



# DRIVING FORCES OF FUTURE CAMBODIA'S ECONOMIC GROWTH

By Senh Senghor



## 1. Background

Cambodia embarked upon a process of economic liberalisation in the early 1990s, replacing central planning with a market economy. Prior to the global economic recession that began in late 2008, Cambodia was experiencing tremendous economic growth, ranking as a star growth performer in the East Asian region. From 1993 to 2013, Cambodia achieved rapid average annual growth of 7 percent, and GDP per capita increased from just USD251.4 in 1993 to USD1006.8 in 2013 (World Bank 2014).

The main drivers of growth are tourism, construction, garments and paddy. These sectors are highly sensitive to the external economic situation and weather conditions. Even for textiles and garments—a stand-out performer in the industrial sector—only low-end products are exported. Cambodia has also made little progress in diversifying its exports of goods and services. Nevertheless, in recent years it has managed to diversify its export markets, shifting from sole reliance on the United States to potential markets in the European Union, Canada and other Asian countries. Estimates by the Ministry of Economy and Finance (MEF 2015) indicate moderate growth rates of around 6–7 percent in coming years. Cambodia is now preparing its growth path to the next middle-income layer. Future prospects for sustainable growth centre on the country's ability to diversify its sources of growth to higher value-added and less vulnerable sectors. It is noteworthy that expected revenues from oil and gas production in the Gulf of Thailand could

significantly change Cambodia's fiscal stance. The anticipated revenues will give Cambodia an opportunity to advance its socio-economic development and further reduce poverty.

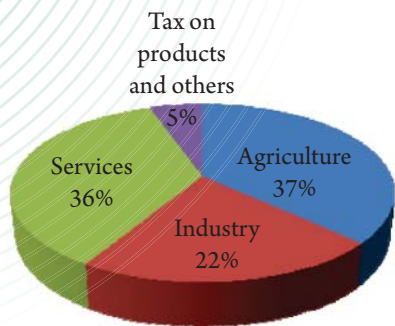
This report summarises the main points concerning Cambodia's future economic growth raised at a series of research workshops and roundtable discussions organised by the Cambodian Economic Association (CEA) in 2014 under Development Research Forum II (DRF II), funded by the International Development Research Centre (IDRC) of Canada. It touches mainly on potential growth drivers that could keep the Cambodian economy on a steady and sustainable growth path. The report is structured as follows. Section 2 presents the characteristics of Cambodia's economic structure and poverty reduction. Section 3 discusses the impacts of Cambodia's integration into regional and global trade dynamics, and Section 4 analyses the implications of potential revenues from oil and gas industry for Cambodia's economy. Section 5 offers some policy implications.

## 2. Cambodia's economic structure and poverty reduction

The Cambodian economy has undergone significant structural change. GDP distribution by sector shows the country remains largely dependent on agriculture and services (Figure 1). Agriculture's GDP share was around 37 percent in 2013 followed by services with 36 percent and industry 22 percent. Tourism industry overwhelmingly dominates the services sector, while paddy is by far the most important crop for Cambodia.

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Figure 1: Cambodia's economic structure

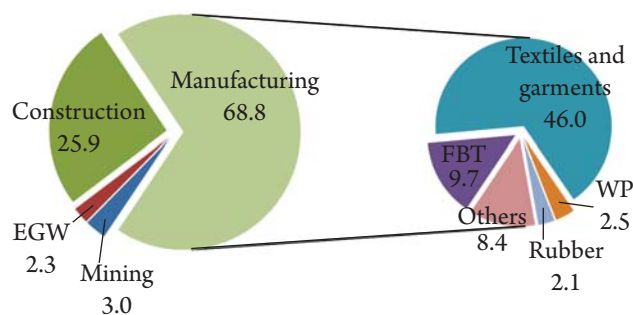


Source: CDC 2013

Figure 2 shows Cambodia's industrial structure by sector. Manufacturing accounts for 69 percent, followed by construction (26.0 percent), mining (3.0 percent) and electricity, gas and water (2.3 percent). Of manufacturing, textiles and garments constitute 46% percent, food, beverages and tobacco represent nearly 10.0 percent, wood and paper 2.5 percent, rubber 2.1 percent and the remaining sectors 8.4 percent. This economic structure reflects the high concentration of Cambodia's economic growth and exports in a narrow production base—textiles, tourism, construction and paddy—that is highly dependent on and sensitive to external market forces and specific climate conditions.

Strong economic growth in the past 10 years has resulted in impressive poverty reduction. Poverty headcount ratio declined steeply between 2004 and 2012, from 53.2 percent to 18.6 percent (Figure 3).

Figure 2: Cambodia's industrial structure by sector



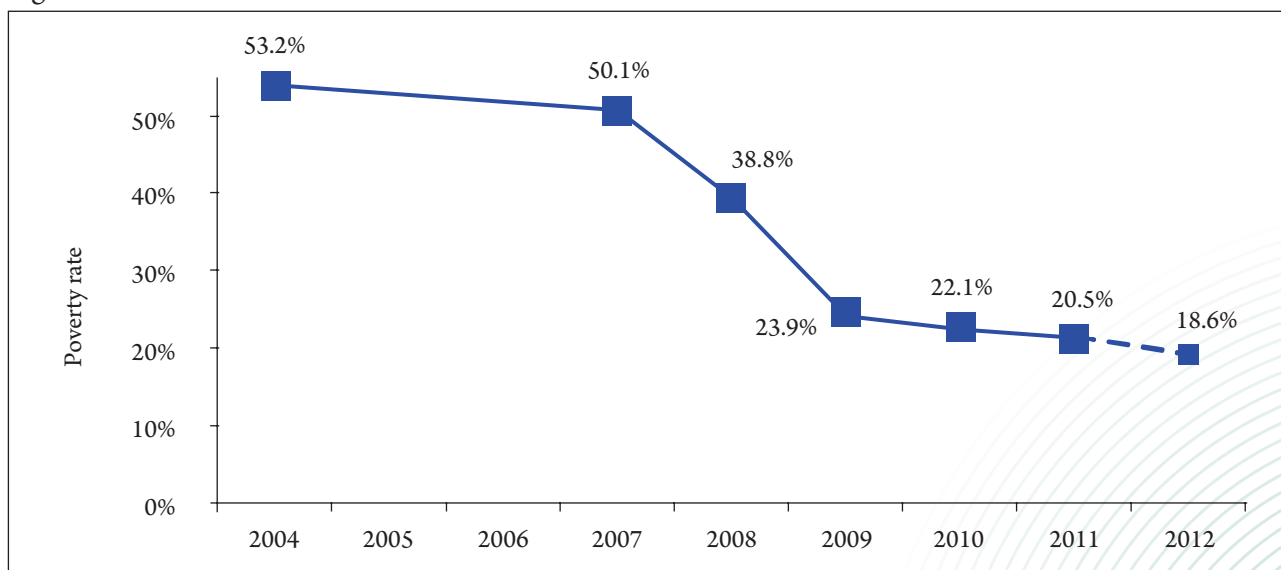
FBT: food, beverages and tobacco; EGW: electricity, gas and water; WP: wood and paper  
Source: CDC 2013

This acceleration in poverty reduction indicates that the country will most likely attain its Millennium Development Goal on poverty eradication. However, these gains in poverty reduction have been concentrated in Phnom Penh and other urban areas. Cambodia's poverty incidence remains a rural phenomenon. There is also concern that the fruits of economic growth are not shared equitably across all households, especially rural households, though growth has helped reduce poverty to some extent in rural areas. Furthermore, those who have just emerged from poverty are highly vulnerable: even very small shocks could quickly push them back into poverty.

### 3. Trade integration and impacts

Cambodia has embraced a series of trade liberalisation measures to fulfil its commitment to freer trade in accordance with ASEAN Free Trade

Figure 3: Headcount ratio from 2004 to 2012



Source: World Bank 2013

Area (AFTA), World Trade Organisation (WTO) and other regional trade agreements.<sup>1</sup> The country is now deepening trade integration with ASEAN and its trading partners, including Japan, China, India, Australia, New Zealand and South Korea. Cambodia has an obligation to set its tariff at zero (excluding sensitive products) with China by 2015, South Korea and India by 2018, New Zealand and Australia by 2024, and Japan by 2026 (Table 1).

Amid strong economic growth, there is a concern that benefits of international trade have exacerbated inequalities in income distribution (CDC 2002). This raises a number of crucial issues related to social goals such as: How are different household groups, especially the poor, affected by the ongoing tariff elimination measures? Are complementary policies needed to ensure that Cambodia's trade policies proceed in a more equitable manner?

Research results<sup>2</sup> have shown that tariff removal induces falling import and consumer prices, resulting in expansion of output and trade volumes. Government policy for indirect tax-led revenue compensation has resulted in a change in structural production output favouring manufacturing industry rather than agriculture and services. These manufacturing sectors include textiles, basic metals, fabricated metal products, machinery and equipment, office machinery and computers. Tariff removal favours the textiles industry as it

is less protected and has access to now cheaper intermediate inputs. This industry will continue to be the backbone of growth and job creation over the short to medium term.

Table 2: Macroeconomic impacts

Indicator	Simulation (% change from baseline)
Output	0.50
Real GDP	0.65
Export	0.97
Import	1.50
Investment	3.26
Consumption	0.44
Consumer price index	-0.61

Table 3: Sectoral impacts

Sector	Simulation (% change from baseline)		
	Import	Export	Output
Agriculture	3.82	0.01	-0.48
Textiles	1.02	0.52	1.21
Other industries	1.19	1.03	0.21
Services	2.39	0.46	0.02

With regard to local labour market effects, high- and medium-skilled workers benefit more from tariff elimination. Welfare gains go to every household group, though they are slightly lower for rural households. Trade liberalisation is pro-urban and pro-Phnom Penh.

Table 1: Tariff commitments under FTAs between ASEAN and its dialogue partners

ASEAN FTAs with	Schedule of zero tariff rates (excluding sensitive product lists)					
	2010	2011	2015	2018	2024	2026
China	ASEAN 6		CLMV			
India		ASEAN 5 (except the Philippines)		Cambodia		
South Korea	ASEAN 6			Cambodia		
Japan				ASEAN 6		CLM
Australia	ASEAN 6				Cambodia	
New Zealand					Myanmar	

CLMV: Cambodia, Laos, Myanmar, Vietnam

Source: WTO 2011

- Section 3 draws on "Impacts of Cambodia's Tariff Elimination on Economy and Households", a research presentation by CEA in May 2014, and a Roundtable on "Cambodia's Trade Policy in the Context of AEC 2015", which was joined by HE Sun Chanthol, Senior Minister, Minister of Commerce, in November 2014.
- This research was carried out by Heng Dyna and Senh Senghor, CEA, with financial and scientific support from the Partnership for Economic Policy (PEP) ([www.pep-net.org](http://www.pep-net.org)) with funding from the Department for International Development (DFID) of the United Kingdom (or UK Aid) and the International Development Research Centre (IDRC) of Canada.

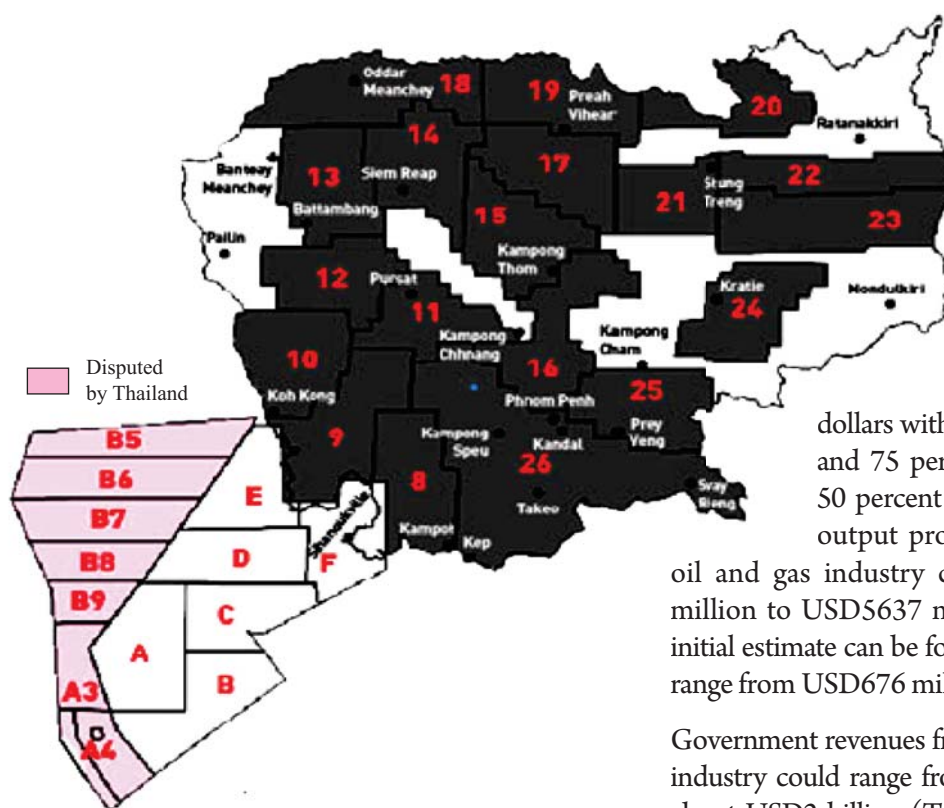
Table 4: Household welfare impacts

Households	Equivalent variation (welfare proxy index)
Rural	0.31
Urban	1.90
Phnom Penh	5.73
Cambodia	1.67

#### 4. Potential oil and gas revenues

A provisional but conservative estimate indicates that Cambodia has significant oil and natural gas resources in the four exploratory wells of Block A (see Figure 4).<sup>3</sup> Chevron has confirmed that it could contain as much as 500 million barrels of recoverable oil and three trillion cubic feet (85 billion cubic metres) of gas. Block A is not the only block in which potential oil and gas reserves have been found. Later, in 2007, China Petrotech Holdings completed a seismic survey of the 360 square kilometres of Block D and concluded that total reserves could be as much as 227 million barrels of oil and 496 billion cubic feet (14 billion cubic metres) of gas (Kunmakara and Mullins 2010).

Figure 4: Location of Cambodia's oil and gas deposits



Source: Cambodia National Petroleum Authority (CNPA)

Together with other blocks covering 37,000 square kilometres, there could be as much as two billion barrels of oil and 10 trillion cubic feet (283 billion cubic metres) of gas. According to a previous survey and exploration results, there is also a potential area of overlapping claims (UNDP 2006).

Oil and gas extraction in areas adjacent to the Gulf of Thailand add to the optimism that oil and gas reserves in the overlapping claims area could be quite large. The 27,000 square kilometres could contain up to 11 trillion cubic feet (311 billion cubic metres) of natural gas and undetermined quantities of condensate and oil, according to some estimations (Robinson n.d.). Initial estimates, especially for Blocks B, C, E and F, will remain uncertain until companies exploring these areas release further results. Nevertheless, these estimates to some extent can act as a benchmark to forecast the potential impacts on Cambodia's economy during the production stage.

The findings shown in Figure 5 provide a complete picture of the direct, indirect and induced effects of oil and gas industry on Cambodia's economy. In terms of total annual output, the total effects on the economy of oil and gas production could be as low as

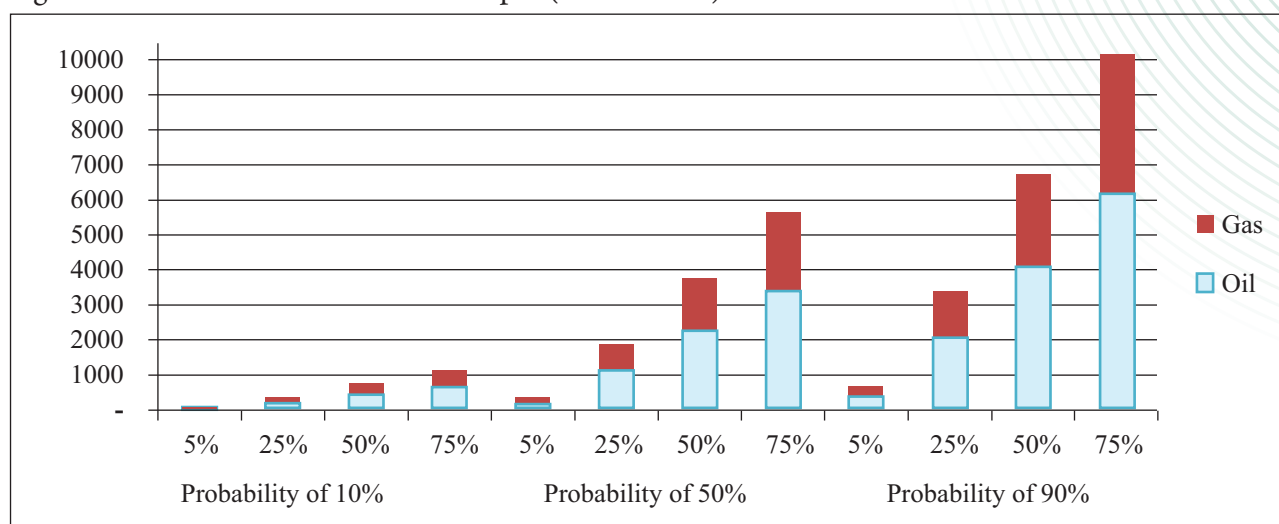
USD46 million and as high as USD10 billion. With a probability of 10 percent (which means that only 10 percent of initial estimates can be found), the total effects of the oil and gas industry combined could be 75, 376, 752 and 1127 million US

dollars with recovery factors of 5, 25, 50 and 75 percent, respectively. Assuming 50 percent probability, the total annual output produced and induced by the oil and gas industry could range from USD376 million to USD5637 million. If 90 percent of the initial estimate can be found, total annual output will range from USD676 million to USD10,147 million.

Government revenues from the upstream oil and gas industry could range from about USD15 million to about USD2 billion (Table 5). Oil and gas industry is a risky business with a low success rate. Thus it

3 This section summarises a presentation on "The Potential of Petroleum Industry in Cambodia: Policy Implications for Sustainable Growth" delivered by Dr Sim Piseth at the 2014 Development Research Forum Symposium, Hotel Cambodiana, Phnom Penh, 11-12 September 2014.

Figure 5: Total effects on total annual output (USD million)



is better to expect average-case estimates. What the government can therefore expect is average annual revenue flows of about USD400 million. However, revenues at the beginning and the end of production will be much smaller than revenues during mid-term production.

In the future, Cambodia should anticipate that oil and gas industry could open up new opportunities in its upstream sector. With production over a 20-year period, annual oil and natural gas extraction could serve as another main source of economic growth. However, national income from oil and gas industry will be small and mainly flow through government revenues.

## 5. Way ahead

Having discussed the potential driving forces of Cambodia's future growth, we believe the following suggestions merit consideration by government and stakeholders.

### Trade liberalisation

- As agriculture is negatively affected by tariff elimination, efforts should be made to support the sector (e.g. through infrastructure development and tax exemptions).

- Government can help low-skilled workers by providing training programs and instituting an income tax system that does not overburden low-income households.
- Households in rural areas should be a priority of government complementary policy help (e.g. social protection policy).

### Oil and gas revenues

- Policy making should not focus on whether a resource curse exists or not. Given Cambodia's meagre oil and gas resources, policy makers and advisors should instead focus on revenue management in a way that provides long-term benefit rather than windfall profit.
- Efforts should be made to create linkages from oil and gas production to domestic sectors to generate income and to create jobs in other sectors.
- Government should not get directly involved in downstream sectors that represent high risk and low returns.

Table 5: Government revenues from the oil and gas industry's upstream sector

Total government revenues	Revenues (USD million)	Share of total revenues and grants (%)
Worst-case scenario with 10% confidence level and 5% recovery factor	14.99	0.9
Average-case scenario with 50% confidence level and 25% recovery factor	400.65	22.9
Best-case scenario with 90% confidence level and 75% recovery factor	2163.51	123.8

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## About DRF

The Development Research Forum (DRF) of Cambodia was established following the All-Partners Forum organised by the International Development Research Centre (IDRC) of Canada in September 2007.

The DRF vision is of a high capacity, professional and vibrant Cambodian development research community. Its goal is to support and strengthen the capacity of the Cambodian development research community.

The DRF partnership involves the Cambodia Development Resource Institute (CDRI), Cambodian Economic Association (CEA), The Learning Institute (LI), National Institute of Public Health (NIPH), Royal University of Agriculture (RUA), Royal University of Phnom Penh (RUPP), Supreme National Economic Council (SNEC) and the International Development Research Centre (IDRC) of Canada.

In DRF Phase II 2012-15, with financial support from IDRC, the partners intend to work together to build research culture and capacity and to share research knowledge through workshops, policy roundtables and symposiums as well as training and online discussion ([www.drfcambodia.net](http://www.drfcambodia.net)) on six research themes: growth and inclusiveness, governance of natural resources, social policy – education, social policy – health, agricultural development, and Cambodia and its region.

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