

Regional Economic Integration for Sustainable Development in Cambodia

Working Paper 5

Toshiyasu Kato, Chan Sophal & Long Vou Piseth



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This working paper stems from an international conference on Cambodia: Challenges and Options of Regional Economic Integration hosted by the Cambodia Development Resource Institute from 27 to 28 October 1997. A separate volume of Cambodia-specific conference papers is also available from the Cambodia Development Resource Institute.

Abstract

This working paper discusses the implication of regional economic integration for Cambodia's sustainable development. The ultimate goal of economic integration is reconstruction and development in Cambodia, but the links between ASEAN/AFTA and Cambodia's long-term sustainable development have been paid relatively little attention. What is the nature of regional economic integration? How, and to what extent, will joining AFTA affect Cambodia's sustainable development? What are challenges of translating the benefits of regional economic integration effectively and efficiently into sustainable development? What are policy options to meet the challenges of regional economic integration?

These are the questions that this working paper seeks to answer. Discussions are centred around growth with equity and poverty eradication, human resource development, agriculture and rural development, service and industrial sector development, and the environment. The main contention of this working paper is that the establishment of policy coherence and coordination within the Cambodian government is the critical factor for the success or failure of regional integration in Cambodia.

Glossary

Acronyms

AFTA	ASEAN Free Trade Area
ASEAN	Association of Southeast Asian Nations
CEPT	Common Effective Preferential Tariffs
CIB	Cambodia Investment Board
EC	European Community
EU	European Union
FAO	Food and Agriculture Organisation
FDI	foreign direct investment
FTA	free trade area
GATT	General Agreement on Tariffs and Trade
GDP	gross domestic product
GNP	gross national product
GSP	generalised system of preferences
HIV	human immuno-deficiency virus
HS	Harmonised System
ICN	Internal Coordination Network
IDS	Institute of Development Studies
MFN	most favoured nation
NAFTA	North American Free Trade Area
NBC	National Bank of Cambodia
NGO	non-governmental organisation
NT	national treatment
PTA	preferential trade arrangement
RCA	revealed comparative advantage
RCAX	revealed comparative advantage of exports
SEATE	Southeast Asian transitional economy
SITC	Standard International Trade Classification
SME	small- and medium-size enterprise
UAP	unprocessed agricultural product
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Programme
UNRISD	United Nations Research Institute for Social Development
WTO	World Trade Organisation

Acknowledgements

This paper is a synthesis of our two earlier works presented at Cambodia Development Resource Institute international conference on *Cambodia: Challenges and Options of Regional Integration*, held from 27 to 28 October 1997 in Phnom Penh. An earlier version of this working paper was also presented at an ASEAN-ISIS conference on *Cambodia's Future in ASEAN*, held in February 1998 in Phnom Penh.

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Regional Economic Integration for Sustainable Development in Cambodia

Introduction

Cambodia embarked on its transition from a command- to a market-oriented economy in the midst of the globalisation of the world economy. It has already taken extensive unilateral liberalisation measures regarding trade and investment in the past few years. Although full membership in the Association of Southeast Asian Nations (ASEAN) was temporarily postponed in July 1997, Cambodia is committed to integrating itself with the ASEAN economies. The government has also taken steps to prepare for accession to the World Trade Organisation (WTO). Cambodia is without doubt accelerating the pace of its integration with the regional and world economies.

Although economic integration is expected to bring new opportunities for Cambodia, it also poses new challenges for policy-makers. A handful of developing countries have benefited enormously from integrating themselves with the world economy in the past three decades. Policy-makers in these countries managed to successfully translate the benefits of economic integration into raising people's standards of living. A large number of developing countries, however, have not reached the same level of success. Some countries apparently have failed to translate the force of globalisation and integration into the development of their own countries. Few would disagree that government policies towards economic integration are critical to the success or failure of development in Cambodia.

This paper will discuss the implications of regional economic integration for Cambodia's sustainable development. The ultimate goal of economic integration is the reconstruction and development of Cambodia, but the links between ASEAN/AFTA (the ASEAN Free Trade Area) and long-term sustainable development in Cambodia have been given relatively little attention. What is the nature of regional economic integration, particularly *vis-à-vis* AFTA? How, and to what extent, might joining AFTA affect Cambodia's sustainable development? What are the challenges to translating the benefits of regional economic integration into sustainable development in Cambodia? What are the policy options to meet these challenges of regional economic integration? These are the questions that this paper seeks to answer.

The paper is organised as follows: Section One discusses the concept of economic integration with special reference to ASEAN/AFTA. It seeks to understand the nature of

AFTA in a general context of economic integration. Section Two investigates the structure of trade and investment in Cambodia. This section also presents a cross-country study of the revealed and potential comparative advantage of Cambodia and the ASEAN countries. Building on the analysis above, Section Three discusses key issues and challenges to achieving sustainable development in Cambodia. The issues and challenges include: 1) equitable economic growth; 2) agricultural and rural development; 3) industrial and service sector development; and 4) environment. Section Four reviews Cambodia's current policies towards the challenges discussed in Section Three, and seeks policy options to meet them.

1. Regional Economic Integration

1.1. Concepts of Economic Integration

Economic integration comprises legal arrangements among nations for economic transactions and activities across national boundaries. Regional integration is a type of economic integration in which a set of nations within a certain region form preferential arrangements, typically on international trade. The word "preferential" is key to understanding regional integration, as it implies that such agreements are extended only to the nations which signed the agreement.

Regional integration may be classified in two broad categories: 1) modest regional integration and 2) deep regional integration (de Melo & Panagariya 1993). Modest integration seeks only a preferential trade arrangement (PTA) or free trade area (FTA). Under a PTA, lower tariffs are imposed on imports from member countries than on imports from the rest of the world. An FTA is one step forward from a PTA, in that tariffs on imports from members are reduced to zero, whereas those from the rest of the world remain at pre-agreement levels. The ASEAN Free Trade Area (AFTA) is actually a case of modest integration. Deep integration envisages either a customs union, in which members set a common external tariff, or a common market, in which free movement across national boundaries is established for capital, labour, services and firms, in addition to the trade of goods. The single market of the European Union (EU) is an example of deep regional integration.

Economic integration can be arranged beyond the regional level. In fact, after the Second World War, multilateral trade agreements have been negotiated and implemented by the General Agreement on Tariffs and Trade (GATT), which evolved recently into its successor, the WTO. The general principle of GATT/WTO is characterised by non-discrimination, which is stipulated in two clauses: most favoured nation (MFN) and national treatment (NT) (WTO 1995). MFN is concerned with non-discrimination among imported goods from different countries. It essentially means that members are bound to grant treatments to the products of other members which are no less favourable than those accorded to the products of any other member countries. NT is concerned with non-discrimination between imported and domestically produced goods. It requires all members to treat imported goods no less favourably than the equivalent domestically produced goods, once goods have entered the markets of member countries. It is well recognised that tariff reductions based on the non-discriminatory approach of GATT/WTO have been a major driving force in the expansion of world trade in the last four decades.

It should be noted that regional trading arrangements such as AFTA involve a discriminatory element against non-members. This is because preferential treatments are applicable only to member countries. In this sense, regional integration contradicts the non-

discriminatory principle of MFN treatment in GATT/WTO. However, regional trading arrangements in the form of customs unions and FTAs are exempted from the MFN clause under GATT/WTO, for the reason that closer integration within regional countries is expected to promote freer trade.¹ In either case, regional arrangements are required to treat non-members no more restrictively than before the arrangement was formed.

1.2. ASEAN Free Trade Area (AFTA)

The formation of AFTA was primarily a response of the ASEAN countries to the emergence of regionalism in North America and Europe in the late 1980s. In North America, bilateral negotiations for a free trade area between Canada and the United States resulted in agreements in 1989, which were further extended to include Mexico in the North American Free Trade Area (NAFTA). In Europe, the European Community (EC) reached agreement to create a single market in 1992. ASEAN countries were concerned that they would be diverted from the North American and European markets, and thus saw the need to expand regional markets to maintain the dynamic growth and development of previous decades. Indeed, international trade within the ASEAN countries, called intra-ASEAN trade, represented only a small portion of total ASEAN trade. For instance, intra-ASEAN exports accounted for only 17.8 percent and 18.5 percent of total ASEAN exports in 1980 and 1990 respectively (UNCTAD 1996). It is clear from these figures that the ASEAN countries relied heavily on international trade with countries outside the Southeast Asian region, such as the United States, the EU and Japan. Another factor which motivated ASEAN to form its free trade area was the adoption by individual member countries of liberal trade and investment policies, particularly the promotion of foreign investment, since the 1980s. The similarity of the policies in the regional countries helped the emergence of common interests to attract foreign investment (Tan 1996).

The implementation of the Common Effective Preferential Tariffs (CEPT) scheme was the main mechanism for AFTA's creation.² Under the CEPT scheme, all member countries are required to reduce import tariffs to levels below 5 percent within 10 years, and to remove non-tariff barriers such as quotas and licences. The CEPT agreement covers a broad range of items, including manufactured and agricultural goods. It should be noted that the service sector is not included in the CEPT scheme. In addition, each member country is allowed to submit exception and exclusion lists of certain products. Tariff concessions from other ASEAN countries are granted to a country if: 1) the product satisfies the ASEAN content requirement of 40 percent; 2) the product has been in the inclusion list of both export and import countries and has a tariff rate of 20 percent or below; and 3) the product has a programme of tariff reductions approved by the AFTA Council.

Cambodia's preparation for full membership in ASEAN/AFTA began in 1996. The initial package of CEPT product lists was prepared by the National AFTA Unit and relevant ministries, and submitted to the Senior Officials Meeting of ASEAN in late July 1997.³ The package was expected to be implemented from January 1998. The delay in Cambodia's entrance to ASEAN, however, postponed its implementation indefinitely. The number of tariff lines in the inclusion list of CEPT came to 3,149, 47 percent of total tariff lines in Cambodia.⁴ This is relatively high in comparison with 15 percent in Laos, 28 percent in Vietnam, and 43 percent in Myanmar in July 1997. The tariff lines in the inclusion list were scheduled to be lowered gradually to between 0 and 5 percent over 10 years.

¹ Whether regional integration would enforce or undermine the effectiveness of the multilateral trading system envisaged by GATT/WTO has been the subject of renewed interest among economists recently. See de Melo & Panagariya (1993), Bhagwati & Panagariya (1996), Sampson (1996), and Levy & Srinivasan (1996).

² A succinct description of the CEPT scheme can be found in Keat & Aun (1996).

³ The initial package of CEPT product lists and strategies of tariff reductions are discussed in detail in Kun (1997).

2. Potential Impact on Trade, Investment and Growth in Cambodia

The essence of the CEPT scheme under the AFTA agreements is the reduction of import tariffs and the elimination of non-tariff barriers on trade in goods within ASEAN. This implies that joining AFTA will affect prices of Cambodia's traded products, both exports and imports, with the ASEAN countries. Joining AFTA will also affect incentives for foreign investors in Cambodia, as Cambodia could potentially be a platform for foreign investment aimed at ASEAN markets. It is therefore necessary to analyse patterns of foreign trade and investment in Cambodia to assess the potential impact of joining AFTA.

2.1. Trade Patterns

The total value of international trade in Cambodia increased dramatically as a result of various trade liberalisation measures undertaken early in the 1990s. In 1995, the exports and imports of goods and services in Cambodia accounted for between 35 and 50 percent of GDP respectively (Table 2.1). These figures are similar to those of Vietnam, the Philippines and Thailand in the same year. Cambodia implemented trade liberalisation only recently, but it has already achieved a fairly open trade regime in the region. In Cambodia, the share of current account deficits in GDP was 7 percent in 1995. This was a better current account deficit position than that of Laos (13 percent) and Vietnam (10 percent). A large amount of unilateral currency transfer in the form of grants and non-repayable external assistance,

Table 2.1. Trade and Current Accounts, 1995 (millions of dollars)

	Goods and services ^a				Net factor		Net transfer		Balance of	
	Exports		Imports		income				current a/c	
Cambodia ^b	969	(35)	1,375	(50)	-57	(-2.1)	277	(10.0)	-186	(-7)
Laos	445	(25)	666	(38)	0	(0.0)	-3	(-0.2)	-224	(-13)
Myanmar	1,120	-	1,669	-	-101	-	312	-	-339	-
Vietnam	7,272	(36)	9,459	(46)	-310	(-1.5)	477	(2.3)	-2,021	(-10)
Indonesia	51,160	(26)	53,244	(27)	-5,778	(-2.9)	839	(0.4)	-7,023	(-4)
Philippines	26,795	(36)	33,317	(45)	3,662	(4.9)	880	(1.2)	-1,980	(-3)
Malaysia	81,692	(96)	86,248	(101)	-3,673	(-4.3)	163	(0.2)	-4,147	(-5)
Thailand	70,292	(42)	82,219	(49)	-2,114	(-1.3)	487	(0.3)	-13,554	(-8)
Singapore	148,394	(177)	134,028	(160)	1,615	(1.9)	-888	(-1.1)	15,093	(18)

^a Percentage share of GNP shown in parenthesis; ^b Cambodia's export value includes re-exports

Source: World Bank, *World Development Indicators 1997*

which accounted for 10 percent of GDP, helped offset the large Cambodian trade deficit.

Trade performance by sector

Table 2.2 summarises import patterns of Cambodia in 1995–96.⁵ Machines and transport equipment (SITC 7) such as motorcycles, automobiles, televisions and video cassette recorders accounted for the largest portion (34 percent) of total imports in 1996. Basic manufactures (SITC 6) such as construction material, fabric, cement and steel totalled 20 percent of imports, followed at 14 percent by mineral fuels (SITC 3) such as petrol, diesel oil, fuel oil and lubricants.

Cambodia's export patterns by sector are also presented in Table 2.2. Crude materials excluding fuels (SITC 2), which includes rubber and wood (logs and sawn timber), made up the largest proportion of exports from Cambodia. The export of crude materials accounted

⁵ Robertson & Pohoresky (1997) compiled customs data for Cambodia in 1995 and 1996 and classified them using Standard International Trade Classification (SITC). Our presentation of trade data relies on their data

Table 2.2. Cambodia's Trade Patterns by Industry, 1995 and 1996 (thousands of dollars)

SITC	Sector	1995	Share (%)	1996	Share (%)
Imports					
0	Food and live animals	77,108	7.2	70,062	7.0
1	Beverages and tobacco	41,767	3.9	46,553	4.7
2	Crude materials (excluding fuels)	24,444	2.3	29,785	3.0
3	Mineral fuels, etc.	127,001	11.8	142,700	14.3
4	Animal, vegetable oil, fat	3,785	0.4	6,669	0.7
5	Chemicals, related products	57,811	5.4	75,227	7.5
6	Basic manufactures	161,946	15.1	197,005	19.7
7	Machines, transport equipment	249,750	23.2	341,466	34.1
8	Miscellaneous manufactured goods	45,915	4.3	51,151	5.1
9	Goods not classed by kind	285,898	26.6	39,984	4.0
	Total	1,075,425	100.0	1,000,602	100.0
Exports					
0	Food and live animals	7,027	4.5	5,644	3.5
1	Beverages and tobacco	3,415	2.2	6,521	4.0
2	Crude materials (excluding fuels)	97,326	62.2	75,236	46.1
3	Mineral fuels, etc.	-	0.0	60	0.0
4	Animal, vegetable oil, fat	-	0.0	5	0.0
5	Chemicals, related products	591	0.4	194	0.1
6	Basic manufactures	12,676	8.1	18,222	11.2
7	Machines, transport equipment	6,068	3.9	6,286	3.9
8	Miscellaneous manufactured goods	29,460	18.8	29,115	17.8
9	Goods not classed by kind	1	0.0	21,911	13.4
	Total	156,564	100.0	163,194	100.0
Re-exports					
0	Food and live animals	7	0.0	20	0.0
1	Beverages and tobacco	205,135	81.6	205,405	89.2
2	Crude materials (excluding fuels)	17	0.0	-	0.0
3	Mineral fuels, etc.	-	0.0	-	0.0
4	Animal, vegetable oil, fat	-	0.0	-	0.0
5	Chemicals, related products	10	0.0	114	0.0
6	Basic manufactures	-	0.0	-	0.0
7	Machines, transport equipment	46,083	18.3	24,772	10.8
8	Miscellaneous manufactured goods	3	0.0	-	0.0
9	Goods not classed by kind	-	0.0	-	0.0
	Total	251,255	100.0	230,311	100.0

Source: Robertson & Pohoresky (1997)

for 46 percent of total exports in 1996. The second-largest sector of exports was miscellaneous manufactured goods (SITC 8), mainly garments. This sector represented 18 percent of total exports in 1996. The value of re-exports in Cambodia, mainly shipped to Vietnam, accounted for about \$230 million in 1996. This was even larger than the \$160 million of (domestic) exports in 1996. The items of re-exports were highly concentrated in two sectors: beverages and tobacco (SITC 1) and machines and transport equipment (SITC 7).

Sources and destinations of Cambodia's trade

Tables 2.3 (overleaf) summarises Cambodia's sources of imports by country and area in

Table 2.3. Cambodia: Sources of Imports and Destinations of Exports (thousands of dollars)

	Imports				Exports			
	1995	%	1996	%	1995	%	1996	%
ASEAN	798,799	74.3	743,728	74.3	300,814	80.3	254,351	66.5
Singapore	529,727	49.3	457,689	45.7	173,475	46.3	116,832	30.5
Thailand	133,728	12.4	137,009	13.7	107,265	28.6	109,167	28.5
Vietnam	109,086	10.1	119,630	12.0	13,674	3.7	24,425	6.4
Malaysia	15,462	1.4	19,714	2.0	2,163	0.6	3,127	0.8
Indonesia	9,091	0.8	9,313	0.9	2,757	0.7	532	0.1
Philippines	1,705	0.2	316	0.0	764	0.2	130	0.0
Laos	1	0.0	47	0.0	-	-	84	0.0
Myanmar	-	0.0	12	0.0	717	0.2	55	0.0
Other Asia/Pacific	173,725	16.2	133,131	13.3	38,194	10.2	30,306	7.9
Taiwan	9,186	0.9	42,925	4.3	21,197	5.7	11,508	3.0
Japan	64,112	6.0	32,619	3.3	7,854	2.1	7,601	2.0
China	28,401	2.6	28,409	2.8	3,548	0.9	5,534	1.4
Hong Kong	58,179	5.4	23,833	2.4	5,288	1.4	5,037	1.3
Australia	13,598	1.3	5,210	0.5	308	0.1	617	0.2
New Zealand	249	0.0	136	0.0	-	-	9	0.0
North America	17,406	1.6	15,495	1.5	4,379	1.2	2,066	0.5
United States	17,406	1.6	15,495	1.5	4,379	1.2	2,066	0.5
European Union	44,772	4.2	42,660	4.3	24,566	6.6	92,224	24.1
France	34,443	3.2	18,835	1.9	8,913	2.4	39,613	10.3
Italy	405	0.0	14,840	1.5	9,429	2.5	30,568	8.0
Germany	7,747	0.7	2,581	0.3	3,433	0.9	12,926	3.4
Other EU	2,177	0.2	6,405	0.6	2,791	0.7	9,116	2.4
Other	2,603	0.2	1,524	0.2	499	0.1	924	0.2
Subtotal	1,019,898	94.8	921,044	92.0	364,073	97.2	377,804	98.7
Discrepancy	55,528	5.2	79,558	8.0	10,440	2.8	4,962	1.3
Total	1,075,426	100.0	1,000,602	100.0	374,513	100.0	382,766	100.0

Source: Robertson & Pohoresky (1997)

1995 and 1996. It is clear from the data that ASEAN countries have been by far the largest source of Cambodia's imports in recent years. Imports from Singapore, Thailand and Vietnam accounted for around 70 percent of total imports to Cambodia. Imports from other Asian countries such as Taiwan, China, Hong Kong and Japan were also notable. Imports from the EU were around only 4 percent of total imports in 1995 and 1996.

As for the destination of Cambodia's exports, ASEAN countries again accounted for the largest shares, 80 percent and 67 percent in 1995 and 1996 respectively (Table 2.3). Exports to Thailand were the largest (31 percent in 1996), followed by Singapore's 29 percent in the same year. A notable change in 1995 and 1996 was the expansion of exports to the EU, an increase from 7 percent in 1995 to 24 percent in 1996. This reflected the development of the garment industry, which expanded rapidly after Cambodia received generalised system of preferences (GSP) status from the EU.

2.2. An Analysis of Comparative Advantage

Land and population, in economic terms, comprise the fundamental factor endowments for the economic activities of a country. The Heckscher-Ohlin theory of international trade posits that the relative abundance of factor endowments determines comparative advantage,

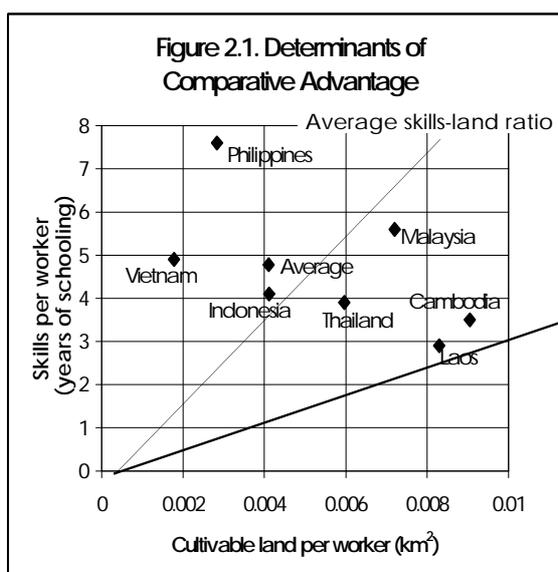
Table 2.4. Resource Endowments, 1995

	Population total thousands	Population density people per sq km	Population growth annual %	Land area thousand sq km	Freshwater resources cubic meters per capita
Cambodia	10,024	57	2.7	177	49,691
Laos	4,882	21	2.8	231	55,305
Myanmar	45,106	69	1.7	658	23,988
Vietnam	73,475	226	2.0	325	5,117
Indonesia	193,277	107	1.5	1,812	13,090
Philippines	68,595	230	2.3	298	4,709
Malaysia	20,140	61	2.4	511	3,073 ^a
Thailand	58,242	114	0.9	329	22,642
Singapore	2,986	4896	1.9	1	201
Brunei	285	54	1.5	-	-

^a Total water resources include river flows from other countries
 SOURCE: WORLD BANK, *WORLD DEVELOPMENT INDICATORS 1997*

and hence trade patterns, of countries. Cambodia is one of the least-populated and relatively land-abundant countries in the region. In 1995, Cambodia had 57 people per square kilometre (Table 2.4). The share of arable land in total land area was 22 percent, the highest after Malaysia's 34 percent. It should be noted, however, that Cambodia's population growth in 1995 was 2.7 percent, one of the highest in the region. In the long term, this trend is likely to decrease the relative land abundance of Cambodia. Another factor which constrains land use in Cambodia is the land area covered by land mines. Cambodia is also endowed with freshwater resources. In 1995, Cambodia held the largest amount of freshwater resources in cubic metres per capita in the region, except for Laos.

The Heckscher-Ohlin theory could be extended to include skills or human resources as a determinant of comparative advantage. Wood (1994) shows empirical evidence from a cross-country study that the proportion of manufacturing exports relative to primary exports was positively correlated with skills-land ratio. Based on the findings, he argues that skills-land ratio is a critical factor in determining potential comparative advantage of countries. Figure 2.1 illustrates relative endowments of cultivable land and skills in Cambodia and selected ASEAN countries (Table 2.5 overleaf summarises the figures).⁶ The Y-coordinate indicates the average years of schooling of working age population as a proxy for skills per worker. The X-coordinate indicates cultivable land (cropland and per-



⁶ The analysis presented here is based on Godfrey (1997).

⁷ Areas excluded from cultivable land are forest, woodland, uncultivated land, wetlands, built-up areas (residential, recreational, industrial lands), and areas covered by roads and other fabricated infrastructure.

Table 2.5. Skills-Land Ratio in Cambodia and Selected ASEAN Countries

	(1)	(2)	(3)	(4)	(5)
	Cultivable land thousands of sq km	Population aged 15-64 millions	Skills per worker year	Cultivable land per worker sq km	Skills-land ratio year/sq km
Cambodia	54	6	3.5	0.0091	387
Laos	17	2	2.9	0.0083	350
Vietnam	73	41	4.9	0.0018	2,751
Indonesia	457	111	4.1	0.0041	995
Philippines	105	37	7.6	0.0028	2,678
Thailand	221	37	3.9	0.0060	654
Malaysia	79	11	5.6	0.0072	778
Total	1,006	245	4.8	0.0041	1,163

(1) 1994 figures. Cultivable land includes cropland and permanent pasture. It excludes forest, wetlands, residential and industrial sites and road

(3) 1992 figures. Skills per worker is proxied by average years of schooling received by a person aged 25 or above

(4) The ratio of column (1) divided by column (2)

(5) The ratio of column (3) divided by column (4)

SOURCES: UNDP, *Human Development Report 1994*; WORLD BANK, *World Development Report 1991*

manent pasture) per working age population.⁷ It is clear from this figure that Cambodia is a country which is the most abundant in cultivable land, but the most scarce—next to Laos—in skills in the region. Skills-land ratio is shown by the line from the origin as indicated in Figure 2.1. As the line from the origin becomes steeper, a country's factor endowments become relatively more skills abundant, and indicate stronger comparative advantage in manufacturing exports relative to primary exports. As Figure 2.1 clearly shows, skills-land ratios in Cambodia and Laos are the lowest in the region, indicating that these countries have potential comparative advantage in exports of primary products.

Although the above analysis of factor endowments is useful in identifying potential comparative advantage, actual trade patterns often diverge from potential comparative advantage for various reasons, such as trade and industrial policies and domestic regulations. Indicators of revealed comparative advantage, which are constructed from actual trade data, help understand the difference between actual and potential comparative advantages. Table 2.6 (see pages 10 and 11) summarises the index of revealed comparative advantage for exports (RCAX) of the top 10 export commodities in Cambodia and the ASEAN countries.⁸ The figures in Table 2.6 indicate that Cambodia's comparative advantage was revealed primarily in natural resource-based products (rubber, wood, timber—SITC 2) and labour-intensive, light manufacturing products (SITC 8) such as garments in 1995 and 1996.

Tables 2.5 and 2.6 raise an important issue regarding Cambodia's agricultural sector. Despite the fact that Cambodia is richly endowed with cultivable land and freshwater resources relative to other regional economies, few agricultural commodities were exported in 1995–96. This contrasts sharply with Thailand, where resource endowments are similar to Cambodia and where a variety of agricultural products had revealed strong comparative advantage. This seems to suggest that Cambodia has potential comparative advantage in agricultural products, and yet the potential comparative advantage has been neither revealed nor developed.

2.3. Foreign Investment Patterns

⁸ Revealed comparative advantage of exports (RCAX) is defined as $RCAX = X_{ij}/X_{iw}$, where X_{ij} is the export share of commodity i in total exports of country j , and X_{iw} is the export share of commodity i in world exports. A country has a comparative advantage in a commodity if the RCAX of that commodity is greater than one.

Cambodia's liberalisation policy was extended to foreign investment in the early 1990s. Cambodia's investment law entered into force in 1994, offering some of the most generous incentives to investors in the region. The liberal investment regime attracted a significant amount of foreign direct investment (FDI) in the 1990s. FDI in Cambodia increased from \$80 million in 1994 to \$240 million in 1996 (World Bank 1997a). Inward FDI stock (i.e. the accumulation

Table 2.7. Inward Foreign Direct Investment, 1995

	FDI inward stock values millions of \$	FDI inward stock as % of GDP
Cambodia*	236	8.5
Laos	225	12.8
Myanmar	38	-
Vietnam	397	2.0
Indonesia	50,755	25.6
Philippines	6,852	9.2
Thailand	16,775	10.0
Malaysia	38,453	45.1
Singapore	55,491	66.3
Brunei	62	1.2

a 1992-95 data

Source: United Nations, *World Investment Report 1996*

of annual FDI inflow) in Cambodia was \$236 million, or 8.5 percent of GDP in 1995 (Table 2.7). The percentage share of FDI stock relative to GDP in Cambodia was higher than that of Vietnam (2 percent) and Brunei (1.2 percent). However, it was still far below that of other ASEAN countries, which had attracted a large amount of FDI during the 1980s and early 1990s.

FDI performance by source country is of considerable interest to researchers and policy-makers who are concerned about whether joining AFTA will affect investment patterns in Cambodia. Table 2.8 summarises the foreign investment projects by country and region which have been approved by the government since 1995.⁹ The ASEAN countries, particularly Malaysia and Singapore, have clearly been major investors since Cambodia adopted a

Table 2.8. Foreign Investment Projects Approved in Cambodia

	Investment Projects (number)				Registered Capital (millions of dollars)				Fixed Assets (millions of dollars)			
	1995	1996	1997	1998*	1995	1996	1997	1998*	1995	1996	1997	1998*
ASEAN	60	60	47	11	1429	104	76	17	1566	286	111	35
Indonesia	1	6	4	2	2	3	2	1	1	13	1	2
Malaysia	21	25	16	3	1361	54	53	8	1421	191	66	20
Singapore	25	19	17	6	44	35	14	9	108	35	16	14
Thailand	12	10	10	0	23	12	7	0	36	46	27	0
Vietnam	1	0	0	0	0	0	0	0	0	0	0	0
Other Asia and Pacific	61	107	150	36	37	172	193	75	38	251	364	93
China	15	31	31	16	10	23	22	56	6	37	36	69
Hong Kong	12	22	34	8	6	12	18	6	13	26	71	6
Taiwan	19	34	63	8	13	125	48	12	14	164	44	16
South Korea	4	7	12	2	4	5	71	2	3	5	189	2
Others	11	13	10	2	3	8	34	0	2	19	23	0
North America	12	7	16	1	46	14	16	0	149	8	97	0
Europe	23	17	20	6	71	67	13	6	213	69	21	7
Middle East	0	0	1	0	0	0	1	0	0	0	0	0

* First quarter figures (January-March)

Source: Cambodia Investment Board

⁹ The available data from the Cambodia Investment Board (CIB), which compiles investment projects approved by the government, should be read with caution as those approved investment projects may not necessarily be actually implemented. It should be also noted that there is a large discrepancy between the CIB's investment

amount of foreign direct investment (FDI) in the 1990s. FDI in Cambodia increased from \$80 million in 1994 to \$240 million in 1996 (World Bank 1997). Inward FDI stock (i.e. the accumulation of annual FDI inflow) in Cambodia was \$236 million, or 8.5 percent of GDP in 1995 (Table 2.7). The percentage share of FDI stock relative to GDP in Cambodia was higher than that of Vietnam (2.0 percent) and Brunei (1.2 percent). However, it was still far below that of

Table 2.7. Inward Foreign Direct Investment, 1995

	FDI inward stock	
	values millions of \$	as % of GDP
Laos	225	12.8
Myanmar	38	-
Vietnam	397	2.0
Indonesia	50,755	25.6
Philippines	6,852	9.2
Thailand	16,775	10.0
Malaysia	38,453	45.1
Singapore	55,491	66.3
Brunei	62	1.2

Source: 1992-95 data

other ASEAN countries, which had attracted a large amount of FDI during the 1980s and early 1990s.

FDI performance by source country is of considerable interest to researchers and policy-makers who are concerned about whether joining AFTA will affect investment patterns in Cambodia. Table 2.8 summarises the foreign investment projects by country and region which have been approved by the government since 1995.⁹ The ASEAN countries, particularly Malaysia and Singapore, have clearly been major investors since Cambodia adopted a new liberal investment regime in 1994. The presence of ASEAN countries as source countries, however, appears to have declined from 1995 to 1997. This is because investment from Hong Kong, Taiwan and Korea increased rapidly during this period.

	Investment Projects				Registered Capital				Fixed Assets			
	(number)				(millions of dollars)				(millions of dollars)			
	1995	1996	1997	1998	1995	1996	1997	1998	1995	1996	1997	1998
ASEAN	60	60	47	11	1,429	104	76	17	1,566	286	111	35
Indonesia	1	6	4	2	2	3	2	1	1	13	1	2
Malaysia	21	25	16	3	1,361	54	53	8	1,421	191	66	20
Singapore	25	19	17	6	44	35	14	9	108	35	16	14
Thailand	12	10	10	0	23	12	7	0	36	46	27	0
Vietnam	1	0	0	0	0	0	0	0	0	0	0	0
Other Asia and Pacific	61	107	150	36	37	172	193	75	38	251	364	93
China	15	31	31	16	10	23	22	56	6	37	36	69
Hong Kong	12	22	34	8	6	12	18	6	13	26	71	6
Taiwan	19	34	63	8	13	125	48	12	14	164	44	16
South Korea	4	7	12	2	4	5	71	2	3	5	189	2
Others	11	13	10	2	3	8	34	0	2	19	23	0
North America	12	7	16	1	46	14	16	0	149	8	97	0
Europe	23	17	20	6	71	67	13	6	213	69	21	7
Middle East	0	0	1	0	0	0	1	0	0	0	0	0

Source: First quarter figures (January-March)

⁹ The available data from the Cambodia Investment Board (CIB), which compiles investment projects approved by the government, should be read with caution as those approved investment projects may not necessarily be actually implemented. It should be also noted that there is a large discrepancy between the CIB's investment data and FDI data in the balance of payments by the National Bank of Cambodia (NBC).

SITC	Industry items	Cambodia	Myanmar	Vietnam	Indonesia	Philippines	Thailand	Malaysia	Singapore	Brunei
034	Fish: fresh, chilled, frozen	2								
036	Shellfish: fresh, frozen		12	38	7	9	13			
037	Fish: prepared, preserved						20			
042	Rice		60	65			33			
044	Maize: unmilled	1								
045	Cereals: unmilled	5								
054	Vegetables: fresh, preserved		30				6			
057	Fruit, nuts: fresh, dried			4		6				
071	Coffee and substitutes			11						
122	Tobacco: manufactured	2								
222	Seeds for "soft" fixed oil	10	12	9						
223	Seeds for other fixed oils									
232	Natural rubber, gum	5			27		30	22		
233	Rubber: synthetic, reclaimed	63								
245	Fuel wood, charcoal	59								
247	Wood: rough, squared	23	71					18		
248	Wood: shaped, sleepers	14	12	7				7		
269	Waste of textile fabrics	15								
287	Base metal ores				7					
292	Crude vegetable material	1								
332	Coal, lignite and peat			9						
333	Crude petroleum			6	4			2		10
334	Petroleum products: refined				2			6		2
341	Gas: natural, manufactured				13			3		41
424	Fixed vegetable oil: non-soft					34		43		
628	Rubber articles	2								
634	Veneers, plywood	8			37					
653	Woven man-made fibre fabrics				5					

752	Automatic data processing equipment						7
759	Office machines: parts, accessories		3				3
761	Television receivers						5
762	Radio broadcast receivers			12			8
763	Sound recorders, phonographs						4
764	Telecom equipment, parts, accessories			2			2
772	Switch gear, parts						1
773	Electrical distributing equipment			5			
776	Transistors, valves			5	2	7	4
778	Electrical machinery						1
831	Travel goods, handbags	1					
842	Men's outerwear, not knitted		8				0
843	Womens outerwear, not knitted	2	3	6	3	4	0
844	Undergarments, not knitted		9				
845	Outerwear, knitted non-elastic	11			4		1
846	Undergarments, knitted	5			8		1
851	Footwear			5		4	
896	Works of art	18					0
931	Special transactions		8		8		0

U: The average of RCA indexes in 1993 and 1996 for Cambodia, the RCA indexes in 1992 for the ASEAN countries

2.4. Joining AFTA: Potential Impact on Trade, Investment and Growth

An overview of patterns of foreign trade and investment in Cambodia revealed that ASEAN countries were by far the largest trading partners as well as primary investors in Cambodia. Joining AFTA and implementing the CEPT scheme is, therefore, likely to have significant implications for Cambodian trade, investment and economic growth.

The long-term impact of joining AFTA on trade in Cambodia could be discussed within the framework of trade diversion and creation. The analysis in Section 2.2 made it clear that Cambodia's trade with ASEAN countries accounted for a large proportion of total exports and imports. This may indicate that the potential for trade diversion will be low in the medium to long term. Cambodia's initial package of CEPT discussed in Section 2.1 indicates that the government takes an active rather than passive approach towards tariff reductions, in comparison with new ASEAN members such as Laos, Myanmar and Vietnam. This means that Cambodia will be able to enjoy lower tariffs on a much wider range of products than the new member countries. Cambodia is thus likely to have a high chance of benefiting from trade creation through stimulated consumption, demand for intermediate input, and hence international trade with ASEAN countries.

Cambodia's entry to AFTA may also stimulate certain types of foreign investment. As Robertson and Pohoresky (1998) discuss in their report, joining AFTA will increase incentives for investors from non-ASEAN countries to establish a production base in Cambodia to supply their products to ASEAN markets. This is because exports from Cambodia to other ASEAN countries will enjoy lower tariffs under CEPT than exports from outside ASEAN. Although this is likely, it should be noted that various conditions need to be met for Cambodia to become a platform for this type of foreign investment. For instance, the products of non-ASEAN multinational firms need to be on the inclusion list of CEPT; tariff rates of these products ought to be less than 20 percent; and 40-percent ASEAN content is required. In addition, new ASEAN members such as Laos, Myanmar and Vietnam are competitors of Cambodia and could be equally attractive to investors.

Menon (1997) pointed out some "indirect" benefits of joining AFTA which are unique in the case of transitional economies such as Laos. These indirect benefits of joining AFTA are also relevant to Cambodia. First, joining AFTA will send a signal to foreign investors that administrative, legal and bureaucratic systems will have to be changed to satisfy the obligations of membership. This will not only create a positive image of Cambodia's investment environment, but will also force the government to actually reform its governing systems to comply with the requirements of membership. Second, a small country with weak bargaining power in trade negotiations, such as Cambodia, could benefit from joining ASEAN perhaps more than large developing countries. ASEAN's dispute settlement mechanism, established in 1996, could enable a small country like Cambodia to be able to negotiate on an equal footing with larger ASEAN countries.

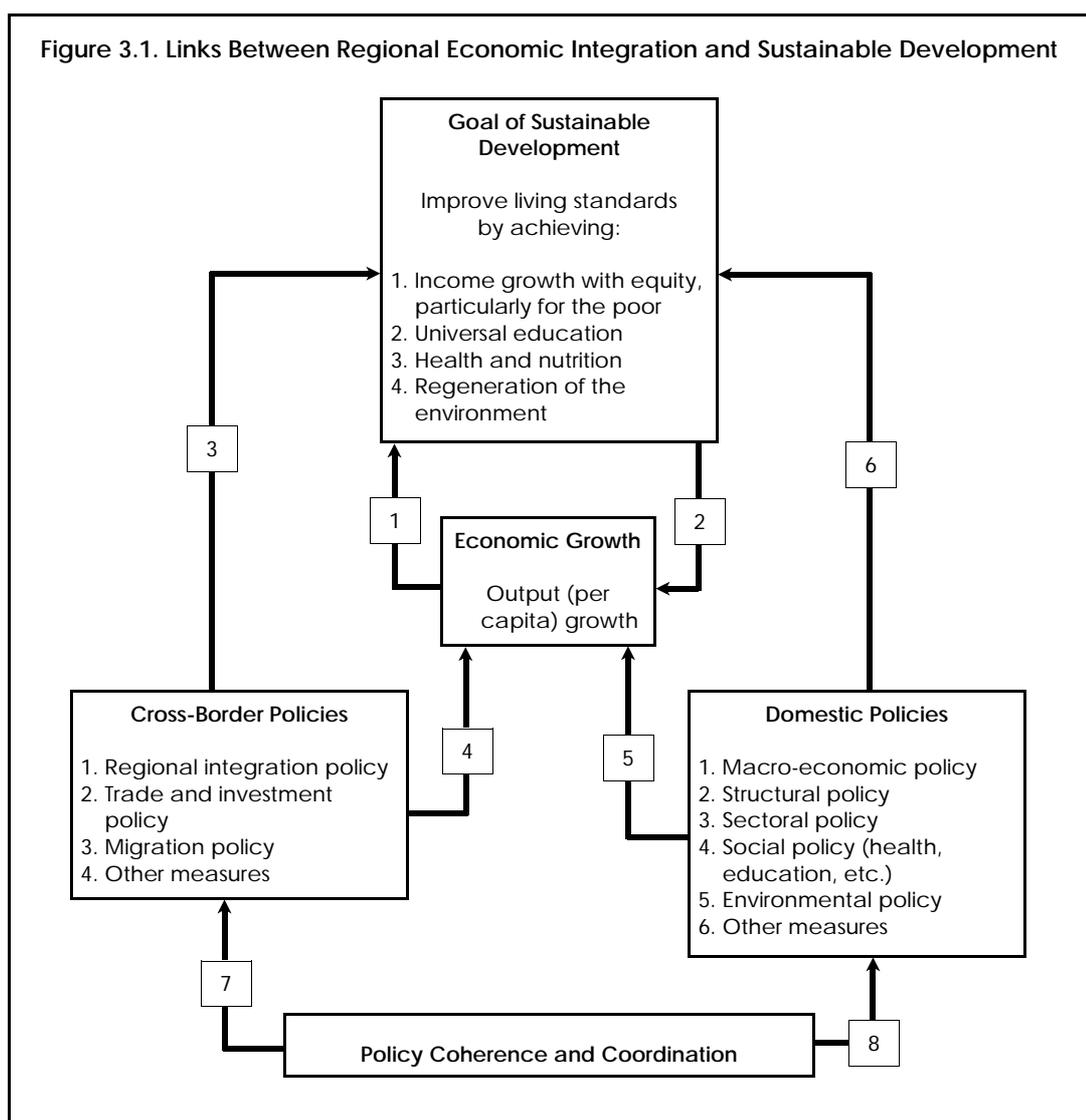
The above analyses suggest that Cambodia's entry to AFTA is likely to bring benefits to Cambodia through the expansion of trade and investment. In addition, there are indirect benefits for Cambodia which are intangible yet significant in establishing a market economy with good governance. All these factors will stimulate economic growth in Cambodia, and the benefits will become more apparent in the long term, as Cambodia's economic integration with the regional economies through AFTA deepens.

These benefits will not be automatically translated into sustainable development, however. Indeed, there are some major challenges for Cambodia to overcome if it is to harness the driving force of regional integration to achieve sustainable development.

3. Challenges of Linking Regional Integration to Sustainable Development

The goal of sustainable development is to raise the living standards of Cambodians steadily, without leaving an extra burden for the next generation. As the goal is centred around people's living standards, it necessarily involves multi-dimensional objectives: 1) income growth with equity, particularly income growth of the poor; 2) universal education; 3) improvement of health and nutrition; and 4) regeneration of the environment. From this perspective, economic integration is viewed as one of various means to achieve sustainable development in Cambodia. In the policy context, any policy measures towards economic integration must be consistent with achieving the goal of development, namely raising the standard of living of Cambodians.

Figure 3.1 illustrates the links between regional integration and sustainable development. In a sustainable development approach, economic growth is seen as a means to raise people's living standard (arrow 1). The approach also posits that raising living standards of the poor, with the provision of universal education, health services and adequate nutrition, will foster human capability, increase the productivity of people, and subsequently enhance economic growth (arrow 2). The high economic growth supported by human capacity development will again contribute to raising living standards (arrow 1). A country's development will be most effective and efficient if the links between the two gather momentum, become dynamic, and perpetuate themselves.



Establishing the links between sustainable development and growth is not automatic, however. Government policies, both cross-border and domestic, can enhance both growth and development (arrows 3, 4, 5 and 6). The government has to play a critical role in establishing and ensuring the links between development and growth. A regional integration policy is an important government policy which could affect both economic growth and sustainable development. The key issues and challenges in the following sections are discussed in line with this analytical framework.

3.1. Economic Growth with Equity

Why does equity matter?

Economic integration will promote economic growth and raise per capita income at the national level. However, there is no guarantee that the benefits of economic integration will be shared broadly. It might happen that a small number of rich people in Cambodia would enjoy a large portion of benefits from economic integration, while the living standards of the poor and the vulnerable would increase only marginally or remain at the same level.

Achieving equity of distribution can improve the standard of living of Cambodians for at least three reasons. First, the eradication of poverty will be most effective and efficient if the benefits from economic growth actually reach the poor. Second, equity tends to curb social tensions, which often cause political and economic instability and consequently undermine the potential for economic growth (Alesina & Perotti 1994). Third, it is not appropriate on ethical grounds to impoverish already poor people for the benefit of the rich.

Equity of distribution in Cambodia and ASEAN

Unequal distribution is typically measured by either the Q5/Q1 ratio or the Gini index.¹⁰ As the two indicators usually correlate positively, the following discussions employ only the Gini index as a distribution indicator. Table 3.1 presents the distribution of income and expenditure in Cambodia and some ASEAN countries. According to this data, the Gini index of Cambodia, measured by consumption expenditure per individual, was 37 points in 1993–94, and increased to nearly 40 points in 1996. Compared with ASEAN countries, expenditure distribution in Cambodia was more unequal than that in Laos, Vietnam and Indonesia. In terms of income distribution, Cambodia was more unequal than the Philippines, Thailand, Malaysia and Singapore in the 1990s.

The gradual change of distribution in ASEAN countries also provides interesting insights on issues of growth and equity. Thailand, Malaysia, and Singapore achieved remarkably high economic growth in the 1980s and 1990s. Yet the equity achieved by Malaysia and Singapore contrasts sharply with that of Thailand. Indeed, the Gini index of Malaysia declined by 2.6 points, from 51.0 in 1979 to 48.4 in 1989, and that of Singapore by 1.7 points, from 40.7 in 1980 to 39.0 in 1989. By contrast, Thailand's Gini index increased sharply by 8.4 points, from 43.1 in 1980 to 51.5 in 1992.

It is difficult to identify why this clear difference of changing inequality among even high-performing ASEAN countries emerged in the 1980s and 1990s. One might argue that high economic growth or trade liberalisation exacerbated equity of distribution. Some recent empirical studies, however, do not support this argument. For instance, Ravallion and Chen (1997) used recently compiled World Bank data on income distribution, and found no support for the view that higher growth rates in average living standards tended to accompany worsening distribution. A cross-country study by Edwards (1997) also found that

¹⁰ The Q5/Q1 ratio is the income (or expenditure) of the highest 20 percent of the population measured against the lowest 20 percent of the population. As the ratio becomes higher, the distribution becomes more unequal. The Gini index is derived from Lorenz curve. It ranges from 0 (perfect equality) to 100 (perfect inequality).

Table 3.1. Distribution of Household Income and Expenditure: Cambodia and ASEAN

Country	Year	Distribution		Q1	Q2	Q3	Q4	Q5	Inequality	
		Type ^a	Unit ^b	Lowest 20%	4th 20%	3rd 20%	2nd 20%	Top 20%	Q5/Q1 ratio	Gini index ^c
Cambodia	1994	I	H	2.8	6.3	10.6	17.8	62.4	22.3	52.4
	1994	E	P	7.0	10.6	14.0	19.4	49.0	7.0	37.2
	1996	E	P	5.8	9.9	14.1	20.7	49.6	8.6	39.4
Laos	1992	E	P	9.6	12.9	16.2	21.1	40.2	4.2	30.4
Vietnam	1992	E	P	7.8	11.4	15.4	22.4	43.0	5.5	35.7
Indonesia	1976	E	P	8.0	11.6	16.0	21.9	42.5	5.3	34.6
	1978	E	P	8.0	10.1	14.8	21.8	45.3	5.7	38.6
	1980	E	P	7.3	12.3	15.9	22.2	42.3	5.8	35.6
	1981	E	P	7.7	12.7	15.7	21.8	42.1	5.5	33.7
	1984	E	P	8.3	12.5	15.2	22.0	42.0	5.1	32.4
	1987	E	P	8.0	12.9	15.6	21.8	41.7	5.2	32.0
	1990	E	P	9.2	12.1	16.2	20.6	41.9	4.6	33.1
	1993	E	P	8.7	12.3	16.2	22.1	40.7	4.7	31.7
Philippines	1957	I	H	6.5	7.8	13.6	23.6	48.5	7.5	46.1
	1961	I	H	4.2	7.9	12.1	19.3	56.5	13.5	49.7
	1965	I	H	3.5	12.5	8.0	20.0	56.0	16.0	51.3
	1971	I	H	3.6	8.1	13.3	21.0	54.0	15.0	49.4
	1985	I	H	5.2	9.1	13.3	20.3	52.1	10.0	46.1
	1988	I	H	5.2	9.1	13.3	19.9	52.5	10.1	45.7
	1991	I	H	-	-	-	-	-	-	45.0
Thailand	1962	I	H	8.0	8.6	12.1	21.5	49.8	6.2	41.3
	1969	I	H	5.1	10.1	14.4	20.3	50.1	9.8	42.6
	1975	I	H	4.9	10.1	14.8	21.8	48.4	9.9	41.7
	1981	I	H	4.3	9.4	13.9	21.3	51.1	11.9	43.1
	1986	I	H	4.2	8.7	13.1	20.9	53.1	12.6	47.4
	1988	I	H	4.1	8.5	12.8	20.4	54.2	13.2	47.4
	1990	I	H	4.0	8.3	12.5	20.0	55.2	13.8	48.8
	1992	I	H	3.7	7.6	11.6	18.6	58.5	15.8	51.5
Malaysia	1970	I	H	4.0	7.7	12.3	19.8	56.2	14.1	50.0
	1973	I	H	-	-	-	-	-	-	51.8
	1976	I	H	3.3	7.8	11.8	19.8	57.3	17.4	53.0
	1979	I	H	3.7	8.2	12.5	19.8	55.8	15.1	51.0
	1984	I	H	4.2	8.6	13.2	20.8	53.2	12.7	48.0
	1989	I	P	4.6	8.3	13.0	20.4	53.7	11.7	48.4
Singapore	1973	I	H	-	-	-	-	-	-	41.0
	1978	I	H	7.2	11.4	15.9	23.5	42.0	5.8	37.0
	1980	I	H	6.5	10.8	13.3	22.8	46.6	7.2	40.7
	1983	I	H	-	-	-	-	-	-	42.0
	1988	I	H	6.5	10.8	13.3	22.8	46.6	7.2	41.0
	1989	I	H	-	-	-	-	-	-	39.0

a (E) expenditure; (I) income; b (H) household; (P) person; c Gini index falls between 0 (perfect equality) and 100 (perfect inequality)
 source: data for ASEAN countries from world bank, *world development indicators 1997*; data for Cambodia from the *socio-economic survey of Cambodia 1993/94* and UNDP, *poverty and human development in Cambodia*

there was no empirical evidence to support the existence of a causal link between trade liberalisation and the increase of income inequality. These observations may indicate that the extent to which benefits from high-output growth reach the poor depends on other factors, such as the domestic conditions in and policies of individual countries.

Recent empirical studies on economic growth and human capital provide useful insights for government policies to achieve growth with equity in Cambodia. It was found in cross-country studies that human capacity development through universal education and training has had a significantly positive impact on economic growth, in addition to reducing income inequality.¹¹ Education expands human capability, which in itself improves people's standards of living. Education also upgrades people's capacity to obtain better jobs and earning opportunities. Furthermore, universal education contributes to eradicating poverty and mitigating inequality of distribution. The development experience of the East Asian countries provides ample evidence to support this argument.

Improving health and nutrition is in itself a major objective of development in Cambodia, as it directly raises the living standards of Cambodians. It also contributes to capacity development of human resources as more people become healthier. This enhances the potential for productivity gains and high economic growth in the future. Thus, both education and health not only improve the living standards of Cambodian people directly, but contribute to economic growth in the long term.

Current situation of education and health in Cambodia and ASEAN

Education indicators of Cambodia and ASEAN are summarised in Table 3.2. The adult literacy rate is one of the commonly used indicators to assess capacity of human resources in a country. According to UNDP's *Human Development Report 1997*, Cambodia's adult literacy rate was 35 percent, the lowest among the 10 regional countries. A more recent study by the Ministry of Planning found, however, that the adult literacy rate was 68.7 percent in 1996 (Royal Government of Cambodia 1996). Although this rate was significantly higher than that of the previous estimate, Cambodia's adult literacy rate was still much lower than that in the regional countries, which, except for Laos, recorded more than 80 percent. In 1994, Cambodia's combined enrolment ratio at primary, secondary and tertiary levels was 58

Table 3.2. Education Indicators in Cambodia and ASEAN

	Adult literacy rate (%)			Combined primary, secondary and tertiary gross enrolment ratio (%)		
	1994			1994		
	Male	Female	Total	Male	Female	Total
Cambodia	-	-	35	-	-	58
Laos	69	43	56	58	42	50
Myanmar	89	77	83	48	47	48
Vietnam	96	90	93	57	52	55
Indonesia	89	77	83	65	59	62
Philippines	94	95	94	80	75	78
Thailand	96	91	94	53	53	53
Malaysia	88	78	83	63	61	62
Singapore	96	87	91	73	71	72
Brunei	-	-	88	-	-	70

Source: UNDP, *Human Development Report 1997*

¹¹ Several empirical studies in new growth theory literature found a close association between human capital accumulation and economic growth. See, for instance, Barro & Sala-i-Martin (1995) and Sachs & Warner (1997). For a study of the relationship between growth and income inequality, see Persson & Tabellini (1994).

Table 3.3. Access to Health Services: Cambodia and ASEAN

	Health care	Safe water	Sanitation	Child immunisation		Births attended
	% of pop.	% of pop.	% of pop.	Measles	Diphtheria	by health staff
	with access	with access	with access	% of children	% of children	% of total
	1993	1994-95	1994-95	under 12 mo.	under 12 mo.	1990
Cambodia	25 ^a	13	14 ^b	75	79	49 ^c
Laos	67 ^b	41	30	65	51	-
Myanmar	60 ^b	39	42	66	69	97
Vietnam	97	38	21	95	93	95 ^c
Indonesia	43	63	55	89	91	36 ^c
Philippines	-	84	75	86	85	76
Thailand	59	81	87	86	93	71
Malaysia	88	90	94	81	90	92
Singapore	100	100	100	88	95	100

a data from the Ministry of Health, Cambodia; b 1990-95 data from UNDP, *Human Development Report 1997*; c 1983-94 data from UNDP,

Human Development Report 1997

Source: World Bank, *World Development Indicators 1997*

percent, which was lower than most ASEAN member countries.¹² Average years of schooling of adults aged over 25 years was 3.5 years in Cambodia in 1993 (Royal Government of Cambodia 1995). This level was much lower than those of the ASEAN-5 countries in 1985. These data indicate that there is a large gap in educational background between Cambodia and ASEAN countries.

Health indicators reveal an even larger gap between Cambodia and ASEAN. With only 25 percent of the population having access to health care in 1993, 13 percent access to safe water in 1994–95, and 14 percent to sanitation in 1990–95, Cambodia had one of the poorest standards of health in the region (Table 3.3). Only 49 per cent of births in Cambodia were attended by health staff in 1990. This figure is next to the lowest, 36 percent in Indonesia, and is much below the average rate of nearly 90 percent in other regional countries. Cambodia's child immunisation rate in 1995 was comparable with the other countries, though largely dependent on international humanitarian aid. Nearly 80 percent of Cambodian children aged under 12 months had access to immunisation programmes in 1995.

Babies in Cambodia tend to be born underweight and malnourished more frequently than those in other regional countries. For every 100 babies born in Cambodia in 1993–94, 18 had low birth weights (Table 3.4 overleaf).

Table 3.4. Risk Factors in Health

	Low	Prevalence	Adult HIV-1
	birthweight	of child	sero-prevalence
	babies	malnutrition	per 100
	% of births	% of children under 5	adults
	1990	1989-95	1994
Cambodia	18 ^a	32 ^a	1.9
Laos	13	40	0.0
Myanmar	13	31	1.5
Vietnam	17	45	0.1
Indonesia	8	39	0.0
Philippines	33 ^b	30	0.1
Thailand	10	13	2.1
Malaysia	8	23	0.3
Singapore	7	14	0.1

a 1993-94 data from the Ministry of Health

b 1985-95 data from UNDP, *Human Development Report 1997*

Source: World Bank, *World Development Indicators 1997*

¹² The UNDP's *Human Development Report 1997* reported that Cambodia's combined enrolment at primary, secondary and tertiary levels in 1993 was 30 percent. It is not clear why the sudden jump from 30 percent in 1993 to 58 percent in 1994 took place.

This was the second-highest figure among the regional countries. At the same time, 32 percent of Cambodian children aged under 5 in 1993–94 suffered from malnutrition, similar to the proportion in Laos, Myanmar, Vietnam, Indonesia and the Philippines. The adult population in Cambodia also faced high risks to health, particularly with HIV infection. For every 100 adult Cambodians, 1.9 had HIV-1 sero-prevalence in 1994. This figure is close to 2.1 in Thailand, which has the highest rate in the region. The high risk data of Cambodia partly confirms the poor capacity of the health system in the country.

Cambodian mortality rates were the highest in the region in 1995 (Table 3.5). Cambodia's life expectancy in 1995 was 52 years for males and 54 years for females. These were far below the other ASEAN countries except for Laos. In addition, Cambodia's infant mortality rate was 108 per 1,000 live births, much higher than the rates in other regional countries, which ranged from 4 to 90 per 1,000. Furthermore, Cambodia's child mortality rate (children under 5 years) was 158 per 1,000, compared with the rates of other regional countries ranging between 6 and 147 per 1,000. There was a similar pattern in maternal mortality ratio. Cambodia recorded a maternal mortality ratio of 900 per 100,000 live births in 1995, much higher than the rest of the region. Finally, Cambodia's adult mortality rate was 444 per 1,000 for males and 375 per 1,000 for females—second to Laos. The above data indicates that Cambodians' state of health and nutrition was, on average, much lower than that in the ASEAN-5 countries in recent years, though some indicators in Cambodia recorded better performances than those in some SEATEs.

Table 3.5. Mortality, 1995

	Life expectancy		Infant mortality rate	Under-5 mortality rate	Adult mortality rate		Maternal mortality ratio
	at birth				per 1,000	per 1,000	
	male	female	per 1,000	rate	male	female	per 100,000
	years	years	live births	per 1,000	male	female	live births*
Cambodia	52	54	108	158	370	298	900
Laos	51	54	90	147	444	375	650
Myanmar	58	61	83	119	308	252	580
Vietnam	65	70	41	49	206	136	160
Indonesia	62	66	51	75	262	205	650
Philippines	64	68	39	53	254	189	280
Thailand	67	72	35	42	199	119	200
Malaysia	69	74	12	14	194	123	80
Singapore	74	79	4	6	143	82	10

* from UNDP, *Human Development Report 1996*

Source: World Bank, *World Development Indicators 1997*

Challenges

The above analysis suggests that there is a huge gap in human capacity development between Cambodia and the ASEAN countries. This observation sends a clear signal to Cambodia's policy-makers that Cambodia urgently needs to catch up with other regional economies in the area of education and health. Otherwise, the benefits from economic growth stimulated by regional economic integration will likely not be broadly shared, particularly by the poor. This will undermine the potential for high and sustainable economic growth in the long term. Therefore, a major challenge to the government is to mobilise limited public resources to fill the existing gap in human capacity development between Cambodia and the ASEAN countries.

3.2. Agricultural and Rural Development

There are several reasons to highlight the priority for agricultural and rural development in Cambodia. First, a majority of Cambodians live in rural areas, and most of them are involved in agriculture, fishing or forestry. For instance, in 1996 rural households were estimated to make up 87 percent of total households in Cambodia. In rural areas, employment in the agriculture, fishing and forestry sectors accounted for 88 percent of total employment in 1996 (Royal Government of Cambodia 1996). Second, agricultural production accounted for 42.7 percent of real GDP in 1996—the highest share—followed by the service (37.4 percent) and industrial (19.9 percent) sectors (Table 3.6). Third, the living standards of rural people in Cambodia are extremely low relative to those of people in urban areas. For instance, the highest incidence of poverty was found in rural areas, where 43 percent of individuals lived below poverty line, whereas only 11 percent of individuals in Phnom Penh fell below the poverty line (World Bank 1996). This suggests that agricultural and rural development will have significant impact on the eradication of poverty, achieving equitable distribution, and thus improving the living standard of a large number of

Table 3.6. Cambodia's Real Gross Domestic Product (by industrial origin)

	GDP (at 1989 constant prices) (billions of riels)						Avg. ann. growth (%) 1991-96	Share by origin (%)	
	1991	1992	1993	1994	1995	1996		1991	1996
Agriculture	135.9	138.5	137.1	137.1	145.9	148.5	1.8	51.8	42.7
Crops and rubber	79.3	79.0	77.2	70.9	82.2	82.9	0.9	30.2	23.8
Rice	47.6	46.7	48.2	38.6	47.9	47.3	-0.1	18.2	13.6
Other crops and rubber	31.7	32.3	29.0	32.4	34.3	35.7	2.4	12.1	10.3
Livestock	34.5	36.9	38.0	39.5	41.1	43.8	4.9	13.2	12.6
Fishery	13.5	12.7	12.0	11.8	12.2	12.1	-2.2	5.1	3.5
Forestry	8.6	9.9	9.9	14.9	10.4	9.7	2.4	3.3	2.8
Industry	39.5	45.7	51.7	55.6	61.1	69.2	11.9	15.1	19.9
Mining and quarrying	3.0	3.2	3.4	3.7	4.0	4.6	8.9	1.1	1.3
Manufacturing	18.4	19.0	20.5	22.1	24.3	27.5	8.4	7.0	7.9
Electricity and water	0.5	0.6	0.7	0.7	0.8	0.9	12.5	0.2	0.3
Construction	17.6	22.9	27.1	29.1	32.0	36.2	15.5	6.7	10.4
Services	86.8	96.5	103.3	111	119.7	130.2	8.4	33.1	37.4
Transport/telecoms	7.0	8.1	8.9	9.7	10.7	12.2	11.8	2.7	3.5
Wholesale/retail trade	34.4	39.9	42.3	44.8	48.8	54.6	9.7	13.1	15.7
Hotels and restaurants	1.0	1.3	1.4	1.7	1.8	2.2	17.1	0.4	0.6
Education and health	11.0	11.0	11.5	12.5	12.9	12.7	2.9	4.2	3.7
Home ownership	16.3	17.4	18.8	20.3	21.8	23.0	7.1	6.2	6.6
Other services	17.1	18.8	20.4	22.1	23.7	25.5	8.3	6.5	7.3
Gross domestic product	262.2	280.7	292.1	303.7	326.8	347.9	5.8	100.0	100.0
Memorandum items									
Nominal GDP	1,336	2,509	5,414	6,131	7,200	8,200	43.7		
Nominal GDP millions of \$	1,900	2,002	2,245	2,340	2,923	3,125	10.5		

Source: World Bank, *Cambodia: Progress in Recovery and Reform (1997)*

Cambodians.

The importance of agricultural sector development has also been reported in a large number of empirical studies in other countries. These studies found that agricultural

development had contributed to the development of other sectors through various channels. These were: the provision of labour for the industrial sector; food for an expanding population with higher incomes; savings for industrial investment; markets for industrial output; export earnings to pay for imported capital goods; and raw materials for agro-processing products (Timmer 1995). Furthermore, a cross-country study of the World Bank pointed out that the industrial development of East Asian countries was in fact preceded by agricultural development (World Bank 1993).

Potential impact of AFTA

New categories of unprocessed agricultural products (UAPs) were included in the CEPT scheme of AFTA in 1994. While the tariff reduction of UAPs does not start immediately, it does have to be added to the inclusion list in the long term. Thus, joining AFTA is likely to have a significant impact on agricultural and rural development in Cambodia. Cambodia's trade policy towards AFTA needs a clear strategy to handle this issue. The selection of the tariff lines for the inclusion list, temporary exclusion list, and sensitive list under the CEPT scheme of UAP must be thought through with careful consideration of domestic conditions and constraints in the agricultural sector.

Domestic conditions and constraints

Cambodia's comparative advantage in the agricultural sector has not been well developed, despite its relatively abundant cultivable land and freshwater resources. The export capacity of agricultural products is also still underdeveloped. Indeed, there is scope for improved agricultural production in Cambodia.

Among the major crops produced in Cambodia, a majority showed relatively low yields relative to the ASEAN region (Table 3.7). For instance, the yield of rice (tons per hectare) in Cambodia was only 31 percent of that in Indonesia, the best in the ASEAN region in 1994/95. Yields of other crops were also behind the performance of the best countries—except for soybeans, in which Cambodia recorded the best performance in the ASEAN region.

The use of agricultural inputs such as labour force, fertiliser, irrigation, tractors and land also affect the performance of agricultural production. Table 3.8 illustrates the intensity of input utilisation in Cambodia and ASEAN. The intensity of input utilisation was measured by each input per hectare. It is clear that agricultural production technology in Cambodia recorded the lowest, or next to the lowest, intensity factor utilisation. The use of labour force, fertiliser, irrigation and machinery was extremely limited in Cambodia relative to that in ASEAN countries. Interestingly, Vietnam used its abundant work force most intensively, with a massive dose of fertiliser and extensive use of irrigation, in lieu of the use of machinery such as tractors.

Cambodia's lack of access to agricultural inputs has been well documented.¹³ In addition to the agricultural inputs discussed above, limited access to credit for farmers is another critical constraint to agricultural development in Cambodia. For instance, commercial bank credits to the agricultural sector continued to make up only 5 to 6 percent of total commercial bank credit until October 1996 (CDRI 1997a). Although rural micro-credit schemes have been developed by some bilateral and multilateral donors and NGOs, the speed of development is slow and the scale appears to be very small. Informal credit certainly exists in rural Cambodia, but there is evidence that interest rates tend to be considerably higher for the poorest people with few assets than for better-off farmers.¹⁴ Farmers' lack of access to

¹³ See for instance FAO (1994), ADB (1996) and Tickner (1996).

technical advice, management expertise and market information was also highlighted as a critical constraint.

Challenges

The above analysis suggests that regional economic integration will pose enormous challenges to the agricultural sector in Cambodia. The sector has not yet gathered momentum to reveal its potential comparative advantage within the ASEAN region. It will be exposed to stiff competition from the regional economies, where farmers have much better access to inputs, modern technology and market information. If the agricultural sector fails to improve productivity and penetrate regional markets, agricultural and rural development will stagnate and rural Cambodians will have to continue their struggle in poverty. On the other hand, if Cambodia can develop its agricultural and rural sectors properly, regional integration will become a powerful vehicle to eradicate poverty, maintain high growth with equity, and hence raise the standard of living in Cambodia. Policies to increase the performance of the agricultural sector are urgent as Cambodia prepares for regional integration.

A challenge for the government is to determine how to articulate cross-border measures such as trade and investment policies to facilitate agricultural and rural development. As for the AFTA/CEPT strategies, some agricultural products may require preferential and time-bound, protection by import tariffs. This could take the form of ensuring producers certain profits, or offering incentives to invest in the enhancement of production capacity. Foreign investment in the agricultural sector may need to be further promoted to supplement the shortage of domestic investment.

3.3. Development of the Industrial and Service Sectors

Economic performance

The industrial and service sectors have shown fairly good growth since the beginning of Cambodia's transition to a market economy in the early 1990s. Average annual growth rates of the industrial and service sectors between 1991 and 1996 were 11.9 percent and 8.4 percent, respectively (see Table 3.6 above). The high rates of growth in these sectors transformed the production structure of Cambodia at a rapid pace. The share of agriculture declined in real terms from 51.8 percent in 1991 to 42.7 percent in 1996, whereas that of industry increased from 15.5 percent in 1991 to 19.9 percent in 1996, and that of services from 33.1 percent in 1991 to 37.4 percent in 1996.

While the overall performance of industrial development in Cambodia was impressive, regional integration may still pose challenges to Cambodia's industrial and service sectors. The major challenges are: 1) to develop agriculture-related industries; 2) to maximise employment, maintain labour standards, and review benefits in the unskilled, labour-intensive industries; and 3) to assist small- and medium-size enterprises (SMEs).

Domestic conditions and constraints

Industrial development maximises benefits for a country when it is based on comparative advantage. Industrialisation in Cambodia thus should be linked to the country's potential comparative advantage.

The agricultural sector is one in which Cambodia enjoys potential comparative advantage. There are several advantages to developing the agro-industry and the food-processing industry in Cambodia. First, it will create employment and substitute imported processed agricultural products for domestic products. In addition, it will strengthen backward links to the agricultural sector. The backward links will increase the demand for agricultural products, which will be an incentive for a large number of farmers in rural areas to expand

production and improve productivity. This will contribute to eradicating poverty and achieving equitable distribution of income. Income growth in rural areas will in turn create the demand for domestic manufactured goods and services.

Despite its potential capacity for development, the agricultural sector (including food-processing industries) has not attracted much investment to date (Table 3.9). Among total investment projects approved by the Cambodia Investment Board (CIB) between August 1994 and March 1998, the agricultural sector accounted for 11 percent of total registered capital, 6 percent of total fixed assets, and 8 percent of total employment created.¹⁵ The challenge to the government is to determine how to facilitate development in the agriculture-related industries.

The development of the manufacturing industry has started and gathered momentum in the labour-intensive, light manufacturing industries, particularly garments. The garment industry alone accounted for \$266 million of registered capital, and created 165,000 jobs between August 1994 and March 1998. This sector has already revealed strong comparative advantage in the ASEAN region. With investment increasingly coming into Cambodia, this sector is expected to expand Cambodia's exports, create jobs, and generate income for a

Table 3.9. Investment Projects Approved in Cambodia

	1994 ^a	1995	1996	1997	1998 ^b	Total from 1994-98	Sectoral share (%) 1994-98
Number of investment projects							
Agriculture	7	32	33	27	3	102	16
Industry	27	91	135	170	41	464	71
o/w garment	12	27	42	105	26	212	33
Service	5	40	24	9	7	85	13
Total	39	163	192	206	51	651	100
Registered capital (millions of \$)							
Agriculture	119	70	82	93	8	373	11
Industry	97	357	332	306	91	1,183	36
o/w garment	76	20	40	103	29	266	8
Service	7	1,574	76	22	28	1,707	52
Total	223	2,001	489	421	128	3,263	100
Fixed assets (millions of \$)							
Agriculture	60	70	96	30	18	274	6
Industry	487	593	551	642	102	2,374	48
o/w garment	29	27	45	110	31	242	5
Service	50	1,859	171	113	85	2,278	46
Total	597	2,521	818	784	205	4,925	100
Manpower (full production)							
Agriculture	1,709	8,775	8,523	4,187	1,946	25,140	8
Industry	17,222	32,669	57,219	123,545	39,272	269,927	86
o/w garment	12,828	14,557	25,326	82,565	29,553	164,829	53
Service	2,883	6,271	5,769	1,171	2,100	18,194	6
Total	21,814	47,715	71,511	128,903	43,318	313,261	100

a August-December 1994; *b* 1st quarter (January-March) 1998

Source: CDRI calculation based on data from CIB

large number of Cambodians. The role of government here therefore may be to build a sound monitoring mechanism to ensure that this sector will actually provide the expected

¹⁵ The CIB data presented here are subject to the same data problems mentioned in Section 2.2.

benefits listed above.

Regional integration will pose challenges to the SMEs which represent the majority of industrial enterprises in Cambodia (Royal Government of Cambodia 1997c). With the reduction of import tariffs under the CEPT scheme, SMEs will be exposed to severe competition with foreign competitors. Although SMEs are a pool of domestic entrepreneurs in Cambodia, their access to credit is limited, just like poor farmers.

3.4. Environment

The implications of ASEAN/AFTA for Cambodia's environment appear so far to have received little attention in policy discussions and research. This does not mean that the issue is neither important nor relevant. On the contrary, there are a number of critical issues which call for research and policy actions by the government to meet the challenges facing the environment in Cambodia.

The first critical issue is concerned with pollution. Regional integration will stimulate the growth of industrial output in Cambodia. As output grows rapidly, it will necessarily increase the generation of pollution and industrial toxic waste. Numerous studies on the environment reported that trade liberalisation has been associated with environmental degradation in ASEAN countries.¹⁶ Pollution of air, soil, and water by industrial waste and increased energy consumption will adversely affect Cambodians' standard of living.

The second pressing issue is the regeneration of forests. Cambodia is richly endowed with forests compared with other countries in the region. In 1990, Cambodia's forested area was 122,000 square kilometres, larger than those of both Vietnam and the Philippines (Table 3.10). Deforestation was less severe in the 1980s, when Cambodia's annual deforestation rate was 1,300 square kilometres and the percentage change was 1 percent, both among of the

Table 3.10. Deforestation

	Forest area		Annual deforestation	
	thousands of sq km	thousands of sq km	percentage change	
	1990	1980-90	1980-90	
Cambodia	122	1.3	1.0	
Laos	132	1.3	0.9	
Myanmar	289	4.0	1.3	
Vietnam	83	1.4	1.5	
Indonesia	1,095	12.1	1.1	
Philippines	78	3.2	3.4	
Thailand	127	5.2	3.5	
Malaysia	176	4.0	2.1	
Singapore	0	0.0	2.3	

Source: World Bank, *World Development Indicators 1997*

Table 3.11. Urbanisation

	Urban population			Population in
	millions	% of total population	average annual % growth	the largest city as % of urban population
		1995	1995	1990-95
Cambodia	2.1	21	6.5	63 ^a
Laos	1.1	22	6.5	53 ^a
Myanmar	12.2	27	3.3	32
Vietnam	15.3	21	3.1	23
Indonesia	66.3	34	3.9	17
Philippines	36.6	53	4.4	25
Thailand	20.9	36	2.3	50
Malaysia	10.8	54	4.0	11
Singapore	3.0	100	2.0	100

^a 1990 data

Source: World Bank, *World Development Indicators 1997*

¹⁶ See, for instance, Repetto, "Trade and sustainable development," in Quibria (1995).

lowest in the region. However, Cambodia's forest situation has undergone dramatic changes in the 1990s. Serious concern has been raised over forest exploitation and management. Exports of logs and timber have accelerated, concessions for logging companies have continued to be granted and illegal logging activities have flourished. A recent government report on forest policy noted the progress made in tackling these issues, but there remains scope for further improvement (Royal Government of Cambodia 1997a; World Bank/UNDP/FAO 1997).

The third issue is urbanisation. In 1995, Cambodia (like Vietnam) had 21 percent of its total population living in urban areas. The rest of the region's urban population ranged from 22 percent in Laos to 100 percent in Singapore (Table 3.11). However, Cambodia's urbanisation has taken place at an unprecedented speed. Cambodia's average annual growth of urban population was 6.5 percent, the highest in the region. This raises the concern that urbanisation will cause various environmental problems, such as traffic congestion, air pollution and waste collection.

4. Policy Options

The previous section discussed various challenges to Cambodia posed by regional economic integration. In this section, several of the points raised above are considered in order to seek options available to Cambodian policy-makers.

4.1. Policy Coherence

Although government policies should be coherent, this is often not the case in reality. Incoherent government policies tend to prevail on a larger scale in developing countries than in industrial countries, as governments in developing countries are generally subject to stricter financial and human resource constraints than those in developed countries. The economic and social costs of incoherent public policies are tremendous. Incoherent government policies waste a huge amount of scarce human and financial resources without achieving their objectives. Developing countries with strictly limited resources, such as Cambodia, simply cannot afford this. Thus it is imperative for the Cambodian government to investigate whether, and to what extent, new policy measures are consistent with, and complementary to, other government policies (in other words, establishing arrows 7 and 8 in Figure 3.1, see page 13). By so doing, the objectives of the new policies are achieved most effectively without undermining the goals of other government policies. Policies toward Cambodia's regional integration should be considered in this context.

Coherence 1: AFTA/CEPT and growth with equity

By joining AFTA/CEPT, Cambodia will have access to ASEAN markets which aim to eliminate import tariffs and non-tariff barriers by the year 2003 (2006 for Vietnam). This is expected to stimulate growth of the export sectors in which revealed and potential comparative advantages lie, hence boosting economic growth. However, growth will not be sustainable unless the benefits from it are broadly shared, as was discussed in Section 3. To ensure this, public investment in human capacity development—providing universal education and improving health and nutrition—is a critical policy instrument for translating the benefits of regional integration into high economic growth with equity, and subsequently achieving development in Cambodia.

The Cambodian government has recognised the importance of public investment in human capacity development. And yet the recognition does not appear to have been

cent of GDP. This was much below the average level of public spending in ASEAN—2.2 percent. By contrast, Malaysia spent 4.1 percent of GDP in 1992, the highest within the region, followed by 3.1 percent in Singapore and 2.7 percent in Thailand. High pupil/teacher ratios are indicative of low quality education. In 1996, the number of pupils per teacher at the primary level was 44 in Cambodia, the highest among the regional countries. The same indicators in the ASEAN countries ranged from 16 to 35 students per teacher in 1993.

Table 4.1. Education Policy and Infrastructure

	Primary school starting age (years)	Duration of primary education (years)	Public spending on education				Primary school pupil/teacher ratio pupils per teacher 1993
			Primary % of GDP 1992	Secondary % of GDP 1992	Tertiary % of GDP 1992	Total % of GDP 1992	
Cambodia	6	6	-	-	-	1.0 ^c	44 ^d
Laos	6	5	0.7	0.8	0.1	1.6	30
Myanmar	5	5	1.3 ^a	-	0.2 ^a		-
Vietnam	6	5					35
Indonesia	7	6	0.0 ^b	0.4 ^b	0.1 ^b	0.5 ^b	23
Philippines	7	6	1.4 ^b	0.2 ^b	0.1 ^b	1.7 ^b	33
Thailand	6	6	1.6	0.6	0.5	2.7	19
Malaysia	6	6	1.7 ^e	1.7 ^e	0.7 ^e	4.1 ^e	20
Singapore	6	6	0.9 ^a	1.2 ^a	1.0 ^a	3.1 ^a	26
Brunei	6	6	0.7	1.2	0.1	2.0	16

Source: World Bank, *World Development Indicators 1997*

a in 1987, b in 1988, c in 1996 (source: World Bank, *Cambodia: Progress in Recovery and Reform*), d Ministry of Education 1997,

e Ministry of Education expenditure only

The government's capacity to provide health services also fell short of that in other regional countries. For instance, public sector health spending in Cambodia accounted for only 0.7 percent of GDP, one of the lowest figures in the region (Table 4.2). The shortage of public provision of health services appears to have put a heavy burden on individuals in Cambodia, where private health expenditures accounted for 6.5 percent of GDP in most recent years. Health personnel and infrastructure available to Cambodians were also limited. For instance, the number of Cambodians per physician, nurse and hospital bed in 1993 were 9,374, 1,231 and 453 respectively, which ranked Cambodia in a group of the least staffed and least equipped countries for health services.

Table 4.2. Health Spending and Personnel

	Health expenditure			People per physician 1993	People per nurse 1993	People per hospital bed 1993
	Total % of GDP 1990-95 ^{a, b}	Public % of GDP 1990-95 ^a	Private % of GDP 1990-95 ^a			
Cambodia	7.2	0.7	6.5	9,374	1,231	453
Laos	2.6	0.8	1.4	4,446	493	405
Myanmar	0.9	0.5	0.4	12,528	1,227	1,605
Vietnam	5.2	1.1	4.1	2,279	1,149	261
Indonesia	1.5	0.7	0.8	7,028	2,732	1,423
Philippines	2.4	1.3	1	8,273	-	780
Thailand	5.3	1.4	3.9	4,416	1,067	765
Malaysia	-	1.4	-	2,441	480	437
Singapore	3.5	1.1	2.4	714	-	275

Source: World Bank, *World Development Indicators 1997*

a Data are for the most recent years available; b Totals may not add up due to rounding

Cambodia's post-war background is reflected in the structure of public expenditure. In 1996, the Cambodian government spent 4.9 percent of GDP on defence expenditures (Table 4.3). Although the defence share had declined slightly since the Paris Peace Agreement in 1991, the level was still the highest within the region in 1996. The share of defence spending in Cambodia looks even more dramatic if defence expenditure is presented relative to current expenditure. Defence expenditure in Cambodia accounted for around 50 percent of current expenditure in 1996, whereas other ASEAN countries, except Myanmar, spent no more than 25 percent of current expenditures for defence.

**Table 4.3. Defence and Total Public Expenditures
(percentage share in GDP)**

		Total expenditure	Defence expenditure
Cambodia ^a	1996	16.4	4.9
Laos		-	-
Myanmar	1994	11.0	4.1
Vietnam		-	-
Indonesia	1993	16.7	1.0
Philippines	1993	18.5	2.0
Thailand	1994	16.4	2.4
Malaysia	1995	23.0	2.9
Singapore	1993	17.7	4.4

^a 1995 data from World Bank, *Cambodia: Progress in Recovery and Reform*

Source: World Bank, *World Development Indicators 1997*

Comparative analysis of Cambodia with the ASEAN countries indicates that there is scope for improving public policy toward human resource development in Cambodia. If the Cambodian government fails to invest in human resource development, the benefits from regional integration may not be translated into sustainable development in Cambodia. Cambodia would then fail to eradicate poverty, would widen the income gap between the rich and the poor, would generate a sense of inequality and unfairness among its people, would heighten social and political tensions, and thus undermine the potential for sustainable development.

Coherence 2: AFTA/CEPT and agricultural and rural development

Few would disagree that one of the highest priorities for Cambodia is agricultural and rural development. Although potential comparative advantage appears to exist in the agricultural sector, it has yet to be revealed and developed. A number of serious local constraints seem to prevent the development of the agricultural sector.

Naturally, a policy package which directly addresses agricultural development is the most critical policy instrument for this purpose. And yet, Cambodia's tariff reduction strategies under AFTA/CEPT will change the incentive structures for farmers and producers, thus affecting the effectiveness of the agricultural policy package.

On the trade and investment policy side, strategies toward AFTA may need to consider some preferential, yet time-constrained, protection of some strategic items which have the potential to become export products. The promotion and facilitation of foreign investment in the agricultural sector should supplement trade strategies. On the agricultural and rural development side, policy-making should be undertaken that takes into account the strategies of the AFTA/CEPT scheme. It is essential that both cross-border and domestic policy measures are complementary, rather than in conflict with each other.

Coherence 3: AFTA/CEPT and industrial/service sector development

Industrial development appears to have gathered momentum since Cambodia's transition to a market economy started in the early 1990s. Light manufacturing, such as the garment industry, has led the industrial sector. The construction industry also has expanded sharply,

reflecting a construction boom after the Paris Peace Agreements in 1991. In other words, markets appear to be working reasonably well, and direct intervention in the form of tariff protection under AFTA/CEPT in Cambodia is not appropriate.

Rather, the government's role in these sectors is to ensure that development will actually contribute to raising the living standards of people by maximising the number of jobs created, exports of products, earning of foreign currency, and increasing tax payments for government revenue. No less important is that labour standards set in the labour law are strictly implemented to protect the living standards of workers.

Setting quality standards for products and services is also a critical role of the government. As Klitgaard (1991) points out, quality standards provide incentives for producers to improve the quality of products and services, and help inform consumers about the quality of those products. In short, adequate quality standards will help mitigate problems arising from the asymmetry of quality information between producers and consumers, and make markets work better.

4.2. Policy Coordination

Policy coherence will never emerge without a high level of coordination among government ministries. As Kaplan (1997) notes, one of the ongoing challenges in the Cambodian government is "building inter-ministerial arrangements that can effectively and efficiently coordinate to generate policy options, develop and share information, and provide technical input to guide Cambodia's participation in ASEAN's various economic initiatives." Institution building and legal reform are pre-conditions for enhancing the coordination capability of the Cambodian government. The roles of the National AFTA Unit and Internal Coordination Network (ICN), which were created for inter-ministerial coordination purposes, are critical for generating a coherent set of policy packages geared toward regional economic integration.

Coordination may be necessary between the public and the private sector as well. ASEAN preparations so far appear to be limited to those within the government. It is not clear to what extent the private sector in Cambodia has been informed about AFTA itself or about the government's policy stance towards AFTA. As the private sector will be exposed to stiff competition within the region, information of this sort will be helpful for its decision-making in preparation for AFTA. The public sector should also benefit from exchanging views with the private sector to generate a coherent policy package towards AFTA.

5. Conclusions

The present paper seeks to discuss what challenges economic integration will pose to achievement of sustainable development in Cambodia.

For this purpose, the paper first made clear the concept of regional economic integration, and identified foreign trade and investment as the key variables which will be directly affected by Cambodia joining AFTA. It then looked at the current patterns of foreign trade and investment in Cambodia. There were two main findings:

- ASEAN countries were by far the largest trading partners for, as well as major investors in, Cambodia. This indicates that Cambodia's membership in ASEAN and AFTA is likely to have significant economic implications for Cambodia.
- Cambodia's comparative advantage was revealed in natural resource-based products (rubber, wood, timber) and labour-intensive manufacturing products (garments). A comparison with neighbouring countries indicates, however, that Cambodia's potential comparative advantage may lie in agricultural and agro-processing products, a sector

which has not yet been well developed.

The main purpose of this paper was to discuss the challenges of translating the benefits of regional integration into sustainable development. It was emphasised that regional economic integration is a means of raising the living standards of Cambodians, the ultimate goal of sustainable development.

The first challenge is to achieve high economic growth with equity. Cambodia's development will not be sustainable unless the benefits from regional integration and economic growth are broadly shared, particularly by the poor. A key policy for the maintenance of equity is public investment in human resource development, particularly in universal education and health. Our comparative study revealed that public investment in education and health in Cambodia was much lower than that in other ASEAN countries. A challenge to the government is, therefore, how to mobilise limited resources to fill the existing gap in human resource capacity between Cambodia and the ASEAN countries.

The second challenge is to promote agricultural and rural development. Agricultural products are already included in the CEPT scheme under AFTA, and thus will be exposed to competition with the ASEAN economies in the long term. Our study found, however, that the productivity of agricultural products in Cambodia was in general far below the best-practice country in the region. Farmers in Cambodia have faced serious constraints, such as the lack of access to various inputs, finance, technology and information. Cambodia has not yet revealed a comparative advantage in agricultural products, where Cambodia's potential comparative advantage appears to exist. A major challenge to the government is how to articulate AFTA/CEPT strategies to facilitate agricultural and rural development.

The third challenge is industrial and service sector development. These sectors have been leading sectors for economic growth since economic liberalisation began. They offer different challenges to the government from those in the agricultural sector. The government should ensure that the development of these sectors actually contributes to raising Cambodians' standard of living. Setting quality standards for goods and services is a critical step for the government to make market mechanisms work better.

Key factors in articulating regional integration policies in Cambodia are policy coherence and coordination. The multi-dimensional objectives of sustainable development require the government to articulate integration policies which are coherent with other policies serving different objectives. This policy coherence will not emerge without coordination among the ministries, and also coordination between the private and public sector. Regional integration will contribute most effectively and efficiently to sustainable development in Cambodia if these conditions are met.

Appendix One

List of Conference Papers

The following papers were presented at the Cambodia Development Resource Institute international conference *Cambodia: Challenges and Options of Regional Economic Integration*, held in Phnom Penh from 27 to 28 October 1997:

- *Cambodia in the Regional Economy: A Cross-Country Study*, Chan Sophal, Toshiyasu Kato & Long Vou Piseth (Cambodia Development Resource Institute)
- *Cambodia's ASEAN Membership: The Institutional and Legal Challenges*, Jeffrey Kaplan (ASEAN Project, UNDP Cambodia)
- *Membership in ASEAN: Public Finance and Tax Reform in Cambodia*, Kun Nhem (ASEAN Department, Ministry of Foreign Affairs)
- *Cambodia: Strengthening the Foundation for Trade and Industrial Development*, James Robertson & Harold Pohoresky (Consultants for Asian Development Bank)
- *Regional Integration for Sustainable Development in Cambodia*, Toshiyasu Kato (Cambodia Development Resource Institute)
- *Lao PDR in the ASEAN Free Trade Area: Trade, Revenue and Investment Implications*, Jayant Menon (Centre of Policy Studies, Monash University)
- *Regional Integration and its Influence on the Forest Resources in Lao PDR*, Takeko Iinuma (Forest Conservation and Afforestation Project, Department of Forestry)
- *Regional Economic Integration and Macro-Economic Management in Vietnam*, Nguyen Xuan Nguyen (Central Institute for Economic Management, Ministry of Planning and Investment)
- *Foreign Trade and Investment Policies in Vietnam*, Hoang Van Thanh (Central Institute for Economic Management, Ministry of Planning and Investment)

Presentations were also made at the conference by H.E. Keat Chhon (Senior Minister in Charge of Rehabilitation and Reconstruction and Minister of Economy and Finance), H.E. Cham Prasidh (Minister of Commerce), Somchith Inthamith (ASEAN Department in the Ministry of Commerce, Laos), and Shigeru Itoga (Institute of Developing Economies, Japan).

A separate volume of the Cambodia-specific conference papers is available from the Cambodia Development Resource Institute. Photocopies of other conference papers are available on request for a nominal charge.

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- Keat Chhon & Aun Porn Monireth (1996), *Strategy for Cambodia's Participation in the ASEAN Free Trade Area and its Implementation of the Agreement on Common Effective Preferential Tariff (CEPT)* (Phnom Penh: Cambodian Institute for Cooperation and Peace, 1996)
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