

Major Development Challenges in Cambodia¹

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Background:

Cambodia has achieved a very high rate of growth over the last ten years and with it, notable reduction in the rate of poverty; high rate of poverty however is still the major challenge that the country has faced with. There are debates as to whether Cambodia could have done better in terms of poverty reduction. Related to the issue, is the growing concerns that inequality in Cambodia has increased. A number of recent studies by CDRI published², together with equity report by the World Bank in 2007, support the view that inequality in Cambodia has worsened in recent periods. CDRI's studies in particular also provide evidence that the poor have not benefited much from the large growth in the economy. Though not necessarily a worrying sign, it is important to look more carefully into the underlined reasons for the limited success in poverty reduction and the increased inequality.

In this presentation, I will briefly go over some of the limiting factors in growth experience in Cambodia and discuss ways that these can be addressed. Before proceeding, it is important to bear in mind that after 30 years of war and destruction, relative peace and stability returned to Cambodia in 1999; what Cambodia has achieved over the period since then should not be taken lightly.

Nature of growth in Cambodia:

Growth in Cambodia over the last decade has been high and comparable to the fast growing economies in East Asian. Cambodian performance in terms of poverty reduction over the period however has been low and similar to those experienced by slow growing economies in Sub-Saharan Africa and South Asia. Though plausible that differences in performance between Cambodia and East Asia as a whole is due to the much longer period of growth in the latter, the differences could also be attributed to the nature of growth experiences in different regions/countries and therefore the impact that these

¹ For a fuller version of this brief please see Chapter 1 in the CDRI's Annual Development Review 2007-8.

² CDRI's publication includes: Fitzgerald, I. and S. So (2007): "Moving out of poverty: Trends in the community well-being and household mobility in nine Cambodian villages", CDRI, Phnom Penh.; and Ballard, B. (Editor) (2007): "We are living with worry all the times: A participatory poverty assessment of the Tonle Sap", CDRI, Phnom Penh. The World Bank study: World Bank (2007): 'Sharing prosperity', WB, Phnom Penh.

differences have had on the rate of reduction in poverty, as well as changes in inequality.

There is a debate in the literature regarding various types of growth and differential impacts that each type may have on the poor and the rate of reduction in poverty. The extent to which growth 'trickles-down' depends on the nature of growth, its sectoral composition and the linkages that exist between different sectors of the economy. If 'inclusive', the benefits of growth are likely to be shared more widely in the economy, including by the poor. Growth is inclusive when it is accompanied by creating opportunities that are accessible to everyone.

A number of cross country studies conducted recently suggests that on average there is no bias in the sharing of benefits of growth; poor and non-poor equally share the benefits of growth. Individual country case studies however indicate that this average picture does not hold for some; specifically the poor may not benefit as much as others and that in exceptional circumstances the link between growth and poverty reduction has not been direct.

Limitations of growth in Cambodia:

Cambodia has experienced an average per capita income growth of around 7% over the last decade. Sectoral composition of this growth however has been very uneven. Sectors that show a sustained and positive growth over the period are industry and service sectors; agricultural sector show a rather unstable and at times negative growth rate. Given the high concentration of population in the rural areas and the relatively poor performance of agricultural sector over the period, it should therefore not be surprising that the poor in Cambodia have not benefited much from economic growth in the country.

Another limitation of the growth in Cambodia relates to the lack of linkages both within and between different sectors. As far as the industrial sector growth is concerned, the garment sector combined with construction have been behind some of the changes that have taken place in that sector; both sectors have very weak linkages to the rest of the economy; their contribution is largely confined to employment generation. Similarly in the service sector, the driving force there has been the massive increase in the tourism. Tourism sector also has relatively weak linkages with the rest of the economy, particularly the agriculture sector; its contribution to the economy is mainly through the employment generation as well. A recent study by CDRI that looked into the poverty reduction effect of tourism found that this sector does not play any significant role in this regard in Cambodia³.

All these indicate that growth in Cambodia has not been 'inclusive', the benefits have been shared by a relatively small portion of the population. Another indication of this is provided by a number of recent studies conducted, including

³ Hing, V. and S. Tuot (2007): 'Pro-poor tourism: Siem Reap case study' in CDRI (2007): 'Pro-poor tourism in the Greater Mekong Sub-region', CDRI, Phnom Penh.

the two major CDRI studies as well as the equity report by the World Bank in 2007. They have all found evidence that inequality in Cambodia has deteriorated in recent periods. Although under certain condition this may not present any problem in the long run, it is important to find out what forces are behind the increased inequality and whether the increased inequality is likely to be detrimental to the sustained long term development of the country.

Detailed discussion of how to make growth in Cambodia more 'inclusive' would have to be left to another occasion. A summary of some of relevant issues are presented here.

Moving forward:

To make growth more inclusive, it is important that private sector takes a much larger and meaningful role in economic activities in the country. Recent studies conducted suggest that Cambodia is one of least competitive countries in GMS; cost of doing business in Cambodia is very high. This high cost is a reflection of problems in the infrastructure and energy sector as well as a high transaction cost that is due to the red tape and rent seeking. There is a lot on the part of the government and donor community that can be done to remedy these problems.

Rate of saving and investment in Cambodia is quite high; latest figure available suggest a rate of saving of around 23% of GDP. There is however a question mark as to whether these savings are channelled into the right type of investment. A number of empirical research on the role that different types of investment may have on growth, find significant link between growth and investment in machinery and transport. In Cambodia most investment seems to be channelled through buildings, as well as speculative investment in Land. It is doubtful whether either can play any significant role in the future prosperity of the country.

To move forward on poverty reduction, it is important that growth and productivity of agricultural sector in Cambodia is substantially improved. One important element in putting the agriculture sector on a sustainable high growth pass is to deal with the issue of land. This is a topic that other colleagues will fully deal with later. It is however important to emphasis that land distribution should be seen as part of a larger package of reform and support in order to increase productivity in this sector. Elements of this package include access to finance, extension services, water as well as irrigation services.

Other important areas that requires a more careful attention are those that relate to the institutional set ups and governance. In the context of institutions, those which strengthen property right in particular seem to have played an important role in other countries that tried to stimulate growth; in Cambodia they are generally weak and non-existence at times. Land titling initiative falls within this category.

As far as governance is concerned, to address some of the problems that are highlighted by researchers in this area, government policy rule should be clear and transparent. Given the limitations in the capacity of policy makers to deal with a large number of policy issues, it would also require a closer look and prioritisation of policies. At the stage that the country is now at, it would be by far the best option if government efforts are directed to getting the growth right; succeeding in this area would resolve most of the challenges that the country is faced with, particularly in poverty reduction efforts.

It is also important to emphasize that there is no unique governance and institutional set up; international donors in particular seem to be pushing for a particular type of governance structure without considering the international experience of successful developers in this context. In the regional context and beyond, these differences are clear in the case of a number of successful developers such as Singapore and Korea in the recent past, as well as Malaysia, Thailand, Vietnam and China at present.

Donor community in Cambodia can further play an important role in pushing Cambodia into a sustainable growth. Given the limitations in resource availability to undertake major infrastructure projects that are important for the economy on many grounds, they can take an active role in supporting investment in these areas and importantly in road and energy as well as IT infrastructure.

The future for Cambodia is bright provided actions are taken to remedy some of the constraints that were highlighted in this brief.