

STRUCTURAL POLICY COUNTRY NOTES Cambodia



This Country Note is an extract from the *Economic Outlook for Southeast Asia, China and India 2014: Beyond the Middle-Income Trap*, <http://dx.doi.org/10.1787/saeo-2014-en>.

Cambodia

A. Medium-term economic outlook (Forecast, 2014-18 average)

GDP growth (percentage change): 6.8
Current account balance (% of GDP): -7.4

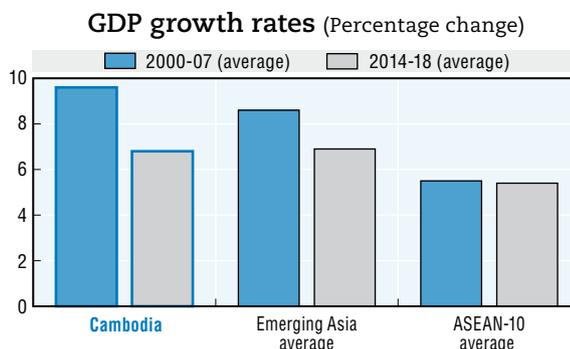
B. Medium-term plan

Period: 2009-13
Theme: Growth, employment, equity and efficiency

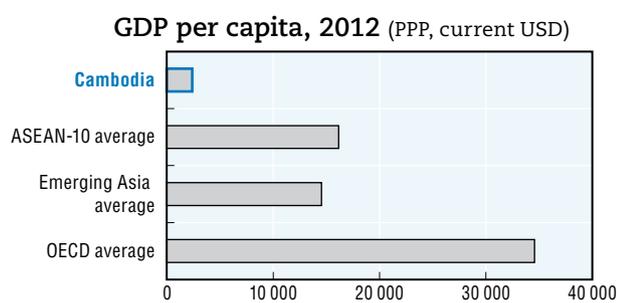
C. Basic data (in 2012)

Total population: 15 million*
Population of Phnom Penh: 1.3 million (in 2008)
GDP per capita at PPP: 2 402 (current USD)**

Note: * Total population data for 2012 are estimates.
** IMF estimate
Sources: OECD Development Centre, national sources and IMF.

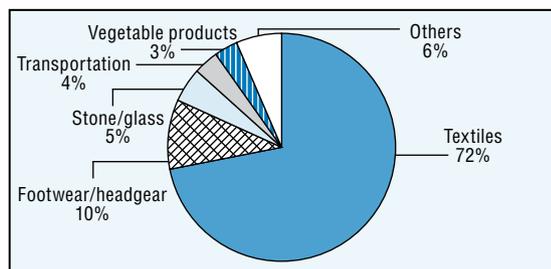


Source: OECD Development Centre, MPF-2014.



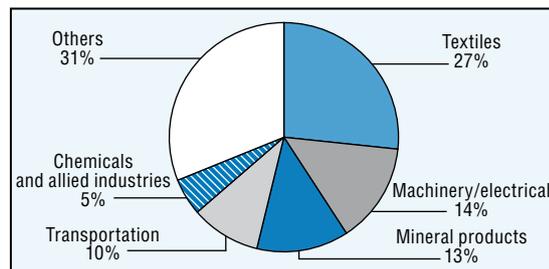
Source: IMF and national sources.

Composition of exports, 2012
Percentage of total exports



Source: Trademap.

Composition of imports, 2012
Percentage of total imports



Source: Trademap.

Over the past decade, Cambodia's economic development has been fast paced. To keep growth sustainable and strong, there are three priority areas on which the government should focus in the medium term.

First, it needs to further promote agricultural and rice production. In fact, it has introduced a new system of rice intensification (SRI) to improve the productivity of ricefield irrigation and taken measures to diversify the agricultural sector. The second priority is to further develop the prudential and supervisory framework of the financial sector to ensure financial stability in a context of fast credit growth. Finally, it must further promote the tourism sector by increasing the number of destinations it offers and improve infrastructure to ensure sustainable growth in the sector.

Cambodia's medium-term policy challenges and responses

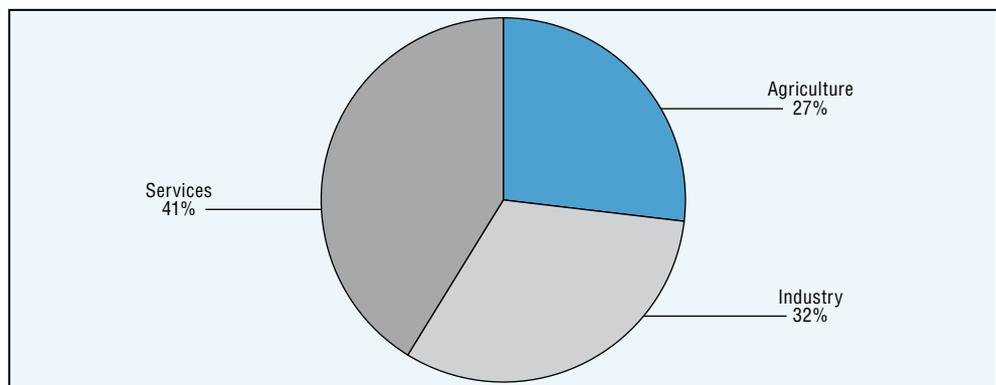
- Improve productivity of agriculture, in particular rice production
- Improve the prudential and supervisory framework for the financial sector
- Develop tourism-specific infrastructure

POLICY FOCUS

Improve productivity of agriculture, in particular rice production

The Cambodian economy performed well in 2012 and the outlook continues to be positive in 2013. The economy grew 7.3% against a backdrop of low inflation (2.2%). The services sector is the biggest contributor to GDP, accounting for 41% of total GDP, followed by industry at 32%, and agriculture with 27%. However, agriculture continues to make a rising contribution to the growth of the Cambodian economy. The sector grew 4.3% in 2012 and accounted for 4.75 million workers out of a labour force of 8 million in 2011.

Figure 2.2.1. Cambodia's GDP, by sector, 2012



Source: Government of Cambodia.

StatLink  <http://dx.doi.org/10.1787/888932937776>

Diversification in production is needed to keep economic growth sustainable

Since the economy relies heavily on the labour-intensive agriculture and textile sectors, it needs to diversify to lessen the risks arising from external shocks and to enable the economy to play a more active part in regional supply chain networks. The government is committed to diversification, as it has demonstrated in its recent agricultural policy measures.

Cambodia is putting considerable effort into diversifying its agricultural sector. In addition to rice production, which reached almost 9 million tonnes in 2012 and makes such a major contribution to output growth, it is also now farming rubber, corn, cashew nuts and cassava. Rubber is the second largest commodity crop after rice in Cambodia and the production of rubber latex is expected to reach 300 000 tonnes by 2020. Corn production rose to 770 860 tonnes, cashew nuts to 60 000, and cassava to 6.86 million

in 2012. Overall, production of these commodity crops increased 4.9%, while ricefield fisheries grew 6.7%. Rice exports increased by around 28% to reach USD 136 million. The contribution of agricultural exports toward total export growth, however, remains small.

As well as diversifying its agricultural sector, Cambodia has also been putting greater emphasis on productivity and promoting economies of scale in the sector. As part of its 2009-13 Master Plan, it has switched from expanding the area of land under cultivation to intensive farming. This strategy involves improving technology, widening the provision of agricultural services to rural areas, setting up community networks of volunteers and partnerships among agricultural industry players, promoting multi-farming activities, and making the investment environment more attractive.

Food security and agricultural productivity are the most important issues

Like other ASEAN member states, Cambodia is becoming increasingly aware of the issue of food security which has come to the fore as a result of commodity price volatility in the uncertain economic climate. Cambodia's response has been to adopt the SRI¹ to enhance productivity. The Centre for Studies and Development of Cambodian Agriculture (CEDAC) first experimented with the SRI in 1999. Its successful trials secured government approval. The Ministry of Agriculture, Forestry and Fisheries (MAFF) set up a national SRI Secretariat in 2004 before officially endorsing the system in 2005 and incorporating it into the National Strategic Development Plan (NSDP) for 2006-10. It also revised SRI for inclusion in the NSDP for 2009-13.

As already stated, rice is Cambodia's most important agricultural product, contributing about 10% to GDP. Although Cambodian rice exports accounted for less than 1% of global rice exports in 2011, it grew 17% over the past three years against a backdrop of higher overall local production and improving yield. Under its Development Master Plan, Cambodia has put rice at the heart of its agricultural improvement efforts. The result has been increased rice production and more efficient paddy rice harvesting and processing, logistics and marketing. The SRI, too, has played a key role in improving productivity.

Sustainable rice cluster method to enhance productivity

To sustain the growth of rice production, the government has devised and implemented a programme that uses the sustainable rice cluster (SRC) method. SRC has increased rice cultivation by some 40% over conventional methods. Essentially, it is an improved, environmentally friendly irrigation and farming method that does not use chemicals. The idea is to phase in organic rice farming so as to ensure sustainable growth. SRC is in its early stages and still being developed since Cambodia remains a factor-driven economy. SRC capitalises on the abundance of low-cost labour and arable land that has not been subjected to intensive use of chemical fertilisers. At the same time, the use of SRI has benefitted poor farmers who have no access to funding and cannot afford fertilisers. The SRI has cut the cost of rice cultivation and delivered yields that are nearly 100% higher than those of conventional methods.

Table 2.2.1. The advantages of sustainable rice farming in Cambodia compared to other key rice-producing Southeast Asian countries – Viet Nam, Thailand, the Philippines and Indonesia

Create	SRI Irrigation and integrated pest management (IPM) Practice	Use 70% less water than conventional rice farming. IPM alongside reduces pesticide/fertiliser/ fungicide loads
	Contract Farming Initiative	Provide farmers guaranteed buyers
	Adopting farming innovation faster (synergies with eco-tourism and fair trade in garments)	Adopt seed varieties, irrigation systems and natural compost practices which drive yields close to conventional rice farming
Inherit	Large amount of arable wetland available for cultivation	Reduce cost of conversion to sustainable agriculture (SA) which is prohibitive in other regions
	Relatively large pool of agricultural labour	Reduce cost of production
	Historically low level of chemical inputs (lack of availability although now using some toxic fertilisers)	Reduce cost of cleaning and shorten adoption cycle of certification

Source: Bedi, A., GCA Paderaga and H.S. Vath (2012), *Sustainable Rice Cluster in Cambodia*, Project for PP5279: Clusters and National Competitiveness, Lee Kuan Yew School of Public Policy.

If SRC is to reap success in Cambodia, the government must improve poor farmers' access to markets. It is crucial that smallholders should be able to sell their produce on key export markets. They stand to gain, in this respect, through the contract farming programme for growing sustainable rice, which helps generate greater economies of scale. Contract farming is an organised institutional arrangement between farmers and contractors that benefits smallholders by opening up new markets for them, providing them with equipment, and lending them technological and financial support. At the same time, it reduces the costs and risks associated with selling rice harvests and offsets the uncertainties associated with timing, pricing, and quality standards. The government also promotes contract farming for small farmers as part of the sustainable rice value chain.

The practice of contract farming has evolved over the last 15 years in Cambodia, shaping the country's agricultural community which has organised into farming co-operatives and commune associations. Organic farmers are no exception. In 2008, over 7 800 of them became members of co-operatives or commune associations and today that number may have swollen to 130 000, all practising SRI farming. Local demand condition for sustainable rice scheme has steadily increased as more farmers have adopted SRI.

A particularly important measure would be to create a niche market for the sustainable rice-growing scheme. Branding would help improve the competitiveness of Cambodia's organic rice against other regional signature products like jasmine rice from Thailand and Indian basmati rice.

Finally, collective action and knowledge-based farming to improve labour productivity in rice farming and SRC is crucial. This will not only improve farmers' understanding of sustainable farming and productivity, it will also increase their bargaining power both in domestic and regional markets.

Land reform to improve the lot of farmers an important goal in the NSDP

Statistically, Cambodia covers a surface area of 18.1 million hectares, of which 2.7 million hectares are cultivated land and 1 million are taken up by urban areas, towns, infrastructure and waterways. Agricultural concessions cover 800 000 hectares, landmine-contaminated areas 100 000 hectares, and protected forestland 1.5 million.

To support landless farmers, the government has included a land reform agenda in its National Strategic Development Master Plan 2009-13. Reform focuses on strengthening land management, distribution and use. In the agricultural sector, the main thrust is to ensure access to land resources, ownership, and security for poor rural farmers and the effective socio-economic development of land markets. Reform also seeks to promote agricultural industrialisation by freeing up land and to make it available for commercial purposes by clearing it of mines.

The Economic Land Concession (ELC) scheme is an important land reform measure that is designed to develop intensive agricultural and industrial-agricultural activities. Its objectives include achieving a set of agreements on land development; increasing employment in rural areas through intensive farming, the diversification of livelihood opportunities, and natural resource management; and generating government revenues at provincial, communal, and state levels through taxation and related service fees.

ELC has, however, come in for criticism as just a way of selling off land. The government must ensure that ELC is implemented transparently and that land concessions are granted and managed within a sound legal and policy framework.

To pave the way for the completion of land reform, the government should speed up related preparatory measures like mapping and registration – particularly of indigenous community land in line with policies for the development of indigenous peoples. Indeed, it is critical that land is equitably and properly distributed to all landless farmers.

In April 2013, the government released a new draft of its public policy guidelines for the country's contentious land sector. It contains new laws and guidance on how to facilitate the use and management of land and natural resources for socio-economic development in efforts to move toward equitable and sustainable growth.

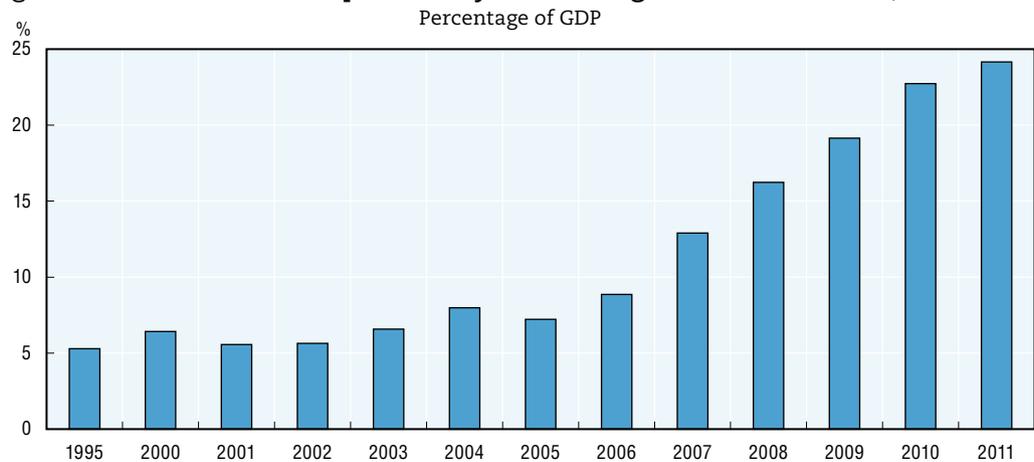
POLICY FOCUS

Improve the prudential and supervisory framework for the financial sector

Fast credit growth raises supervisory and regulatory challenges

Credit growth in Cambodia has continued to surge on the back of excess liquidity from domestic savings, external financing and increased financial needs. Owing to the Cambodian economy's consistently high growth, the current growth in domestic credit to private sector is fuelling concerns over loan quality. Compared to its regional neighbours at the same stage of development, the economy has witnessed high, rapid growth in credit to private sector – in 2012, credit grew 34.2%, up from 31.6% the previous year. Since 2005, domestic credit provided by the banking sector has increased rapidly, while the lending rate has consistently declined and the savings rate has remained steady since 1995 (Figures 2.2.2 and 2.2.3).

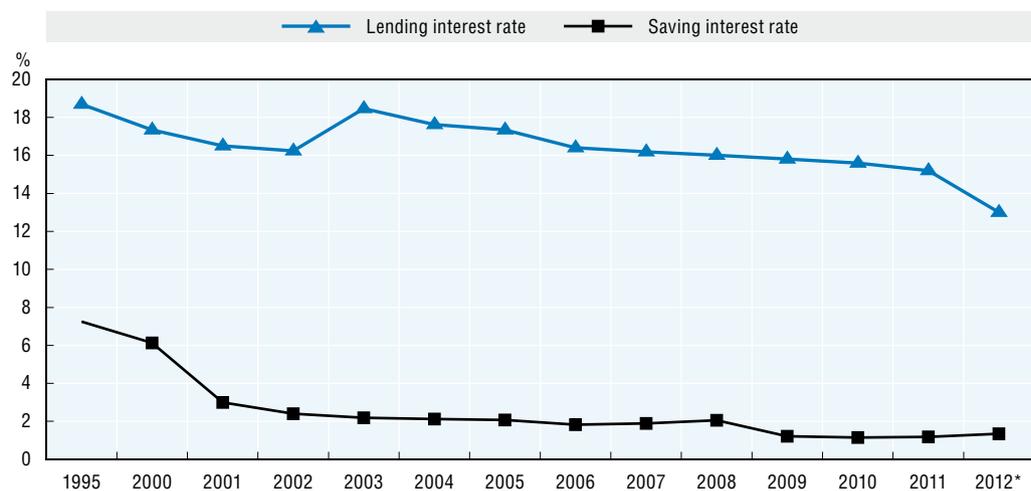
Figure 2.2.2. Domestic credit provided by the banking sector in Cambodia, 1995-2011



Source: Government of Cambodia.

StatLink <http://dx.doi.org/10.1787/888932937795>

Figure 2.2.3. Average annual lending and saving interest rates in Cambodia, 1995-2012



Source: Economist Intelligence Unit (2013), "China economy: Fiscal challenges mount", *The Economist Intelligence Unit*, 13 May.

StatLink <http://dx.doi.org/10.1787/888932937814>

Given the strong private demand for financing and fiercer competition among domestic banks, credit growth is expected to maintain its momentum this year. There are rising concerns over faster credit growth prompted by rising bank deposits, declining lending rates, and growing risks from the lower credit underwriting standards that arise from the constraints on bank management capacity. Adequate prudential regulations and supervisions are required to monitor and control rising household indebtedness and prevent financial sector risks like bubbles and increases in non-performing loans. Other concerns are the rise in the external debt of the banking sector and foreign lending activities.

In response to such policy challenges, the National Bank of Cambodia (NBC) tightened its monetary policy with a hike in reserve requirements to 12% in foreign currency and 8% in local currency deposits. In October 2012, the NBC again raised the reserve requirement to 12.5%.

Cambodia has also gradually implemented other supporting initiatives as the banking sector has expanded. It has, for example, put in place a credit bureau to help banks and microfinance institutions (MFIs) improve risk management and credit allocation practices by sharing credit information. In December 2012, the National Clearing System was also introduced to facilitate inter-bank electronic payments and single-day check clearance across all banks.

Nonetheless, weak external demand has made the government reluctant to tighten monetary policy much more in 2013. Most important is to stabilise the financial sector and prepare the economy for further global uncertainty. The government should therefore consider employing more macroprudential tools such as higher capital requirements and lending ratios.

The goal of Financial Sector Development Strategy (FSDS) 2011-20 is financial sector development which, by supporting economic growth and affording the poor greater access to financial services, can help reduce poverty. There are two main thrusts to FSDS 2011-20. One is to upgrade the legal and co-operation frameworks that govern the finance and banking sector in order to avoid inconsistencies and overlaps and adjust to international standards. The other is to ensure crisis preparedness in the event of global financial turmoil. Cambodia needs an early warning system and stable financial market to counter any internal or external disruption to its financial sector. In response, FSDS 2011-20 focuses on ensuring close co-operation between the banking and other sectors in order to build effective joint supervision and surveillance, combat money laundering and the funding of terrorism, and improve governance.

Dollarisation still poses risks to the financial system

Foreign currency continues to be used nationwide in Cambodia. The United States dollar (USD) is still a much favoured medium of exchange, store of value, and unit of account in Cambodia. The local currency – the Cambodia riel (KHR) – is typically used for rural trade in agricultural goods, as well as for the payment of tax and public utility bills. Over 95% of bank deposits are denominated in US dollars as are most deposits in the central bank, while there continues to be a lack of demand for the riel. The considerable inflows of US dollars that started in the early 1990s in the form of foreign funding aid, foreign assistance, and FDI totalled more than USD 2 billion by 2009.

A high degree of dollarisation can limit the flexibility of exchange rate policy in the event of external shocks. Equally, it could restrict the NBC's ability to manage the money supply in the economy and hamper the development of domestic interbank market. Cambodia uses foreign currencies principally because of constraints related to macroeconomic stability and the level of development of the country's financial, banking and monetary system. To encourage greater use of the riel, the confidence of Cambodians and investors in the country's economy and currency needs to be built. To that end, the government should consider market-based policies to ensure a stable macroeconomic environment. It should also have in place an appropriate policy for holding the exchange rate stable and further develop the money market to reduce risks associated with the

dollarisation of credit to the non-tradeable sector. Moreover, a sound financial policy and prudential regulations could help boost intermediation with the riel. Currently, the NBC is pursuing its practice of managing a floating exchange rate along with promoting the use of national currency through its KHR-denominated certificates of deposit.

POLICY FOCUS

Develop tourism-specific infrastructure

International tourism has made, and is making, a growing contribution to Cambodia's GDP growth. The sector has expanded considerably over the past five years, with the number of foreign arrivals climbing from 2.1 million in 2008 to 3.6 million in 2012 and generating total revenues of some USD 2.2 billion. In 2013, the expansion has continued. The number of visitors was up by 15.4% in January over the previous year and in February by 19.8%. As for the provenance of tourists, those from ASEAN accounted for 32.4% of all arrivals at the beginning of 2013, thanks to an easing of visa requirements and intra-regional border restrictions.

Cambodia needs to develop its tourism-specific infrastructure

In 2011, Cambodia recorded the highest international tourism receipts of any ASEAN country as a share of GDP (15%). However, its regional ranking is low when it comes to travel facilitation and competitiveness (WEF, 2012b). It improved its ranking in 2012, but there is plenty of room for improvement in areas such as tourism infrastructure, accommodation, and financial facilities such as automated teller machines (ATMs) that accept Visa cards. Box 2.2.1 describes examples of tourism-specific institutions in OECD countries put in place by governments keen to improve industry competitiveness.

Box 2.2.1. Government initiatives to improve industry competitiveness: Examples from OECD countries

The role of government in tourism is continually evolving and most countries address supply-side issues as well as the demand side of marketing and promotion. Supply-side improvements focus on enhancing the competitiveness of the tourism industry by increasing productivity and quality and encouraging innovation (OECD, 2006b). They may seek to develop niche markets (e.g. the revitalisation of health and spa tourism in **Hungary**); improve infrastructure; build the capacity of tourism businesses to capitalise on the Internet and ICT; provide skills training; or reduce negative social and environmental impacts. Below are some examples from OECD countries.

The **Australian** Tourism Data Warehouse (ATDW) system is a central distribution and storage facility for tourism industry product and destination information from all Australian States and Territories. Content is compiled in a nationally agreed format and electronically accessible by tourism business owners (operators), wholesalers, retailers and distributors for use in their websites and booking systems. The ATDW also provides an online education programme for the Australian tourism industry comprising a complete suite of tutorials with information on basic online marketing concepts such as website design to more complex issues including the use of online booking systems (www.atdw.com.au).

Box 2.2.1. (contd.)

The **Canadian** Tourism Commission (CTC) is Canada's national tourism marketing organisation. Its objective is to sustain a vibrant and profitable tourism industry. Together with its industry partners, it provides a consistent voice and strong visibility for Canada in the international tourism marketplace. It supports a co-operative relationship between the private sector and governments at the federal, provincial and territorial levels. As part of its governance structure, its five advisory committees are mostly made up of highly skilled, knowledgeable players from the industry which advise on core and emerging markets, brand experiences, Meetings, Conventions and Incentive Travel (MC&IT) and research.

FONATUR is the central government agency responsible for the development of tourism in **Mexico**. It identifies potential large-scale tourism development projects; assists and supports sub-national governments in the planning of local tourism development projects; contributes to the construction of basic infrastructure in tourism destinations; and is in charge of attracting private investment to them.

The Madeira Regional Secretariat for Tourism and Transport (in **Portugal**) won the 2011 UNWTO Ulysses Award for Innovation in Governance for its work on the environmental certification of tourism businesses.

Mature destinations are experiencing a loss of competitiveness because of territorial saturation, environmental impacts, and ageing infrastructure and equipment (in **Spain**). The associations representing the private sector have expressed concern. The General Secretariat for Tourism and Domestic Trade has made significant efforts to change the Spanish tourism model since the creation of the Tourism Plan 2020 and to revitalise coastal tourism. It is undertaking specific activities through the Programme for the Integral Requalification of Mature Tourism Destinations in four pilot destinations: Beach of Palma in the Balearic Islands; Costa del Sol in Andalusia; San Bartolomé de Tirajana; and Puerto de la Cruz in the Canary Islands.

Source: OECD (2012a), *Tourism Trends and Policies 2012*, OECD Publishing, Paris; Canadian Tourism Commission, *Helping Tourism Businesses Prosper, 2013-2017 Corporate Plan Summary*, <http://dx.doi.org/10.1787/tour-2012-en>.

The Cambodian government recognises the importance of the tourism sector and has made developing and improving it a priority. In 2006, for example, it introduced an electronic system in 25 languages to facilitate tourists' online visa applications. It is also seeking to encourage more visitors and longer stays. To promote itself as a tourist destination, Cambodia has launched a marketing campaign called "Cambodia – Kingdom of Wonder", which also promotes the country's clean cities and resorts and its good-quality services.

Transport infrastructure not yet fit for the tourism purpose

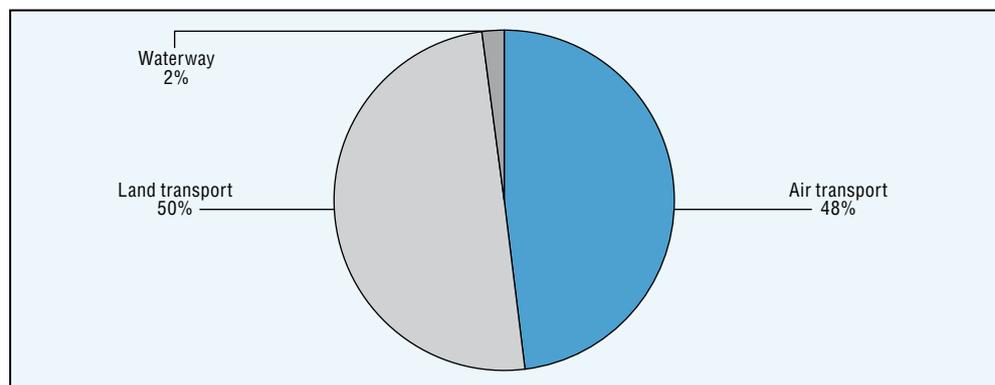
Among the tourism development measures that are considered top priority is the continued implementation of the ASEAN Open Skies Policy. The policy is a component of ASEAN's economic integration. Due to be in place by 2015, it is designed to boost regional air transport connectivity and allows all regional air carriers to fly freely between ASEAN member states.

In 2012, 1.7 million tourists entered Cambodia through Phnom Penh and Siem Reap International Airports. However, both airports are still small and inadequate for growing needs. Phnom Penh Airport has limited capacity as a gateway for investors and business people or high-value imports and exports. Clearly, airport expansion is vital to the country's fast-growing tourism sector.

A considerable challenge for Cambodia's road infrastructure is natural disasters such as the 2011 floods that destroyed infrastructure and affected over 1 million people. In 2012, Cambodia increased its flood-related maintenance budget to USD 73 million from USD 11 million in 2007 and its road infrastructure budget to USD 50 million from USD 19 million in 2007. Yet road density in Cambodia remains relatively low – 0.26 in 2012 compared to 0.35 in Thailand and 0.78 in Viet Nam in 2009.

The government has not overlooked its rail network. It is also rehabilitating its two main railway lines – the Northern and Southern Lines – and supporting the Trans-Asian Railway which will run from Singapore to China and Russia and from South Korea to Europe.

Figure 2.2.4. Modes of tourist arrivals in Cambodia, 2012



Source: Ministry of Tourism, Cambodia.

StatLink  <http://dx.doi.org/10.1787/888932937833>

Diversify tourist destinations and ensure sustainable tourism

The main tourist attraction in Cambodia is the Angkor Wat temple in Siem Reap. However, to further promote tourism, the government needs to attract tourists to other destinations such as the tropical beaches on the south-west coast and the colonial and historical buildings in Phnom Penh. Diversifying tourist destinations will have knock-on benefits for the local economy. For example, local people have acknowledged that community-based tourism development in the coastal areas near Sihanoukville has created jobs and helped to revitalise local nature tourism and the arts and crafts industry.

In this respect, the government must ensure that sustainable tourism practices are in place to encourage the conservation of natural resources and the protection of the environment and Cambodia's cultural heritage.

Sustainable tourism should also contribute effectively and efficiently to poverty reduction in Cambodia. Siem Reap, visited by more than half of all foreign tourists, is one of the most popular tourist destinations in Cambodia. Yet it is still the country's second poorest province with about 52% of its population living below the poverty line. The main barriers to reaping the benefits of tourism include skills shortage, poor education, lack of capital, weak family structures, insufficient social networking and inadequate transport infrastructure.

The tourism sector has weak linkages with the rest of the economy

In 2005, approximately 30% of revenue from tourism in Cambodia was leached out of the economy by imported foreign products purchased precisely to serve the tourism sector. Although such losses of income appeared to decline slightly in 2012 to around 25%, they are still significant enough to hurt the country's balance of payments. The government has realised that the import of equipment and agricultural products from neighbouring countries such as Thailand and Viet Nam to meet the demand of Cambodia's hotels and restaurants is a serious issue. The national development plan included an agenda to address the problem by identifying local enterprises that could be developed and improved to compete with imported products and supply their wares to the tourism – and related – sectors.

Efforts to upgrade the tourism sector will need to take place on several fronts. The diversification of tourist destinations and the development of tourism-specific infrastructure and facilities are crucial. The government should also seek to promote tourism, put in place legal measures to protect the environment, ensure that there is cultural heritage management and stakeholder collaboration, and develop human resources. It should also address the questions of political stability, national security, safety, and regional co-operation as part of its commitment to Cambodia's tourism sector.

Note

1. The System of Rice Intensification (SRI) is a less resource-intensive irrigation method which uses environmentally friendly farming techniques for improving soil fertility, ploughing and planting. It ensures high quality crops, reduces production costs and causes less pollution.

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