



CAMBODIA *A Publication of CDRI—
Cambodia's leading independent
development policy research institute*
DEVELOPMENT REVIEW

VOLUME 17, ISSUE 1

MARCH 2013

\$4.00

**SECURING CAMBODIA'S FUTURE: TRENDS
AND POLICY PRIORITIES FROM THE 2013
CAMBODIA OUTLOOK CONFERENCE¹**

The 7th annual Cambodia Outlook Conference, a partnership between CDRI and ANZ Royal Bank, took place on 20 February 2013 in Phnom Penh. Leaders from government, the private sector, development partners, the research community and NGOs came together to discuss the theme *Securing Cambodia's Future - Food, Energy and Natural Resources*. In his opening address, Prime Minister Hun Sen congratulated CDRI and ANZ Royal Bank for their long and fruitful partnership and highlighted the important role of the conference in informing government on areas where policy action is necessary.

This article provides an overview of the conference sessions and addresses the major issues pertaining to Cambodia's sustainable and inclusive growth. The first section covers a review of Cambodia's strong macroeconomic indicators and an acknowledgement of the need to pursue more inclusive development models; the second identifies agriculture as a key source of inclusive growth and suggests policies to enhance efficiency and equitability in the sector; the third discusses the changes needed to push Cambodia into and up the middle-income country bracket focusing on energy and transport; and the final section suggests how Cambodia might implement policies to benefit from a growing Asia.



H.E. Dr Sok Siphana, Chair of CDRI Board of Directors, presenting his welcoming remarks at the opening ceremony of the 2013 Cambodia Outlook Conference presided by Prime Minister Hun Sen, Phnom Penh, February 2013

High but not Inclusive Growth

Cambodia's growth, recently revised to 7.7 percent, remained strong in 2012. Gains were made in virtually all sections of the economy. Agriculture grew by 4.3 percent, benefitting from the EU's tariff-eliminating "Everything but Arms" trade initiative and the government's drive to commercialise rubber and rice production. As a result, rice exports reached 180,000 tonnes in 2011

In This Issue

Securing Cambodia's Future: Trends and Policy
Priorities from the 2013 Cambodia Outlook
Conference 1

Leveraging Trade for Economic Growth in Cambodia 8

Gender Inequality in Agriculture: A Household
Survey of Farmer Organisations in Four Provinces.. 13

Economy Watch—External Environment 19

—Domestic Performance..... 21

—Indicators..... 23

CDRI Update 28

¹ Prepared by Benjamin C. R. Flower, Kim Sour, Roth Vathana and Sum Sreymom (CDRI). Presentations from the Outlook Conference are accessible on CDRI's website at www.cdri.org.kh.

and 207,168 tonnes in 2012, of which more than 80 percent went to the European Union. Industry grew by 9.2 percent, with garment exports to the European Union increasing from 23 percent to 30 percent of total, also resultant of the “Everything but Arms” trade initiative. The service sector grew by 8.1 percent, buoyed by high numbers of tourist arrivals that achieved a year-on-year increase of 24.4 percent, reaching a total of over 3.5 million visitors and bringing in around USD2 billion in revenue. Construction also continued its resurgence following the financial crisis with indications of a strong performance in 2012, though concrete figures are not yet available.

There have been signs of diversification within sectors into more value-added economic activities and new sources of growth. In agriculture, the sweeping fishery reforms to create new community fisheries have begun to bear fruit, with the sub-sector registering output growth of 6.7 percent in 2012. There are encouraging signs that the tourism sector is diversifying into beach and eco-tourism, especially with the development of Cambodia’s islands opening growth opportunities in the sector. Mining is emerging as an important source of economic growth since the recent discovery of

significant coal reserves in Kratie.

Sectoral growth has been built on macroeconomic stability and a low inflation rate, which is predicted to drop further to 2.9 percent in 2012 despite high growth (Table 1). Strides have been made in revenue collection as the government seeks to increase resources for health, education and infrastructure: domestic revenue collection by the General Department of Taxation is estimated to increase by 27 percent to KHR2501 billion (USD625 million) in 2012. In this fertile economic climate, Cambodia’s banking sector is becoming increasingly developed: deposits rose by 26.2 percent from USD4.9 billion in December 2011 to USD6.2 billion in 2012, and credit to the private sector in 2012 increased by 35.4 percent to USD5.9 billion from a year earlier. Microfinance deposits also went up more than twofold to USD273.9 million in 2012, while the total loan portfolio grew by 37.9 percent to USD885.8 million.

Cambodia’s progress in improving inclusive development indicators, such as for education and healthcare, has lagged behind its impressive economic development. Recent research suggests that Cambodia is moderately poor on consumption indicators, but is making

Table 1: Key Macroeconomic Indicators

(% of GDP, if not indicated otherwise)	2009	2010	2011	2012p
GDP nominal (USD million)	10400	11634	12937	14231
Real GDP (% growth)	0.1	6.0	7.1	7.3
- Agriculture (share)	33.5	33.9	34.6	36.8
- Industry (share)	21.7	21.9	22.1	21.9
- Services (share)	38.8	38.3	37.5	35.9
GDP per capita (USD)	753	830	911	990
Inflation (%)	-0.6	4.0	5.5	2.9
National savings (% of GDP)	21.1	24.7	24.4	23.7
Domestic revenue	11.9	13.2	13.2	13.7
Budget expenditure	20.5	21.3	20.7	19.0
Overall deficit	-6.4	-8.7	-7.3	-5.3
Investment expenditure	9.1	10.3	9.3	7.3
Domestic investment	13.4	14.1	13.7	13.3
Private investment	16.6	18.2	16.8	16.7

Source: Dr Hang Chuon Naron, 2013 Cambodia Outlook Conference

slow progress on ensuring inclusiveness in non-consumption dimensions. In education, for example, many, especially girls and those living in poor households, cannot afford the costs of secondary or tertiary study. Cambodia's healthcare system, which fails to cover poor households adequately, is also a constraint to inclusive social and economic development. The population also suffers high rates of land and consumption inequality, though recently there has been evidence of a declining rate of consumption inequality.

Failure to respond to underlying issues of socioeconomic inclusion risks jeopardising the hard-won gains Cambodia has made over the last two decades. There is a consensus that persistent high inequalities in income and especially opportunity imperil sustainable growth. Worse, inequality can undo social cohesion and potentially ignite unrest. Cambodia has to be ever vigilant of the level of social inequality to ensure that prosperity is equitably distributed to all segments of society.

Cambodia's progress in improving inclusive development indicators...has lagged behind its impressive economic development. In education, for example, many, especially girls and those living in poor households, cannot afford the costs of secondary or tertiary study. Cambodia's healthcare system, which fails to cover poor households adequately, is a constraint to inclusive social and economic development. Income, assets, and particularly land inequalities are high and in some cases rising.

Agriculture for Inclusive Development

Agricultural development – particularly rice cultivation – is key to inclusive socioeconomic development and poverty reduction. The core sub-sectors (rice, other crops, livestock, fisheries and forestry) play a crucial role in providing food and livelihood security for most of the country's population, employing around 72 percent of the labour force including the majority of the poor.

Agricultural production is hindered by costly and poorly regulated farm inputs. A 2012 case study found that ineffective regulation has resulted in low entry barriers, which lead to the distribution of poor quality fertilisers: up to 10 percent of fertilisers in the study area were counterfeit. Application of fake or adulterated inputs can reduce crop yield equivalent to about USD285-350 per farm per year, hitting the poorest hardest

(CEFP 2011: 22).

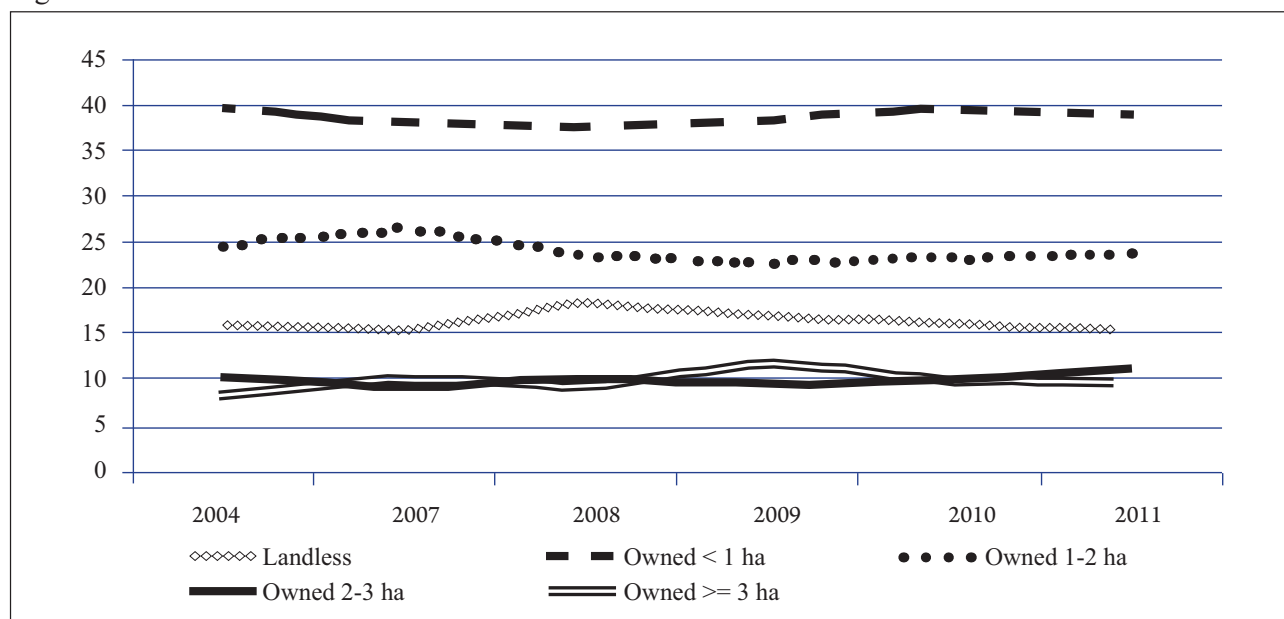
The Ministry of Agriculture, Forestry and Fisheries has made concerted efforts to disseminate high-yield rice seeds across the country. However, persuading farmers to use these varieties has proved challenging as they prefer to use seeds with established markets, for example the IR 504 strain from Vietnam. In addition, farmers find it difficult to access seeds due to supply shortages and high prices. A recent study found that supply was equal to only 20 percent of demand. Future policy must focus on removing constraints to seed supply (CDRI: 2012).

Credit is one of the most expensive farming inputs, especially for smallholders who rely on informal credit markets. Majority of farmers obtain high-interest (around 5 percent per month) moneylender loans, which are readily accessible in times of need. Although microfinance institutions' activity is growing, interest rates remain high at about 2.5 percent per month – a major burden for smallholders.

Expensive credit, fertilisers, pesticides and fuel combine with a lack of extension services to render many small farms inefficient. Better extension services are crucial if Cambodia's agriculture is to become more efficient and diversify. In rice production, for example, farm production training must focus more on pest control, fertiliser use and other modern rice-farming techniques. In livestock farming programmes, policy should promote animal husbandry, breeding programmes and veterinary extension services.

Research has shown that the promotion of contract farming in Cambodia has addressed many of the constraints facing smallholders. Contract farmers receive better quality seeds and are able to learn modern production techniques, access low interest credit, and trade within institutional frameworks that offer fairer prices

Figure 1: Land Distribution in Cambodia



Source: Dr Theng Vuthy, 2013 Cambodia Outlook Conference

and more stable demand. However, there remain issues regarding rice contract farming. The main drawback is that contractors control the production process: farmers are unable to influence the terms of agreement, have little bargaining power to negotiate output prices, and can generally only agree or disagree to the terms. In addition, some of the terms are too complex for smallholder farmers. Many have left contract schemes due to these factors. Future policy, therefore, should focus on simplifying contract agreements so that farmers can have more say.

Farmer organisations are another growing institutional production and market mechanism to empower smallholders. At present, there are 14,000 producer and resource-user groups nationwide, including 240 agricultural cooperatives. These organisations promote productivity by enabling farmers to negotiate better prices for their products, and disseminate information and technology. However, they do not address the fundamental issue of smallholder access to input and output markets. A more holistic approach is needed to link farmer organisations to contract farming and to tackle the multiple constraints to smallholder investment.

A major constraint to agricultural development and a source of social and economic exclusion is the low capacity of land governance institutions.

This has resulted in inequitable distribution of land that is negative from both production-efficiency and poverty-equity points of view. As Figure 1 illustrates, landlessness over the past decade has hovered between 15 and 20 percent of rural households, and those owning less than 1 hectare has remained at around 40 percent. This rural demographic is in many cases limited to subsistence farming, mainly because of the paucity of subsistence farmers' asset base. The majority of farming households cannot create a surplus that would contribute to growth, and are stuck in a continuous cycle of poverty.

The government's land governance institutions are both a cause and a potential solution to inequitable land distribution. On the one hand, poorly regulated economic land concessions (ELCs) have been used to expropriate land from vulnerable smallholders, and have thus contributed to land inequality. On the other hand, if properly regulated, ELCs and social land concessions (SLCs) are strong tools with which the government can increase the efficiency and equity of agricultural land distribution. Recognising this, the government ordered reviews into the process of allocating ELCs – many have been since been cancelled for violation of contract terms. Redistribution of this land is happening, but at a slow pace. ELCs covering about 133,000 hectares have been cancelled since

the prime minister's announcement of more rigorous review procedures, yet only about 40,000 to 50,000 hectares have been made available for reallocation as SLCs.

The national land titling programme is also intended to ensure legal security of tenure for households across the country. At the prime minister's behest, the programme was recently expanded to speed up the issuance of land titles to rural smallholders, thereby increasing their tenure security. These efforts need to be sustained if universal tenure security – a foundation of inclusive growth – is to be achieved.

There are also issues pertaining to the sustainable management of fisheries and forestry resources. Fisheries are an important growth sub-sector, but effective controls for legal fishing are needed so that stocks and biodiversity are maintained. More research should be done into the country's fisheries reserves so that fishing lots can be allocated appropriately. Efforts must be stepped up in the classification and demarcation of forests, and the monitoring of their usage. Conservation of forest biodiversity is critical to both environmental sustainability and the sustainable use of forests as an economic resource.

Securing Cambodia's Medium-term Development

Along with inclusive development, the key to sustaining Cambodia's high rates of growth is

restructuring the economy to reflect changing internal and external economic conditions. It is important to recognise that Cambodia's economy will change as it moves closer towards middle-income status. Looming is the so-called "middle-income country trap", a precedent that suggests economic development stalls as rising per capita GDP diminishes the effect of comparative advantages that caused past high growth. If not countered now, this effect could spell the end of Cambodia's remarkable period of development.

At present, a major advantage that has attracted investment and made exports competitive is low cost labour, but as per capita GDP grows this advantage will be lost. It is essential, therefore, that the labour force is appropriately skilled to diversify economic activity into more complex, more value-added industrial, agricultural and service industries. The government has been promoting Technical Vocational Education and Training (TVET) programmes to up-skill the labour force and avoid the middle-income trap. Such programmes need to be scaled up and an institutional mechanism that can bring together government, higher education institutions and the private sector to develop curriculums that are dynamic and can fit economic changing conditions must be put in place.

A key part of the government's medium term economic strategy is to massively increase milled rice exports to become the globe's third largest rice exporter by 2015. But there are constraints that have to be overcome if this is to become a reality. The high price of electricity adds significantly to the cost of milled rice exports. High-cost electricity imported from Thailand and Vietnam serves about 41 percent of the country's energy needs, resulting in consumers facing some of the most expensive electricity bills in the region. The country lacks sufficient infrastructure to transmit the power it produces to the population and their businesses, particularly those in rural areas. In 2010, the power grid supplied just 7 percent of rural households and around 11 percent of total villages' energy needs. In areas connected to the grid, there are wide variations in cost.

Poor energy infrastructure directly affects rice-milling operations, adding significant costs for producers. A 2012 survey of rice mills found that Pursat, which is relatively far from the border

Table 2: Electricity Costs for Rice Mills, 2012

Province	Price per KWh	
	USD	KHR
Banteay Meanchey	0.25	1000
Siem Reap	0.21	820
Battambang	0.25	1000
Pursat	0.40	1600
Svay Rieng	0.16	650
Kandal	0.28	1100
Kg Cham	0.33	1300
Prey Veng	0.26	1050
Takeo	0.24	950

Source: Mr David Van, 2013 Cambodia Outlook Conference

and hydropower dams, had the most expensive electricity at USD0.40 per KWh, while Svay Rieng near the Vietnamese border had the cheapest at around USD0.16 per KWh (Table 2). Because of disparities in electricity services and problems of supply reliability, many businesses use their own power sources. A survey of 97 rice millers in Banteay Meanchey, Siem Reap, Kompong Cham, Kompong Thom, Prey Veng, Kandal and Kompong Speu provinces found that the majority (83) use their own diesel generators.

Low-capacity hard infrastructure means that transport costs in Cambodia are among the highest in the region. Road haulage is the primary mode of transport and costs on average around USD15-17 per tonne, significantly higher than in neighbouring Thailand and Vietnam. Official and unofficial fees associated with export procedures (e.g. customs paperwork, sanitation controls) add still more to export costs. In the case of rice exports, the total processing cost is estimated to be about twice the official fees, adding around USD10 per tonne. The government's present strategy to upgrade transport infrastructure prioritises roads, railways and bridges. However, river transport offers a potential mode of transport that is cheap and efficient. In Vietnam, for example, river transport costs just USD3 per tonne, significantly cheaper than Cambodia's road haulage costs. Although there is great potential for river transport, it has received little investment or attention from policy makers.

Public-private partnerships (PPPs) can link the complementary aspects of public and private entities to upgrade transport, electricity infrastructure and increase the capacity of higher education. This is crucial in the case of Cambodia because neither public nor private sector can alone meet the huge demands that are required. State

investment in infrastructure is limited because low tax receipts and declining overseas development assistance inflows reduce fiscal space. Although the business climate has improved in recent years, private companies tend to lack the capability to take on large-scale projects, especially in infrastructure development.

PPPs have already played a crucial role in upgrading Cambodia's energy and transport infrastructure. The Power Transmission Line Project covers the construction of 221 km of 115 kV transmission line from Poipet to Siem Reap and Battambang, and includes three substations and one switching station. This transmission line transmits electricity from Thailand to Siem Reap, Banteay Meanchey and Battambang provinces. In transport, the USD141.6 million railway rehabilitation project was facilitated through a concession agreement signed with a private railway operator, Toll Royal Railway, in June 2009. The government retains ownership of the existing and rehabilitated assets, while the concessionaire pays concession fees to the government. Similar programmes should be extended to the education sector.

For future PPPs to be effective, they must be underpinned by solid institutional frameworks that set out best-practice procedures. These include clear output specifications, service payments, whole-life project costing, optimal risk allocation, competitive bidding, leveraging public resources, and effective contact management. Better coordination between ministries and key stakeholders is vital and can be achieved by the development of cross-ministerial mechanisms, such as the PPP and Risk Management Unit. Transparent and accountable operating procedures are of particular importance given the attention recently given to the social and environmental impacts of PPP projects, for example

***Public-private partnerships (PPPs)
can link the complementary aspects of public
and private entities to upgrade transport,
electricity infrastructure and increase the
capacity of higher education. This is crucial in
the case of Cambodia because neither public nor
private sector can alone meet the huge demands
that are required.***

the resettlement of communities affected by infrastructure upgrading. It is crucial that potentially damaging impacts are built into project design and mitigated, with responsibilities clearly delegated among partners.

Planning for the Asian Century

The emergence of Asia – and in particular China – as driver of global growth offers new opportunities for policy makers to push inclusive and sustainable growth strategies across the region. Perhaps most notable are the opportunities afforded by the emergence of China as an economic superpower. China's regional presence has increased dramatically in recent years: it is now at the core of production networks, effectively linking the different components of regional manufacturing processes, facilitating the efficient supply of goods to global markets and providing a core source of FDI. So integrated are Asian economies, and the Greater Mekong Sub-Region (GMS) countries in particular, that even slight changes in China's GDP growth have major implications at a national level.

If China's economy continues to grow and its society becomes more affluent, large markets will emerge for a variety of GMS products. Already, there has been strong growth in domestic demand for durable goods and agricultural products as the Chinese population's consumption needs change. Sustained and diversified industrial development means Chinese industry will require vast quantities of raw materials, minerals and energy. The GMS is geographically, economically and politically well placed to satiate this demand.

As Chinese labour costs rise, industry will migrate to sites of low-cost production. Again, the GMS is well poised to become a global manufacturing hub; increasingly it is becoming a destination of labour intensive manufacturing.

For Cambodian policy makers, the challenge will be to restructure the economy to realise the opportunities offered by a growing China. If utilised effectively, policy tools can take advantage of changing patterns of intra-regional capital flows to increase employment, raise labour productivity, enable more effective technology transfers, move the economy higher up the value chain, and, ultimately, enable sustained high

GDP growth.

A strong ASEAN will increase Cambodia's negotiating power and enable the economy to benefit from favourable trade agreements with China and other emerging economies in the region. Cambodia, as Chair of ASEAN in 2012, enthusiastically encouraged member states to pass the requisite reforms for inclusion into the ASEAN Economic Community 2015. There is a risk, however, that Cambodia's policy space may be reduced by commitments to ASEAN. This is an important issue for Cambodia, as there are a number of areas where the country lags behind its neighbours and where decisive policy action is needed.

It is also crucial that policy frameworks are receptive to the increasing intra-regional flows of investment. A prerequisite to this is improvement in the country's business environment. The biggest constraint is corruption, especially as regards conflict resolution and contract enforcement. Long-term, diversified foreign investment requires an institutional environment that promotes strong property rights and even distribution of market information. The capacity of existing institutions has to be developed to satisfy this need. The government must work to strengthen the financial sector to aid this economic restructuring by extending well-regulated credit to small and medium-sized enterprises. In the longer-term, de-dollarising the economy is crucial for the long-term stability and development of the financial sector. As the Chinese economy becomes a greater force in the region, the government may consider the Chinese renminbi a more appropriate foreign currency to work with than the United States dollar.

References

- CEFP–Committee for Economic and Financial Policy (2011), *Review Report on the Implementation of Policy paper on the Promotion of Paddy Production and Rice Export* (Phnom Penh: Ministry of Economy and Finance/Committee for Economic and Financial Policy)
- CDRI–Cambodia Development Resource Institute (2012), “Fertiliser Value Chains in Cambodia: A Case Study in Takeo Province” *Cambodia Development Review*, Volume 16, p 5 – 9 (Phnom Penh: CDRI)