

Global Financial Crisis Discussion Series

Paper 4: Cambodia

**Hossein Jalilian, Chan Sophal, Glenda Reyes
and Saing Chan Hang, with Phann Dalis
and Pon Dorina**



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Acronyms

ACLEDA	Association of Cambodian Local Economic Development Agencies
ADB	Asian Development Bank
ASEAN	Association of Southeast Asian Nations
BFC	Better Factories Cambodia (ILO)
CDC	Council for the Development of Cambodia
CDRI	Cambodia Development Resource Institute
CIS	Credit Information Sharing
CMT	Cut Make and Trim
CNN	Cable News Network
CPI	Consumer Price Index
CPR	Common Property Resources
CRDB	Cambodia Rehabilitation Development Board
CSES	Cambodia Socio-economic Survey
DAC	Development Assistance Committee (OECD)
EC	European Commission
EIC	Economics Institute of Cambodia
EITI	Extractive Industries Transparency Initiative
EIU	Economist Intelligence Unit
EU	European Union
FDI	Foreign Direct Investment
FFW	Food For Work (WFP)
fob	Free on Board
GDP	Gross Domestic Product
GMAC	Garment Manufacturers Association in Cambodia
GPSF	Government–Private Sector Forum
GSP	Generalized System of Preferences
HDI	Human Development Index
HEF	Health Equity Fund
ID Poor	Identification of the Poor project
IFAD	International Fund for Agricultural Development
IFI	International Financial Institution
ILO	International Labour Organization
IMF	International Monetary Fund
IOM	International Organization for Migration
MCH	Mother and Child Health Programme (WFP)
MDG	Millennium Development Goal
MAFF	Ministry of Agriculture, Forestry and Fisheries
MEF	Ministry of Economy and Finance
MFA	Multi-fiber Arrangement
MFI	Microfinance Institution
MNC	National Bank of Cambodia
MoC	Ministry of Commerce
MOPS	Moving out of Poverty Study
MoP	Ministry of Planning
MoT1	Ministry of Tourism
MRD	Ministry of Rural Development
NBC	National Bank of Cambodia
NGO	Non-governmental Organisation
NIS	National Institute of Statistics
NPL	Non-performing Loan
NSDP	National Strategic Development Plan
ODA	Official Development Assistance
ODI	Overseas Development Institute
OECD	Organisation for Economic Co-operation and Development
RGC	Royal Government of Cambodia
SCA	Société Concessionnaire des Aéroports

SME	Small and Medium-sized Enterprise
UK	United Kingdom
UNDP	UN Development Program
UNESCO	UN Educational, Scientific and Cultural Organization
US	United States
VAT	Value Added Tax
WDI	World Development Indicators
WFP	World Food Programme
WTO	World Trade Organization

Abstract

The global financial crisis has had a serious impact on the Cambodian economy, which has been heavily dependent on the world economy. The main drivers of high growth in the past decade, garments, tourism and construction, are all facing setbacks. The severest impacts are in the garment industry, which exported US\$2.9 billion in 2008, accounting for 65% of total exports: in the past six months, 51,000 workers have been laid off, a significant proportion of the 350,000 workers in this leading industry. Future orders are in doubt. Tourism registered a slowdown in 2008 and there are indications that it will decline in 2009. The International Monetary Fund (IMF) has recently projected a 5% fall in the sector, citing less world demand. Construction is also set to decrease, as foreign investors in real estate are either scaling back or suspending their mega projects as a result of the credit crunch at home. The global financial crisis has burst the bubble in the land and real estate markets, where were arguably over-buoyed by the global bubble of recent years. This has directly reduced construction activities and demand in general. The agriculture sector is expected to grow in volume significantly to offset declines in the rest of the economy. However, some crops face lower prices or no markets at all as world conditions change, which means less income and a harder situation for farmers, especially those who took loans to expand production in response to the rising prices in the first half of 2008.

The Cambodian government has taken a number of policy measures, such as loosening monetary policy and piloting subsidies in the agriculture sector. Training schemes have been planned for laid-off workers. Tax measures so far have included the suspension of the 1% advance profit tax and continuance of the profit tax holiday for certain garment factories. A more expansionary budget has been set for 2009 to serve as a stimulus and to accommodate plans to augment spending on infrastructure, agriculture and social programmes.

1. Introduction

Over the past few decades, financial crises have become a recurrent phenomenon. A number have taken place in Latin America, including those originating in Argentina, Brazil and Mexico. The mid- to late-1990s saw the Japanese, East Asian and Russian financial crises. We are now experiencing a global financial crisis. All of the previous crises had considerable impacts for far more countries than just the countries of origin, but none has been as serious and as all-encompassing as the one we are witnessing now. In terms of its impact and spread, the global financial crisis, whose epicentre is the US, has been unprecedented, and arguably more serious in its impact than those associated with the Great Depression. The purpose of this paper is to look more deeply into the impact of the crisis on growth and poverty in Cambodia. Details of methodological issues as well as the broader literature will be provided by the Overseas Development Institute (ODI).

Assessing and attributing the impact of the crisis is not likely to be easy, given the various events that have taken place around the same time with similar impacts. Prior to the crisis, Cambodia, along with many other developing countries, faced a crisis as a result of food and oil price increases, which created hardship for a large number of vulnerable groups in the country. In addition, last year, a serious border dispute between Thailand and Cambodia affected both countries. Disentangling some of the impacts associated with the global financial crisis from those arising from other events taking place within the same period is likely to be a difficult task.

The rest of the paper is organised as follows. Section 2 provides a brief overview of the impact of the global financial crisis and its transmission mechanisms in Cambodia. Section 3 deals with the impact of the crisis on growth and poverty in Cambodia. Section 4 considers policy implications that follow from these analyses, and Section 5 concludes this paper.

2. The global financial crisis and shocks at the national level

In order to consider the impact of the global financial crisis, it is useful to distinguish between immediate and direct effects and those associated with its secondary and indirect effects. The immediate impact on countries that are not fully integrated into world financial markets, or whose financial sector is not that developed and integrated, is not likely to be that severe. Over the medium term, however, the impact may be more severe, through the indirect or second-round effects of the crisis, on trade and investment flows for example. The recession and slowdown in economic activities in many major economies, such as the US, Europe and Japan, will negatively impact exports to these economies as well as investment outflows from them. This will also be the case for other Organisation for Economic Co-operation and Development (OECD) members, such as South Korea, which is a major player in East Asia. For these same reasons, official development assistance (ODA) flows from most affected countries is likely to be downwardly adjusted.

In the case of Cambodia, this indirect impact may be far more severe than the direct impact: export of garments from Cambodia, which make up around three-quarters of total exports from the country, have already declined sharply and seen mass layoffs of workers. Monthly exports fell 50%, from US\$250 million in 2008 on average to \$100 million in January 2009. Although the garment sector employs a mere 4% of the total labour force, the indirect and multiplier effects of job losses in this sector may be substantial. They will certainly aggravate the hardships faced by the vulnerable rural households from which many of the garment workers come.

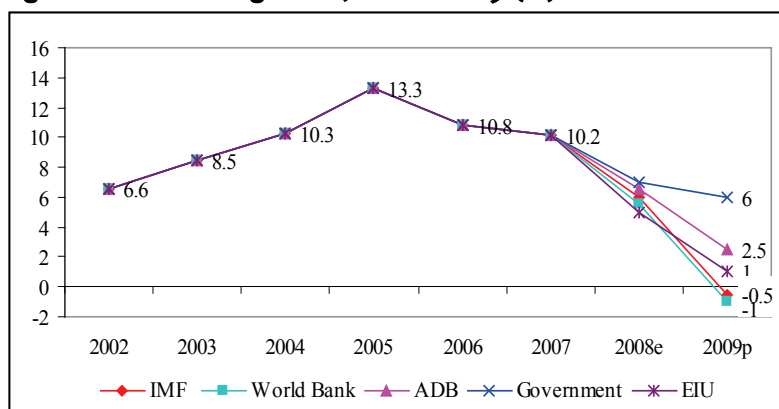
The impact of the crisis on the growth of gross domestic product (GDP) in Cambodia is likely to be severe. Most analysts initially expected growth to fall to half of what Cambodia has experienced over the past decade. However, as actual movements in the economy seem to signal sharper decelerations in key growth drivers, initial estimates may be rather optimistic and, unless measures are taken to counter this, GDP growth is expected to fall well below forecast levels. Already, the International Monetary Fund (IMF) has further adjusted downward its GDP growth projection for 2009, from an initial estimate of 4.8% to -0.5%.

The global financial crisis and economic downturn have translated themselves into a national-level shock in Cambodia through several key transmission channels. Cambodia, which is less integrated into the global financial economy and has negligible exposure to sub-prime products, has not really been directly affected; the severity of impact has ensued more from indirect channels. These channels refer chiefly to the four specific growth sectors of the Cambodian economy, namely: garments, tourism, construction and agriculture. All of these sectors, except agriculture to a large extent, depend significantly on external private and official flows; hence, such resource transfers constitute another transmission mechanism by which the global shock has become a national shock. Remittance earnings comprise another mechanism, though less important from a macroeconomic perspective owing to their small size. The strain on the domestic banking system is another, as heightened risk aversion and reduced liquidity have affected domestic credit. In turn, the harm this causes to the real economy has adverse repercussions for the sector, potentially worsening the strain.

3. The effects of the global financial crisis on growth and development

The global financial crisis has essentially put a brake on Cambodia's decade-long exceptional growth. There is a consensus that growth in 2008 slowed down and that this growth will recede even more in 2009. Nevertheless, it is important to note that there is disparity among growth projections. From 10.3% in 2007, real GDP growth is estimated to drop to an average of 6.4% in 2008 and to somewhere between -1% and 6% in 2009. As mentioned, the IMF already revised its growth forecast to -0.5%. The World Bank and the Asian Development Bank (ADB) have likewise downgraded their projections to -1% and 2.5%, respectively. In any case, the optimistic 6% growth forecast of the Cambodian government stands out, resting on a much more upbeat outlook on the performance of the country's growth sectors (see Figure 1).

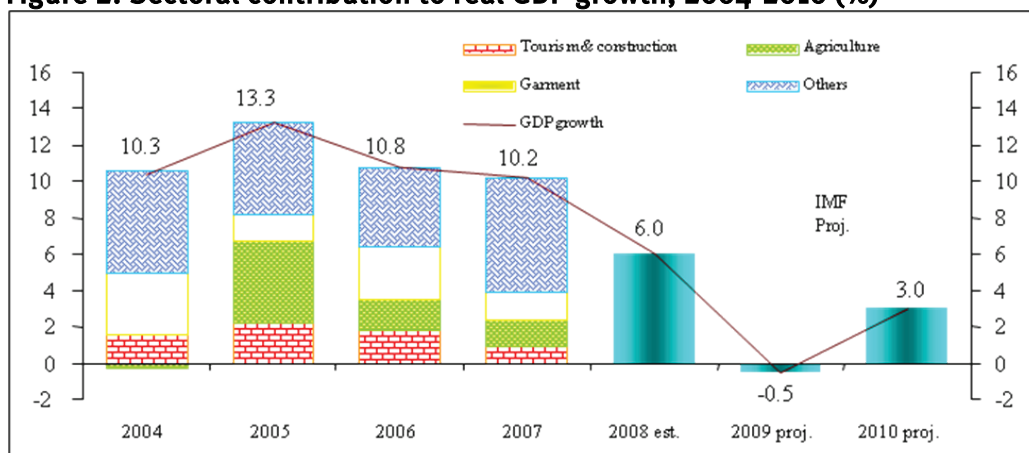
Figure 1: Real GDP growth, 2002-2009 (%)



Sources: ADB (2009); IMF (2009b; 2009c); World Bank (2009c); EIU and government public estimates as cited in Cambodia Economic Watch (2009).

As mentioned, the impact of the crisis and the subsequent slump spilled over into the Cambodian economy via several specific transmission mechanisms. The primary channels of contagion pertain to the country's key drivers of growth, namely, garments, tourism, construction and agriculture. Figure 2 illustrates the contribution to growth of each sector and suggests a serious contraction in their performance in the coming two years. Foreign direct investment (FDI), aid and remittances, together with the strain on domestic banking sector, constitute other channels.

Figure 2: Sectoral contribution to real GDP growth, 2004-2010 (%)



Source: Nelmes (2009); Prasidh (2009).

Before proceeding, it is crucial to underscore once more what was stressed in the introduction. The downturn in the key sectors of Cambodia's economy may not owe completely to the contagion from the global financial crisis. As is known, the crisis has not only unfolded in the aftermath of the food and energy crisis but has also coincided with some unfortunate domestic events, including the Thai–Cambodia border skirmish, which likely affected the tourism sector. It is difficult to isolate the effects of these developments. Nevertheless, where they could be a significant explanation, they will be dealt with in the individual discussions on the transmission channels below.

A related matter to consider in the context of development is the impact of the crisis on poverty reduction and inequality. Cambodia is a low-income country that suffers from a very high level of poverty as well as inequality. As of 2007, poverty incidence was estimated at 30% (based on the national poverty line), and the Gini coefficient stood at approximately 0.43.² As for the Human Development Index (HDI), which provides a broader measure of wellbeing, Cambodia ranked 136th out of the 179 countries with data in 2006, with an HDI value of 0.575 (UNDP, 2008).

Given recent impressive growth, poverty reduction should have been much higher than the 15% reduction achieved over the period (from over 45% in 1994 to around 30% in 2007). The reason for this lies in the limited linkages between the growth poles and the rest of the economy. Poverty elasticity with respect to growth is around 1,³ far below the average for developing countries, which is estimated to be anywhere between 2.5 and 5.⁴ The greatest contribution that the growing sectors make to the economy is in limited employment generation; otherwise, they are not much linked to the rest of the economy. This is less so in the case of tourism, however.

To consider more fully the impact of reduced growth on poverty, it would be useful to distinguish between the growth effects transmitted through the labour market and impacts on overall expenditure on consumption and investment. Given the limited linkages between the growth poles and the rest of the economy, the direct effects of reduced growth on poverty that are transmitted through the labour market are not likely to be as severe. However, loss of employment would have knock-on effects, not only on the welfare of the unemployed but also on the larger families that these individual support through remittances. Large proportions of rural migrants to urban areas send remittances back to their villages.

Reduced growth, especially to the extent predicted by the most recent forecasts, would also have a considerable impact on households through its effects on consumption and investment expenditure. A large portion of the population is living close to the poverty line; any small decline in their income is likely to push them below the line. The Moving out of Poverty Study that the Cambodia Development Resource Institute (CDRI) published last year shows this vulnerability very clearly. In some of the study villages, a change of income by a couple of hundred riel would have made considerable difference to the level and severity of poverty. The same study shows significant change in the poverty ratio and its depth between dry and wet seasons. This indicates that the poor have very limited coping mechanisms in dealing with seasonal variations in their earnings.

In addition to the adverse employment effects of the crisis, poor and vulnerable groups are likely to be hit hard because of the slowdown in economic activities. The crisis will affect the relatively well-off and the rich adversely as well. They are likely to reduce their consumption and particularly their investments. This reduced demand and expenditure will affect a much larger section of the population; these are the third-round effects. As is normally the case, the groups most at risk of losing parts or all of their livelihood are those with no or limited human and physical capital; that is, the poor and relatively poor.

In addition to rural–urban migration, about a quarter of a million of the labour force in Cambodia migrate to other countries, mainly Thailand. A large portion of these migrants are likely to lose their jobs owing to the effects of the crisis in host countries. Migrants to Thailand are likely to face a more

² These figures were sourced from the World Bank's (2009c) report on Cambodia, which in turn credited the data to the results of the Cambodia Socio-economic Survey (CSES) 2004 and 2007, as analysed by James Knowles.

³ This is a very rough estimate, one which ignores changes in inequality. Given that inequality in Cambodia has risen considerably over the period, the growth elasticity of poverty is expected to be even lower than this figure.

⁴ For more details on this subject see, for example, Adams (2004).

serious problem. Over 80% of migrants to Thailand are illegal. Amid the crisis, Thai authorities have announced intensified crackdowns on illegal migrants.⁵ This would have serious implications for remittances from Thailand and subsequently the wellbeing of households supported by remittances. Remittances cover not only part of consumption of households but also their expenditure on physical and human capital.

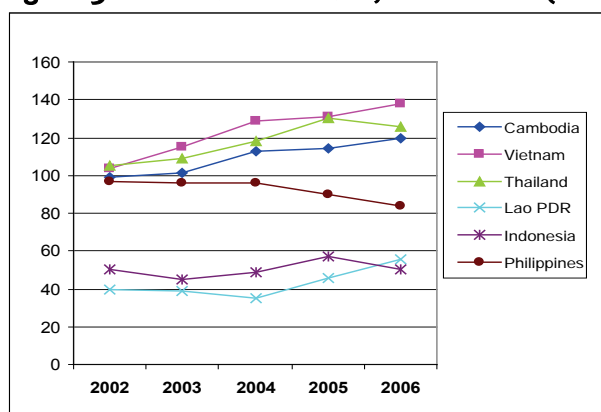
Overall, therefore, as a result of the crisis, Cambodia is likely to face an increased level and severity of poverty. How severe these and other consequences are will be determined by Cambodia's main trading partners, such as the US and European Union (EU), and how well they can cope with the crisis and, importantly, the reaction of the Royal Government of Cambodia (RGC) and its development partners. It has been estimated that about 53 million people more in developing countries could be trapped in poverty as a result of the crisis, thereby joining the 130-155 million that were driven into poverty in 2008 owing to the food and fuel crises (Kay, 2008; World Bank, 2009a; 2009b). In the case of Cambodia, as many as two million people have been estimated to have fallen below the poverty line owing to the food and fuel crises, based on preliminary evidence (ADB, 2008a). No specific estimates are known to have been given, but it is nonetheless believed that the global financial crisis will affect the 1% per year reduction in poverty that Cambodia has experienced in recent years and make it less likely that poverty will drop fast enough to meet the country's Millennium Development Goal (MDG) target of 19.5% by 2015, which some considered ambitious even in the context of continued high growth (Corey-Boulet, 2008).

How the effects of the crisis are transmitted to growth and development in Cambodia will be more fully discussed using relevant information from the growth poles of the economy in the country, starting with the trade sector effects.⁶

3.1 Effects on trade

Cambodia's trade sector has grown rapidly since it commenced liberalising outside trade back in the early 1990s. The country's trade openness ratio has tripled since such liberalisation began,⁷ and has caught up with its more advanced neighbours (Figure 3). The East Asian financial crisis in 1997 did not do much damage to Cambodian trade since it started from such a low base that it could hardly fall back. The country's induction into the Association of Southeast Asian Nations (ASEAN) in 1999 and the World Trade Organization (WTO) in 2004 helped the country to become more integrated in the region and the world and earn more confidence from foreign investors.

Figure 3: Merchandise trade, 2002-2006 (% of GDP)



Source: World Bank WDI CD-ROM (2008).

5 This announcement was made by the current Thai Prime Minister himself at the beginning of 2009 and has triggered words of admonishment by migrant worker groups, fearing arbitrary deportations and mistreatment especially given perceived suspect incidents involving Burmese migrants. See Channel News Asia (2009); Shay (2009; and Zar (2009).

6 To better understand these mechanisms, it is important to undertake a historical and comparative look at the nature of Cambodian growth and its implications for poverty and inequality in the country. A brief discussion is in Annex 1.

7 The trade openness ratio here is simply defined as the ratio of merchandise exports to GDP. According to the World Development Indicators (WDI), such a ratio for Cambodia stood at 120% in 2006, from 44% in 1994.

Today's crisis and worldwide recession has had grave repercussions for Cambodia's trade and growth. Owing to high oil prices for one, last year's current account deficit (excluding official transfers) as a percentage of GDP was estimated to have ballooned from about 8% in 2007 to possibly as much as 16% in 2008. By the end of 2009, the ratio is expected to bounce up to somewhere between 7% and 12% of GDP, but this is more because the recent reversion in inflationary trends and import growth is expected to offset the deceleration in export growth (see Table 1).⁸

Table 1: Balance of payments, 2007-2009

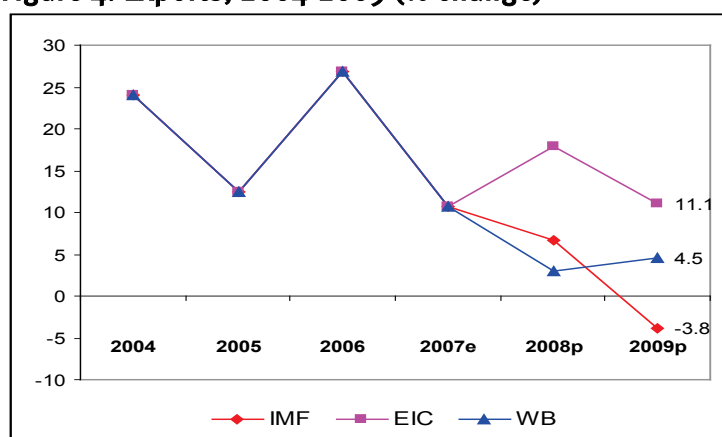
	2007 estimated (US\$m)	2008 projected (US\$m)	2009 projected (US\$m)	08/09 % change
Current account*	-296	-1268	-845	-33.4
Exports, fob**	4089	4363	4197	-3.8
Imports, fob	-5419	-6523	-5798	-11.1
Capital and financial account	724	1648	715	-56.6
Overall balance	427	379	-130	-134.3

Note: * Including official transfers. ** Free on board.

Source: IMF (2009a).

Exports are seen to be headed for a serious slowdown this year, their projected growth being somewhere between 11.1% and -3.8% by end-2009, based on initial estimates (Figures 4 and 7). While other factors, such as the recent appreciation of the riel and real effective exchange rate (Figure 5), may help explain the drop in export demand, such decline can ultimately be attributed to Cambodia's narrow export base. The slowdown in exports draws mainly from the decline in garment exports, the country's dominant export product and one of the four key drivers of Cambodian growth. Additionally, export slowdown has been induced by decreased demand for Cambodian natural rubber and cassava. Other agricultural exports, such as rice, have proven more resilient so far. A slump in import growth, between 8.6% and -11%, based on initial estimates, is likewise envisaged this year (Figures 6 and 7). A factor behind this has been the weaker domestic demand for such durable goods as cars, motorcycles, buses, trucks, tractors and other vehicles. The following immediate sections elaborate on these.

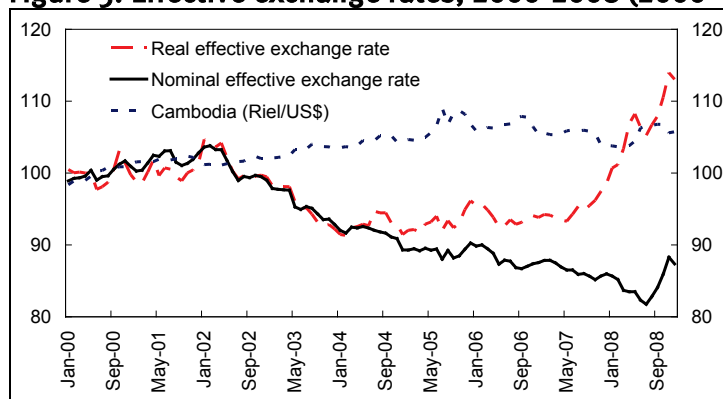
Figure 4: Exports, 2004-2009 (% change)



Sources: IMF (2009a; 2009b); NIS (2008); World Bank (2008a); and EIC data as cited in Cambodia Economic Watch (2009).

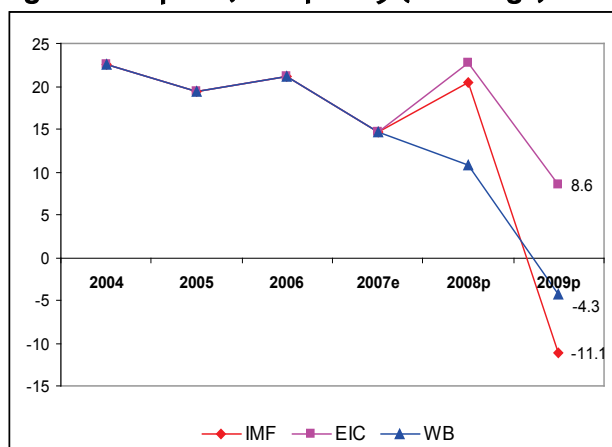
⁸ Figures based on data from IMF (2009a), NIS (2008), World Bank (2008a) and EIC as cited in Cambodia Economic Watch (2009).

Figure 5: Effective exchange rates, 2000-2008 (2000=100)



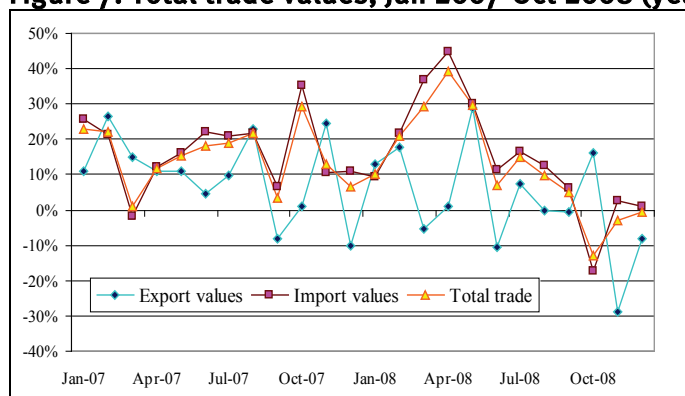
Source: Nelmes (2009).

Figure 6: Imports, 2004-2009 (% change)



Sources: IMF (2009a; 2009b); NIS (2008); World Bank (2008a) and EIC data as cited in Cambodia Economic Watch (2009).

Figure 7: Total trade values, Jan 2007-Oct 2008 (year-on-year % change)



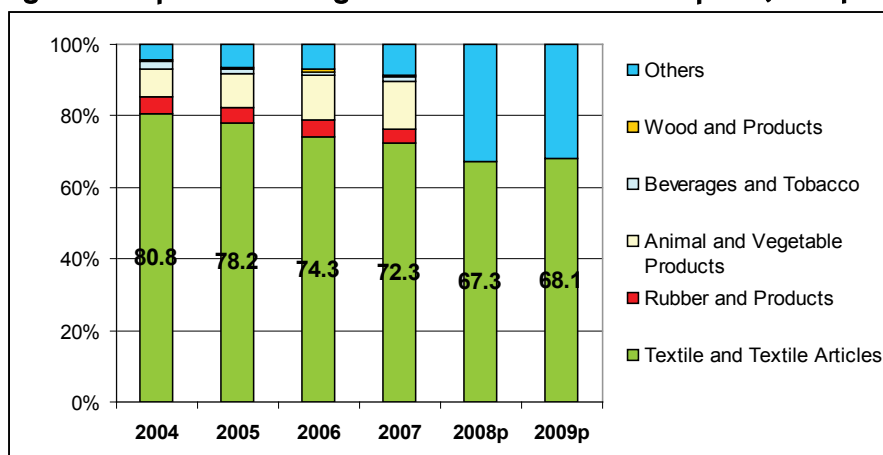
Source: Data from Customs and Excise Department of MEF.

3.1.1 Effects on garment exports

The garment sector accounted for 17% of Cambodia's GDP in 2007 and its share of total exports ranged from 70-80% in the years prior to the height of the global crisis. Other primary exports of the country include agricultural and animal products, rubber, wood and beverages and tobacco, but garments by far surpass the export values of these products (Figure 8). However, with Cambodia's top destination for its garments, the US, officially in recession, the sector registered a slowdown in 2008, with its export value reaching US\$2.9 billion, or around 65% of total exports (Figure 9). The sector's growth is

expected to contract more in 2009.⁹ Garments' export value beginning this year have already dropped alarmingly, from a monthly average of \$250 million in 2008 to \$100 million in January 2009 (Figure 10). The market concentration on the US explains one aspect of the garment industry's serious vulnerability to the crisis. US market share was more than 65% in 2008, compared with around 20% for the EU.¹⁰

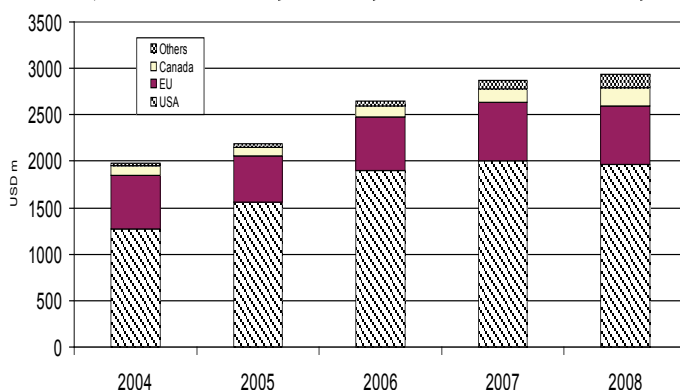
Figure 8: Export share of garments vis-à-vis other exports, 2004-2009 (%)



Note: * Others for 2008e and 2009p refer to total exports less textiles and textile articles.

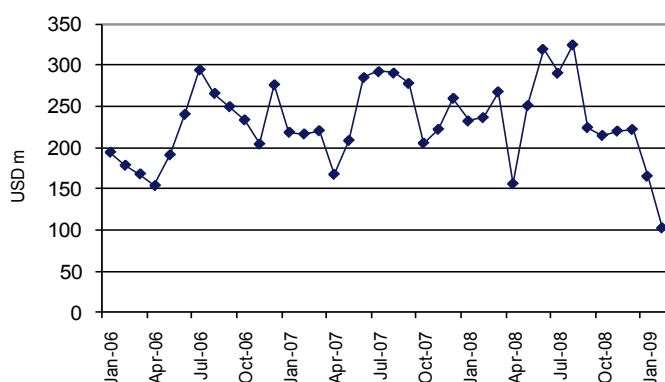
Sources: IMF (2009b); NIS (2008).

Figure 9: Garment exports by destination country, 2004-2008 (US\$m)



Source: Data from MoC, 6 March 2009.

Figure 10: Garment exports, Jan 2006-Jan 2009 (US\$m)



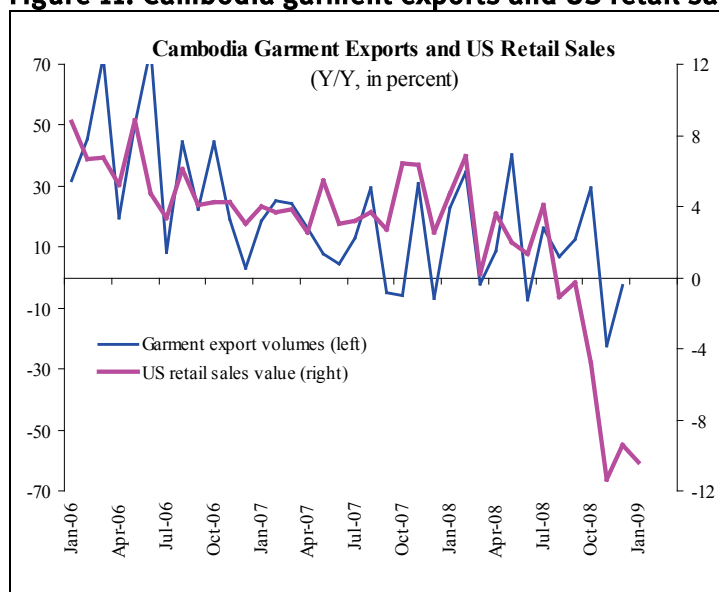
Source: Data from MoC, 6 March 2009.

⁹ Based on Ministry of Commerce (MoC) figures and IMF forecasts.

¹⁰ As Figure 9 indicates, over the period shown there has been an increased share of exports to 'other' categories. According to government sources, this trend is going to continue in future.

Indeed, even with the expiry of the Multi-fiber Arrangement (MFA) in 2004, Cambodia was able to keep its niche in the US market against initial expectations, although this is partly because the US continued some of its restrictions on Chinese imports¹¹ rather than just because of an increase in the competitiveness of the country's garment industry and productivity of its labourers, although such an improvement has indeed been observed over time. US safeguards on Chinese imports ended in December 2008.¹² This, coupled with the ongoing US recession, constituted a blow to Cambodia's garment sector. Following trends in the US, where retail sales are down and some retail stores have closed (Figure 11), Cambodia's garment exports to the biggest economy were lower than last year's, with recent figures showing a sharp decline in January and February 2009, causing jitters among domestic manufacturers and slashes in operating costs.

Figure 11: Cambodia garment exports and US retail sales, Jan 2006-Jan 2009 (year-on-year in %)



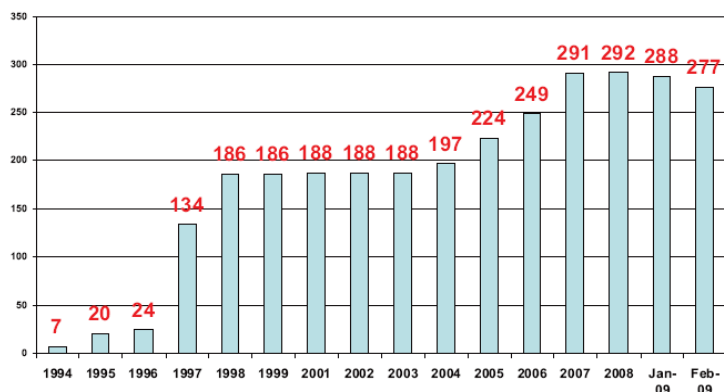
Source: Nelmes (2009).

In line with the above trends, the number of textile and apparel factories in operation has gone down from 292 in 2008 to 277 as of February 2009 (Figure 12). Most garment factories are foreign owned, with estimates somewhere between 90% and 95%, and mainly focused on 'cut make and trim' (CMT), the lowest end of the garment value chain. These constitute another aspect of the garment sector's vulnerability to the crisis. Major FDI sources include Taiwan, Hong Kong, China and South Korea (Figure 13), countries that have likewise been hit hard by the credit crunch and the associated economic downturn. Beginning 2008, 60 factories in Cambodia have reportedly already closed down and a number have suspended operations, but some were newly established, lessening the drop in the total number of factories. Because CMT factories in Cambodia are also mostly subsidiaries, the unfavourable effect of the crisis on their parent companies based abroad has direct implications for them in terms of garment order allocations (Kang et al., 2009). In terms of employment, 51,000 garment workers were laid off between September 2008 and February 2009 (Figure 14). This 15% contraction in employment in this leading industry is substantial. Apart from the layoffs, higher underemployment is also expected and in fact already underway, with workers reportedly forced to work fewer hours. An estimated US\$4-5 million has been lost in wages per month as a result.

¹¹ The US and the EU imposed such restrictions in line with the 'Textile Safeguard Clause' incorporated into China's WTO accession agreement. This clause expired in December 2008. For this, see Keane (2008).

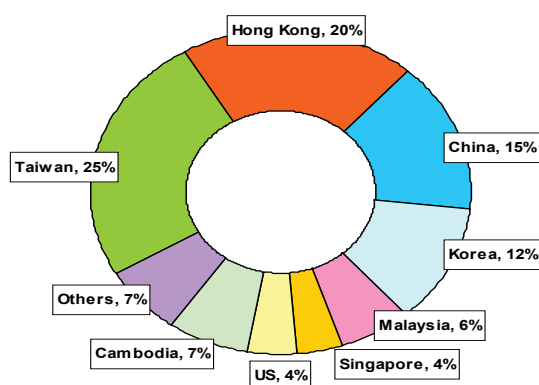
¹² See International Labour Organization Better Factories Cambodia (ILO BFC) (2005; 2008) and World Bank (2009).

Figure 12: Number of textiles and apparels factories in operation, 1994-2009



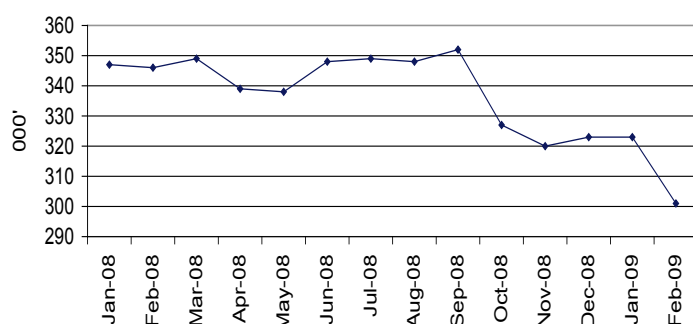
Source: Prasidh (2009).

Figure 13: Investors in the garment industry (%)



Source: MoC as cited in Kang et al. (2009).

Figure 14: Size of workforce in garment industry, Jan 2008-Jan 2009 ('000s)



Source: Prasidh (2009).

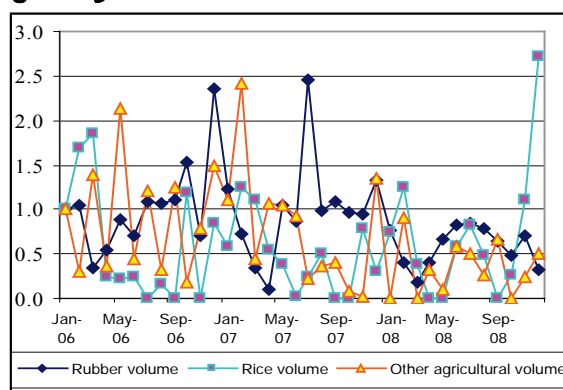
3.1.2 Effects on agricultural exports

On rice exports, the sector tended to be able to withstand the effects of the financial crisis during the last three months of 2008 as rice exports remain resilient, posting at 199 tonnes (October), 843 tonnes (November) and 2080 tonnes (December), higher than the 595 tonnes (November) and 230 tonnes (December) in 2007 (Figures 15 and 16). However, this partially explains the rice export, because Cambodia had a surplus of 2.5 million tons of paddy in 2008 and most was exported informally (without registration) across the border. Additionally, it is worth noting that the sharp decline in rice prices during the past six months does not appear to distort production, as lowest prices in recent months remain higher than those in past months in 2006 and 2007 (Figure 17). On other food and

industrial crop exports, export volumes indicate slower growth from a year earlier, but export values marked a meagre change from last year resulting from rising rice prices in 2008.

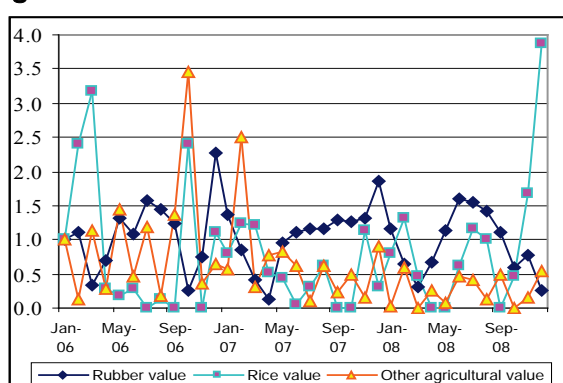
By contrast, natural rubber producers, smallholders and private estates appear to be substantially hit by the financial crisis. During the last three months of 2008, average year-on-year growth of Cambodia's natural rubber exports contracted at around -62% (Figures 15 and 16). Therein, as several rubber-based manufacturers across the region and the globe cut back their production processes owing to weak domestic and external demand for rubber-based products, coupled with declining petroleum prices, natural rubber price has tumbled tremendously since mid-2008. The situation in the last quarter of 2008 and the first quarter of 2009 deteriorated further as the global financial crisis compounded the effects. The magnitude of the effects on smallholders' and rubber estates' returns looks significant as rubber prices in early 2009 hit the lowest record since 2006 (Figure 17). Although it has been argued that natural rubber could be stored and sold once the storm subsides, most, if not all, smallholders and rubber estates need cash to cover their operating expenses and other overhead costs. Partly as a result of the crisis, demand for cassava, which is an important product for farmers in Cambodia, has also declined sharply in price in recent periods. Gross margins for cassava were reduced by 166%, making a negative loss of US\$180 per ha. Some farmers are forced to leave the crop on the farm as there are no buyers. A number of farmers even took loans to grow or expand cassava production in response to the tripling in its price in early 2008 (CDRI, 2008).

Figure 15: Index of volumes of main commodities exports, Jan 2006-Sep 2008 (Jan 2006=100)



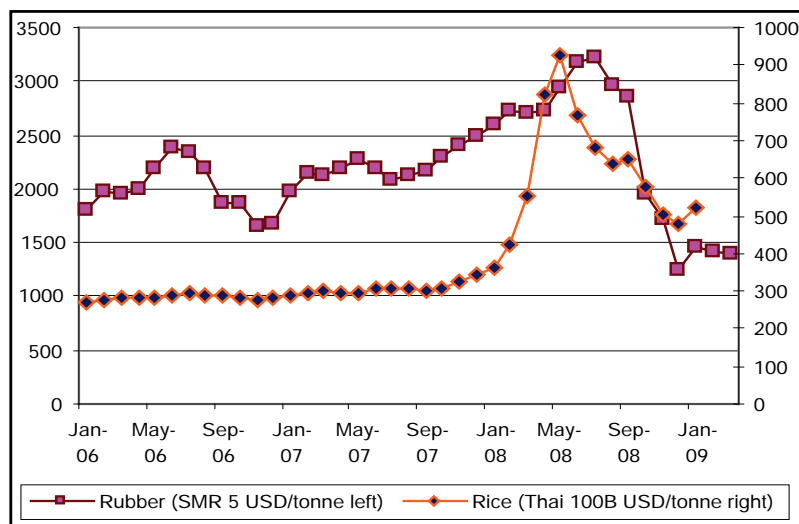
Source: Data from the Customs and Excise Department of MEF.

Figure 16: Index of values of main commodities exports, Jan 2006-Sep 2008 (Jan 2006=100)



Source: Data from the Customs and Excise Department of MEF.

Figure 17: Prices of rice and rubber, Jan 2006-Jan 2009

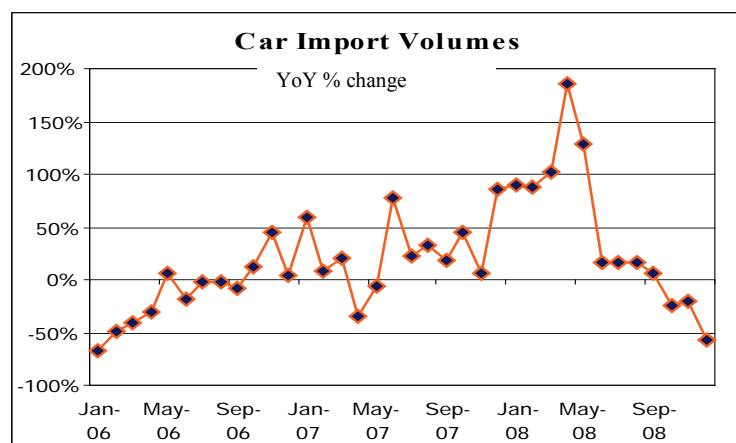


Source: Data from the Customs and Excise Department of MEF.

3.1.3 Effects on durable goods imports

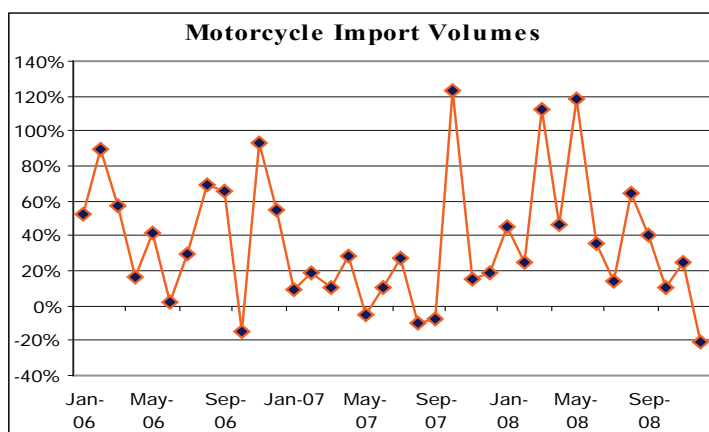
Despite the appreciation of the riel against the US dollar, along with a rising real effective exchange rate, making imported products cheaper, domestic demand for certain durable imported goods continued to slide in the last quarter of 2008. Year-on-year growth of car, motorcycle and other vehicle imports plummeted markedly (Figures 18 and 19), which could be attributed to the decline in real estate and land transactions. The latter in turn is partly attributed to the global financial crisis. Regional and global economic recession was a factor contributing to weaker domestic demand, compounded by food and energy shocks between the last quarter of 2007 and the first two quarters of 2008 and consumers' cautiousness over the outcome of the July 2008 election. Such a downturn in durable imports reduces a certain proportion of revenue from trade tax. The reduction, if substantial, could possibly limit the government fiscal capability.

Figure 18: Car import volumes, Jan 2006-Sep 2008 (year-on-year % change)



Source: Data from the Customs and Excise Department of MEF.

Figure 19: Motorcycle import volumes, Jan 2006-Sep 2008 (year-on-year % change)

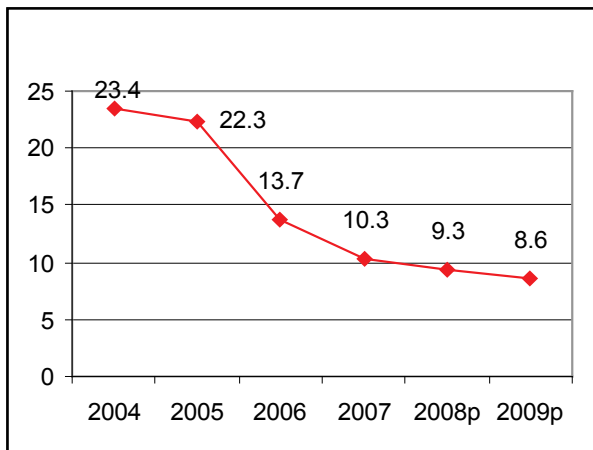


Source: Data from the Customs and Excise Department of MEF.

3.2 Effects on tourism

Tourism, again one of the four principal drivers of Cambodian growth, has been experiencing setbacks since last year.¹³ Its positive growth was initially projected by everyone to continue in 2009, though at a lower rate (Figure 20). However, the IMF has recently revised the growth of tourism to -5%, a dramatic diversion from relatively optimistic outlooks. The flagging pace can certainly be attributed to the widespread recession, which has compelled tourists from the richer countries to diminish the frequency of their travels. However, it must be noted that other factors are similarly accountable for the weakening in Cambodia's tourism sector. It must likewise be noted that there appears to be no consensus on the depth of the downturn in the industry or its associated impact on domestic revenues.

Figure 20: Growth of tourism sector, 2004-2009 (%)



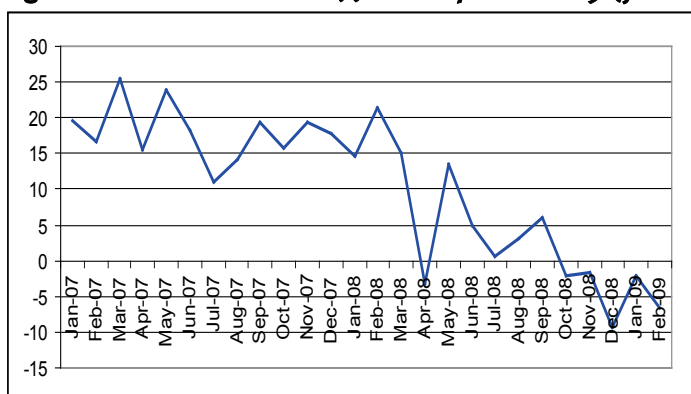
Source: NIS and EIC data as cited in Cambodia Economic Watch (2009).

Tourism arrivals at Cambodia have slowed down observably (Figure 21). Growth of passenger traffic at Phnom Penh International Airport plunged rapidly, from 21% in May to a mere 3% in September 2008. The situation at Siem Reap International Airport has been even worse, with the same statistic reaching -10% in September 2008 (Figure 22). Consistent with this, flight movements at both airports were considerably lower in 2008, and expectedly also in 2009 compared with previous years. Incidence of domestic flights actually shrank by 22% in Siem Reap for the period January-May 2008 over the same

¹³ The GDP contribution of tourism is mainly incorporated in the hotels and restaurants category of the national accounts. According to government statistics, hotels and restaurants accounted for an estimated 4.4% of GDP in 2007.

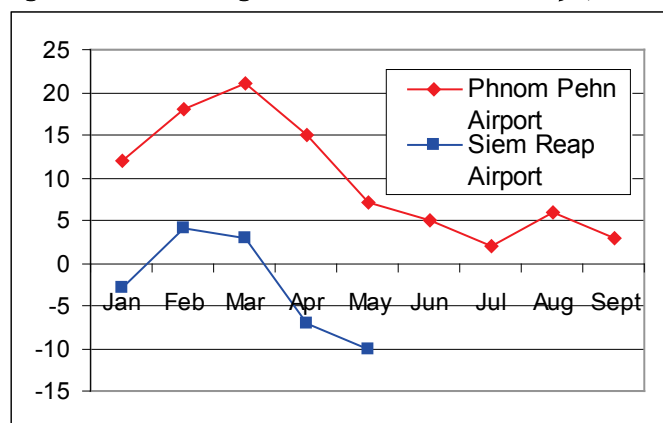
period in 2007, and by 10% in Phnom Penh for the period January-September 2008 over the same period in the preceding year (Figure 23). Most airlines have already made plans to cut capacity on existing routes, especially in 2009. Tourist arrivals from top markets, South Korea, Japan and the US, all in serious recession, are expected to decelerate this year. Still in line with these trends, growth in Angkor Wat sales began its steep decline around May 2007 and only reached half a percent during the first eight months of 2008. While employment in the industry appears to be largely unaffected so far, locals dependent on tourism sales in major tourist locations have already reported at least a 50% decline in their income. Meanwhile, hotel operators have indicated that occupancy rates have already significantly dropped, by up to 30% (IMF, 2009a; Kay and Neth, 2009; May, 2009a).

Figure 21: Tourist arrivals, Jan 2007-Feb 2009 (year-on-year growth %)



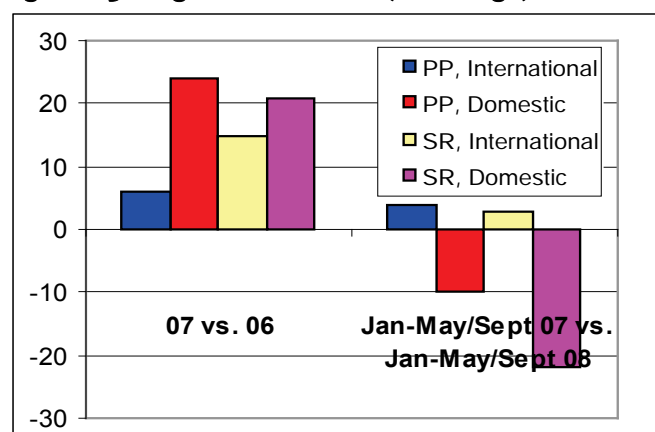
Source: MoT (2007; 2008; 2009)

Figure 22: Passenger traffic, 2008 vs. 2007 (% change)



Source: SCA (2008a; 2008b).

Figure 23: Flight movements (% change)



Source: SCA (2008a; 2008b).

As mentioned, the trouble in the tourism sector has been instigated by factors other than the global crisis, specifically the political instability in Thailand and the border stand-off between Cambodian and Thai troops.¹⁴ Thailand is a major entry point for flights destined to Cambodia; thus, the closure of Bangkok International Airport back in November-December 2008 and the subsequent heightened sense of risk of flying through Bangkok inevitably affected tourist arrivals in Cambodia. The near military clash between Cambodian and Thai troops at the Preah Vihear border was another factor that compounded the problem. The conflict, which led to the temporary closure of the gates of Preah Vihear Temple and tourist sites in the Thai section, observably suspended cross-border tourism, slashed incomes of locals reliant on tourist payments and renewed this misperception of a lack of security in Cambodia following its decades-old civil war. Another blow to Cambodian tourism came in November 2008 when Siem Reap Airways was added to the safety blacklist of the European Commission (EC). It is difficult to isolate precisely the impact of these incidents vis-à-vis the effect of the global crisis on the domestic tourism sector. Nevertheless, both government authorities and independent analysts consider such impacts to be significant.

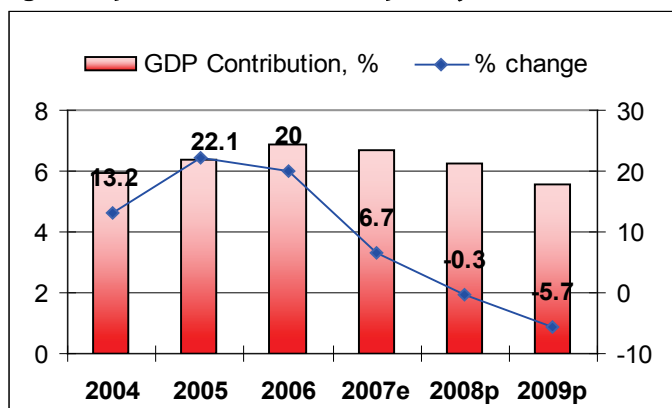
There appears to be a noticeable discrepancy in views about the extent of the downturn in Cambodia's tourism industry and associated impacts on domestic revenues. The government seems to be more optimistic and emphatic about the fact that, while less compared with previous years, sector growth remains and will remain positive. It has set recovery by 2011 or earlier (Chun, 2009). By contrast, a greater sense of foreboding seems to prevail among travel agents, hotel operators, locals depending on tourism, opposition parties and independent analysts. On top of this, there seem to be mixed assessments as to how revenues from the sector will fare in light of the existing downturn. Needless to say, tourism is an exceptionally important revenue source (especially of value added tax – VAT) for Cambodia. Predictions on the industry's revenue contributions have unfortunately varied, from a drop (-5% by the IMF) to a rise, from significant to minimal. Opposition parties have pointed this out and commented that, if the government envisages an increase in tourism arrivals, then it follows that it must expect an increase in tourism revenue. Such indecision, implied the opposition, is possibly in implicit accommodation of 'potential rent-seeking opportunities'. A factor that appears to aggravate efforts to measure more precisely the bearing of the downturn on government revenue shares has been the difficulty of securing more detailed figures. It has been noted that the Apsara Authority and Sokimex, the two institutions receiving revenues from Angkor Wat, seem so far to have rebuffed requests to release more detailed and concrete numbers (May, 2009a; 2009c). In any case, available data denote that the revenue contribution of the tourism industry will be about 6.3% of total domestic revenues, not really far off earlier levels (Figure 21). It will continue being a key and increasing source of non-tax revenues, although the slowdown in tourist arrivals will certainly have knock-on effects on government revenue.

3.3 Effects on construction

Again, construction is one of the four key propellers of Cambodia's economic progress. The sector's contribution to GDP stood at around 6.7% in 2007. However, just like the other three growth poles, it is experiencing hardship in light of the global economic meltdown. The boom in the sector since 2002 found itself unsustainable in the face of the real estate bubble (arguably contributed to by the global bubble), the pullback in foreign investment and the weaker prospects for the Cambodian economy in the immediate term.

¹⁴ The Cambodia–Thai border conflict started in July 2008 following the listing of Preah Vihear Temple as a UN Educational, Scientific and Cultural Organization (UNESCO) World Heritage Site. High-level talks have been held since then and resolution of the conflict, which relies on agreement on border demarcations, seemed imminent at one point. Unfortunately, an exchange of gunfire between Cambodian and Thai troops at the border occurred in April 2009. See Cheang (2009) and Thet (2009).

Figure 24: Construction, 2004-2009



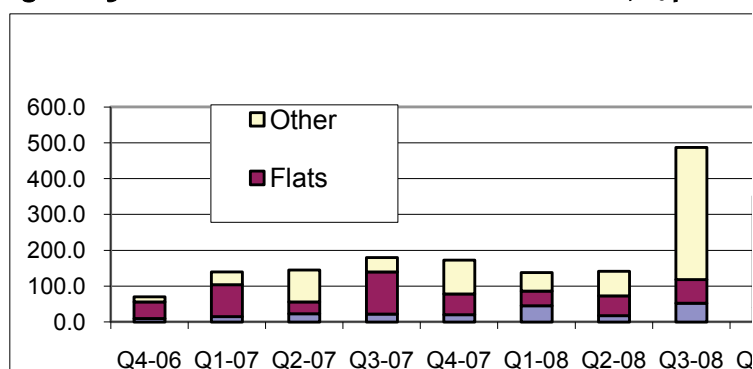
Sources: NIS (2008) and EIC data as cited in Cambodia Economic Watch (2009).

Based on estimates, growth of the construction sector decelerated from 6.7% in 2007 to -0.3% as of end last year, bringing its GDP contribution down from 6.7% to 6.2% over the same period. The slowdown in growth is expected to worsen to -5.7% by end 2009, further dragging down the sector's GDP contribution to a low of 5.5% (Figure 24).

Construction in Cambodia has closely followed real estate development. Most construction projects have been in commercial and residential real estate. Back in mid-2008, property prices skyrocketed by as much as 100% on prices the year before. Overheating was evidenced by increased input costs, including labour. But the bubble burst soon after, given declining incomes and crunch in credit. Prices eventually dropped by as much as 25% (other estimate put it between 30% and 40%) and sales have reportedly gone down between 50% and 80%. Growth of the real estate sector as a whole is conservatively estimated to have slowed down from 10.9% in 2006 to 10.7% in 2007 (IMF, 2009a; May and Nguon, 2009; Cambodia Economic Watch, 2009; An and An, 2008).

Construction projects in the country have also been predominantly foreign-financed, signifying the sector's vulnerability to the crisis. With the global tightening in liquidity and gloomier prospects in the domestic economy, foreign investors scrambled to defer or cancel their investments in the country, including mainly in construction. Some mega projects have been cancelled or scaled back, notable among which were Korean-financed projects, in light of the depreciation of the Korean won and the liquidity crunch in parent companies (Cambodia Economic Watch, 2009; Nguon and Soeun, 2009; Sothea, 2008; Sturrock, 2009; World Bank, 2008c). New investments, on the other hand, were noted to have decelerated 12.5% during the first 11 months of 2008 over the same period in 2007 (Kang et al., 2009). However, approval of construction projects by value in Phnom Penh peaked in the third quarter of 2008 and remained quite high in the last quarter of 2008 (Figure 25). This suggests an influx of applications earlier in 2008, because it takes around six months for construction projects to be approved. Though it may be true that confidence in the domestic real estate sector remains among national players (see Chhun, 2008), heightened risk aversion and global illiquidity have evidently dampened foreign appetite in the meantime.

Figure 25: Value of construction in Phnom Penh, Q4 2006-Q4 2008 (approval basis US\$m)



Source: Data from the Municipality of Phnom Penh.

In terms of employment, about 299,000 (3.6%) of the total labour force were employed in the construction sector in 2007. Reportedly, 15,000 construction jobs in mid-2008 were lost. An even more worrying estimate is that around 30% of the country's construction workers have so far lost their jobs following the closure or suspension of construction projects. Many of these laid-off workers had no choice but to return to their provinces (Kang et al., 2009).

3.4 Effects on external resource flows

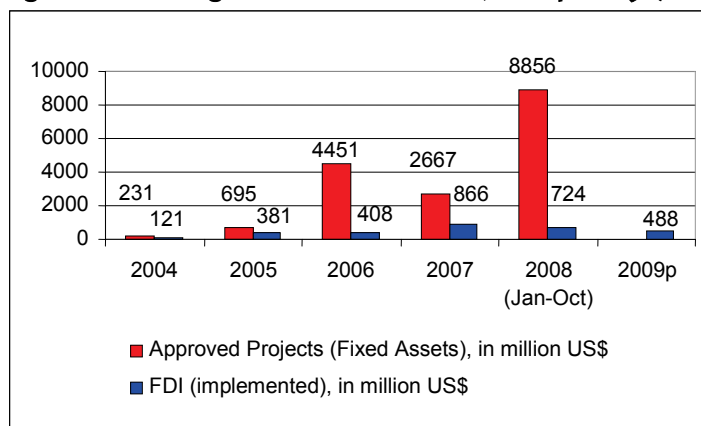
Main external resources that Cambodia attracts include FDI, aid flows and inward remittances. Effects of the crisis on each of these will be investigated separately, starting with the effects on FDI.

3.4.1 Effects on foreign direct investment¹⁵

The role that FDI plays in spurring the Cambodian economy is of extreme value. All of the country's key growth sectors depend significantly on FDI for financing, technological know-how, innovation, managerial capacity and skills transfer. Given this significant contribution, the Cambodian government has granted priority attention to enhancing the country's investment climate, passing crucial laws, implementing non-discriminatory regulation and striving to bring down the official costs of investing in the country. While recognising that there remain important constraints to FDI facilitation (e.g. high cost of so-called 'unofficial' payments), the efforts implemented so far have apparently paid off in view of the outstanding growth of large- and medium-scale FDI that flowed into the country in recent years, especially in construction. The benefits can be seen concretely with the proliferation of FDI-financed garment factories, construction projects and tourist establishments.

The crisis then has had the most undesirable impact of decelerating and even reversing FDI growth in Cambodia. Available figures show that, while the amount of approved projects (fixed assets) increased tremendously from US\$2667 million in 2007 to \$8856 million as of October 2008, the value of actual investments made decreased.¹⁶ Implemented FDI is estimated to have contracted by 16.4% as of October 2008, the amount in question representing less than 10% of the amount of the projects approved over the same period. Recent pronouncements revealed that about \$10.89 billion worth of fixed asset investments were granted approval for the whole year of 2008. However, recent pronouncements conveyed that only about 20% of such a figure was actually implemented (Kay, 2009d). FDI growth is expected to decline further in 2009 (Figure 26).

Figure 26: Foreign direct investment, 2004-2009 (US\$m)



Sources: IMF (2009a, 2009b) and NBC and CDC data as cited in Cambodia Economic Watch (2009).

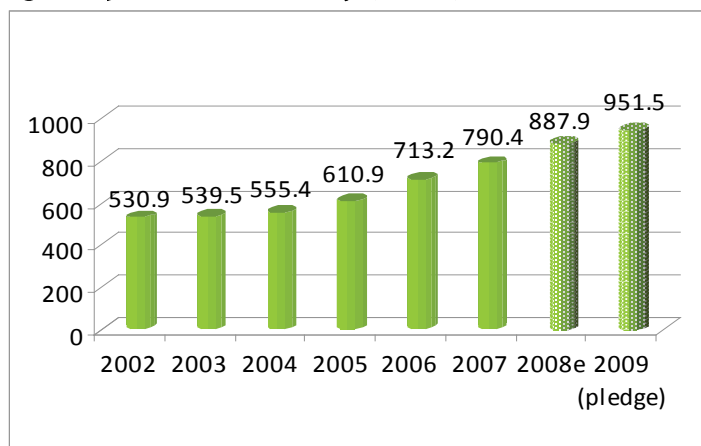
¹⁵ Given the current absence of a stock market in the country, portfolio investment does not really constitute one of the channels by which the crisis has adversely affected the country. The process of establishing such an exchange has been underway in line with the government's Financial Sector Development Strategy 2006-2015. It was reported that the government just recently signed a joint venture agreement with the Korea Exchange for the setting up of the country's first stock market, but no launch date was set. The signing of this agreement was scheduled earlier and the launching of the exchange was initially scheduled in September 2009, but both have been delayed, with the crisis triggering mixed messages from the government regarding plans on the matter. See McLeod (2009b; 2009c).

¹⁶ FDI approval figures should be treated cautiously. FDI disbursement used in the balance of payments suggests US\$375 million in 2005, \$483 million in 2006, \$866 million in 2007, \$785 million in 2008 and projected \$448 million in 2009 (IMF, 2009a).

3.4.2 Effects on aid

Cambodia is a highly aid dependent country, with its amount of development assistance increasing from around US\$531 million in 2002 to an estimated \$790.4 million in 2007 (Figure 27). Foreign aid as a percentage of certain macroeconomic aggregates remained high, though seems to have decreased over the years. It stood at approximately 9% of GDP in 2007, from slightly more than 12% in 2002. It has accounted consistently for the bulk of the government's capital expenditures, with external financing covering around 79% of such expenditures in 2007.¹⁷

Figure 27: ODA, 2002-2009 (US\$m)



Source: CRDB-CDC (2008b); The Mirror (2008).

Going back to the impact of the crisis, the country has been identified as among the low-income countries with high exposure to the economic meltdown, given its high poverty rate and low fiscal and institutional capacity to deal with the effects of the global shock (World Bank, 2009b). Especially so because its traditional major sources of revenues have been the ones severely hit by the global crisis, the government currently has very limited fiscal space at its disposal to boost spending and help counter the damage to the economy. Notwithstanding the progress made in improving tax administration, which significantly increased taxes collected as envisioned under, for instance, the government's public financial management reform, the possibility of promptly implementing other broader fiscal reforms that the crisis demands, including rationalisation of tax incentives and expansion of the tax base, is impeded by constraints ranging from weak public sector capacity to deeply seated vested interests in the status quo.

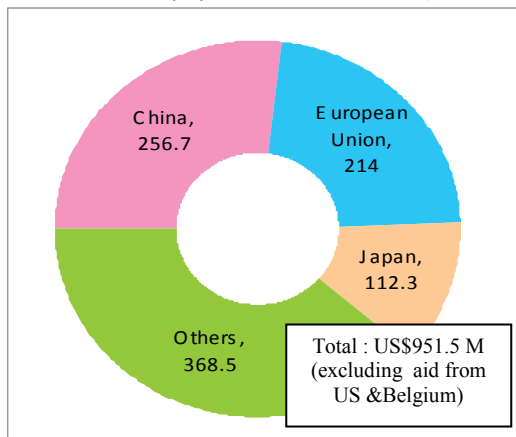
Cambodia is largely reliant on the predictability of external official flows to meet the budgetary pressures created by the crisis. The crisis is expected to result in revenue downfall of 1% of GDP, from 12.1% of GDP in 2008 to 11.1% in 2009. The budget deficit is expected to increase from -2.2% of GDP in 2008 to -4.8% of GDP in 2009. The current budget surplus is projected to reduce from 3.2% of GDP in 2008 to 1.2% in 2009. The 2009 budget will see domestic financing increased by 3% of GDP (government deposits at the central bank in 2008 would go from -3% of GDP to 0% of GDP). Foreign financing is projected to remain at same level, around 4.7-5.0% of GDP (a more detailed account of the budget is presented in Table 3 with accompanying notes (figures provided by the Ministry of Economy and Finance – MEF). As was the case before, the deficit of around R2020 billion arising from the proposed 2009 budget will have to be filled in chiefly by aid proceeds (IMF, 2009a). This predicament is similar to that in other low-income countries, which altogether is expected to require additional external financing of at least US\$25 billion for 2009. A higher figure is possible in the event that the recession deepens and lasts and other downside risks materialise (IMF, 2009b).

There is unnerving uncertainty, however, as to what extent donors can hold on to their aid commitments, given the severity of the shock's impact on their own economies and pressure for them to devote resources inward. Despite the pledge made by Development Assistance Committee (DAC) members in late 2008, whereby relevant donors vouched to maintain aid flows consistent with their existing commitments as well as to strive to continually improve aid effectiveness (OECD, 2008), recent

¹⁷ Figures were based on data from CRDB-CDC (2008a; 2008b) and IMF (2009a; 2009b).

developments have seen slashes in budgeted aid (i.e. Ireland, Italy), reduction in aid value in light of lower GDP and currency devaluation (i.e. UK) and setbacks in aid effectiveness (e.g. increase in tied aid) (Eurodad, 2009; CAFOD, 2009). As if the ongoing economic crisis is not enough, an aid crisis will certainly reverse the gains made in poverty reduction and push more people back into poverty. In the case of Cambodia, donors to the country pledged in December 2008 development assistance worth US\$951.5 million (excluding aid from Belgium and the US, then still undecided). The top three donors for this pledge were reportedly China, the EU and Japan (Figure 28) (The Mirror, 2008). It is yet to be seen whether actual flows for this year will match the pledged aid but, given recent developments concerning European aid budgets, there is reason to feel cautious. Moreover, while the amount of foreign aid for 2008 was originally estimated at \$887.9 million, the actual amount disbursed reportedly was only \$690 million (ibid; Xinhua, 2008). Seemingly, therefore, the prudent strategy given uncertainties in donor support ultimately lies in fiscal management and wise optimisation of the effectiveness of whatever aid that will come.

Figure 28: Top-pledged aid, 2009 (US\$m)



Source: The Mirror (2008).

China's pledged aid of US\$257 million represented an almost 180% increase from its 2007 aid allocation of \$92 million. From a pragmatic point of view, the diversification of aid sources to incorporate non-DAC donors will pay Cambodia well at this time of crisis, when the hands of traditional sources are tied. As a medium-term strategy, however, it must be noted that Chinese and other non-DAC aid has been criticised for lack of governance and environmental standards. Many times already, the donor community in Cambodia has been censured by civil society groups for their perceived indulgence in the midst of endemic corruption within the government. This corruption constitutes another paramount concern, as it has so far resulted in actual leakages in aid money and compromised the efficiency of aid. Prominent incidents include the discoveries of corruption in World Bank projects in 2003 and 2006 and by the World Food Programme (WFP) in 2004 and, just last year, alleged corruption within the Khmer Rouge Tribunal. At this time of crisis, it must be remembered that not only the quantity of aid counts but also its quality and the quality by which it is delivered.

3.4.3 Effects on inward remittances

Cambodia has experienced significant movement of people in the past and present. Migrants from Cambodia can be classified into the 'old stock', those who migrated to places such as the US, EU and Australia, mainly as a result of civil war and the Vietnam conflict; and the relatively more recent economic migrants, who have moved to the countries within the region in search of better job opportunities. Remittances from both categories of migrants play an important role in economic activities and social welfare in Cambodia. Steadily, the number of Cambodian economic emigrants and concomitant remittances has grown over time with the reintegration of the country into the international arena in the early 1990s. Cambodian emigration stock in 2005 was estimated at almost 349,000.¹⁸ Currently, the government encourages labour exports and has made it its strategy to assist aspiring overseas workers. Remittance earnings, though not sizeable enough to have significant

¹⁸ See World Bank (2008b).

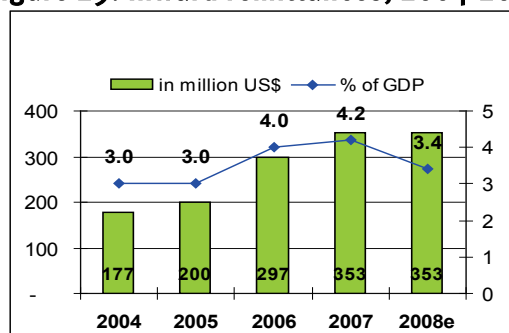
macroeconomic impact, are nonetheless important to the individual households that are dependent on them and to poverty reduction efforts in general.

As they fell hard on major destinations of migrant workers, both developed and developing, the crisis and economic recession have unsurprisingly affected overseas employment and remittance flows. The slower global growth in 2008 and much slower growth expected this year have had disastrous consequences for global employment prospects. While their stocks of international migrants are estimated to remain more or less unchanged, developing countries have been expected to suffer from declines in migration and remittance flows. All in all, remittances levels are estimated to have stagnated or decelerated in 2008. An estimate places the slowdown in growth in real terms at 1.8% of GDP in 2008 from 2% of GDP in 2007. The deceleration is projected to be even sharper in 2009, given additional concerns that the tightening in labour markets caused by the crisis will spur anti-foreign labour sentiment and harsher crackdowns on unauthorised migrants. Whatever the case, however, the extent of slowdown is expected to be not as much as that of other private transfers and even official flows (ILO; 2009; IMF, 2009b; Ratha et al., 2008).

Cambodia has been expected more or less follow to this global trend, starting with the decline in overseas employment opportunities for its nationals. In 2008, the number of Cambodian workers destined for Malaysia and Thailand reportedly went down 10% (May, 2008). Note that much of Cambodian emigration has been intraregional (especially if illegal and irregular workers are to be accounted for) and that Malaysia and Thailand have traditionally been the top destinations for Cambodian labour, with their respective labour export agreements with the Cambodian government underpinning the process of migrant worker employment. Unfortunately, the open economies of Malaysia and Thailand have been experiencing serious upsets in view of the global economic shock, the former projected to grow only 3.7% this year (versus an estimated 5.5% in 2008 and 6.3% in 2007) and the latter 3.6% (versus an estimated 4.6% in 2008 and 4.9% in 2007).¹⁹ Moreover, Malaysia has announced a temporary suspension of foreign labour employment in the industrial sector amid pressure from local trade unions and a hike in the levy on foreign workers (May, 2009d; Suresh Ram, 2009).

All this has meant job cuts or, at the very least, increase in underemployment. South Korea has also become a top host country for Cambodian labourers. Owing reportedly to the country's stimulus programme, which boosted demand for low-cost labour, the number of Cambodian workers sent there increased slightly in 2008; however, this is also foreseen to decline in 2009 (May, 2008; 2009d). Other migrant destinations include the advanced countries: US, France, Australia, Canada, New Zealand, Japan, Switzerland and Germany. In terms of remittance inflows, a (temporary) arrest in the previous steady rise in inward remittances is foreseen in line with global trends. Prognoses indicate that the amount of remittance inflows in 2008 remained unchanged from last year at US\$353 million. As a percentage of GDP, such inflows are estimated to have decreased from 4.2% in 2007 to 3.4% in 2008 (Figure 29). Slower growth in emigration flows and remittance earnings is expected in 2009, as companies in host countries cut back on operations or close down owing to bankruptcy or resort to nationals. However, the slowdown may not be as sharp or volatile compared with other resource flows, signifying the resilience of remittances.

Figure 29: Inward remittances, 2004-2008



Source: World Bank WDI CD-ROM (2008) and Ratha et al. (2008).

¹⁹ World Bank figures and estimates (see World Bank, 2008a).

If one were to consider undocumented and irregular workers, the loss in overseas employment and increase in underemployment may be bigger. No exact figures on illegal and irregular migrant workers are available, but approximations indicate that they may be as many as the authorised ones. Thailand in particular, because of its proximity to Cambodia, has a huge share of these undocumented migrants. Many such migrants have been able to cross the border and secure employment through the assistance of so-called middlemen and likewise are driven to work in Thailand by a host of push factors, including wage differentials, landlessness, lack of opportunities in Cambodia and need to repay debts (Chan, 2008). Similarly, the extent of the effect of the crisis on remittances may be possibly even bigger if remittances channelled through unregistered means are accounted for. Indeed, a significant share of remittance earnings is believed to be transmitted through returnees, the phone system and, perhaps just recently, money transfer institutions.

Notwithstanding the above, the elasticity of migrant labour demand and remittances at this time of crisis is largely dependent on the employment sector in question. For instance, migration and remittance flows to and from the health sector in the advanced countries is likely to remain strong, given that such a sector is predicted to expand continuously in the coming years. Unfortunately, as most of them are unskilled, Cambodian workers (both documented and undocumented) have been engaged mostly in the so-called 3-D sectors (dirty, dangerous and degrading) (see Crassard, 2008; IOM, 2006). Migrant labourers in Thailand are concentrated in the subsistence sectors, plus construction and housekeeping. Meanwhile, many of those in Malaysia are females serving as domestic workers, whereas those in South Korea are trained in the industrial and service sectors, although some are also in the agriculture sector. The crisis has specifically exposed the vulnerabilities of the industrial sector, particularly manufacturing and construction, in the aforementioned three countries, and this explains the suddenly reported decreases in the demand for Cambodian labour in such sectors. On the other hand, housekeeping jobs and other 3D jobs that nationals of host countries may be averse to engaging in because of their nature may be expected to remain generally unaffected. In these low-skilled sectors, remittances may be resilient.

3.5 Effects on the domestic banking system

Initially, Cambodia's banking system together with other Asian financial systems was deemed capable of weathering the effects of the crisis owing to its insignificant direct exposure to toxic securitised products, sound balance sheets and fortified regulatory and supervisory framework following the lessons from the East Asian financial crisis.²⁰ However, as the crisis prolonged and spilled in to the real economy, Cambodia's banking system was placed under mounting strain, with its existing and imminent vulnerabilities suddenly put to the light. Indeed, the crisis has been a test of the resilience and robustness of the domestic banking system, although it is interesting to note that there appear to be divergent views on the extent of the problem caused by the crisis, with some parties more optimistic than others. Note that the banking system dominates Cambodia's financial sector. It remains small compared with other countries, although liberalisation began in the early 1990s. Contribution to growth of bank finance remains limited in Cambodia and the banks' financial outreach remains low, though improving.²¹ Most banks in Cambodia also rely on foreign capital. As of 2007, foreign and Cambodian shares of paid-up capital stood at 56% and 44%, respectively (see Table 2).

Table 2: Foreign and Cambodian share of paid-up capital as of December 2007 (%)

	2003	2004	2005	2006	2007
Foreign share	54	53	58	52	56
Cambodian share	46	47	42	48	44

Source: NBC (2007).

²⁰ For a good discussion on the initial resilience of East Asian financial systems and the vulnerabilities thereafter exposed by the crisis, see ADB (2008b).

²¹ This limited financial outreach underpinned the Cambodian banks' lack of direct exposure to the sub-prime crisis. A strict investment rule was for banks to surrender the excess of their reserves to the NBC, which in turn invests them in very safe financial instruments overseas. The NBC has only relatively recently authorised financially sound commercial banks with excess liquidity to invest some of their assets abroad. For this, see CRDB-CDC (2008a; 2008b) and Naron (2008). For more discussion on the limited outreach of banks and low penetration of Cambodia's financial sector as a whole, see Pak et al. (2008).

Table 3: 2009 budget (in riel billions)

	2008			2009				
	Budget	Outturn	% GDP	Budget	US\$m	Bo8/Bo9 (%)	Projection	% GDP
Total revenue	4109	5461	12.1	5397	1316	31.3	5423	11
Tax revenue	3241	4,494	9.9	4342	1059	34.0	4480	9.1
Customs	2040			2400	585	17.6		
Tax department	1100			1700	415	54.5		
Non tax revenue	710	766	1.7	871	212	22.7	760	1.5
Capital revenue	157	200	0.4	183	45	16.6	183	0.4
Total expenditure	5680	6,450	14.2	7325	1787	29.0	7761	15.8
Current expenditure	3569	3,833	8.5	4658	1136	30.5	4659	9.5
General admin	486			610	149	25.5		
Defence and security	546			896	219	64.1		
Social sector	1306			1600	390	22.5		
Health	405			504	123	24.4		
Education	622			743	181	19.5		
Economic sector	298			361	88	21.1		
Agriculture	66			77	19	16.7		
Rural devt	47			64	16	36.2		
Water resources	24			31	8	29.2		
Eco sub and social protection	146			473	115	224.0		
Capital expenditure	2111	2,617	5.8	2661	649	26.1	3103	6.3
Locally financed	709	700		874	213	23.3	874	
Externally financed	1400	1,915		1700	415	21.4	2137	
Current balance	383	1,428	3.2	555	135	44.9	581	1.2
Overall balance (excl. grants)	-1571	-990	-2.2	-1928	-470	22.7	-2338	-4.8
Financing	1571	2,354	2.2	1928	470	22.7	2338	4.8
Foreign (net)	1501	2,456	5.2	1895	462	26.2	2332	4.7
Domestic (net)	70	-1365	-3	33	8	-52.9	7	0
Bank financing (net)	120	-1171	-2.6	63	15	-47.5	37	0.1

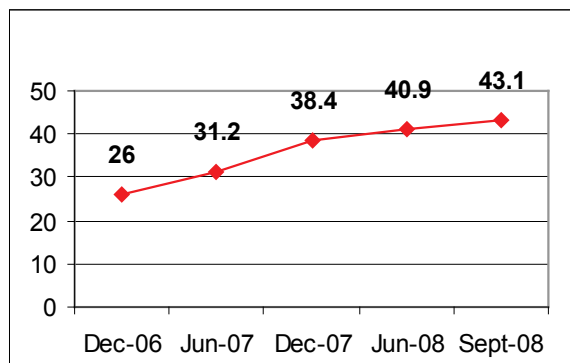
Notes: Within the context of the crisis and revenue shortfalls, achieving the targets set by the 2009 budget would require considerable efforts. Budget estimates are usually conservative and implementation during the past five years, especially since the implementation of public financial management reform, has exceeded substantially budget targets. In real terms, revenue is expected to decline from 12% to 11% of GDP. However, total expenditure is projected to increase, in real terms, from 14% of GDP in 2008 to 15.8% of GDP in 2009. 15.8% of GDP is a kind of stimulus package. The increase in spending in 2009 can be achieved with the following conditions:

- Revenue is projected to fall, in real terms, by 1% of GDP;
- Current expenditure is projected to increase from 8.5% of GDP to 9.5%;
- Capital expenditure is projected to increase from 5.8% of GDP to 6.3%;
- Locally financed expenditure, in nominal terms, to increase by 23%;
- Externally financed expenditure is projected to increase, in nominal terms, by 11.5%;
- Current budget surplus is projected to reduce from 3.2% of GDP to 1.2%;
- Overall budget deficit is projected to increase from -2.2% of GDP to -4.8%;
- Overall budget deficit will be financed by ODA and domestic financing (including bank financing);
- Foreign financing is projected to be 4.7% of GDP (not all ODA is included in the budget; only investment-related technical assistance and investment expenditure; for 2009 only US\$462 million of the \$950 million was included in the budget; not all the pledges will be disbursed, taking into account the absorption capacity, salaries and technical assistance etc.); there are no data on planned disbursement by sector in 2009;
- Domestic financing is projected to increase by 3% of GDP (in accounting terms, the sign (-) means accumulation of resources and (+) means spending; in 2008, government deposits at the central bank increased by 3% of GDP, leading to increase in foreign currency deposits; in 2009, domestic financing equals 0, which means that there will be no accumulation of government deposits); this means that revenue gains during the previous year will be used to finance expenditure in 2009.

Source (including for the notes): Data from MEF.

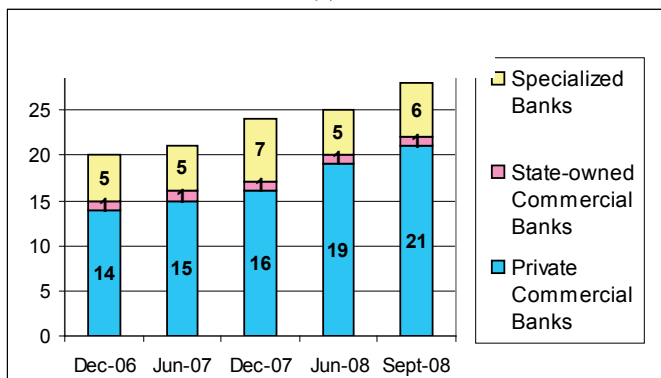
The continued expansion of and upgrading within Cambodia's banking sector does positively indicate confidence in the profitability of investing in banking in the country. The number of banks grew steadily from 20 by end-2006 to 28 by end-2008, bringing the ratio of total bank assets to GDP from 26% to 43.1% over the same period (Figures 30 and 31). Despite increased competition from new entrants, however, two banks have kept their dominance in the sector, accounting for 25% of the banks' total assets.

Figure 30: Bank assets, Dec 2006-Sep 2008 (% of GDP)



Source: IMF (2009a).

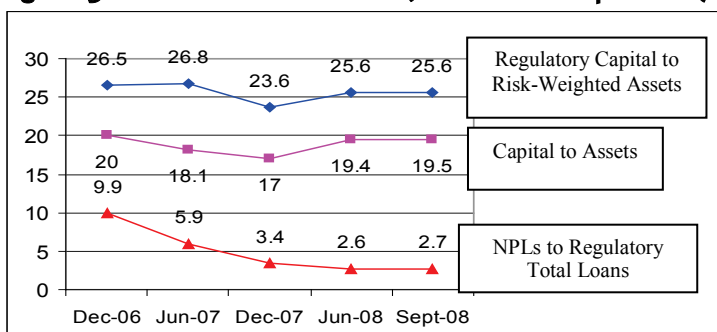
Figure 31: Number and type of banks, Dec 2006-Sep 2008



Source: IMF (2009a).

Prudential indicators show that the domestic banking system has been in a sturdy financial position (Figure 32). Capital cushion has remained strong, with the share of regulatory capital to risk-weighted ratios bouncing back to the 26% level by September 2008 after a slight drop in December 2007. This level is way above the regulatory minimum of 12%. Even more exceptional has been the very low ratio of non-performing loans (NPLs) to regulatory total loans. This ratio has kept declining, from 9.9% at end-2006 to just 2.7% by September last year. Bank profitability, on the other hand, remains high, with estimated 3.1% and 15.8% rates of return on assets and equity, respectively, by same month last year.

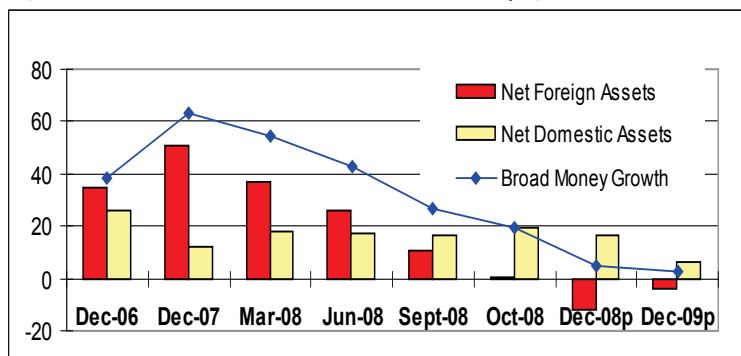
Figure 32: Financial soundness, Dec 2006-Sep 2008 (ratios)



Source: IMF (2009a).

As mentioned however, as the crisis deepened and spilled into broader economic activity, the domestic banking system's good health has been unavoidably infected. From 62.9% growth at end-2007, broad money is projected to grow a mere 5% by end-2008 and 2% by end-2009. This shrunk year-on-year growth is and will primarily be driven by a sharp cutback in the growth of net foreign assets, whose growth contribution of 50.6% at end-2007 fell down to an estimated negative 11.9% and negative 3.8% by end 2008 and 2009 respectively (Figure 33).

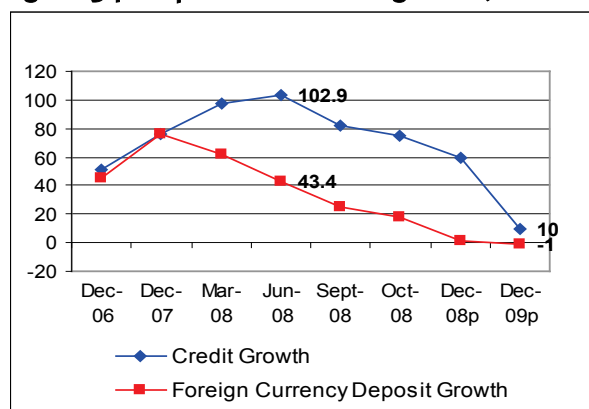
Figure 33: Contribution to broad money growth, Dec 2006-Dec 2009 (%)



Source: IMF (2009a).

Liquidity and credit risks have also become upfront concerns, especially for a number of unspecified banks. Year-on-year growth of foreign currency deposits, which comprise about 97% to 98% of total bank deposits, has sharply receded, from a high of 76% at end-2007 to an estimated 1.1% at end-2008 and negative 1% by end of this year (Figure 34). It has been reported that large amounts of foreign currency have been withdrawn already, especially by firms connected to the real estate sector. To address liquidity shortages, banks have raised deposit rates; unfortunately, with loan rates sticky, this has caused margins to contract. It has also been noted that, in a few cases, borrowing from parent companies overseas has been carried out, partly in order to meet the hike in reserve requirement on foreign currency deposits. Much of the borrowing in 2008 has been short-term finance, resulting in a decline in the liquid asset ratio net of short-term liabilities (see IMF, 2009a). Alongside this, tightening in bank lending has been affecting the private sector which, in the midst of global slump, is in dire need of cash infusions. Credit growth (year-on-year) is forecast to retreat sharply, from a peak of more than 100% in mid-2008 to 60% at end-2008 and 10% by end-2009 (Figure 34). It is worth noting, however, that in terms of level, private sector credit remains high.

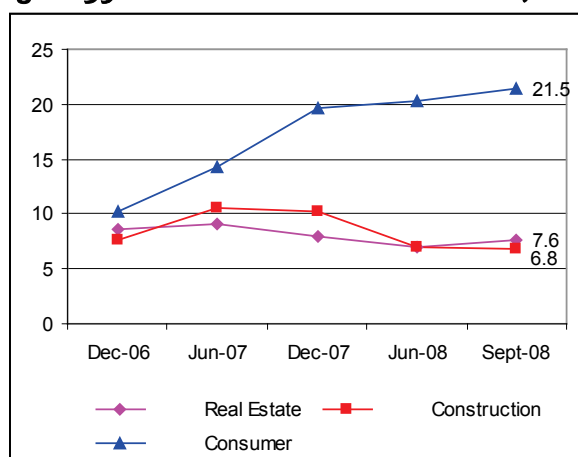
Figure 34: Deposit and credit growth, Dec 2006-Dec 2009 (year-on-year %)



Source: IMF (2009a).

As property prices continue their decline, construction projects get cancelled or deferred and loan delinquencies appear to be on the rise, credit risk is felt to be worsening.²² Despite policy responses to ease lending, especially to risky sectors, loans to such sectors saw a reduction by 2008 after booming in 2007. As a percentage of total loans, loans to the real estate sector dropped from 9.1% in June 2007 to 7% in June 2008 (Figure 35). By contrast, consumer finance remained strong, but there is an inherent risk in this trend as well, since much of the rise seems to be attributable to mortgage loans and there is a lack of reliable information and information systems on the creditworthiness of borrowers.

Figure 35: Sectoral distribution of loans, 2006-2009 (year-on-year % of total loans)



Source: IMF (2009a).

At the outset, it must be noted that, while there is a consensus that the crisis and associated economic stagnation has had contagious effects on the domestic banking sector, there appear to be divergent sentiments as to the extent of such contagion. Government and market leaders seem to be more upbeat, with the former announcing better forecasts for banking sector performance this year (e.g. credit growth is projected at somewhere between 20% and 30% and deposits are expected to pick up 15-20%, subject to downside risks) and the latter banking on what they believe to be a large reservoir of cash that remains outside the banking system (estimated between US\$1 and \$1.5 billion) (Banking Cambodia, 2009b; Kay and Brady, 2009; Nguon and McLeod, 2009).

International financial institutions (IFIs), primarily the IMF and World Bank, are more pessimistic, not least because they consider the 'picture possibly misleading'. With limited transparency, overstretched supervisory capacity, drooping domestic economy and so-called realities on the ground, the reported solid performance of domestic banks may be deceptive. NPLs, for instance, have been revealed by mid-year audits conducted by the National Bank of Cambodia (NBC) as higher than reported by banks by around 2%. The IMF and World Bank have also sounded the alarm on small banks that have large exposure to the real estate sector and further admission of new entrants that have limited banking experience (IMF, 2009a; World Bank, 2009d).

3.6 Effects on poor and vulnerable groups

Given the low growth elasticity of poverty in Cambodia, all other things being equal, the direct and immediate effects of reduced growth on poverty are expected to be relatively less severe. However, a decline in growth of the magnitude most forecasters predict for the country is likely to have a more severe impact on poor and vulnerable groups.

Since poverty in Cambodia, as in many other places, is heavily rural based (the poverty headcount was estimated at 35% in rural areas compared with 0.8% in Phnom Penh and 22% in other urban areas),²³

²² So far however, there has been no report of drastic increase of NPLs, according to a source from MEF. The figure in mid-2008 was low, at 2.6%.

²³ These figures were sourced from World Bank (2009c), which in turn credited the data to the results of CSES 2004 and 2007, as analysed by James Knowles.

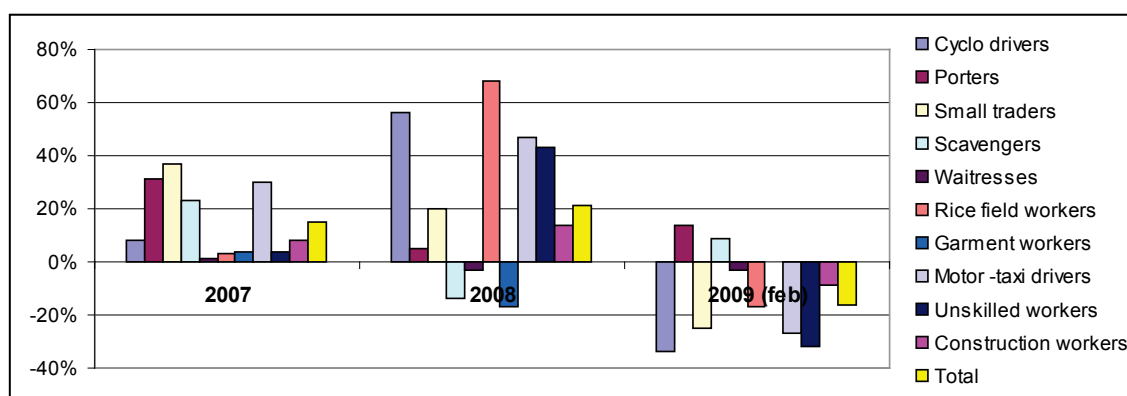
and that most rural activities are agriculture based, it is important to consider the effects of the crisis on the agriculture sector in Cambodia. Agriculture accounted for an estimated 28% of GDP in 2007 and about 59% of the population is also estimated to rely on this sector for their livelihood. Over the past decade, the sector is estimated to have been growing at 4.4% (World Bank, 2009d). Offsetting the declines in the rest of the economy, the agriculture sector is expected to grow significantly in volume and is unlikely to be much affected by the global financial crisis. Growth in this sector has been buoyed by an expansion in cultivated areas, higher prices for agricultural exports and continued increases in livestock production (Cambodia Economic Watch, 2009). However, a number of factors may contribute to the worsening of the situation for poor and vulnerable groups.

Not directly related to the crisis, production costs in 2008 were about 50% higher than in 2007, but farm gate prices at the end of 2008 fell by 7% to 57%, except for rice, which continued to be 11% more expensive compared with a year ago. Gross margins for wet season rice went down by 10%, although prices were still 11% higher than in late 2007. Additionally, a substantial decrease in the prices of cassava vis-à-vis last year has been seen, owing to the reduced demand for this crop in recent periods, partly because of the global crisis. As mentioned, gross margins for cassava were slashed by 166%, leading to a negative loss of US\$180 per ha. This hurt many cassava producers, most of whom are already poor and some of whom have taken loans to grow or expand cassava production, inspired by the drastic rise in early 2008 as cassava was used for bio-fuel production as a substitute for fossil fuels. It could be inferred that poverty is likely to increase in 2009 as a result of the pervasive impact of the fall in agricultural prices when people had already incurred high production costs in 2008 (CDRI, 2008).

In other case, many farmers needed to borrow more money to meet rising production costs, essentially fertiliser, pesticides, machinery and labour. Some could obtain loans, mostly at high interest rates, to maintain production. This, plus borrowing for consumption, put about half the households in debt, which is a worrying sign. Now they could be in trouble, as most prices of agricultural products are down, seriously cutting back or negating their gross margins (CDRI, 2008).

A survey of earnings of vulnerable/unskilled workers in Phnom Penh conducted by CDRI over the past few years reveals that earnings (in real terms) of 10 groups of unskilled workers have decreased considerably in 2009 (Figure 36). Although the sample is limited, the majority of the 480 workers surveyed reported that their colleagues and friends had been laid off or faced decreasing earning prospects. It is interesting to note that, among the 10 factories in the survey sample, two were closed recently.²⁴

Figure 36: Real earnings of unskilled workers, 2007-Feb 2009 (% change)



Source: CDRI Vulnerable Workers Survey, see www.cdri.org.kh/economic.htm.

²⁴ To investigate more fully the impact of the crisis on the poor and vulnerable, CDRI intends to mobilise funding to conduct a survey that can yield results representative of the country or at least by concerned sections of society.

4. Policy implications

In this section, we consider the actual and possible policy responses that may be required to tackle the effects of the global financial crisis. For each of these we consider sector-specific responses for a number of key sectors, starting with actual ones.

4.1 Actual policy response

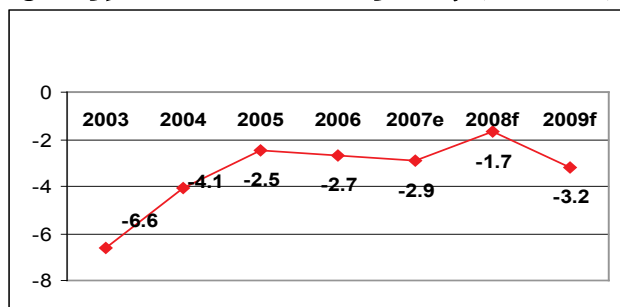
4.1.1 Fiscal policy

With the persistence of high dollarisation – riel as a percentage of total currency in circulation remains in single digits – the government can practically only utilise fiscal policy to tame the effects of the crisis on macroeconomic stability. Over the years, the Cambodian government has been able to exercise fiscal discipline. Deficit as a percent of GDP dropped from a high of 6.6% in 2003 to an estimated 2.9% in 2007 (Figure 37). This deficit reduction has been driven primarily by continued increments in tax revenues, which in turn have been engendered mainly by improved tax and customs administration, which is illustrative of the government's efforts towards fiscal reform (Figure 38). Strong fiscal performance in 2008 is particularly notable in light of budgetary pressures from the parliamentary elections and skirmishes along the border during that year. Another core feat attributable to government efforts has been the continued sustainability of debt. Cambodia's external indebtedness as a percentage of GDP remains one of the lowest in the East Asian region (Figure 39). Note that fiscal tightening was one of the official means of containing the inflationary pressures arising from the food and energy crises. Headline inflation in Cambodia actually peaked at 26% in May 2008 (IMF, 2009a).

The crisis and ensuing slump reversed the picture facing the country and, more importantly, underscored further the persistent weaknesses in the country's fiscal management. Owing to erstwhile successes in reining in the deficit, it is expected that there is indeed fiscal space that can be tapped for the purpose of rejuvenating the economy. However, such space is considered to be narrow, especially because the government's traditional revenue sources are those hit seriously by the worldwide recession. Further, while inflationary concerns seemed to have abated (the consumer price index (CPI) in December 2008 stood at 13.5%, from 15.7% a month before) (Hor and Chun, 2009a), allowing for the strategy of fiscal easing, caution must be exercised such that the spectre of high prices does not return or the external position is not further enfeebled. In Cambodia, moreover, there is the imperative of guaranteeing that fiscal responses in the face of the crisis will be pro-poor.

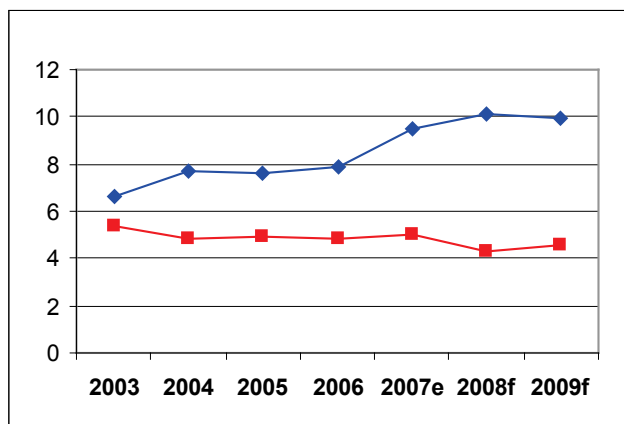
There is concurrence among the government and its development partners that countercyclical fiscal policy must be implemented in order to restrain the effects of the crisis this year and in the forthcoming years. Cambodia's 2009 budget, already proposed to be much more expansionary compared with previous years, is reportedly set to accommodate augmented spending on infrastructure, agriculture and social safety nets, while still striving to maintain the gains made in revenue collection. Following regional trends, the fiscal deficit is expected to swell to 4.8% of GDP from an initial estimate of 3.2% by end-2009 (Figures 37 and 40). The higher figure is contingent on revenue performance (import growth and corporate, for instance, may be lower than assumed) and whether more stimulants will be needed.

Figure 37: Fiscal deficit, 2003-2009 (% of GDP)



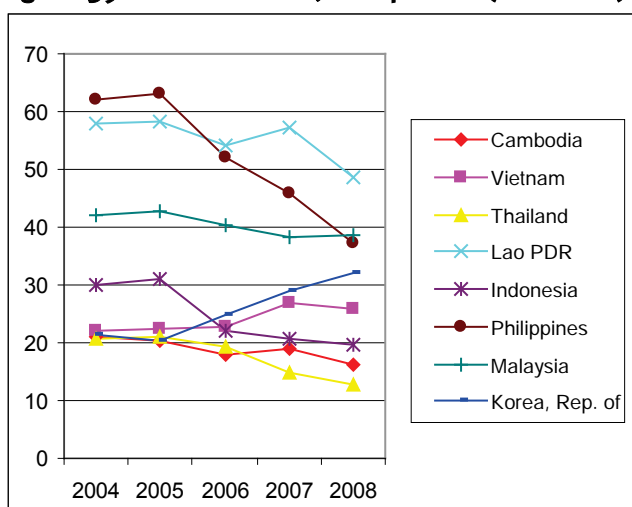
Source: IMF (2009a; 2009b).

Figure 38: Foreign financing and tax revenues, 2003-2009 (% of GDP)



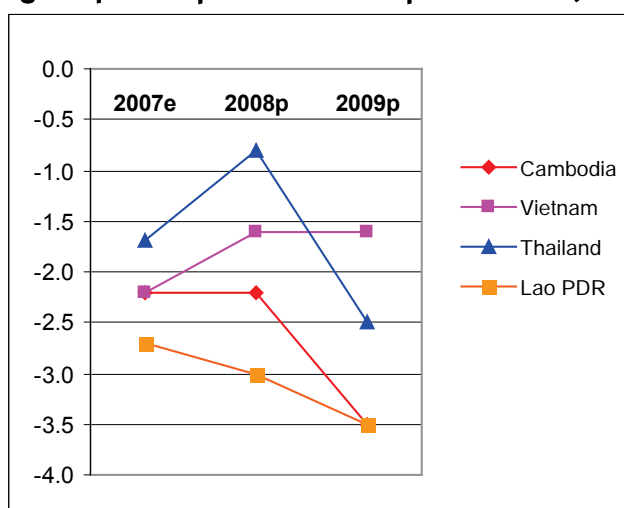
Source: IMF (2009a; 2009b).

Figure 39: External debt, 2004-2008 (% of GDP)



Source: ADB (2008b).

Figure 40: Comparative deficit performance, 2007-2009 (% of GDP)



Source: World Bank (2008a).

Already, the government has executed fiscal measures to incentivise producers and consumers alike and thus resuscitate the sluggish real economy. Tax measures so far have included the suspension of the monthly turnover tax of 1% on garment factory expenditures and extension of the profit tax holiday,

at least for garment factories established prior to 2006. The government has also announced a 10% reduction in export management fees and other costs. The higher budget deficit in 2009 is also said to accommodate augmented spending on infrastructure, agriculture and social programmes. There is speculation that the US\$144 million ‘unplanned expenditures’ provided for under the proposed 2009 budget will be used for such purposes. However, the adequacy of such an amount has been questioned by the country’s opposition parties, which have been advocating for a stimulus package worth \$500 million on top of the 2009 budget. This can purportedly be financed by requesting more grants and loans and by reductions in corruption, which has been estimated to have resulted in huge losses in state revenue (Xinhua, 2009; Cambodia Economic Watch, 2009; Kang et al., 2009; Kate, 2009; Rainsy, 2009; Rith and Strangio, 2009).

Other measures announced by the government encompass both revenue-enhancing and cost-cutting measures. On the revenue side, authorities have signified potential expansion of the VAT base and generally agreed on instituting a transparent fiscal regime for the country’s budding oil and gas industry. On expenditures, savings are expected through cutbacks in operational costs, in fuel spending for instance.

4.1.2 Monetary policy and banking²⁵

Working around the constraints posed by high dollarisation, the Cambodian government through the NBC has implemented the following monetary and banking response to the crisis:

- Initially increased the reserve requirements of commercial banks from 8% to 16%, eventually reducing it to 12% after conditions permitted some room for monetary easing.
- Limiting bank exposure to high-risk sectors, specifically real estate, by introducing a 15% cap on real estate lending. This cap was scrapped when conditions opened some room for monetary easing. Given heightened risk aversion, the effect of cutting back the reserve requirement and scrapping the cap on real estate loans may not be on a par with expectations. Banks may not be that keen to resume lending to risky sectors.
- Increased the minimum capital from R50 billion (US\$13 million) to R150 billion (\$36.5 million) for commercial banks (unless they have an influential shareholder that is a bank or financial institution with an investment grade rating from a reputable rating agency) and increased the minimum capital to R30 billion (\$7.3 million) for a specialised bank.
- Opened an overdraft facility for banks that may eventually be in need of liquidity.
- Interventions in the foreign exchange market.
- Prudential measures:
 - Enhanced prudential monitoring and examination (e.g. NBC-issued regulation related to use of external auditors and sanctions imposed on banks in case of transgressions);
 - Improved licensing requirements effective September 2008, with the NBC setting stricter criteria for bank management apart from a higher capital base.

Future plans include:

- Promotion of inter-bank lending;
- Improvement of loan classification to limit credit risk;
- Improvement of the valuation of collateral of bank lending;
- Enhancement of prudential supervision through strengthening of on-site and off-site inspections and supervision and building capacity of relevant staff;
- Strengthening of the credit information sharing (CIS) system, now beset by technical constraints and lack of participation from banks;
- Strengthening of the system for implementing reserve requirements;
- Issuance of the necessary legislation on internal and external auditing, corporate governance and assets classification;
- Seeking amendment of the Law on Banking and Financial Institutions to enhance, for instance, the transparency and effectiveness of exit policy.

²⁵ Sources used for this item include: Banking Cambodia (2009a); Cambodia Economic Watch (2009); IMF (2009a); Nguon (2009a); Kay and Brady (2009); McLeod (2009a).

4.1.3 Sector-specific actual policy response

Actual policy response on garments²⁶

- Suspension of the 1% advance profit tax (as mentioned above);
- Announcement of a 10% reduction in export management fees and other costs (as mentioned above);
- Plan to negotiate with the EU for the relaxation of its tight rules of origin, i.e. lowering of the required local input content from 45% to 25%;
- Plan to continue to seek preferential treatment with the US or reduction in import tariffs for Generalized System of Preferences (GSP) projects;
- Recommendations of the following during the January 2009 meeting of the ASEAN Federation of Textiles and Apparels, whose current chairmanship is held by the Garment Manufacturers Association in Cambodia (GMAC):
 - Source raw materials less from China and more from the ASEAN region;
 - Exploit duty-free arrangements not only with EU but also with Japan and Canada;
 - Strengthen links with Vietnam, especially with a new bilateral agreement now in place (allowing for conditional cross-border trade without custom permits) and reach same agreements with Thailand and Laos;
 - Application of the ASEAN Single Window Programme that can significantly expedite customs clearance and provide traders access to the whole ASEAN region through Sihanoukville port.

Actual policy response on tourism²⁷

To stave off the further ebbing of the tourism sector, the Cambodian government's proposed chief strategy is to boost the total number of tourists from last year by 5-7% by enhancing the number of national tourists and tourists from the ASEAN region, the Middle East and Russia. This is targeted to be fulfilled through various measures including:

- Simplification of the travelling process: consider visa-free agreements with Laos and Vietnam and consider simplified visa documentation for Thailand and Indonesia by 2010;
- Facilitation of transportation services (i.e. freely allow 150 vehicles, both passenger and cargo carriers, from countries that have land borders, for one week);
- Boosting of budget and direct flights, especially from European countries (the country's airports are said to be capable of accommodating eight times the current traffic); in connection with this, enlarging and adding the necessary infrastructure to airports;
- Marketing and enhancing of the potential of an airport in the beach city of Sihanoukville;
- Creation of a competition system for the most beautiful and clean domestic cities;
- Enhancement of eco-tourism (e.g. the dolphin site in Kratie province and the mangrove forest in Koh Kong province);
- Boosting of advertising;
- Lowering of fees at tourist sites;
- Requesting hoteliers to cut their rates, since 50-70% of tourism spending is on accommodation;
- Arranging via ASEAN reductions in the prices of package tours and visa-free agreements with Laos and Vietnam.

A tourism stimulus package has been spoken of but the government has sought to downplay expectations about its breadth in advance, as it ultimately depends on up to how much the government coffers can accommodate. Caution has also been expressed with regard to the easing of visa requirements, as this has direct and grave ramifications for domestic revenues. More importantly, the Law on Tourism was passed recently,²⁸ destined to fill up the gaps in policy and regulation that hindered even more robust growth in the tourism sector.

²⁶ Sources used for this item include: Asia News (2009); Cambodia Economic Watch (2009); Hor and Chun (2009b); IMF (2009a); Kang et al. (2009); Kay (2009b); Xinhua (2009).

²⁷ Sources used for this item include: Cambodia Economic Watch (2009); Chun (2009); Kang et al. (2009); Kay (2009a; 2009b; 2009c; 2009d); Kay and Neth (2009); May (2009a; 2009b; 2009c).

²⁸ According to a source from MEF.

Other stakeholders in the tourism sector, including the Tourism Working Group of the Government–Private Sector Forum (GPSF), the Cambodia Association of Travel Agents, hotel and restaurants associations, the Société Concessionnaire des Aéroports (SCA), opposition groups and independent analysts, have put forward the following recommendations on top of and to concretise the measures advanced by the government:

- Crack down on unlicensed agents and hotel and restaurant operators that do not meet relevant standards (this issue is addressed by the Tourism Law);
- Reduce visa fees;²⁹
- Encourage tourists to come to Cambodia via Malaysia, Singapore, China and Vietnam;
- Enact a comprehensive incentive package, which can include rebates on handling fees for services;
- Further promote Sihanoukville and diversify tourist destinations by more active promotion of other touristic sites;
- Strengthen the attractiveness of Cambodia;
- Targeted strategies meant to capture both high-end and backpacker markets;
- Forge cooperation among the various and numerous governmental and non-governmental stakeholders.

One specific issue of sensitivity has been raised in light of its bearing on the governance and efficiency of the tourism industry in Cambodia. This is the perceived lack of transparency and fairness in the granting of concessions over domestic tourist spots, the most prominent of which is Angkor Wat.

In December 2008, a new task force, composed of private and public sector representatives, arrived at the following additional recommendations:

- Suspend the 2% accommodation tax;
- Consider launching a national carrier;
- Fund a national tourism board modelled after Singapore’s successful Tourism Promotion Board;
- Engage a public relations company to market Cambodia’s tourism potential;
- Increase security, especially at the Cambodian–Thai border.

Actual policy response on construction

To provide an anchor to the construction sector, directly or indirectly, in this time of economic meltdown and depressed real estate market, the government has initiated some actions and plans. For instance, in a bid to revive the property market once some room for monetary easing materialised, the government scrapped the 15% cap on bank lending to the real estate sector (Nguon, 2009b). It is yet to be seen, however, whether this move will influence the bankers’ current perceptions of risk. Because of its linkages to the other key driver of Cambodian growth, tourism, official plans to stimulate tourism can have positive knock-on effects on the construction industry. The government-announced stimulus package, which purportedly includes augmented spending on infrastructure programmes, is likewise likely to lead to new construction projects that can absorb workers who have been laid off as a consequence of the stoppage or deferment of some of the foreign-financed projects.

Actual policy response on social protection³⁰

Safety nets are programmes that target benefits to the poor and most vulnerable. A safety net programme may take the form of cash transfers (conditional or unconditional); in-kind transfers (e.g. school feeding or mother/child supplementation programmes); labour-intensive public works schemes (food or cash for work); or exemptions from fees for essential services (e.g. healthcare or schooling). Safety nets are an important part of a broader poverty reduction and social protection strategy that includes policies for health, education, social insurance and affordable credit and savings schemes.

- **Health equity funds:** The 45 existing HEF schemes provide free medical assistance to poor people in 40 operational districts in Cambodia. The HEFs are financed by a regular government budget of US\$6 million, and receive additional donor support of \$7 million. The funds are

²⁹ The Thai government recently revealed its plan of offering free three-month visas, which reportedly will also benefit Cambodia’s tourist sector. There is, however, doubt that this scheme will lead to substantial increase in tourists coming to Cambodia. Thailand already offers free visas to tourists coming from a number of countries and staying in Cambodia for certain period. See Mom and May (2009).

³⁰ Information for this section was provided by MEF.

managed in cooperation between government, donors and local non-governmental organisations (NGOs). HEFs work closely with the Identification of the Poor project (ID Poor; see below), as poor individuals, whether identified through the ID Poor process or through an *in situ* assessment by medical staff, are covered for all costs of hospitalisation and other medical services, as well as expenses for transportation and food during their stay in the medical structure.

- **Food Emergency Programme:** MEF and the ADB implemented the Food Emergency Programme in October 2008 to mitigate the effects of the increase in food prices on poor households. The emergency package consisted of a US\$17.5 million grant and an additional \$17.5 million loan at concessional rates from the ADB, as well as an additional \$5.08 million from the RGC. Approximately \$19 million will be allocated to social protection measures, with the remaining amount being allocated to measures aimed at increasing food productivity and government capacity. In the first phase, roughly 342,000 people in 200 communes received in-kind assistance (35kg rice ratios) in the eight provinces surrounding the Tonle Sap Lake. The project management unit is now considering food-for-work assistance to poor households for the next three years.
- **Food for Work (WFP):** The RGC provides annually 2000mt of rice to the WFP to be redistributed to vulnerable groups. In 2007, the FFW programme provided roughly 16,600mt to 252,300 vulnerable beneficiaries in identified food-insecure communes in exchange for work in public infrastructure projects. The FFW programme is implemented in the 12 most food-insecure provinces in the country, as identified by the WFP Integrated Food Security and Humanitarian Phase Classification. In 2007, the FFW constructed/rehabilitated 333km of rural roads, 267km of irrigation canals, 52km of dikes, 15 community ponds and seven rice banks.
- **Mother and Child Health programme (WFP):** Through the MCH programme, in 2007 the WFP distributed monthly food ratios to 20,200 pregnant and lactating mothers and 41,800 children living in poor households in food-vulnerable communities, to a total value of US\$1.6 million. The total MCH budget for 2005-2007 was of \$6 million, planned to increase to \$10 million for 2008-2010. All funds come from WFP donor contributions, to which the RGC participated with a \$0.5 million in-kind donation. The food ratios consist of fortified corn soy blend, rice, vitamin-enriched vegetable oil and sugar. The WFP works in partnership with local NGOs, which handle the food distribution, as well as health centres, which provide basic health education during the distribution.
- **School feeding programmes:** Programmes currently reach about 500,000 students and supplementary food and nutrition programmes for mothers and children.
- **Targeted scholarship programmes** for secondary education students (especially girls) from poor households in selected provinces (reaching almost 29,000 students in 2008).
- **National Social Security Fund:** The RGC established in mid-2008 a social security fund designed to provide protection to government employees. It currently provides coverage to up to 250,000 employees in the formal private sector.
- **Pre-paid health insurance scheme:** A number of NGOs, with the support of the government, have piloted pre-paid health insurance schemes for rural households.
- **The rural sector acts as an informal social safety net** in Cambodia. Garment workers return to rural areas after losing their jobs in the city. In some rural communities, migrant workers account for some 20% of the economically active population. To help Cambodia's rural sector weather the storm of the economic downturn, the government works closely with the ADB to develop and implement two projects, which constitute a stimulus package at the grassroots level:
 - Emergency Food Assistance Project, with a total amount of US\$38.5 million: ADB provides \$35 million (\$17.5 million in loans and \$17.5 million in grants) and government provides a counterpart fund of \$3.5 million. The project covers the following activities: i) consumption support: free food distribution (\$8.36 million); FFW (\$11 million); productivity enhancement: rice seed (\$8.72 million); fertiliser (\$6.28 million); capacity development (\$3.06 million); and contingencies. Detailed activities include free distribution of rice to most vulnerable groups; limited food distribution (cash transfer or voucher system) to the urban poor; provision of food to government's school feeding and take-home ration programme; provision of food to children in selected early childhood learning centres; creation of employment for the landless and low-income households through FFW; provision of seeds

and fertiliser for small and marginal farmers whose capacity to purchase inputs has been significantly eroded; development of a system of emergency food security reserve and rapid response; and strengthening the capacity of implementing agencies.

- Tonle Sap Poverty Reduction and Smallholder Development Project. The total amount of the project is US\$60.5 million, with the following contribution: ADB \$24 million; International Fund for Agricultural Development (IFAD) \$13.38 million; government of Finland \$5 million; RGC \$12 million; beneficiaries (household equity contribution for demonstration and technology piloting) \$5.88 million.

Project activities include the commune development module. **A.1. Factor productivity improvement:** work plan for implementation of commune development module; review commune land use plan; feasibility study on commune-level irrigation, flood control and soil and water conservation; empower farmers through training of farmer groups; construction of civil works related to commune-level resource management and development; commune-level operations and maintenance mechanism for infrastructure; farmer-managed on-farm technology demonstration with emphasis on integrated farming systems; distribution of agricultural inputs, implements and equipment; commune extension workers with regard to farming system improvement, fishery and forest resource conservation, livestock development and seed, fertiliser, pesticide and water use; commune-/village-level credit funds. **A2. Market links strengthening:** feasibility study on rural roads, rural markets, village storage; construction of civil works related to market links; monitoring of civil works at commune level; pilot programme for rural information and communication technology. **A3. Improvement of access to local finance:** establish credit line in microfinance institutions (MFIs) to lend to farmers. **A4. Promotion of social development.** **B. Policy and institutional reform and implementation capacity development:** identify key issues for policy and institutional reforms; work plan for technical assistance support to project.

4.2 Possible policy response

The role that policymakers, donors and NGOs may play is expected to determine the outcome of the crisis on growth and poverty in Cambodia. Given the extent and severity of poverty and vulnerability in Cambodia, it is particularly important to emphasise policies required to assist these groups. In some countries, when faced with increased hardship, the poor are assisted directly or indirectly by their governments, donors and NGOs. This support may come in kind or in the form of price subsidy, food ration, food coupons, work for food, school meals, etc. The poor in the region suffered badly from the Asian financial crisis; many are likely to suffer from the current world financial crisis. The fallout from the global financial crisis is likely to be severe for poor and vulnerable groups. Because of their economic and social status, they are likely to be among the first to suffer from any sort of shock, either because of loss of job and income or diminished purchasing power owing to price increases. They are also likely to be among the last to benefit when the recovery starts.

In the longer term, steps should be taken to improve food security and reduce vulnerability. Improving growth prospects of the country along an 'inclusive' growth path is the surest way of achieving this in the long run. Given that the poor in many developing countries live mainly in rural areas, particular attention should be paid to the state of agriculture in these economies.

4.2.1 Possible policy response in the agriculture sector

The global financial crisis presents an opportunity for policymakers to become engaged more fully in the agriculture sector, assisting in the introduction and uptake of better and improved seeds, improving irrigation facilities, performing better distribution at reasonable prices of fertilisers, improving technical and vocational education in rural areas: the list is endless. Rural communities are faced with considerable transaction costs in production and trade of agricultural commodities. Infrastructure development, physical, social and financial, will help to reduce these heavy costs and as a result improve production and productivity.

There is scope for improving international cooperation and trade, particularly regionally, in some key food crops such as rice. Cambodia can learn from the experience of Thailand and realise its potential of becoming a major producer and exporter of rice in the ASEAN region. Multilateral/bilateral agreements between exporters and importers may be a way forward to reduce uncertainties regarding international trade in these commodities. Cambodia has recently signed an agreement with Senegal to export a portion of its rice surplus to that country (World Bank, 2008c), which could prove beneficial to both parties. There are reports that Kuwait is leasing land in Cambodia and the RGC is negotiating other investment opportunities with the country: the Prime Minister recently visited Kuwait to follow up on some of these ideas. If negotiated and managed effectively, these types of bilateral relationships could be highly beneficial to the country. Bilateral negotiations of these types would reduce uncertainties in trade inflows and outflows that could be destabilising for small countries that are highly dependent on narrow lines of trade.

A serious constraint in most poor countries, however, is the bureaucratic ability and capacity to design and implement appropriate policies. To be able to improve the situation, a certain level of decentralisation and empowerment of regional and local authorities is required. In Cambodia, enactment and implementation of the Organic Law may prove to be a significant step forward in relaxing some of the administrative and bureaucratic burdens that rural populations in particular are facing at present.³¹

In the wake of the worldwide financial crisis, it is important to respond to problems quickly and efficiently in the short term as well. Short-term policy options that may have adverse long-term effects on the economy and the poor should be avoided, although inevitably resources required for tackling short-term problems may have to come from those planned for longer-term investment.

There should be a way to reduce the price of fertiliser, which increased two or threefold over the previous year. All chemical fertilisers are imported, reportedly through highly inefficient channels that rely heavily and informally on Vietnamese and Thai traders. Directly importing fertilisers in bulk might cut costs considerably. Lack of water and irrigation is a fundamental problem, although there has been a significant increase in public provision of and commitment to irrigation. A controlled water supply, which is now available for less than 30% of rice fields, provides stability and certainty to crop production. Water is a critical prerequisite for farmers to be able to apply other inputs such as fertiliser and higher-yielding seeds. A reliable water supply enables crop intensification and reduces the costs of production. Without irrigation, it is too risky or impossible to apply good inputs for production in many areas.

Long-term strategy should include better land allocation and management. A current goal of maintaining forest cover at 60% of the country is perhaps desirable but not realistic when demographic and economic pressures are paramount. Because of this goal, new agricultural lands have unclear legal status, which tends to favour those with the financial means, power or backing to take them, not necessarily for production.

4.2.2 Possible policy response on labour market, migration and remittances

In line with the imperative to ameliorate the undesirable impact of the crisis on Cambodian external labour migration and remittance inflows, the RGC reportedly signed a memorandum of understanding with Kuwait and Qatar that will facilitate the sending of Cambodian workers to those countries.³² This move will at least diversify the country's labour export markets and help cancel out the problems faced in traditional markets. The crisis is also taken as a window of opportunity for the government to shift over the medium term the emigration pattern away from Thailand and Malaysia, where the pay is relatively lower, to countries like South Korea, which offer relatively higher wages. Other actions for the RGC to undertake, not only to combat the effects of the crisis but also to address the lingering problems that have been spoiling Cambodian external migration, are as follows:³³

³¹ For more details on this, see Prime Minister Hun Sen (2008).

³² Between 2000 and 3000 workers reportedly can be sent to the new migrant worker destinations, Hong Kong and the Middle East. See May (2009e).

³³ Useful recommendations are mentioned in the report of the Regional Thematic Working Group on International Migration (2008).

- Ratify the 1990 UN Convention on the Protection of the Rights of All Migrant Workers;
- Seek to reduce the cost and simplify the process for migration (which can in turn reduce illegal and irregular migration) by regulating further and setting limits on the fees charged by private recruitment agencies, currently considered exorbitant;
- Fast track and improve the implementation of existing labour export agreements;
- Seek to improve surveillance of illegal and irregular migration as part of the effort to combat human trafficking by strengthening collaboration not only with bilateral partners but also with the many international NGOs that work on migration, mobilising further existing relevant institutional frameworks including the National Task Force on Anti-Trafficking and implementing the enhanced Law on the Suppression of Kidnapping, Trafficking, and Exploitation of Human Persons and other related bilateral agreements.

4.2.3 Possible policy response in the construction sector³⁴

- Strengthen the legal framework for real estate;
- Integrate the Association of National Evaluators into ASEAN;
- Establish a real estate association;
- Allow foreign ownership of buildings (except ground level), condos and apartments immediately;
- Concessional rate of interest on real estate;
- Transparent valuation of land by the Tax Department;
- Database on real estate/land;
- Security for investors;

4.2.4 Possible policy response on domestic banking system³⁵

While commending the steps undertaken and planned by the NBC to address the vulnerabilities uncovered by the crisis, development partners have called for supplementary actions to cement other gaps, including:

- Improved transparency;
- Stricter enforcement of transparency regulations (e.g. more frequent reporting of banks' liquidity position);
- Reduction of the costs of information acquisition;
- Improvement of regulation on acceptable collateral (e.g. strengthening of the Credit Bureau);
- Stricter licensing prerequisites with improved fit-and-proper tests and higher banking experience requirements for new entrants and small foreign banks;
- In place of sector lending caps, attachment of higher risk weights to riskier types of lending including to the real estate sector;
- Making new minimum capital requirements, meant to take effect in 2010, effective earlier for banks facing greater solvency risk;
- Improvement of physical structure, including the inter-bank payments system;
- Supervision of modern banking services that aim to extend the financial outreach of banks and diversify products (i.e. e-banking, mobile banking, ATM networks, credit cards);
- Given capacity and resource limitations, closer coordination of bank supervision with external auditors;
- Facilitation of banking consolidation where necessary;
- Pursuance of a financial sector assessment programme to enhance oversight of the financial sector.

4.2.5 Possible policy response on social protection³⁶

The National Strategic Development Plan 2006-2010 (NSDP) highlights policy objectives to establish social safety nets that reduce the vulnerability of the poor and mitigate the impact of economic and

³⁴ Information for this section was provided by MEF.

³⁵ Sources used for this item include: Banking Cambodia (2009b); Cambodia Economic Watch (2009); IMF (2009a); Nguon (2009a); Kay and Brady (2009); McLeod (2009a).

³⁶ Information for this section was provided by MEF.

natural shocks. The Rectangular Strategy Phase II acknowledges that social safety nets are not yet efficient and includes priorities for their development. Further actions are required, including:

- **Developing a social protection framework and strategy:** Social protection interventions are currently scattered across ministries, and there is no clearly designated agency in government to coordinate and monitor the performance of the social protection system. A strategy paper would also set out the key social protection interventions or issues on which the government wishes to focus its efforts in the future, and related fiscal and public financial management implications.
- **Expanding the coverage of the pre-identification of poor households:** There is a growing recognition that the pre-identification of poor households has helped social protection interventions such as HEFs and emergency food distribution targeting poorest households. Moreover, there is a growing consensus that ID Poor, implemented by the Ministry of Planning (MoP) and other actors, represents one of the best and largest targeting efforts implemented by government. It is necessary to pilot the effectiveness of cash-based interventions (such as cash-based, labour-intensive public works or conditional cash transfers) in the Cambodian context as opposed to in-kind assistance.
- **Operationalising the Social Security Fund** and expanding its coverage to garment workers, especially in the area of health insurance.
- **Expanding the coverage of the pre-paid insurance scheme** and complementing it with the HEFs.

4.2.6 Development partners

So far, no clear picture has emerged regarding the role that development partners/the donor community in Cambodia have played or expect to play in addressing the effects of global financial crisis. These are key actors pushing Cambodia into more sustainable growth. Given the lack of resources available internally to undertake major infrastructure projects important for the economy, donors can support investment in these areas, including physical and social infrastructure. Cambodia is one of the least competitive economies in the region; addressing limitations in the area of roads, energy, transport and infrastructure, for example, could substantially rectify this problem.

5. Conclusion

The impact of the global financial crisis on Cambodia is expected to be significant, unless policies are put in place to reverse some of the adverse effects, which seems increasingly unlikely. Although the financial sector in the country is unlikely to be greatly affected, the secondary effects of the crisis are likely to reduce growth and increase economic hardship and poverty in the country.

Sustained growth of around 10% per annum is at best likely to be halved and at worst turn negative; most recent forecasts indicate a possible small negative growth for 2009 and a couple of percent growth for the year after. To a large extent, what happens to the growth in Cambodia, at least in the short to medium term, is determined by how fast the main growth poles in Cambodia will recover. Growth poles in Cambodia consist of garments, tourism, construction and agriculture. The recovery of the garments sector depends on the recovery in US. Tourism depends heavily on the economic conditions in source countries such as South Korea and Japan. The construction sector is also heavily dependent on investment by Korean firms. Although the agriculture sector has been growing steadily over the past few years, its contribution to overall GDP growth in Cambodia is relatively small. However, the sector has the potential to play a much bigger role for both growth and development in the country.

Development in a country such as Cambodia, which suffers from a very high rate of poverty and vulnerability, can be measured only by the extent to which these problems are addressed. Growth has been impressive over the past decade, at around 10% per annum. Poverty in the country has been reduced by around 10%, which is substantial, but not as much as it should have been, given the growth rate. In addition to high poverty, a large portion of population lives close to poverty line and therefore is very vulnerable to adverse economic conditions. Unless policies are put in place to reduce the adverse effects of the global financial crisis, some of the gains achieved over the past decade in terms of higher GDP per capita and reduced poverty in the country could be reversed. The RGC's capacity to implement the necessary policies is limited. A bigger role should be played by the development partners and major donors in the country.

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Annex 1: Nature of Cambodian growth and its implications for poverty and inequality

Over the past few years, CDRI has produced a number of research reports and working papers on poverty and inequality. Published last year were two major reports: *Moving out of Poverty: Trends in Community Well-being and Household Mobility in Nine Cambodian Villages* and *We Are Living with Worry All the Time: A Participatory Poverty Assessment of the Tonle Sap*. Both these studies provided ample evidence that the poor in Cambodia, for various reasons, have not benefited as much as other income groups from the exceptional growth that the country has experienced over the past decade. These studies, together with the most recent publication by the World Bank on the issue, also provide statistical evidence of increased levels of inequality. Various CDRI publications, particularly two just completed on land titling, find increased evidence of inequality in land ownership.

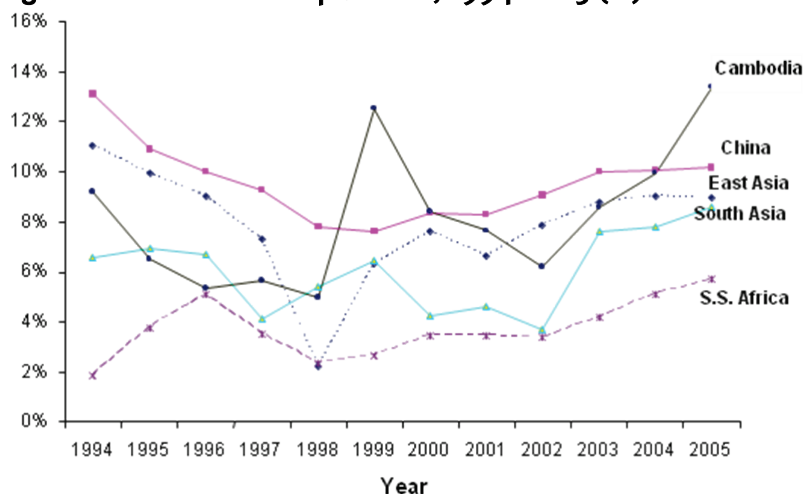
The impressive growth so far in Cambodia has not affected the status of the poverty as much as it could have, indicating that growth has not been inclusive. Closer inspection of the growth experience in Cambodia over recent years as well as drivers of growth in the country, together with comparison with some regional players as well others outside the region, would shed some light on the limitations of growth in the country.

Figure A1.1 shows growth in Cambodia, China and some regional blocs over the past decade. Cambodia's growth has been high, comparable with that which China has experienced over the period. Figure A1.2 shows performance of the same blocs and China over the same period with respect to the poverty rate. This is where the Cambodian experience compares unfavourably: its rate of poverty reduction was slow and follows the overall trend in the sub-Saharan African and South Asian regions. A top performer in this respect was China. One could argue that the difference in performance owes in part to the much higher growth in China, which has experienced sustained growth over the past two decades, more than doubling in size every decade. The difference could also be attributed to the different nature of growth in different countries.

The extent to which growth 'trickles down', as discussed already, depends on the nature of growth, as well as its sectoral composition and the linkages that exist between different sectors of the economy. In Cambodia, the poor may not have benefited as much as the non-poor from the impressive growth of the past decade. A closer look at the sectoral composition of growth may shed further light on this issue.

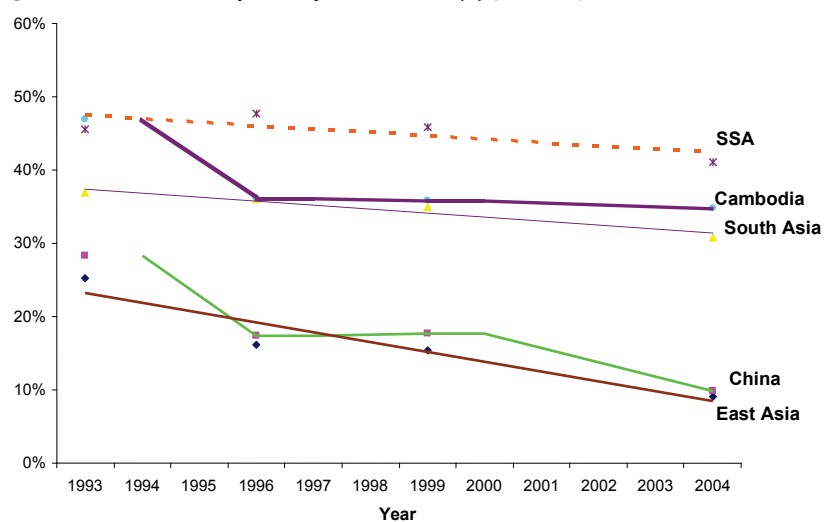
Figure A1.3 shows the sources of growth in the Cambodian economy over the past decade. The sectors that show a sustained and positive growth contribution over the period are industry and services; agriculture had an unstable and at times negative growth contribution. The garment sector, combined with construction, has been behind industrial sector growth. Both sectors, however, have had very weak linkages with the rest of the economy; their contribution has been confined largely to employment generation. Similarly, in the services sector, a driving force has been the massive increase in tourism. As with garments and construction, tourism has had a relatively weak linkage with the rest of the economy, particularly agriculture; its contribution to the economy is mainly through employment generation.

Figure A1.1: Growth comparisons, 1994-2005 (%)



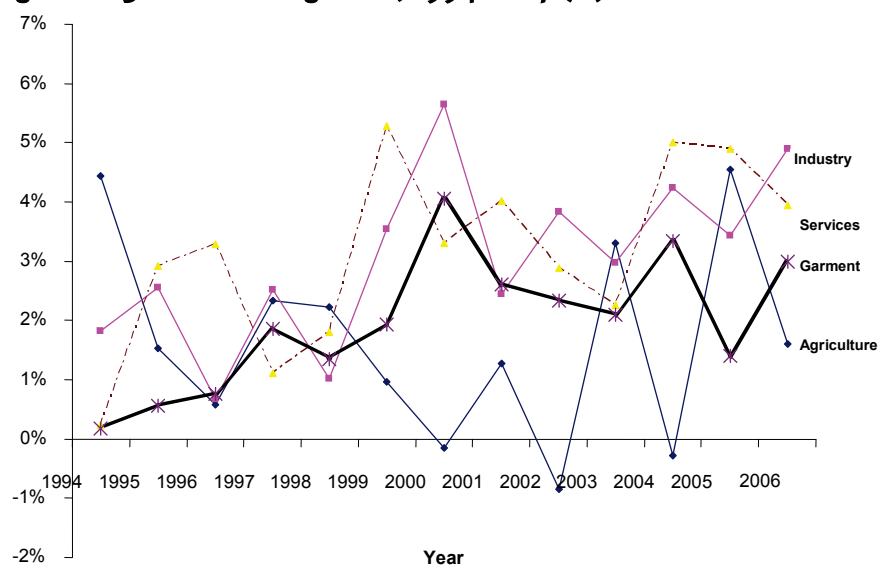
Source: World Bank WDI CD-ROM (2008).

Figure A1.2: Poverty comparisons, 1993-2004 (%)



Source: World Bank WDI CD-ROM (2008).

Figure A1.3: Sources of growth, 1994-2007 (%)



Source: Data from NIS.

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Annex 2: Summary of the findings of the Moving out of Poverty Study

Community wellbeing and prosperity are determined largely by two factors: location and accessibility of the village, including its proximity to rural centres and markets and year-round road access; and its geographical endowment, including soil quality, availability of arable land and irrigation. Strongly performing villages are characterised by good roads, location close to the Thai–Cambodian border or rural towns, good soil, irrigation and larger than average landholdings. Moderately and poorly performing villages are less accessible, have less productive soil, have less arable land, lack irrigation and tend to be more reliant on common property resources (CPR).

In future, strongly performing villages are likely to continue to perform well, given improvements in agricultural productivity and access to waged employment, including through cross-border migration. Trapeang Prei (a moderately performing village) may also benefit from the availability of paid employment, owing to its proximity to Phnom Penh. Of the other moderately and poorly performing CPR-reliant villages, Prek Kmeng and Khsach Chi Ros, while relatively isolated, have good soil and irrigation, with potential to further improve productivity. Kompong Tnaot, a coastal village, is well located, with potential to benefit from tourism if natural resources in nearby Ream National Park are well managed. For the two forest-dependent villages, Dang Kdar and Kanhchor, the outlook is relatively bleak; with limited arable land and restricted access to forests, they are likely to be increasingly reliant on emigration.

Migration, including into Thailand, is an increasingly important source of income for study households, contributing to upward mobility, in particular for better-off households and in villages close to the border. Migration is not a quick fix for poverty reduction, however, because most jobs are unskilled and often seasonal or short term. Local employment opportunities are typically agricultural and seasonal, and are usually poorly paid or involve ‘in advance’ cash for labour, which constrains potential earnings.

Demographic change, including immigration, population growth and new marriages, is impacting on all study villages, putting pressure on resources, including land and CPR. Land and water conflicts, over-exploitation of fisheries and forests and new security issues resulting from an underemployed male youth population and an influx of outsiders are particularly acute in villages that are CPR-reliant, where resources and opportunities are more limited.

There is a significant generational difference in education, reflecting the relatively recent reestablishment of schools in the study villages. While more children are now attending school, children from poor families, in particular girls, continue to miss out. As education becomes more important, for example to secure the limited number of skilled jobs available in the garment sector, educational inequalities are likely to widen differences between villages and between poor and better-off households.

Because illness is the most frequent household shock or crisis, lack of affordable healthcare plays a direct role in driving households into poverty. Use of private health services among better-off households is accelerating, with significant policy implications, whereas poor households are stuck with lower quality care or miss out altogether.

Poor governance and weak institutional capacity are undermining pro-poor policies and exacerbating inequalities between households. Natural resource-dependent villages are most affected by poor governance. Some better-off households take advantage of corruption and impunity to improve their status, whereas for poor households corruption is a shock they can ill afford.

Rural villages and households are not the same, and policy interventions will have quite different impacts on communities and households according to their history and status. Location, assets and risk-spreading investments enable the comfortably rich to stay well off; they have multiple earners and sources of income, as well as assets and savings that act as insurance against shocks and crises and allow investment in new opportunities. Upwardly mobile households grasp every opportunity to

improve their status; they are more likely than others to take risks, invest in health and education and have members migrating for work. Downwardly mobile households typically experience shocks, lifecycle events, debt and destructive behaviours that drive them into poverty, and do not have the assets, savings or income sources to cope with these events. Chronically poor households are trapped in poverty owing to limited or no assets, old, sick or disabled household heads, fewer earners and more dependants and reliance on only a few income sources, including CPR. It is very difficult for these households to move upwards without a significant change in circumstances.

The Moving out of Poverty Study (MOPS) provides a local perspective on national poverty studies and analysis, by validating national trends with local data, explaining national trends from the perspective of the poor and providing insights that are not captured by national studies. For example, the study shows a similar rate of growth, but a slower rate of poverty reduction and higher poverty rates than provincial averages reported in national studies. The study suggests that, when measures other than consumption are taken into account, rural inequality can be seen to be increasing, while static consumption inequality may be explained by ‘flattening’ at the top and bottom end of the distribution. The MOPS provides additional insights into the drivers of rising inequality, including the role of corruption and impunity in household mobility, and illustrates the ways in which poor governance undermines local implementation of pro-poor policies, including natural resource management. The study also shows that the changing nature of social capital, including the erosion of traditional mutual assistance and the increasing importance of patronage networks, plays a significant role in determining households’ opportunities and the support they receive.

The MOPS may overestimate the importance of garment sector work, because it is likely that fewer households benefit from employment in this sector than focus group discussions indicate. The study may also overstate the reduced incidence of domestic violence, because national studies suggest that the incidence continues to be high, indicating that further investigation is required of factors leading to successful intervention. Reproductive health issues are not well addressed in the study, an oversight, given the relationship between dependency ratios and mobility and the high infant and maternal mortality and low adoption of birth spacing and safe obstetric care among rural women.

Differences between rural villages and households need to be understood and taken into account in order to target policy interventions effectively. The study supports the case for investment in rural infrastructure, in particular roads, as well as in agriculture, including irrigation and extension services. Because some villages are CPR-reliant, with limited agricultural land, the study suggests that important complementary strategies are promotion of local employment opportunities, including agri-businesses, formalising and protection of the rural labour force and greater support for small family-run businesses. While stressing the importance of effective natural resource management, the study cautions against overestimating the impact of these policies, in particular in the short term, because pressure on CPR is likely to continue as the population grows. Other key priorities for policymakers are the impact of demographic change on poverty reduction initiatives, greater public investments in health and education and clean water and sanitation. While the study points to the need for increased investment in local government, including devolution of funds and revenue raising, it also suggests that governance failures cannot be addressed locally but require a national response.

The study points to the need for more specific targeting of households, in particular the rural poor. It suggests that comfortably rich and upwardly mobile households are more likely to benefit from community investment, for example in roads, initiatives to boost agricultural productivity and new opportunities for business and skilled employment. Downwardly mobile households are more likely to benefit from measures such as greater public investment in human services and different forms of social protection, including income and weather insurance, health equity schemes, targeted skill development and subsidised healthcare and education, as well as labour protection and savings schemes. Chronically poor households require very specific interventions to address poverty traps and enable them to cope with their circumstances, such as food for work programmes and other food security initiatives, locally provided free healthcare and health prevention programmes, clean water and sanitation, free or heavily subsidised education, increased locally available employment and basic labour protection and free health insurance and other forms of social protection. Stronger and more accountable local government that can protect the interests of poorer households, together with stronger rule of law and legal protection, is essential for poor and vulnerable households.

Longitudinal, mixed-methods, contextual research can contribute to national poverty monitoring and analysis by providing an understanding of the relationship between transitory and chronic poverty, the interaction between poverty, vulnerability and opportunity and the impact of national and local trends on poverty rates and dynamics. Studies like the MOPS can help to inform design of national research, ‘ground truth’ and validate national surveys with local data and identify explanations and causal relations that national studies are unable to pick up. Considerable investment has been made in the MOPS, with two rounds of the study conducted, in 2001 and 2004/05. The value of panel data really becomes evident with three or more rounds, however, because it is then possible to identify the extent of transitory and chronic poverty. There is a strong case for consolidating and institutionalising the MOPS, including by building on lessons from the current study, aligning study findings and future rounds more closely with national poverty monitoring and analysis and integrating the study into a broader, longer-term programme of poverty research and analysis within CDRI.

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Annex 3: Cambodian garment industry: A model sector?

Apart from its contribution to job creation, the garment industry in Cambodia is additionally relevant because it paves the way for the accumulation of capital for more sophisticated activities with higher value added. By doing so, it can be in time, just like the textile industries that have historically served as the base from which countries have leaped to higher stages of development. There is another significance of the industry that is noteworthy, having been duly commended inside and outside. That is, it can serve as a model for sector-specific governance and coordination.

The linkage of market access to labour standards back in 1998 under the agreement between the US and Cambodia set the bar for compliance with workers' rights protection and improvement of working conditions among domestic manufacturers. The ILO, through its unique Better Factories Cambodia programme, was handed the responsibility of monitoring and reporting such compliance. Based on the findings indicated under BFC's 21st synthesis report on working conditions in Cambodia's garment industry (October 2008), it appears that the level of this compliance is high. Said report indicated, for instance, that 97% of the visited 205 factories complied with the minimum wage requirement for regular workers. It also stated that 159 factories at least had one union, only 11 factories interfered with freedom of association and 34 strikes occurred during the relevant investigation period. It can be argued that this observance of labour standards helps Cambodia's garment industry during this crisis period, even with the expiry of the quota privilege with the US, inasmuch as buyers' decisions, as they move towards further consolidation of purchases, have been found to be significantly influenced by labour standard compliance of suppliers. As trade restrictions imposed on the Chinese break down, garment manufacturers in Cambodia can continue to bank on this sector-specific governance to constitute a part of their comparative advantage.

The success of Cambodia's garment sector is also credited to the relatively tight coordination between and among its major stakeholders including GMAC, BFC, the GPSF and the MoC. GMAC liaises closely with the MoC and uses its representation in a GPSF working group to convey the key concerns of its members and lobby the authorities for needed reforms and opportunities. These relationships prove highly useful at this time, when manufacturers are striving to find quick solutions to ameliorate the damage induced and to be induced by the global economic stagnation.

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Annex 4: Cambodia's domestic banking system: Underlying weaknesses

The infection caused by the crisis has certainly been magnified by several problems in Cambodia's financial system, four of which are as follows:

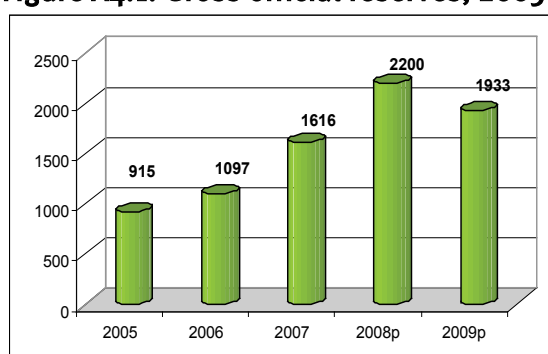
Thin and weak regulatory and supervisory capacity: The increase in the number of banks in the country has not been evenly matched with enhancement in the institutional and technical capacity of the NBC to regulate the activities and supervise the balance sheets of the commercial and specialised banks. For bank competition to translate to improved service quality and bank infrastructure without compromising the stability of the banking system, stronger surveillance and enforcement are essential, and these in turn call for capacity building of bank supervisors and political support for their mandate.

Low financial literacy and weak public trust in the financial system: While confidence in Cambodia's banking system has been growing, as evidenced by high rates of deposit growth over the past years, the level of public trust and financial literacy remain low compared with neighbouring countries. Informal means of financing remain popular, and instilling greater awareness and causing an attitudinal shift among the locals is the most unique challenge facing the government and financial institutions alike.

Uncertainty over legal governance: Poor quality of collateral is compounded by the problem of high uncertainty over enforcement of loan contracts. Interest rates in Cambodia are higher than those charged in comparable countries, and one chief factor driving such rates up is the lack of confidence in the quality of legal governance in the country. Loan recoveries after the effects of the crisis might be very difficult because of this problem.

High dollarisation: High dollarisation limits the policy options available to the NBC for overcoming the inflictions induced by the crisis. In case of sharper deceleration in external inflows, central bank reserves may not be big enough to cushion the blow, resulting in an even more precarious liquidity position.

Figure A4.1: Gross official reserves, 2005-2009 (US\$m)



Source: IMF (2009).

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Annex 5: Microfinance institutions: The success of ACLEDA

MFIs constitute a small but highly important segment of Cambodia's financial system. As of 2008, 18 licensed MFIs and 26 registered and 60 unregistered NGOs providing microfinance services were known to be operating in the country. Total loan portfolios stood at US\$586 million, total borrowers over a million and total savings \$343 million.

While small relative to the commercial banking system, neither the significance nor the skyrocketing growth of the MFI sector can be discounted. Double-digit growth of micro-lending is projected to continue in 2009. Minimal impact is felt from the crisis as, unlike commercial banks, MFIs have little exposure to real estate and lower dependence on foreign capital. The speedy growth is also attributable of course to greater awareness of MFI services among nationals and strong local deposits.

Needless to say, MFIs in Cambodia perform the crucial role of providing more accessible and reasonably priced financial services to small and medium-sized enterprises (SMEs) and the agriculture sector especially (MFI total lending for agriculture exceeds that of commercial banks). Regulation and supervision are done by the NBC but the Cambodian Microfinance Association essentially oversees operations.

The experience of ACLEDA (Association of Cambodian Local Economic Development Agencies) is one success story that can provide incentives to continually support MFI development. Starting as a MFI in 1993, it attained full commercial bank status in 2003 and now plans to become a regional bank. It is set to jumpstart regional ambitions in Laos.

The distinction attributed to ACLEDA can be credited to two things: its close proximity to customers and its attention to the agriculture sector. ACLEDA has 226 branches, covering all major districts and communes. This and the priority it gives to transparency have basically attracted the loyalty and trust of the locals. About 12% of ACLEDA's lending is to the agriculture sector. Creditworthiness is ensured through use of stringent and informed selection criteria, collaboration with clients on preparation of business plans and tailoring of disbursement and repayment schedules according to clients' specific needs. This prudent strategy underpins ACLEDA's insignificant NPLs, estimated at 0.4%. Like other MFIs, ACLEDA has trivial exposure to real estate, and local deposits comprise its lifeblood; hence, its performance forecasts this year remain to be optimistic. It will be able to weather the crisis

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Annex 6a: Global crisis: A window of opportunity for deeper reforms on fiscal management

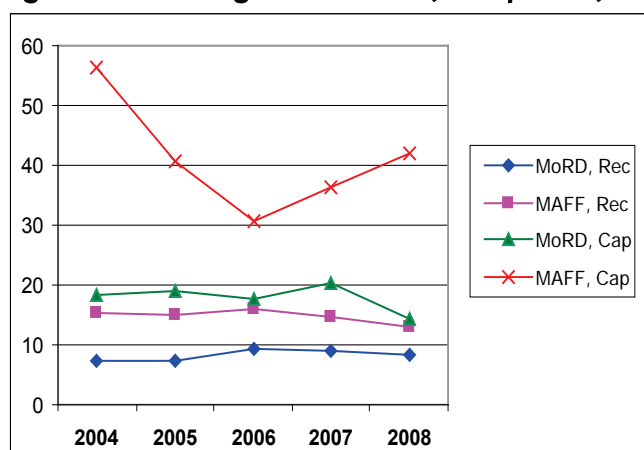
While laudable and of import, the fiscal rejoinder of the government to the crisis so far has been felt to be deficient. The present situation offers a window of opportunity for the enactment of deeper fiscal reforms that would otherwise have been difficult to act out and such a window must be exploited. If the country is to surmount the plague incited by the crisis on not only a temporary but also a longer-term basis, these reforms, which address the very frailties that the crisis has uncovered in the country's economic structure, will have to be carried out.

Notwithstanding the impact of the prospective cash flows from the petroleum industry, tax and non-tax revenues will have to be increased by both fortifying revenue administration and expanding the tax base. Tax holidays will have to be reconsidered as they possibly distort incentives; property and capital gains taxes will have to be implemented assertively to contain speculative investments in real estate.

Sizeable or not, oil and gas revenues will have to be managed in a transparent and egalitarian manner. The possibility of a petroleum fund may be explored on top of subscribing to the principles of the Extractive Industries Transparency Initiative (EITI).

Increases in the wage bill must be linked to civil service reform. Notwithstanding their underlying political justifications, rising public sector wages and administration costs must be a matter of concern. Budgeted increase in non-wage recurrent expenditures will also have to be reoriented towards pro-poor social spending. Furthermore, increments, for instance in military spending, should not crowd out social expenditures. Note that it has been regarded that a lack of linkage between Cambodia's national budget and national priorities exists. Altogether, these priorities set out in the government's NSDP emphasise poverty reduction and, with poverty concentrated in rural areas and in the subsistence economy, it is expected that programmed and actual budgetary transfers to the public ministries involved in such sectors (i.e. Ministry of Rural Development or MRD and Ministry of Agriculture, Forestry and Fisheries or MAFF) will have had bigger shares over the years. However, analyses of budget laws, including the proposed 2009 Budget Law, and the sparse data on budget execution reveal that there has been no clear trend towards higher recurrent and capital budget allocations for such ministries and greater prioritisation of the rural and subsistence sectors.

Figure A6a.1: Budget allocations, 2004-2008, 2007 prices (US\$m)



Source: NGO Forum on Cambodia (2008).

Foundations for a sound, established and more comprehensive safety net programme that targets the most vulnerable have to be laid out. The programme can involve interventions, direct or indirect, that support household income, employment and private transfer flows in times of vulnerability.

Public financial management reforms must be accelerated, especially those in connection with budget integration and treasury management. In the long term, institutional improvements really hold the key to fiscal sustainability.

As it is coming from a very low base, budget allocations to agriculture must be significantly augmented. Compared with its neighbours in the region, Cambodia has an exceptionally low allocation of agricultural GDP to the agriculture sector. Agricultural productivity can be boosted by setting up an agricultural fund from where financing for training, research and development and information exchange can be secured.

Capital spending must be increased, especially in high-return investments in infrastructure and agriculture. A necessary concomitant to this, however, is the adoption of an improved appraisal system. Now also is the right time to undertake labour-intensive public works projects as such serve both as a fiscal stimulant and a social safety net.

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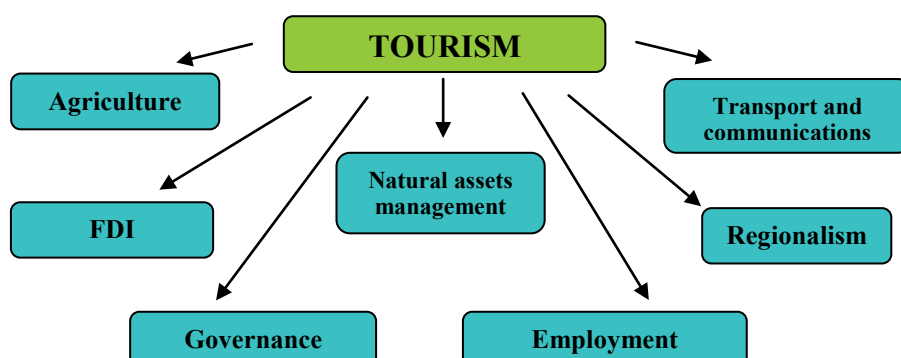
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Annex 6b: Global crisis: A window of opportunity for deeper reforms on tourism



There is a broader issue that involves the tourism sector and whose resolution will enable the industry to weather not only the present crisis but also any future tests to its robustness and resilience. The current crisis offers the ideal window of opportunity to deliberate on this conundrum and enact reforms to deal with it.

The issue in question is the lack of linkages among tourism and other sectors and sectoral initiatives. Priority linkages that can be given more attention are as follows:

Linkage with the agriculture sector: A lucrative effort is the promotion of agro-tourism. It has been suggested that tourism can serve as a test as to which agricultural products can entice international demand. Diversification in this sense will be beneficial to both tourism and agriculture sectors.

Linkages with transport and communications: Tourism is a key driver of growth in transport and communications. The government's proposals to boost tourism by considering adding onto airport infrastructure will serve the transport sector well, while its plans of bolstering cross-border and national tourism can materialise only really when cross-border and domestic transport networks and costs improve.

Linkages with natural assets management: The strength of the Cambodian sector is ultimately credited to its natural endowment and cultural heritages. Unfortunately, deterioration in the quality of these assets has been observed over the years. Addressing this problem of sustainability undoubtedly requires coordination in management among relevant ministries and in connection with various issue areas, including land and forestry management, community-based initiatives and eco-tourism.

Linkages with FDI promotion: Tourism is one of the few sectors in which FDI is concentrated in the country. Foreign financing has heretofore been the major lifeline for many hotel and resort constructions in the key tourist locations (approximately 75% of capital spending). The deceleration of FDI as a consequence of the global credit crunch and intensified risk aversion therefore seriously affected tourism and vice-versa. This mutual relationship underpins the exigency of connecting FDI promotion and tourism.

Linkages with employment creation: In Cambodia's case, tourism plays a central role in job creation and absorption, especially given the pattern of employment shift from traditional sectors to the industrial and services sectors observed in the past 10 years. While huge job losses have been recorded in the garment sector and construction for 2008 and 2009, tourism by contrast has absorbed jobs. Underemployment in the industry is of course predicted to increase (especially for those self-employed) as a result of the crisis, but with it set to grow continually employment opportunities in tourism remain significant.

Linkages with regionalism: Further ASEAN integration implies better prospects for Cambodia's tourism industry. The country's position in the dynamic region must be exploited and this connotes the need to secure a more pronounced niche in the global value chain, not only in the area of trade of goods but also in tourism trade. As previously mentioned, the crisis underscored the pros of tapping ASEAN in the formulation of solutions meant to save the depressed tourism sector. Moreover, it emphasised the need to reach out to unconventional markets, with the Middle East having the greatest potential. All these revelations define the link between regional initiatives and tourism.

Governance: Tourism growth must not be at the expense of improved governance. Good governance has its own clear benefits for the tourism industry as it can enhance efficiency of operations and protect the government from leakages of revenues that otherwise can be allocated for tourism development. As mentioned earlier, there have already been concerns about transparency in the allocations of concessions over tourist sites. This predicament can be solved only if governance improvement joins profit and revenue growth as the major motivations for developing the industry.

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Annex 6c: Global crisis: A window of opportunity for deeper reforms on the garment industry

Some other broader reforms are needed in an effort to address the underlying vulnerabilities not only of Cambodia's garment industry but also of the country's trade sector as a whole. Four of such are as follows:

Lowering of input costs: Comparably speaking, costs of electricity and transport remain high in Cambodia. The recent riel appreciation has also undermined labour competitiveness. The government of course has been undertaking steps to address these problems, including improvement of road networks and rehabilitation of its electrical systems.

Accelerate improvements in trade facilitation: Improving trade facilitation at the border will bolster trade within the Greater Mekong Sub-region. A necessary strategy in this regard, one that will reduce costs significantly, is the computerisation of customs systems. The computerisation of customs at Sihanoukville port was a welcome development and must be replicated.

Diversification in terms of products and markets: In relation to the garment industry, Cambodia must aggressively seek for the relaxation of the local content requirement imposed by the EU to make the most out of its duty free access. Beyond its traditional buyers, Cambodia must also direct its attention to non-traditional markets including Russia, Germany, the UK and the Middle East. To this end, private manufacturers greatly need leadership from the government in terms of promotion, for one. Moreover, most of the garments produced in Cambodia are of the CMT type. It is true that the evolution to products at the higher end of the value chain will be difficult, especially because the country's comparative advantage has traditionally rested on the simplest garments. But the search for newer markets opens up the opportunity for the industry to carve out comparative advantage in more sophisticated products.

Sector-specific governance and coordination: The success of the garment industry in instituting sector-specific governance and close multi-stakeholder coordination must be maintained and replicated. Utilising a third party for monitoring purposes and the GPSF for dialogue and lobbying has particularly proven effective.

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Appendix 7: Summary of stakeholders' perspectives on impacts of financial crisis on specific sectors

Private sector's perspectives

Hotel and restaurant industry

Despite subdued inflation during the last two quarters of 2008, a new course of external shock, the US credit crunch, coupled with a regional one, the Cambodia–Thai border dispute, has further distressed growth of the tourism industry, the hotel and restaurant industry in particular. During the last quarter of 2008, significant deceleration in the number of foreign visitor arrivals was evident from some advanced countries, such as Japan, Korea, the US and Europe. Stakeholder consultation in late February 2009 indicates that hotels in Siem Reap are now struggling to maintain the once-high rate of bookings. The number of hotel bookings in Siem Reap was down by about 40% in January 2009 relative to last year, whereas the number of hotel bookings in Phnom Penh remains insignificantly affected, which could last only by the end of March 2009.

It was estimated that the situation could become worse starting from June this year if the economic downturn in such countries as Japan, Korea, France, the UK and several others continues to deepen. Stakeholder interviews further reveal that the total number of job losses in the industry could be between 8000 and 9000 as of June 2009. In order to weather possible serious impacts of the credit crisis, industry operators are discussing concerted action on the selection of a professional advertising agent and potential global advertisement through cost sharing among operators with support from the Ministry of Tourism. In line with this, hotel and restaurant associations are examining the likely possibility of Japanese and Korean high-end and long-distance travellers changing their destinations from Europe to Asia, such as Cambodia, as their earnings decelerate.

Thus far, industry operators have appreciated government efforts in branding Cambodia through global advertisement on CNN (Cable News Network) and its continuous consultation with the operators. In mitigating the likely impacts of the financial crisis on the sector, it is recommended that temporary provision of free visa entry for potential tourist groups, such as the Chinese, could to some extent help address the decline in the number of visitor arrivals. Additionally, the establishment of a national airline with an airfare below market prices could help bring down the costs of flights connecting Cambodia to regional destinations.

Garment manufacturing industry

Following the grave pressure from the energy and food price shocks between late 2007 and the third quarter of 2008, the industry continues to bear another severe burden from the global economic meltdown. During the last three months of 2008, the industry was hit hardest compared with others. Stakeholder consultation in late February revealed that there were 20,000 job losses, resulting from the closing down of 43 factories in 2008, regardless of the non-operation of their subcontractors. Additionally, around 10 factories were closed in January 2009, with five new ones established, which created 2317 jobs. It is worth noting that subcontractors have been more severely affected as number of clothing orders continue to decelerate, particularly from the US and EU. According to GMAC's 30-factory survey in early 2008, the overall number of orders in January plummeted by 30% from the same month last year, whereas exports declined by 31%, driven mainly by the 42% drop in exports to the US market. The consultation further confirms that the total number of subcontractors is between approximately 200 and 300, where a certain number of factories could have up to 15 subcontractors. This reflects the high exposure of these subcontractors to US economic performance.

As of February, there have been clearer signs of reduction in production activities in several factories. Consultation indicates that some factories have reduced their operation by between 50% and 70%; a number of others have submitted applications for suspension, which normally is a two-month period, to the Ministry of Labour and Vocational Training. A noticeable drop in the number of orders, as well as export values and volumes, casts mounting concern among stakeholders over the prospects of the

sector's growth. More importantly, a sharp rise in the number of unemployed workers in China may create fierce competitive pressure over regional clothing producers once those unemployed resort to accepting low-wage rates in the industry.

For the time being, there have been concerted efforts among stakeholders, including the public sector, in diversifying current markets, uplifting productivity and cutting production cost. New market destinations are Japan, Russia and the Middle East. With regard to this, despite government assistance in bringing Cambodian garment representatives and potential Japanese buyers together, garment exporters will need to grapple with a certain number of challenges, such as higher standards, tougher conditions and comparable profit margins with other markets, the US and EU in particular. The situation is not yet clear regarding the Russian market. Representatives of the sector appreciate current assistance and support provided by the MoC, followed by the extension of a 1% advance tax on profit exemption until 2012.

Stakeholder consultation further discloses that the industry is also facing internal challenges, particularly increasing numbers of strikes, from 80 in 2007 to 105 in 2008. It is estimated that the effects of the global economic crisis, coupled with internal pressures, could become more severe in 2009. Thus, in order to ensure the sustainability of the sector, it was recommended that import and export procedures be further simplified; quicker issuance of export permits, as well as certificates of origin, be guaranteed; and a favourable overall business environment be assured as a priority. Stringent enforcement of the Law on Labour Unions was also suggested. In line with this, a social security fund was also recommended: such a fund has been established by the government for the garment industry and is now in its pilot phase. A number of factories have been chipping into the government budget for those workers who have been laid off in the remaining three quarters to come.

Banking industry

The last three months of 2008 saw significant challenges faced by several commercial and specialised banks as the US and EU financial crisis continued to dampen regional economies. Liquidity risk, coupled with a volatile deposit base, is the major concern, as growth of bank deposits decelerated noticeably, turning into negative growth since September 2008 (IMF, 2009a). Stakeholder consultation in early March indicates that the crisis is having effects on businesses. Significant reduction in Cambodia's trade (imports and exports) with neighbouring and global partners has reduced the frequency of the use of trade finance instruments, letters of credit, which affects banks' profitability. Some are experiencing stagnant growth in the use of letters of credit; others show a reduction in the use of these since the last quarter of 2008. Despite strong confidence among depositors, deposit demand has been slow, and so has lending demand. Stakeholders expressed their concern over the banks' exposure to real estate and property lending, which could weaken consumer confidence as real estate prices continue to slide.

Realising the possible consequences of the real estate price bubble, the central bank has restricted bank lending to the property sector and, to ensure liquidity in the banking sector, reduced the 16% reserve ratio to 12%. Certain banks are optimistic about such measures. Strengthening and enhancing the sector in times of crisis are mounting challenges for the central bank. The consultation recommended that, in order to promote transactions through banks and enhance deposit and lending activities, redirecting donor development funds from other sectors to the banking sector should be given serious consideration; immediate establishment of a commercial court and adoption of an anti-corruption law should be ranked high among government priority actions; and building investors' confidence through the provision of stronger assistance and support to major industries, such as the garment sector, should also be listed among the government priority actions.

Development partner perspectives

ADB

There has been a range of different views over the depth and extent of the impacts of the global financial crisis on the Cambodian economy. A brief consultation with ADB shows that overall impacts are temporary, but it is uncertain how long they will last. Cambodia could be severely affected in 2009.

Even though it appears that there are no direct effects, indirect ones do exist in a number of major sectors, such as banking, garments, tourism and construction, which are exposed to external shocks. In the banking system, some banks are facing less liquidity and considerable risk; others are able to maintain liquidity stance. ADB expresses concern over the vulnerability of the banking sector to the external environment and further emphasises the capability of the central bank in supervising the rapidly growing number of commercial and specialised banks.

Additionally, the decline in garment exports has been significant during past months, resulting in the closure of several factories. As the sector has been highly exposed to retail sales in the US, the sharp drop in US retail sales in the past couple of months has caused significant reductions in the number of clothing orders from the US. On the tourism side, during the last quarter of 2008 the industry saw slower growth in the number of foreign visitor arrivals compared with the same period of 2007. It is worth noting that although numbers have been increasing, tourist spending is tending to be lower. Construction has also been affected, via the suspension of a number of large construction projects concentrated in Korean-owned firms. In essence, the slowdown in these sectors could result in a significant contraction in GDP growth in 2009. Consultation further indicates that concrete measures and bold stimulus plans have not been taken by the government in order to sustain these key growth-supporting pillars.

In the brief consultation, it was recommended that identification of sectors most severely affected, and redirecting of currently available resources to those sectors, should rank top among government priority actions. In addition, redirecting resources for the development of irrigation systems and infrastructures is vitally important in times of crisis. It was also suggested that current technical working groups in various sectors work more on issues of private sector development, public financial reform, food security, agriculture and infrastructure. On private sector development, immediate implementation of trade facilitation action plans, such as mechanisms to reduce licensing costs and solve commercial disputes, is a priority in such a climate.

References

Interviews and consultations conducted in February and March 2009 by CDRI staff with representatives of the tourism, garment and banking sectors and the donor community.