Cambodia: sustaining rapid growth

facts and questions

External Advisory Panel
February 25-26, 2008
the structural transformation of Cambodia

Population growth
- 1993
- 1998
- 2006

Population 0-14 (%)
- 1993
- 1998
- 2006

Urban pop. (%)
- 1993
- 1998
- 2006

GDP per capita (US$)
- 1993
- 1998
- 2006

Poverty incidence (%)
- 1993
- 1998
- 2006

Inequality (Gini of real per capita consumption)
- 1993
- 1998
- 2006

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the structural transformation of Cambodia, cont.
reaching new heights?

Income per capita (2007 $)

- 1950: 250
- 1955: 250
- 1960: 250
- 1965: 250
- 1970: 310
- 1975: 310
- 1980: 310
- 1985: 310
- 1990: 310
- 1995: 550
- 2000: 725
- 2005: 1,513
- 2010: 1,513
- 2015: 1,513
- 2020: 1,513

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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?
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1 growing with four fragile engines

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

<table>
<thead>
<tr>
<th>Export potential</th>
<th>Products</th>
</tr>
</thead>
<tbody>
<tr>
<td>High</td>
<td>Garments, tourism, footwear, rubber, cassava</td>
</tr>
<tr>
<td>Medium</td>
<td>Fishery, rice, fruits and vegetables, wood products, light manufacturing, labor services, soybeans</td>
</tr>
<tr>
<td>Low</td>
<td>Silk, livestock, cashew nuts, corn, beer, web-based services, transport services</td>
</tr>
</tbody>
</table>
# the role of agriculture

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

Growth of value added per worker (%)

Yield per hectare (kg/Ha) for cereals

Agriculture  Industry  Services

Low private investment & innovation

- Low return to economic activity
  - Low social returns
    - Low human capital
      - Bad geography
  - Low appropriability
    - Natural resource management
      - Bad infrastructure
    - Micro risks (property rights, corruption, taxes)
  - Government failures
    - Macro risks (financial, monetary, fiscal, instability)
  - Market failures
    - Information externalities (self discovery)
  - Coordination externalities
    - Poor intermediation
- High cost of finance
  - Bad international finance
  - Bad local finance
- Low domestic savings
  - Low domestic savings
corruption & governance

Major obstacles to business, as reported by firms established in Cambodia

Sources: Investment climate surveys in Cambodia
what is really binding?

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


Country’s Percentile Rank (0-100)
Infrastructure costs

**Electricity costs (from grid)**

<table>
<thead>
<tr>
<th>Country</th>
<th>US$ / KWh</th>
</tr>
</thead>
<tbody>
<tr>
<td>South Africa</td>
<td>0.04</td>
</tr>
<tr>
<td>Vietnam</td>
<td>0.05</td>
</tr>
<tr>
<td>PDR Lao</td>
<td>0.06</td>
</tr>
<tr>
<td>China</td>
<td>0.07</td>
</tr>
<tr>
<td>Taiwan</td>
<td>0.07</td>
</tr>
<tr>
<td>Pakistan</td>
<td>0.09</td>
</tr>
<tr>
<td>Cambodia</td>
<td>0.18</td>
</tr>
</tbody>
</table>

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

- Installing Electricity line: $250
- 3MWt generator: $1,500
- Water line: $180
- Well establishment: $3
Cambodia as % of 10 comparators

- School enrollment, tertiary (% gross): 19%
- Real interest rates (%): 236%
- Road density (km of road per 100 sq. km of land area): 39%
- Pump price for super gasoline (US$ per liter): 132%
- Pump price for diesel fuel (US$ per liter): 140%
- Roads, paved (% of total roads): 10%
- Price basket for mobile (US$ per month): 117%
- Price basket for Internet (US$ per month): 334%
connecting to compete

2007 Logistics Performance Index

Singapore: 4.2
Malaysia: 3.5
China: 3.3
India: 3.1
Vietnam: 2.9
Pakistan: 2.6
Cambodia: 2.5
Bangladesh: 2.5
Lao: 2.3
Afghanistan: 1.2
sustaining discoveries

Survival Rate of New Exports After 1 or 5 Years

- China: 64% (After 1 year), 62% (After 5 years)
- Japan: 62% (After 1 year), 58% (After 5 years)
- Korea: 57% (After 1 year), 56% (After 5 years)
- Thailand: 56% (After 1 year), 55% (After 5 years)
- Vietnam: 51% (After 1 year), 43% (After 5 years)
- Indonesia: 55% (After 1 year), 39% (After 5 years)
- Philippines: 51% (After 1 year), 37% (After 5 years)
- Bangladesh: 43% (After 1 year), 35% (After 5 years)
- Ghana: 39% (After 1 year), 37% (After 5 years)
- Cambodia: 35% (After 1 year), 35% (After 5 years)
- Cameroon: 35% (After 1 year), 35% (After 5 years)
inflation now picking up

CPI growth rate (YoY, %)

-10 -5 0 5 10 15 20


Inflation rate (all items) — Inflation rate (food, beverages, tobacco)
size and productivity in agriculture

Distribution of households by land holding (%)

<table>
<thead>
<tr>
<th>Landholding</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Landless</td>
<td>19</td>
</tr>
<tr>
<td>0.0 to 0.5 ha</td>
<td>27</td>
</tr>
<tr>
<td>0.5 to 1.0 ha</td>
<td>22</td>
</tr>
<tr>
<td>1.0 to 2.0 ha</td>
<td>20</td>
</tr>
<tr>
<td>2 ha and more</td>
<td>13</td>
</tr>
</tbody>
</table>

Log of value of crop per hectare vs. log of land operated, hectares

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