

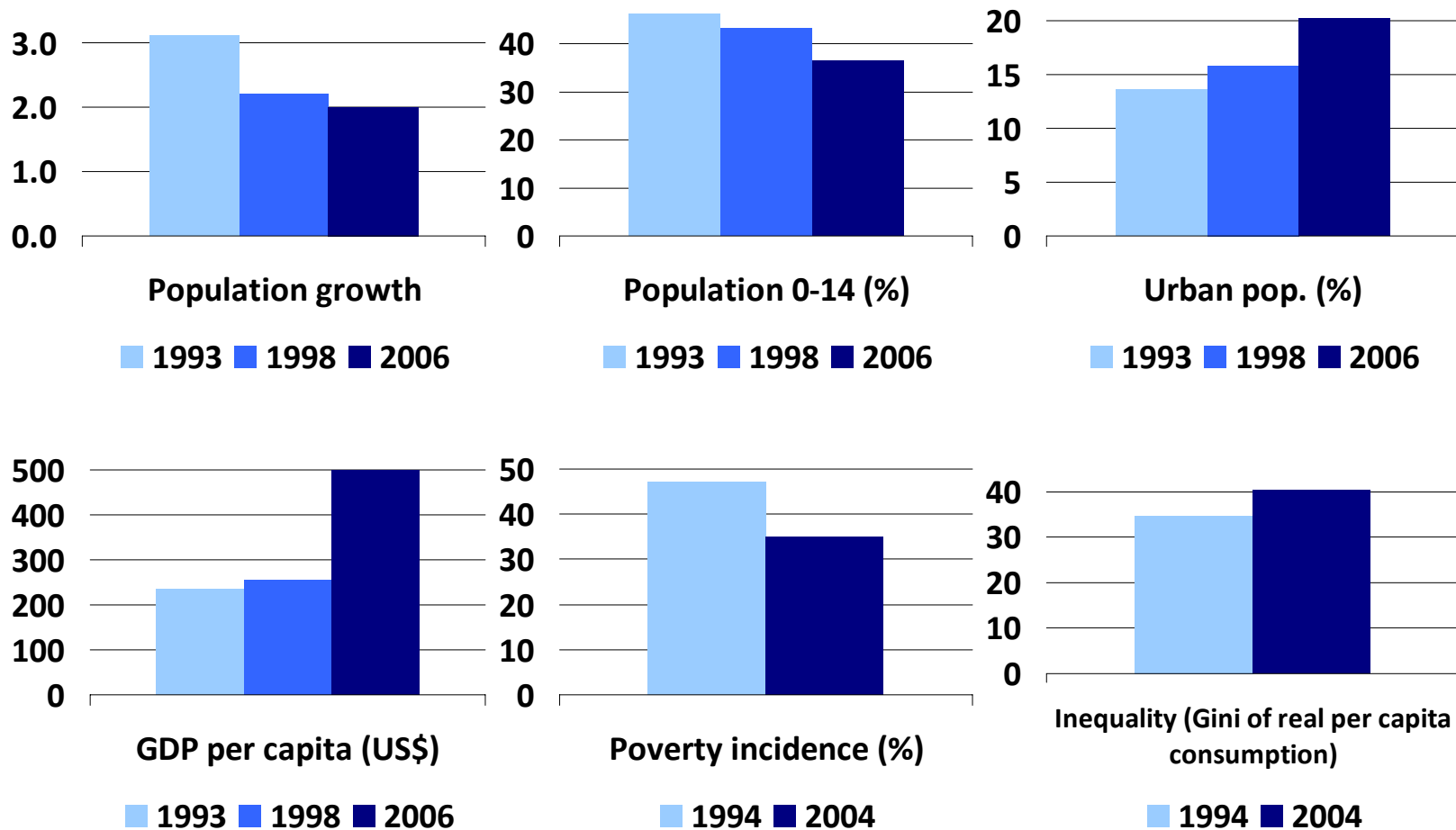


# **Cambodia:** *sustaining rapid growth*

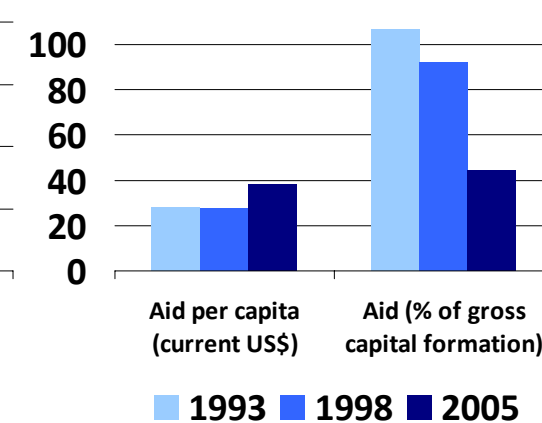
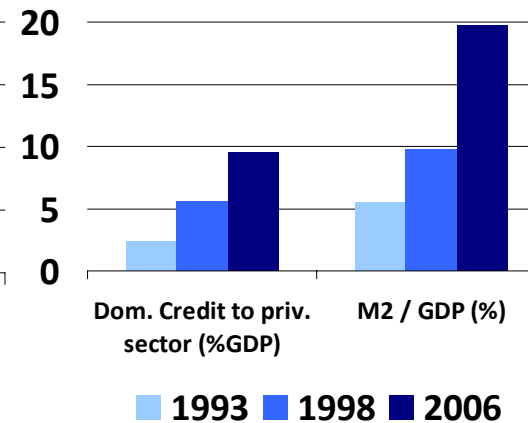
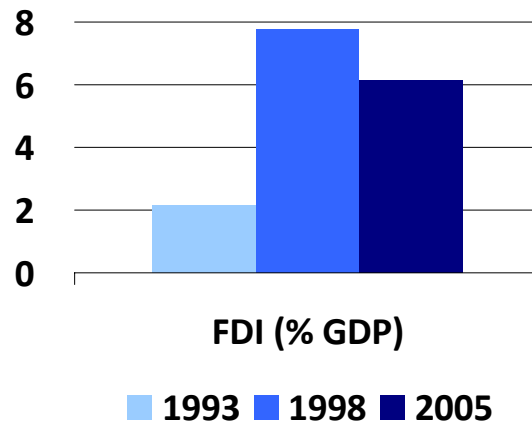
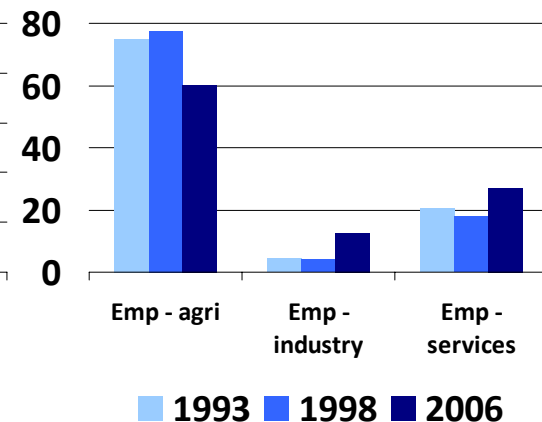
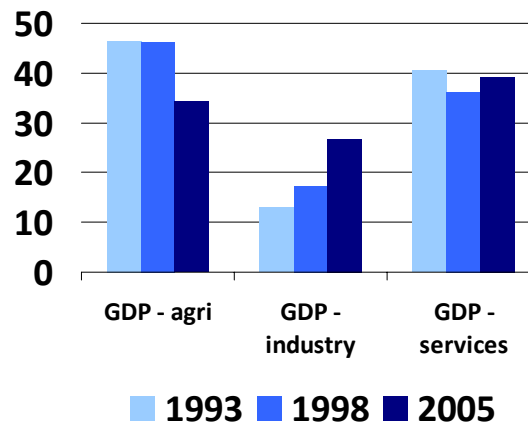
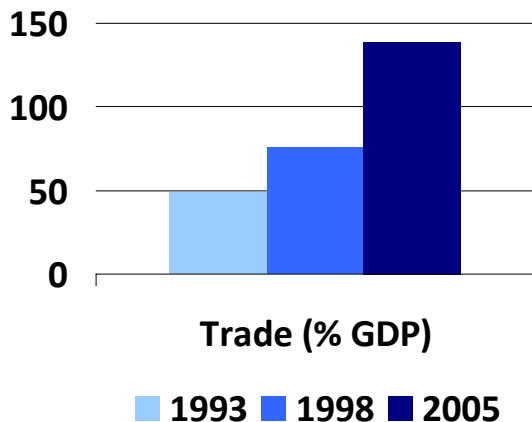
facts and questions

External Advisory Panel  
February 25-26, 2008

# the structural transformation of Cambodia

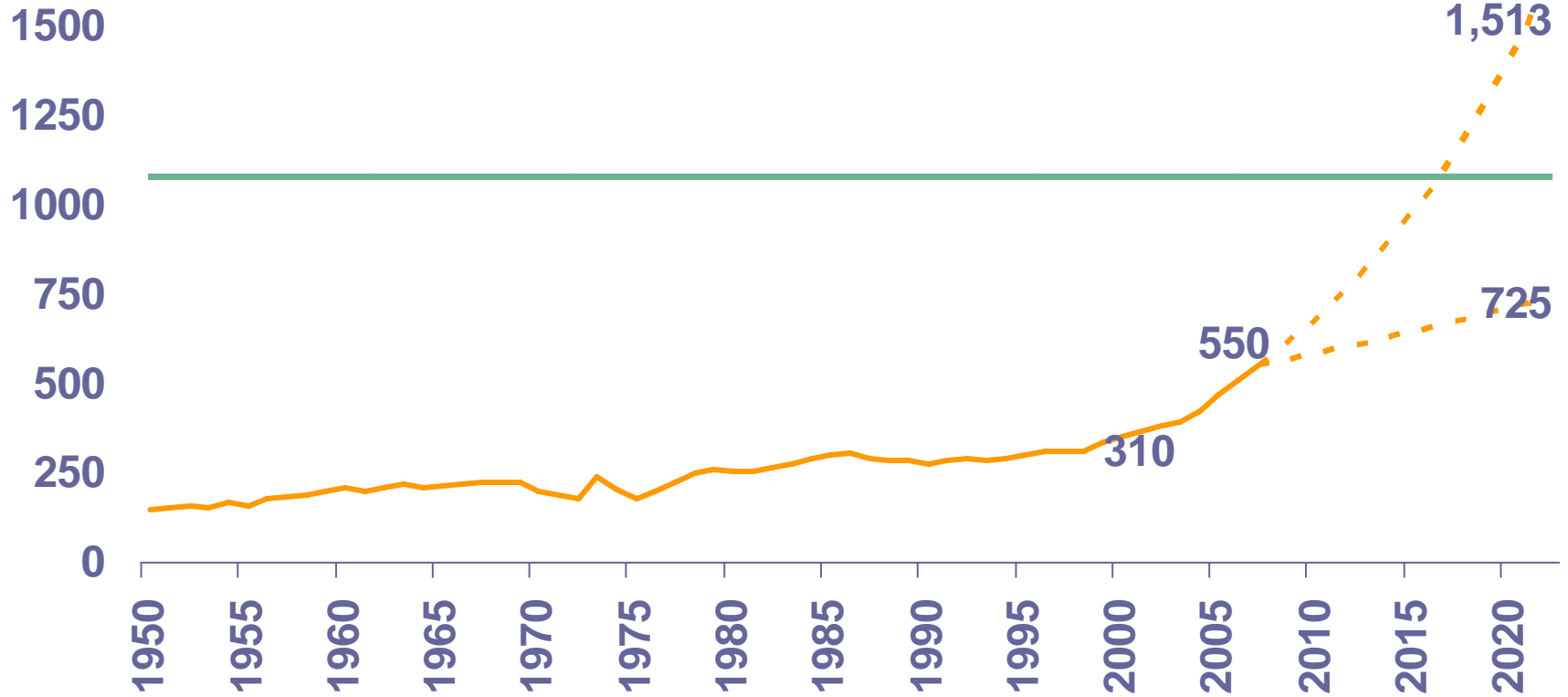


# the structural transformation of Cambodia, cont.



# reaching new heights?

Income per capita (2007 \$)



# reaching new heights?

**1**

**where are the sources of growth?**

**2**

**where are the binding constraints?**

**3**

**how to alleviate these constraints?**

# 1. where are the sources of growth?

## FACTS

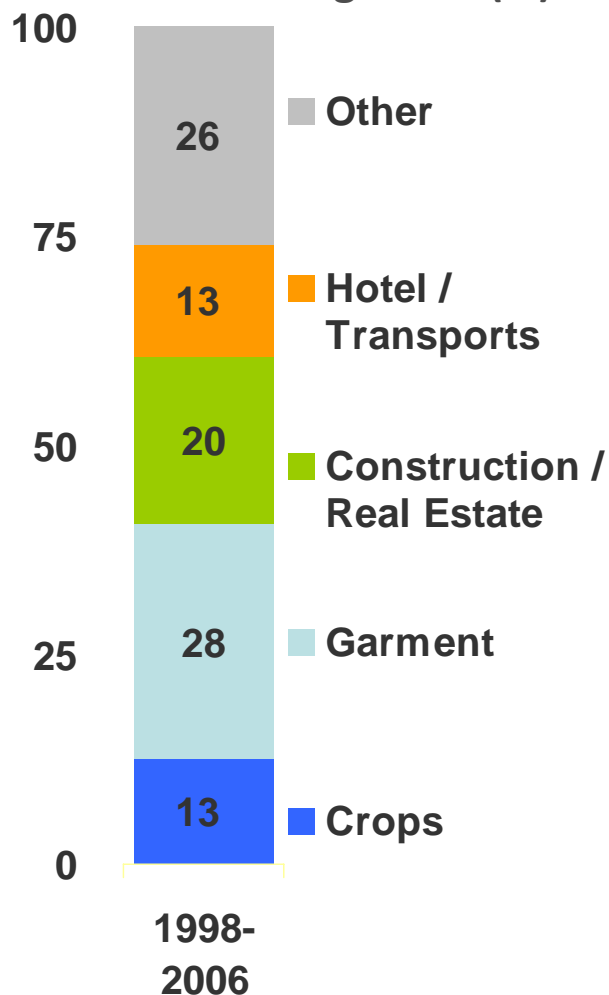
- Narrow base of growth
- Export driven
  - Garment and tourism niches
  - Good location in South-East Asia and open economy
- Key role of the rural economy and agriculture
- Possible new sources of growth in oil, gas, and mining

## QUESTIONS

- How to diversify? What should be the approach? Can priority products be identified?
- What will / should be the role of agriculture?
- What are the employment implications of various sectoral scenarios?

# growing with four fragile engines

Contribution to growth (%)



**Tourism:** rapid growth. Initially mainly to Siem Reap and Angkor – gradually to Phnom Penh and Sihanoukville, with further potential

**Real estate / construction:** very rapid growth, especially in Phnom Penh; talks of a bubble

**Garments:** main (only?) export; mainly to US market; slow growth in 2007 with competition from Vietnam; further competition (inc. China) in the future?

**Crops:** rain-fed; mainly rice

# 19 priority products

Export potential	Products
High	Garments, tourism, footwear, rubber, cassava
Medium	Fishery, rice, fruits and vegetables, wood products, light manufacturing, labor services, soybeans
Low	Silk, livestock, cashew nuts, corn, beer, web-based services, transport services



# the role of agriculture

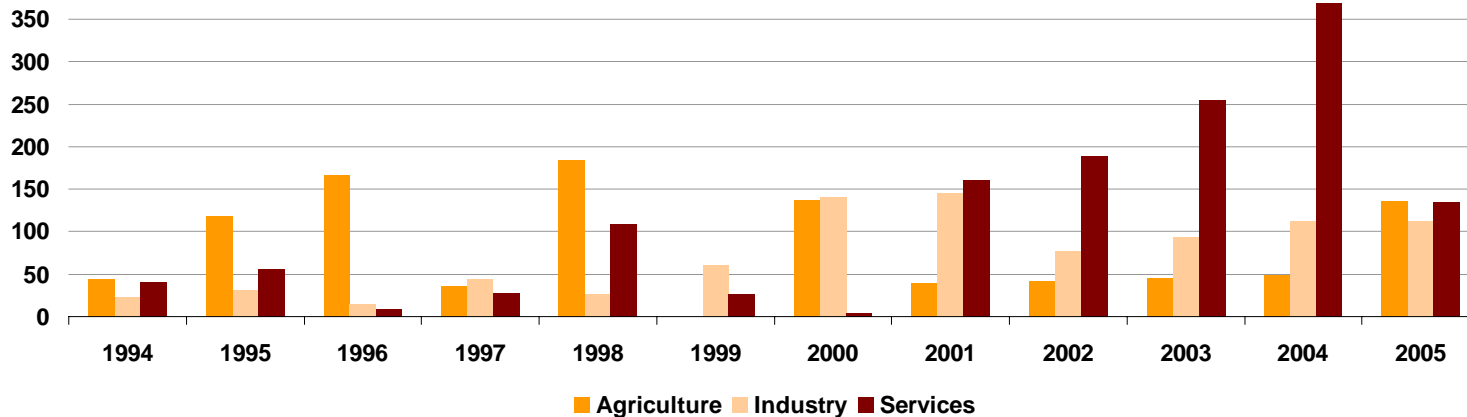
	Agriculture based	<b>Cambodia</b>	Transforming
Rural population, 2005 (%)	68	<b>81</b>	63
Agricultural GDP per capita, 2005 (US\$ 2000)	111	<b>127</b>	142
Share of agriculture in GDP, 2005 (%)	29	<b>31</b>	13
Share of agriculture in labor force, 2005 (%)	65	<b>69</b>	57
Annual agric. GDP growth, 1993-2005 (%)	4.0	<b>3.8</b>	2.9
Annual nonagric. GDP growth, 1993-2005 (%)	3.5	<b>9.9</b>	7.0
Total \$1.08/day poverty rate, (%)	49	<b>66</b>	22
Share of rural poor in total poor (%)	70	<b>88</b>	82

# extractive industries – making it a blessing

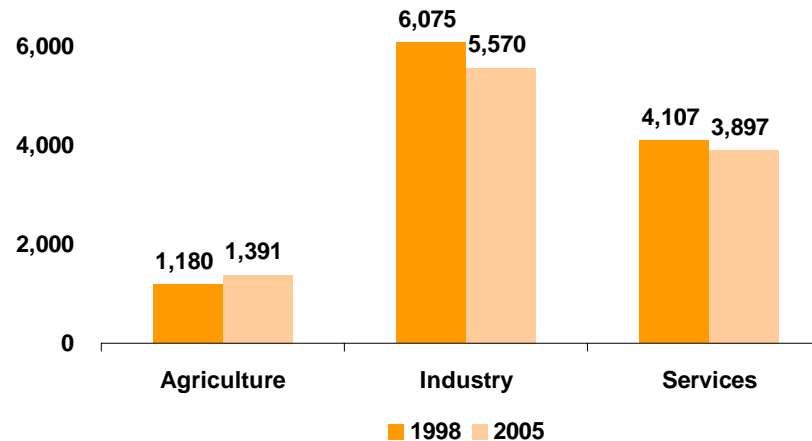
- Oil, gas:
  - Some exploration (offshore), but no proven reserve yet
  - Hypothetical scenario (IMF) of revenues on-stream in 2011; net present value of oil wealth at \$15b (115% of 2011 GDP); revenue stream max at 4% of GDP in 2021
- Mining:
  - Bauxite, iron, gold
  - Just initial exploration
- Maximize revenues:
  - Legal and fiscal regime
  - Good investors
- Manage assets, volatility and macro
- Other impact:
  - Economic (downstream industry?)
  - Environmental (esp. artisanal mining)
  - Social, safety, etc.

# creating 200-250,000 jobs per year

Annual job creation ('000 jobs)



Value added per worker (constant riels)



# what are the constraints?

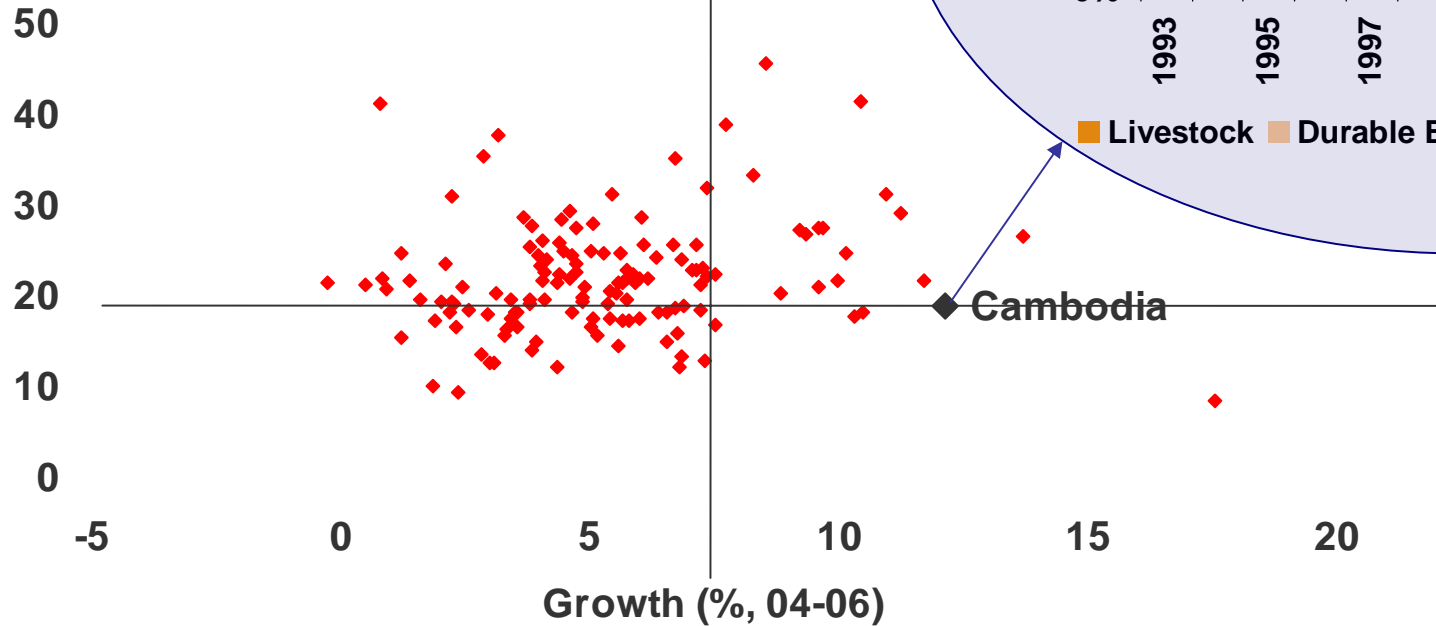
## FACTS

- Increasing investment, but focused on real estate
- Weak productivity, limited diversification and innovation
- Constraints seem to be many!

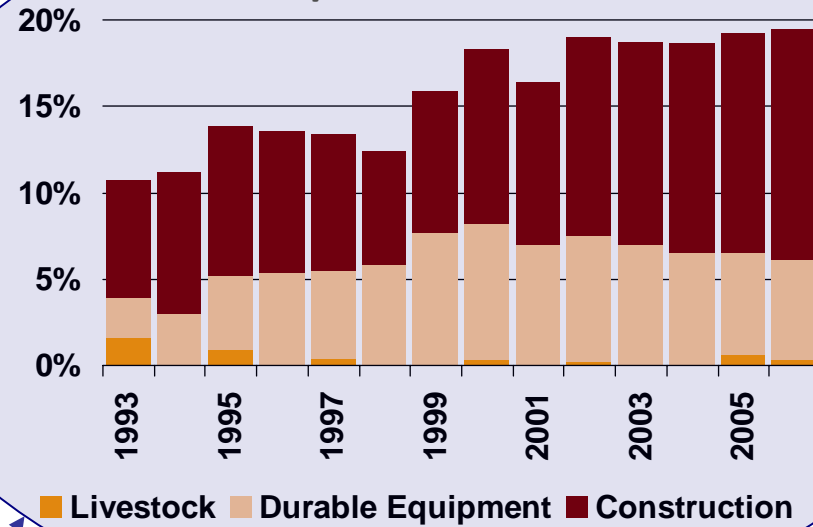
## QUESTIONS

- How to identify binding constraints? Are some of them sector-specific?
- What are the stylized facts of private sector development that are symptoms of binding constraints?

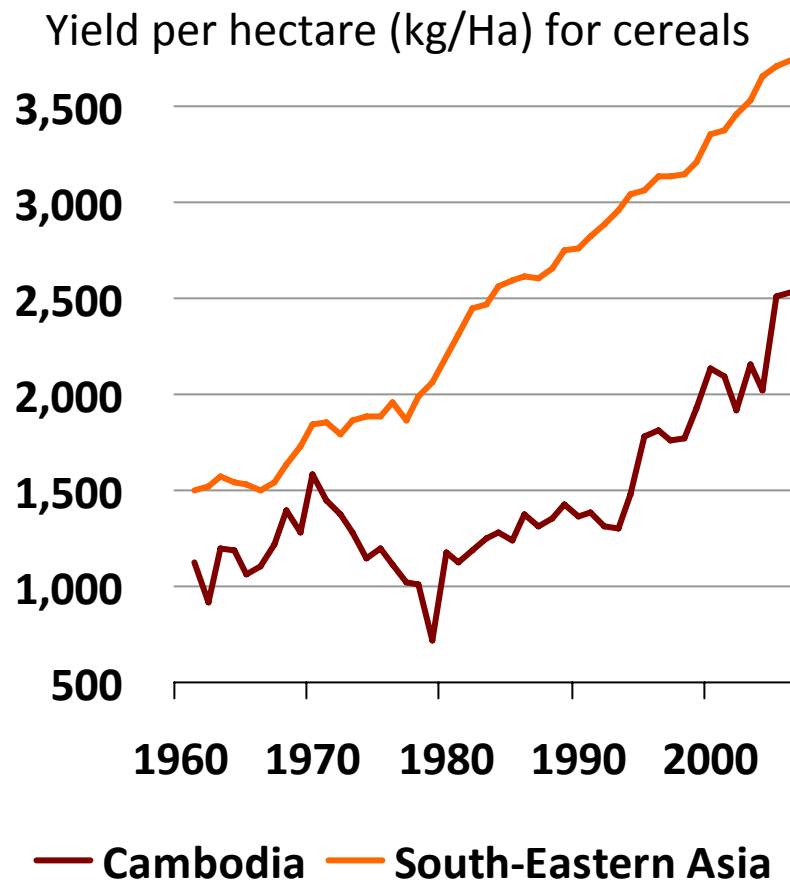
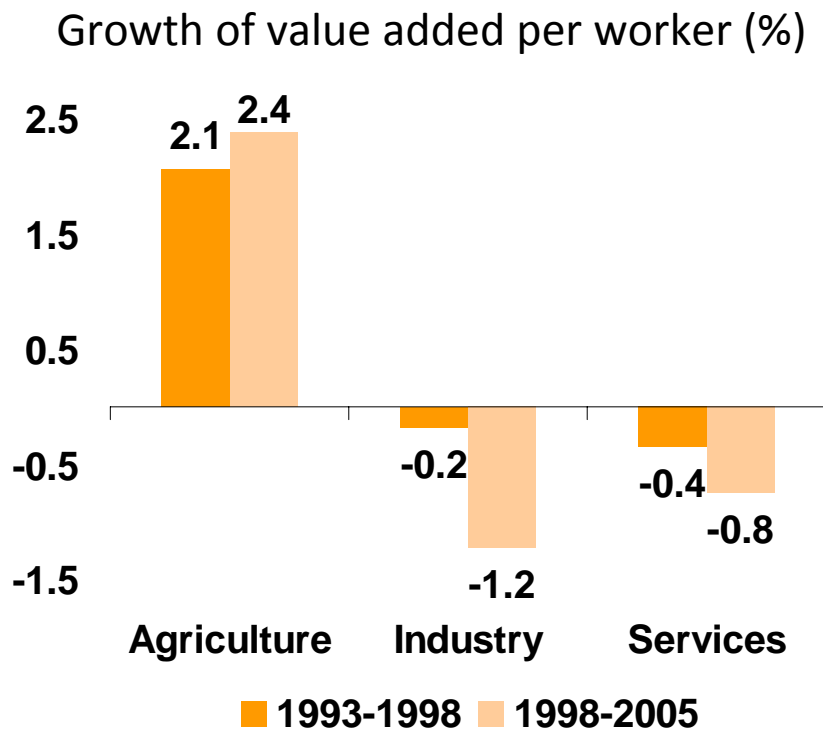
## investment

Investment /  
GDP (%, 04-  
05)

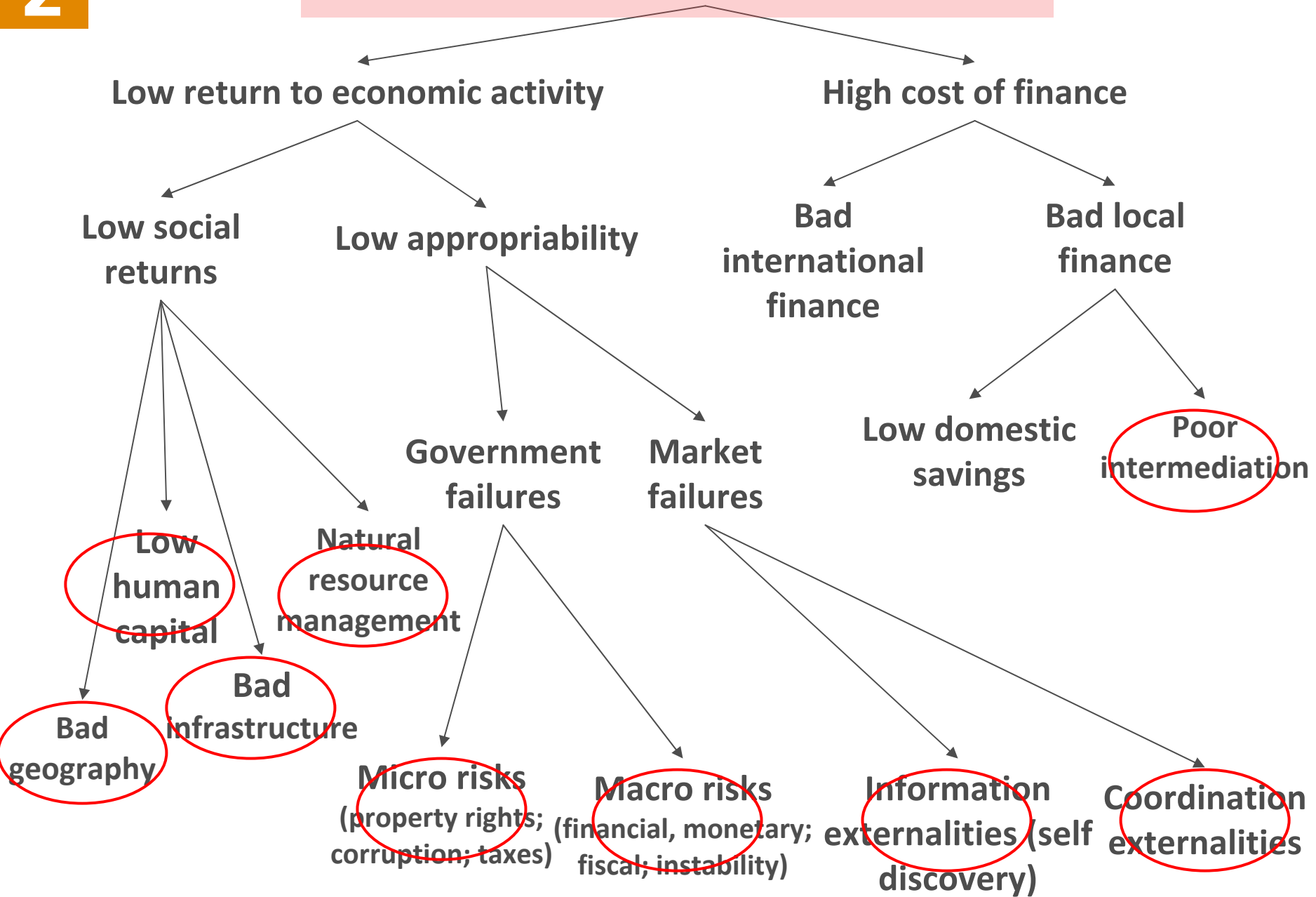
Investment / GDP



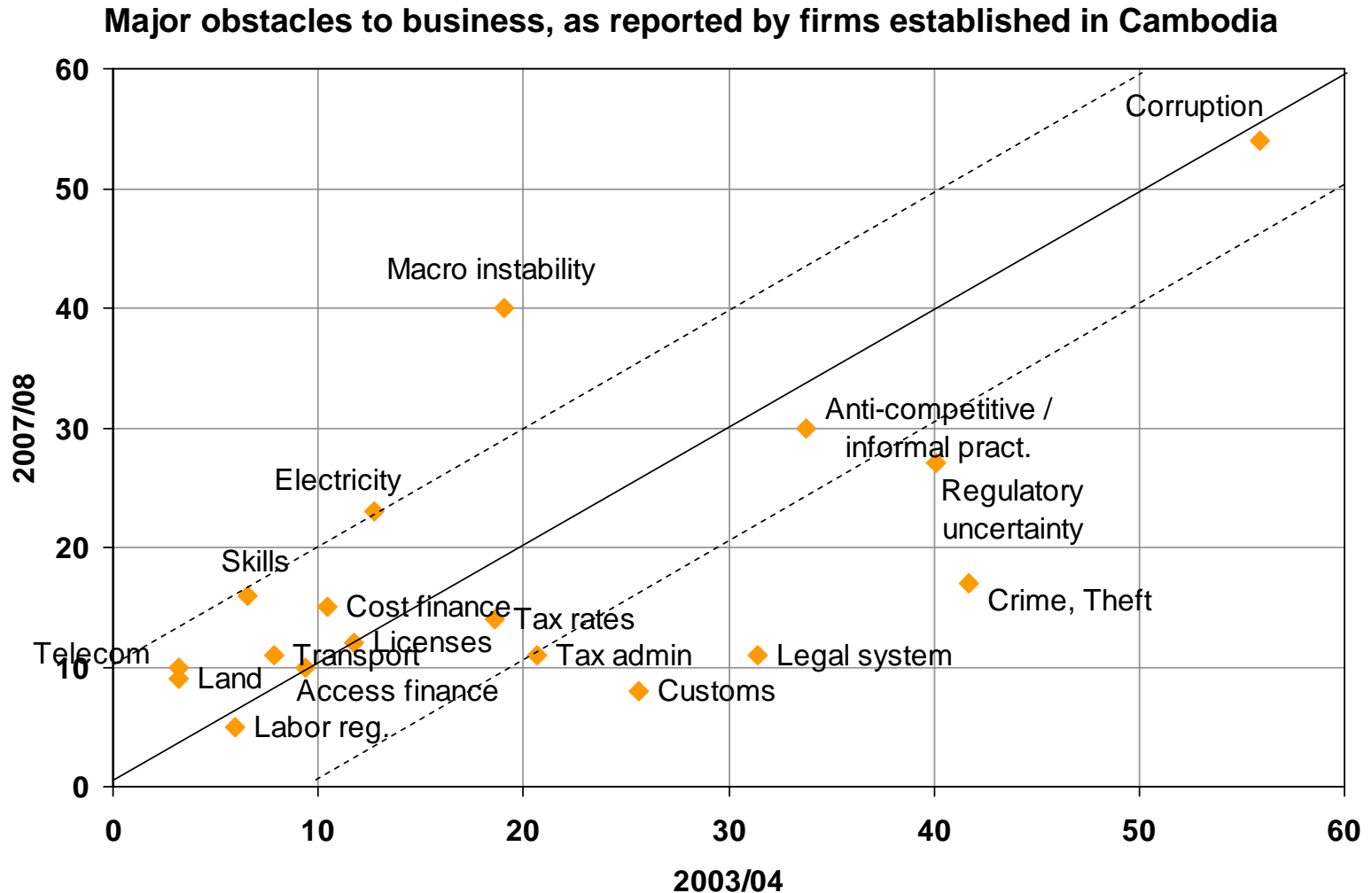
# productivity lagging behind



Low private investment & innovation



# corruption & governance



Sources: *Investment climate surveys in Cambodia*



# what is really binding?

Acceleration of  
growth in early  
2000

- Political stability increased after 1998
- Inflation went down at that time; then first LDC to join WTO (2004): signal credible shift in policies and credible macro management

Garment

- Initial rents: quotas in US (linked to labor standards) plus tax incentives
- Then rent replaced by good industry coordination
- But enough competition? Now competition from Vietnam and, soon, China; plus recent real appreciation

**A few fundamentals: political stability and signaling of commitment to good business environment; creating rents to pay for entry / discovery**

# what is really binding?

Large informal economy

- Entry costs (in terms of regulations and corruption)
- Limited benefits of formalization (weak coordination; limited access to finance)

No sustained diversification

- Coordination / information (on markets, technologies)
- Incentives for innovators (both formal incentives – e.g. standards, trademarks – as well as informal – scaling up means becoming a target of corruption)
- Access to finance for locally-generated projects (in agriculture; for SMEs)

No capital-intensive or processing industry

- Governance (high informal taxation of higher rents created by capital investment; property rights)
- Poor complementary inputs (electricity and water; skills; coordination issues)

## 3. how to alleviate constraints?

### FACTS

- Good macro management so far
- Limited fiscal space – large needs
- Several industrial policy instruments (e.g. tax, SEZ, etc.)
- Growth is – and will – bring a number of issues to manage (equity; environment; cities; etc.)

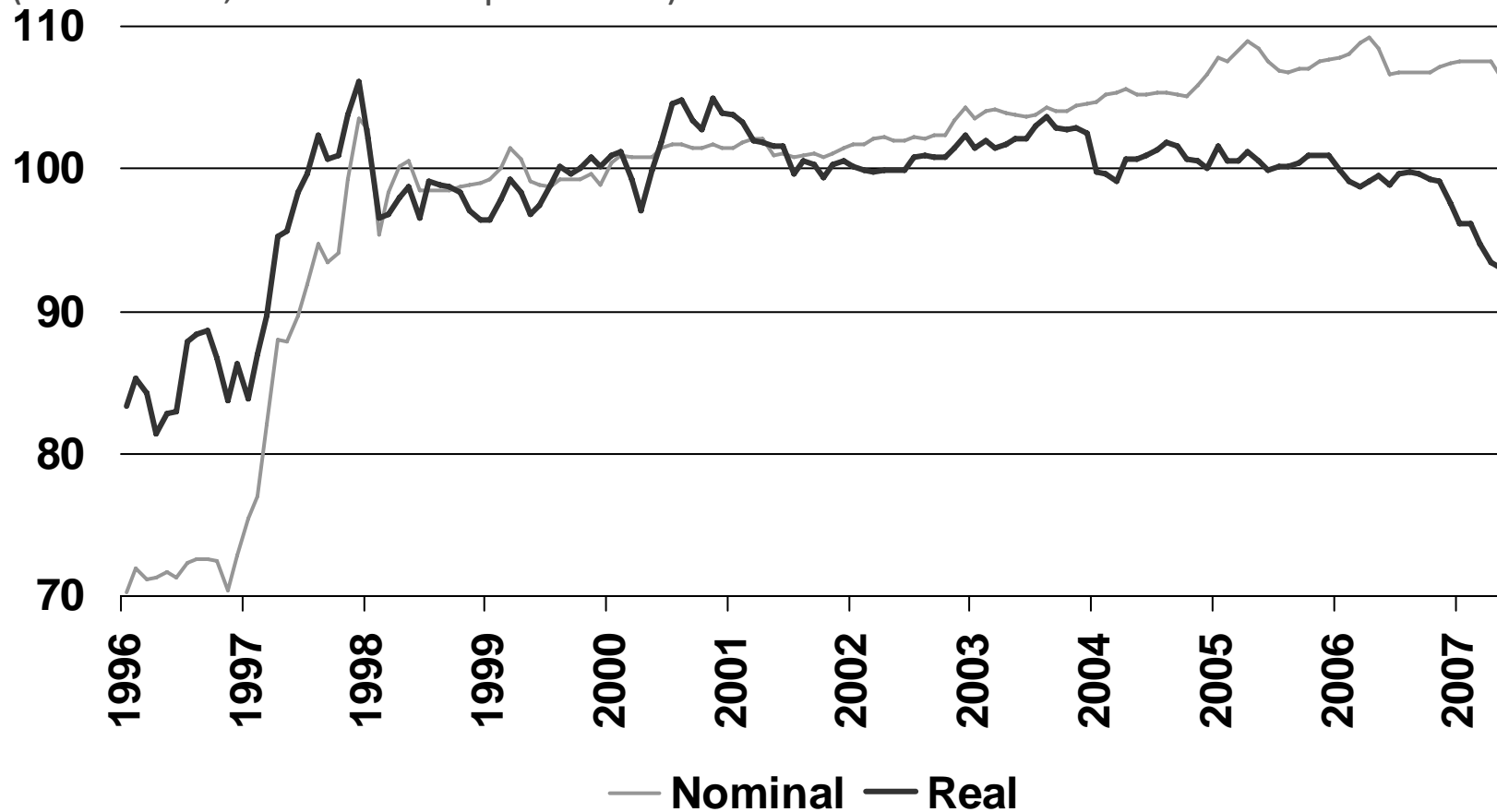
### QUESTIONS

- How to address upcoming macro challenges (inc. from oil)?
- How to increase fiscal space and best use it? (inc. in the context of oil production)
- Industrial policy?
- Complementary policies to manage growth?

# stable exchange rate

Effective exchange rate with key trade partners

(100 = 2000; increase = depreciation)



# creating fiscal space

- Limited fiscal space:
  - Low revenue / GDP (12% only), cf. generous tax incentives
  - Negative domestic borrowing (cash deposits increasing)
  - Some room for expenditure reallocation
  - Despite generous aid (6% of GDP, although mainly off-budget)
- Large needs to address some binding constraints (infrastructure; education; insufficient civil service wages)
- Some potential:
  - Oil and gas?
  - Private sector participation in infrastructure (existing for airport, power generation)

# industrial policy instruments

- Several instruments already used:
  - Generous tax incentives
  - Special Economic Zones
  - Quotas for labor standards (until 2004 for garments; ILO monitoring still ongoing)
  - Ongoing efforts to promote various products
  - Also alternative dispute resolution mechanisms (e.g. labor; soon commercial)
- What is their effectiveness?
- Political economy constraints?
- Targeting instruments:
  - Agriculture (research; marketing; etc.)
- Other regulatory instruments:
  - Simplifying processes
  - Standards

# in sum...



- Cambodia has enjoyed very rapid growth over the last decade, but on a narrow base and despite seemingly many constraints
- Some fundamentals are in place to sustain rapid growth – macro management, openness in a dynamic region, etc – although they are not unchallenged
- Diversification is key. It requires interventions to (i) address coordination / self discovery issues and (ii) help successful entrepreneurs sustain their innovations
- Sustained rapid growth will also bring a number of challenges, to be well managed

# Additional slides

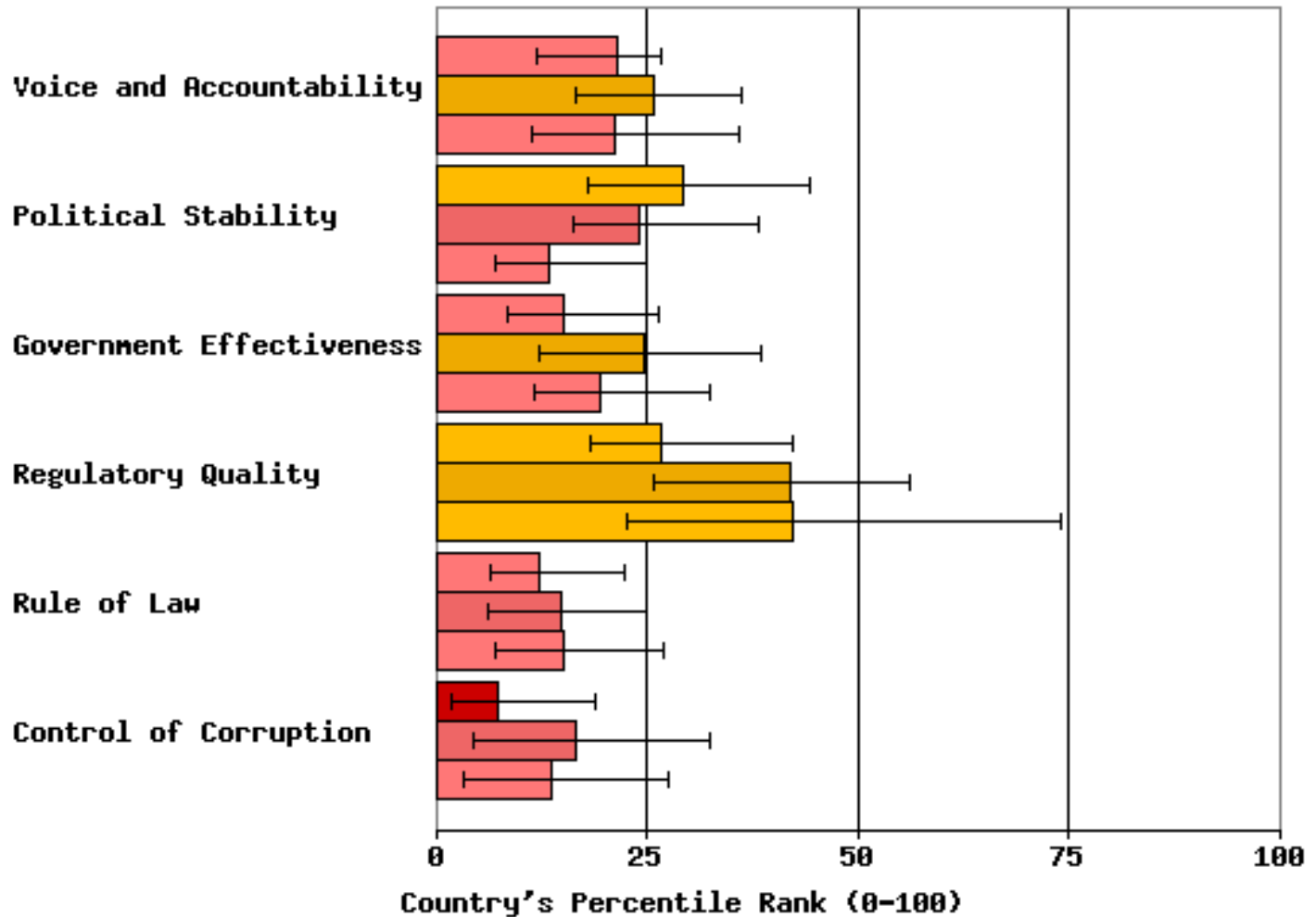
Background data on various potential binding constraints to growth



# weak governance

## CAMBODIA

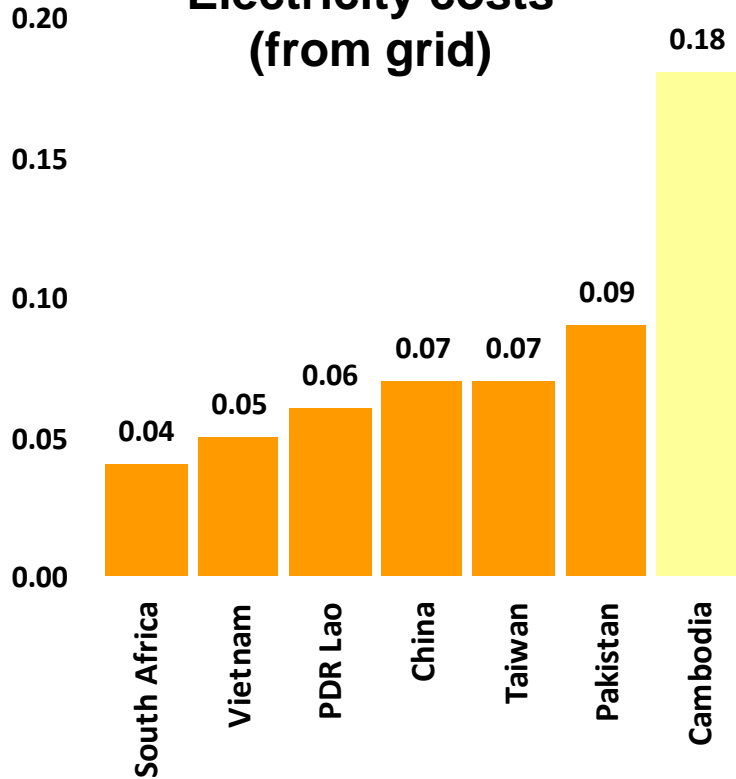
Comparison between 2006, 2002, 1998 (top-bottom order)



# infrastructure costs

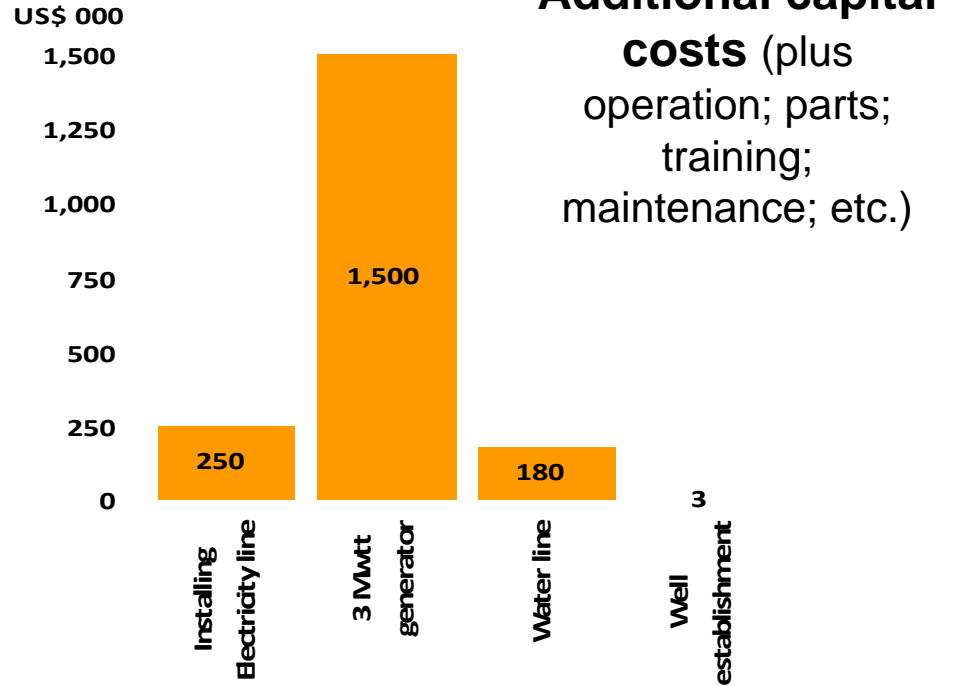
US\$ / kWh

## Electricity costs (from grid)

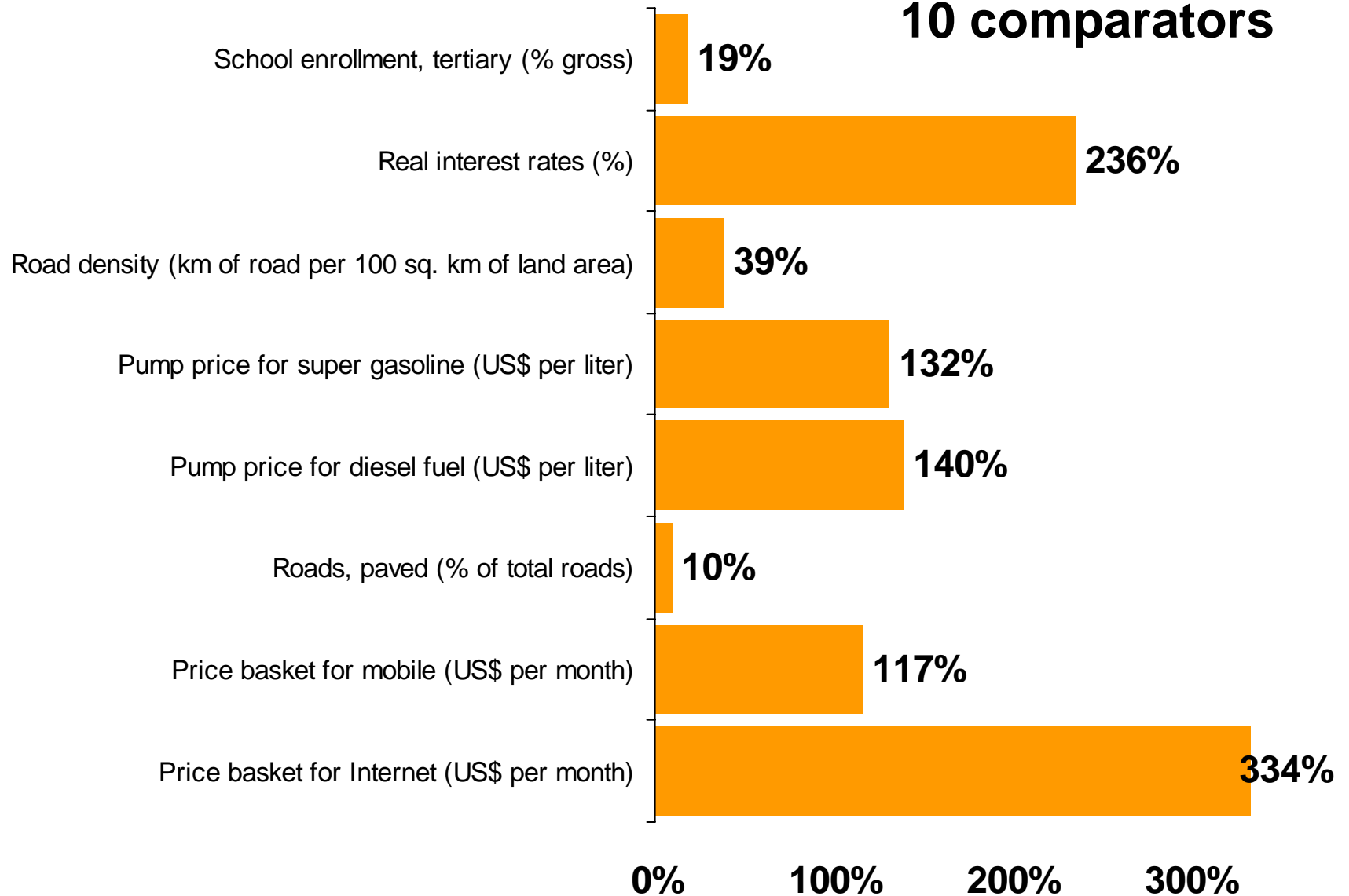


US\$ 000

## Additional capital costs (plus operation; parts; training; maintenance; etc.)

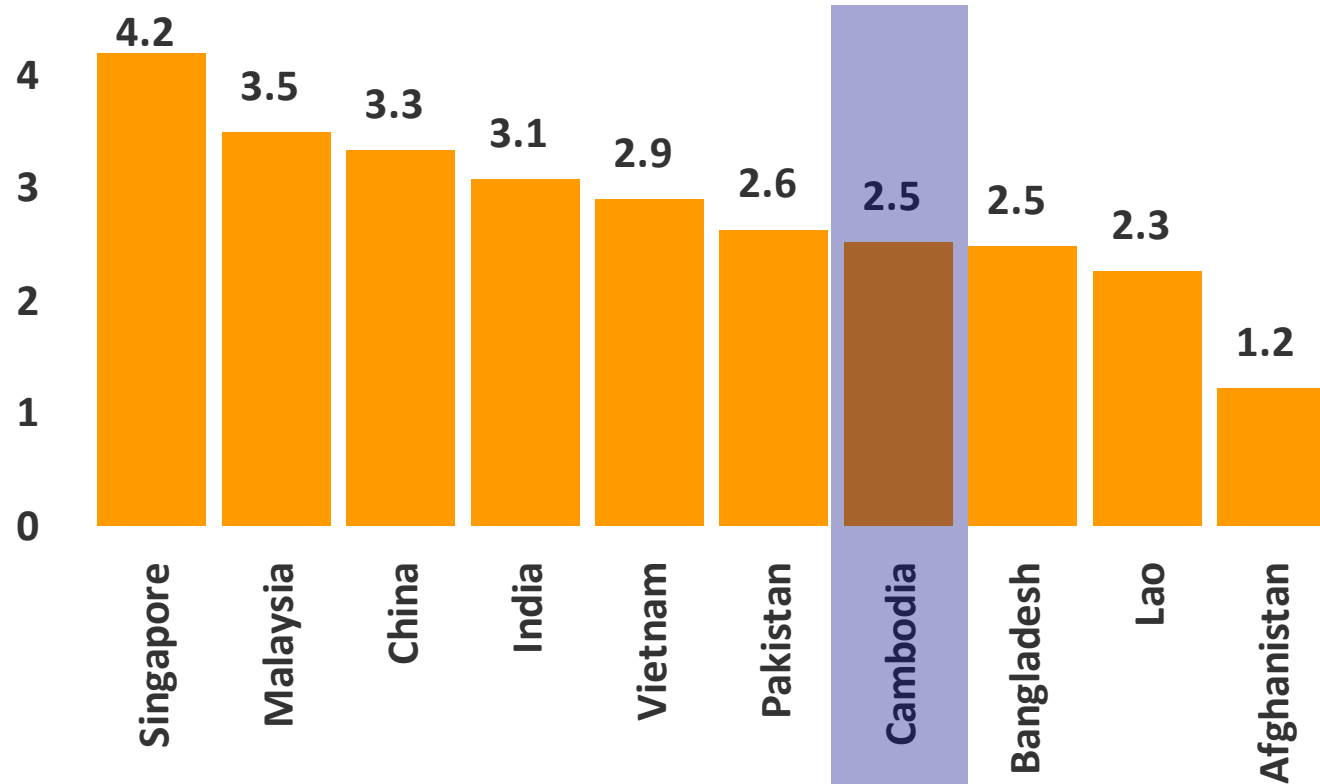


# Cambodia as % of 10 comparators



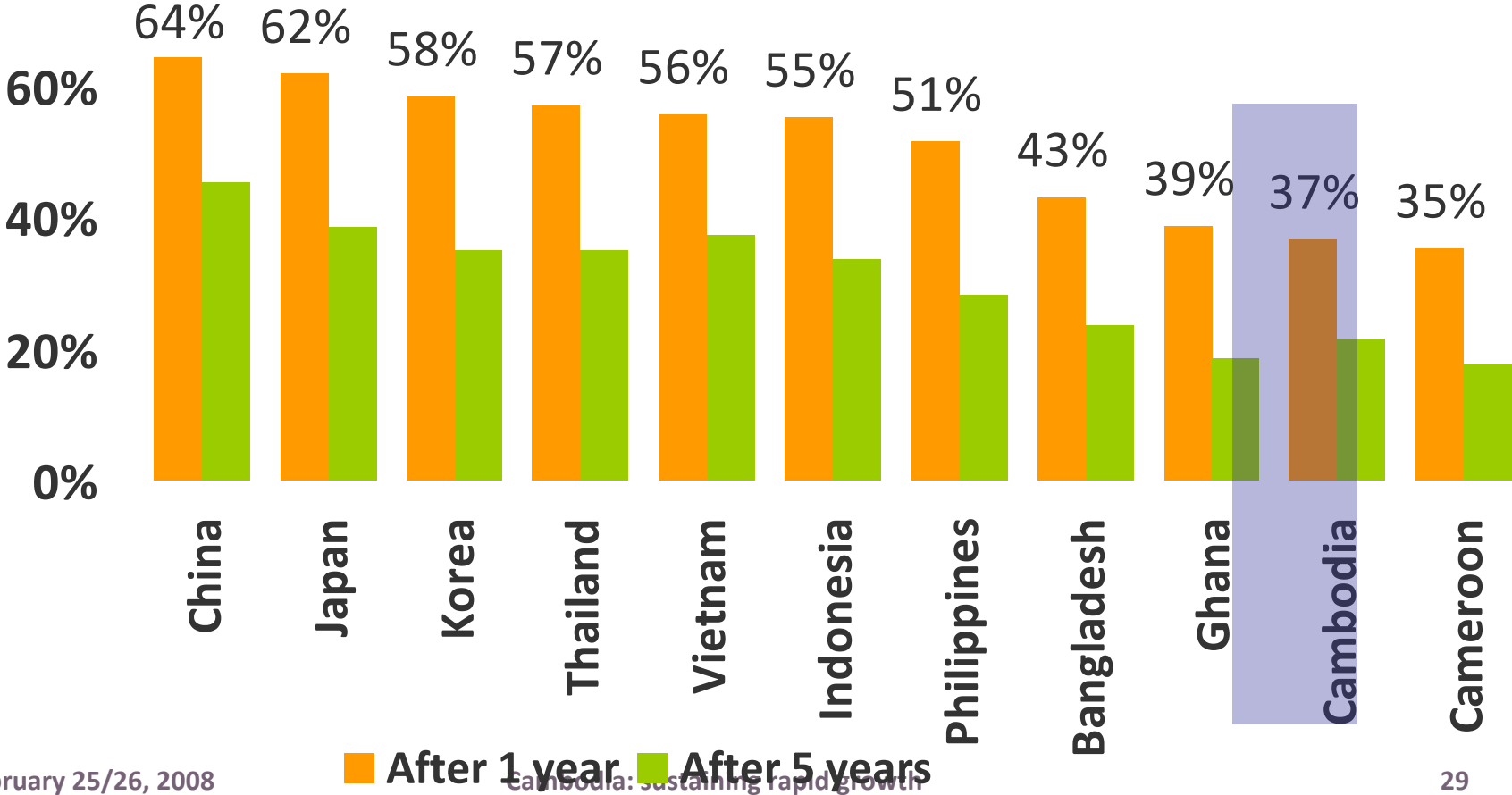
# connecting to compete

2007 Logistics Performance Index

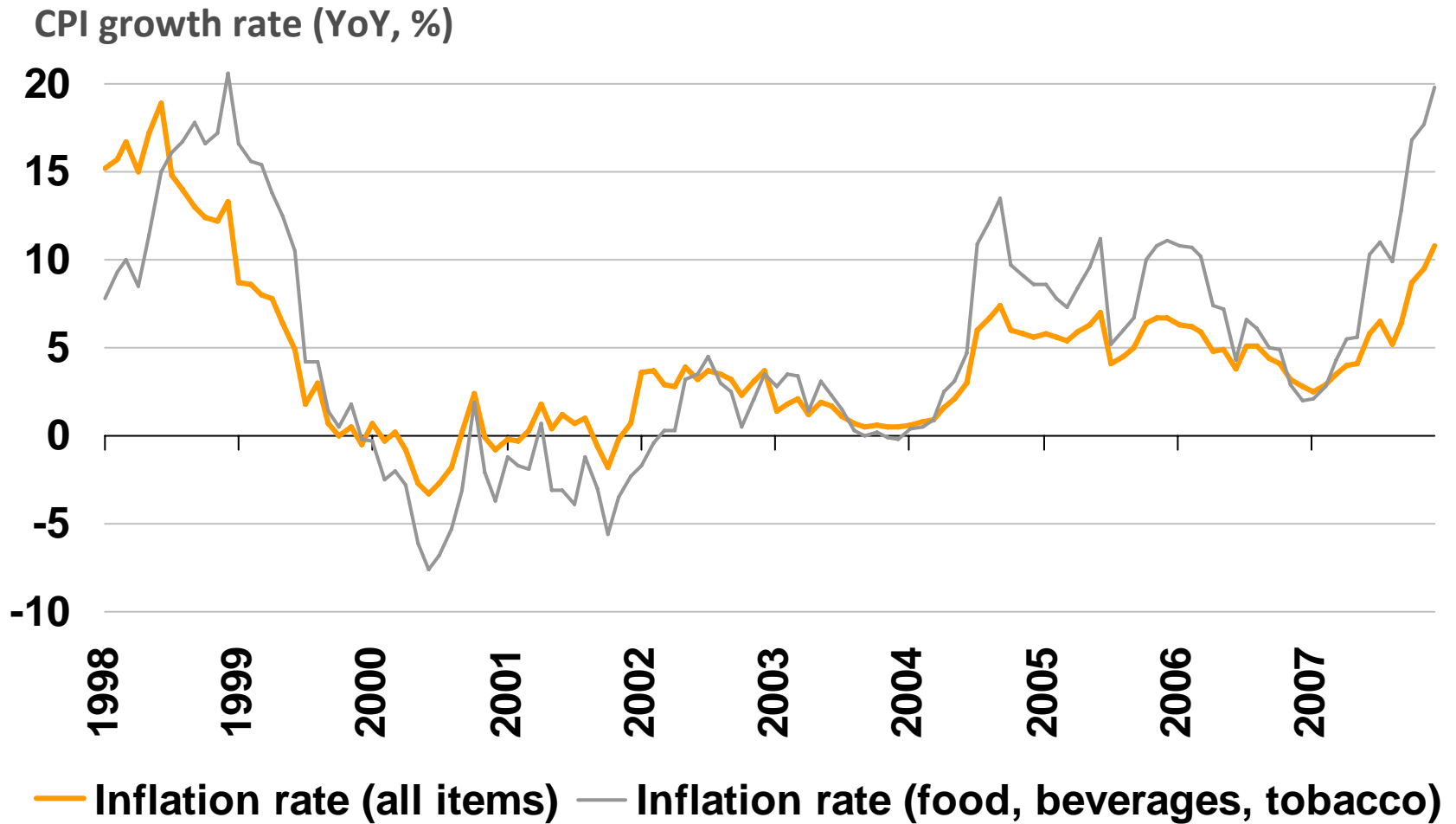


# sustaining discoveries

Survival Rate of New Exports After 1 or 5 Years



# inflation now picking up



# size and productivity in agriculture

Distribution of households by land holding (%)

