

Potential Impact of financial crisis on the poor and vulnerable groups in Cambodia

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1. Introduction:

Most of the poverty effects of Global Financial Crisis (GFC) are transmitted through growth, and for that it would be necessary to consider the impact of crisis on growth first. The channels through which growth in Cambodia would be affected include: trade, foreign investment, tourism, remittances and international aid.

The financial market effects are likely to be limited given that Cambodia is not that integrated into the world financial markets and the fact that Cambodia's own financial market is underdeveloped. However the indirect effects of GFC are likely to be substantial. The crisis has already led to a slow down in economic activities which is likely to worsen in short to medium term. This in turn is likely to have considerable implications for the level and severity of poverty.

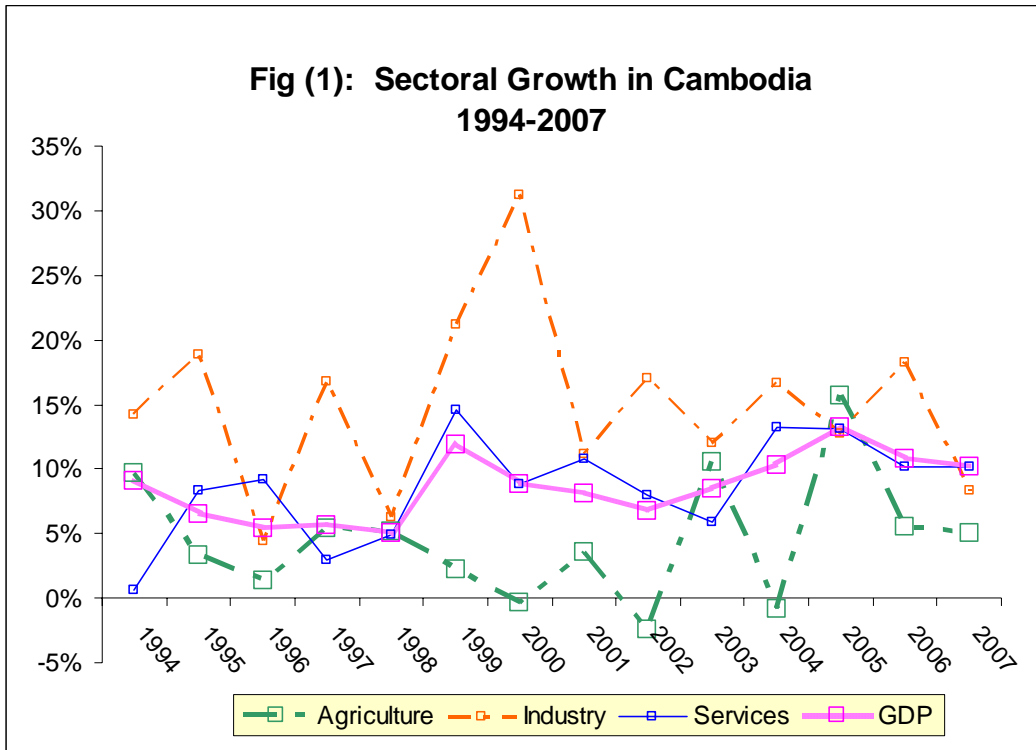
2. Impact of GFC on growth and poverty in Cambodia:

2.1 Impact of GFC on growth in Cambodia:

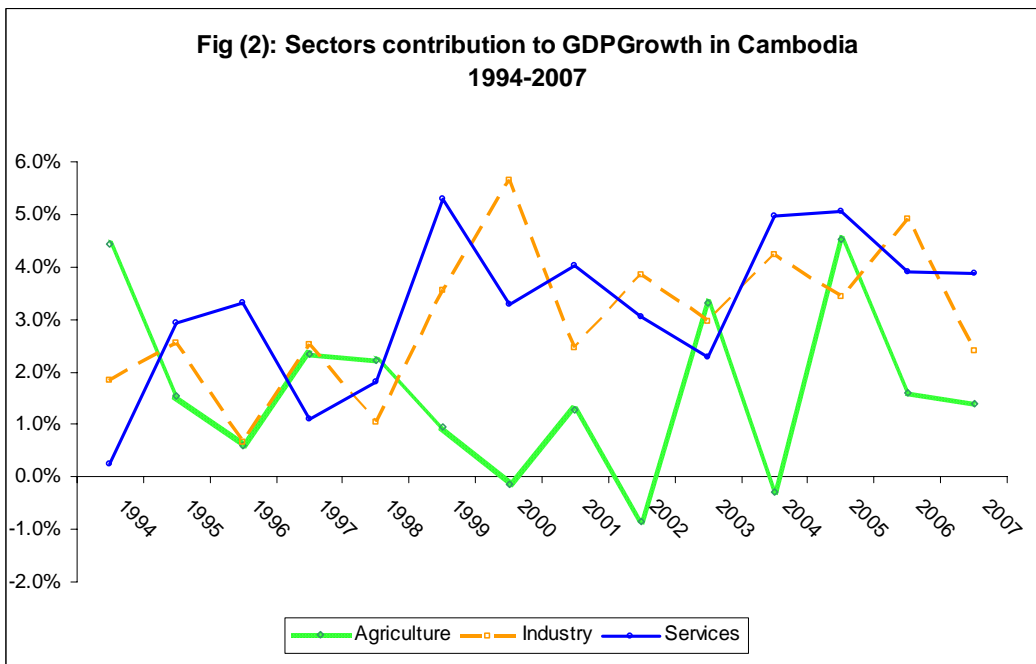
To assess the possible impact of crisis on growth, it would be useful first to look into GDP and sectoral growth in Cambodia as well as contribution of different sectors to the overall growth in the country; figure (1) shows the sectoral growth performance and GDP growth in Cambodia, while figure (2) illustrates sectoral contribution to overall growth.

Over 1994-2007 Cambodia experienced a GDP growth rate averaging around 10%. Most of this is attributed to the substantial growth in industry and then service sector. Industrial growth was driven by the considerable growth of garments and construction. Service sector growth is due to tourism.

Figure (2) illustrates the sectoral contribution to overall GDP growth. Both industry and services have made considerable contribution to GDP growth; agriculture's contribution, as shown, has been rather limited until recently. The sectoral growth in the case of agriculture has also been more unstable.



Source: NIS



Source: Generated based on the NIS data.

Given this picture, the impact of the financial crisis on the growth of GDP in Cambodia is likely to be severe. Predictions are that industrial and service sector growth will be hardest hit. Industrial growth is driven by garments and construction, both of which have already experienced reversals that are expected to worsen near term; output in both sectors is expected to fall by a quarter. Tourism is likely to face similar shortfalls. The combined decline in these sectors is expected to pull down GDP growth; most analysts expect growth to fall to half the average for the last decade. As the GFC unfolds however, forecasters seem to become more pessimistic. Most recent forecasts predict a negative overall growth of GDP for Cambodia this year.

Agriculture over the last few years has recorded a growth rate of around 5% per annum; this is not likely to change much given that external demand for agricultural produce is rather limited. If the right policies are adopted to support the sector, agriculture may lift both growth and the rate of poverty reduction.

2.2 Impact of GFC on poverty in Cambodia:

Given the recent impressive growth, poverty reduction should have been much higher than the 10% point reduction achieved over the period. The reason for this lies in the limited linkages between the growth poles and the rest of the economy. The greatest contributions that the growth sectors make to the economy is in employment, 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 its impact 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 the larger families that these individual support through remittances. Large proportions of rural migrants to urban areas send remittances back to their villages.

In addition to rural-urban migration, about a quarter of a million of labour force in Cambodia migrates to other countries, mainly Thailand. A large portion of these migrants are likely to lose their jobs due to the effects of GFC in host countries. Migrants to Thailand are likely to face a more serious problem. Over 80% of migrants to Thailand are illegal. Thai authorities have announced that they will send illegal migrants back to their home country. This would have serious implications for the remittances from Thailand and subsequently the well being of households. Remittances cover not only part of consumption of households but also their expenditure on physical and human capital.

Reduced growth, especially to the extent predicted by the most recent forecasts, would have 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 CDRI published last year shows this vulnerability very clearly. In some of the study villages a change of income by a couple of hundred Riels would have made considerable difference to the level and severity of poverty. The same study also 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 GFC, poor and vulnerable groups are likely to be hit hard because of slow down in economic activities. GFC 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 would affect a much larger section of the population. 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.

Overall therefore, as a result of GFC, 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 US and EU and how well they can cope with the crisis, and importantly by the reaction of the RGC and its development partners.

3. Policy options to cope with the adverse effects of GFC:

A study just published by the IMF classifies Cambodia amongst the most exposed countries within the Low-Income Countries. The exposure is measured as vulnerability of households to the increased risk of poverty and hardship that may be caused by GFC. If the case then, it is important that the key players in the policy arena in the country can play effective roles in order to reduce the impact of GFC on the poor in the immediate to short run and put in place policies to reverse the downward pressures on growth and poverty in the medium to long term.

In the immediate to short term, government and other players should ideally put in place mechanisms to support the poor and vulnerable. This support could come in the form of food for work, food subsidies, school meals, food vouchers and the like. It would also be a good time to put in place an effective social safety net programme. This will not only help the poor, but be good for the economy and social and political stability and cohesion.

A number of constraints however make such a contribution less likely. Although relatively well placed in terms of monetary and fiscal policies, the RGC does not have sufficient fiscal and monetary capabilities to adopt the expansionary policies required. The fixed exchange rate considerably reduces the role that monetary policy can play. The government also has limited options in applying expansionary fiscal policies. Its capacity is limited in both funds for fiscal stimulus and capacity to implement such policies. Other actors, such as development partners however, can play a more significant role. Given the economic environment at present however that may not be forthcoming, although in its recent meeting in Jakarta, ASEAN members gave a

mandate to Indonesia to present a strong case for supporting poor countries in the meeting of G22 in April.

Longer term, steps should be taken to improve food security and reduce vulnerability. It is important to put in place policies that encourage a more inclusive growth, so that a larger portion of the population can share the fruits of growth. Given the present stage of development, a strategy to reduce the constraints and pressure on agriculture seems to be the best strategy. There are many other constraints. Given the limited physical, financial and human resources to address these, it is important to be selective, implementing policies to relax the most limiting constraints. These limitations seem to be most severe in the case of physical and social infrastructure. Cambodia is one of the least competitive countries in the region partly because of its high production and trade costs. Addressing infrastructure limitations is likely to improve Cambodia's competitiveness.

4. Conclusion:

Although the adverse effects of the GFC for Cambodia are likely to be severe, it also offers an opportunity to the RGC to consider more carefully its development strategy. A core component should be a more effective and cohesive agricultural development; a development strategy that addresses serious limitations and constraints in that sector. These limitations include insufficient investment in physical and social infrastructure; lack of linkages between agriculture and the rest of the economy; as well as problems associated with marketing; these are all interlinked. Addressing them would have considerable impact on both growth and the level and severity of poverty. It may be advisable in particular to pay more attention to removing barriers to production and sale of rice, internally and internationally. The rice surplus in the country is over 2 million tons per year; with improved irrigation alone the surplus could potentially be doubled. Unlike most agricultural products, price of rice internationally has been increasing continuously over the present decade; in spite of a drop from its highs recently, it is still above what it was last year. Revenue raised through this channel alone could make substantial contribution to the economy.

Thank you