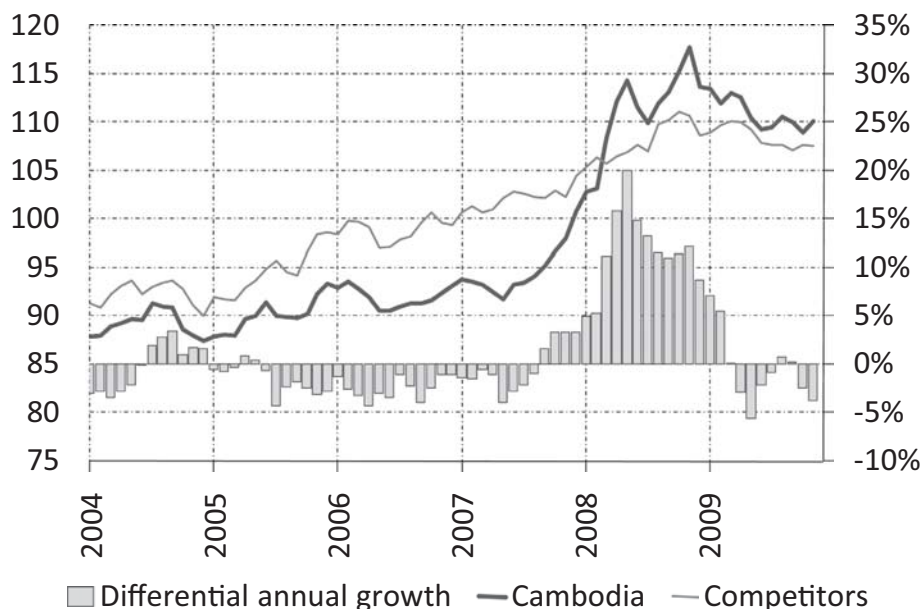
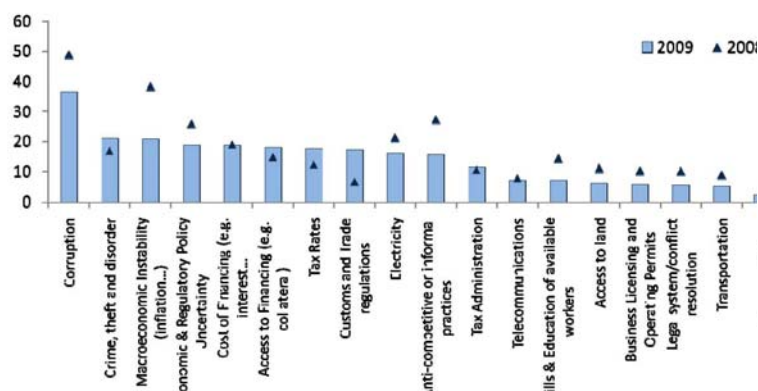


Figure 2: Most Severe Constraints (% firms reporting those as “severe”)



competitiveness in the last few years. This relates to Cambodia’s dollarised economy and strengthening of the dollar in the last few years.

Key constraints to growth, competitiveness and trade in particular, according to the summary of study presented include:

- coordination of value-chains
- complex regulations / informal fees
- electricity
- trade and logistics.

Although most seem to have been reduced in more recent periods, including the most severe constraint that relates to corruption as shown in Figure 2, a number of them however, including customs and trade regulation, seem to have worsened over the period of coverage.