

**2007 Cambodia Outlook Conference:
Opportunities for Growth, Development and Shared Prosperity**
Session 4: From Aid Dependency to Shared Prosperity:
Managing Cambodia's Oil and Gas Resources.

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Excellencies, ladies and gentlemen,

Today I am honoured to have the opportunity to speak at this important CDRI Outlook Conference on managing Cambodia's coming oil and gas resources. CDRI strongly believes that potential oil and gas revenue represents a unique opportunity contributing to a positive social and economic transformation of Cambodia.

In my speech today I will identify the investment opportunities, raise some risk management issues relating to oil revenue and suggest a way forward designed to ensure that oil and gas revenue is used in a way that benefits all Cambodian people.

Investment Opportunities

1. The recent discoveries of natural gas and the subsequent plans for extraction beginning in 2008–09 are timely in the midst of high oil prices, as the government is still in dire need of external resources to cover the annual overall budget deficit. Revenues from oil production, therefore, are expected to play an important role in reducing reliance on foreign assistance and to offset the loss of revenue caused by the customs tariff reductions due to membership in ASEAN and WTO. Oil and gas revenue will be an important resources to finance pro-poor growth through investment projects that promote growth, such as national roads, public facilities, education, health, rural roads, irrigation systems, strengthening services. Investment in these public goods will ensure long-term as well as short-term growth.

Oil revenue can also be used to strengthen social safety nets by establishing social and pension funds. These investments provide the most direct benefits to the Cambodian people and therefore, serve the CMDGs.

Oil revenue is also a good opportunity for the government to speed up reform in the public sector by increasing salaries of government officials, building up capacity through training, updating equipment and facilities.

Oil revenues can also be used to provide technical and financial support to domestic industry and handicrafts, this in turn, will help reduce the reliance on imports and create jobs for people.

Excellencies, ladies and gentlemen,

2. There are, however, both positive and negative impacts of oil revenues on the economy. Lessons learnt from other countries show that oil revenues can be a curse as well as blessing. The Democratic Republic of Congo, Angola, and Chad are rich in natural resource such as gold, diamonds, oil and gas, but their economies are stagnant. The resource rich countries such as Norway, Canada, Indonesia and Malaysia have successfully used their natural resources for economic development.

Risk Management

Generally, experience shows that resource rich countries have much lower growth rates than resource poor countries. To utilise the oil and gas revenue for development, Cambodia needs to

both learn from countries that failed to use oil money constructively for development, and also to learn from countries that have used their natural resource wealth positively for development. Allow me to identify three risks associated with managing oil resources.

The first economic risk is the ‘Dutch Disease’. The term emerged from the experience of the Netherlands in the 1960s when that country discovered oil and gas and received huge amounts of foreign exchange from the exports of the booming energy sector. ‘Dutch Disease’ can be understood as a decline in manufacturing production as a result of growth in the boom sector. The guilder appreciated and services and construction experienced a boom due to high demand. There were plenty of jobs created in these sectors. The economic situation, however, was reversed as the price of oil collapsed in the mid-1980s and oil revenues subsequently declined. The declining demand in construction and other services pushed many people out of work.

The second economic risk concerns the diversification of the oil industry. In developing countries, oil industry may not often offer much opportunity to diversify the production structure. Equipment technology and labour used in production are technical and highly industry specific, and mostly imported, so domestic resources are usually not needed. Oil industry will, therefore, be an enclave in the country; growth in oil production cannot be imitated by other sectors. That is one of the reasons why some oil producing countries pay less attention on promoting education. Empirical evidence shows that some oil rich countries have lower education levels than resource poor countries. It is very important to address this issue as education is a most vital development stimulus.

Another risk concerns corruption. Experience shows that oil revenues can lead some oil producing countries into high levels of corruption. Nigeria is a classic example of squandering natural resources. Oil revenues are mostly distributed among political elites, and used to strengthen the regime. Economists argue that Nigeria would have had better growth if it had stopped producing oil and gas or if all oil and gas revenues are allocated to all Nigerian people instead of just the elites. The Nigerian economy is stagnant and poverty increases in the midst of high natural resource revenue.

Cambodia needs to pass strong anti-corruption legislation, in order to avoid similar kinds of problems in the future.

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According to these experiences, some negative effects could occur in the Cambodian economy, when the oil and gas revenues begin to phase in and those revenues have not been wisely managed. Overall prices could increase and the **riel could** appreciate. That would weaken the competitiveness of exports of some cash crops and of garment products. The drop of these exports will subsequently push some out of employment.

Prices of buildings, housing, and land would all increase if demand for these goods increases driven by oil money. Cambodia may, therefore, become a more expensive country in which to live and to invest.

Although oil revenue could have such negative effects, it provides, at the same time, a unique opportunity for equitable economic growth and faster poverty reduction.

The way forward

In order to minimize the negative effects associated with oil revenue and to maximize the potential benefit for Cambodian people, I mention three useful measures that have been practised in other countries that have used oil money constructively for development.

- Avoid appreciation of the domestic currency and drastic price increases by avoiding excess demand. To achieve this, oil revenue needs be incrementally spent in the domestic market, and part of the oil revenues should be used for debt repayment.
- To reduce reliance on energy sector, the government needs to promote diversification of production structure. This, in turn, may help mitigate the negative effects of the Dutch Disease.
- The government needs to accumulate oil funds in order to stabilise spending in the leaner periods when the export of oil and gas declines due for example to a decline in production or in oil prices, and to intervene in foreign exchange market. The last point will help in stabilising the exchange rate.
- These strategies should be accompanied by establishing a petroleum fund that is committed to transparency and accountability. Cambodia should join the *Extractive Industry Transparency Initiative (EITI)* which provides criteria and principle to increase transparency and accountability. The main objective of EITI is to help resource rich countries overcome the possibility of suffering from a resource curse.

Excellencies, ladies and gentlemen, in conclusion

A blessing or a curse depends primarily on the ways in which natural resource revenue is managed and used rather than on the revenue itself. CDRI's vision is that oil and gas revenue will be wisely managed and used for the benefit of all Cambodians.

Thank you for your attention