

Potential Impact of the Financial Crisis on the Poor and Vulnerable Groups in Cambodia

This article summarises the presentation by Dr. Hossein Jalilian¹ during session 1 of the 2009 Cambodia Outlook Conference.

Introduction

Most of the poverty effects of the global financial crisis are transmitted through growth, and therefore it is necessary to consider the impact on growth first. The channels through which growth in Cambodia would be affected include: trade, foreign investment, tourism, remittances and international aid.

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

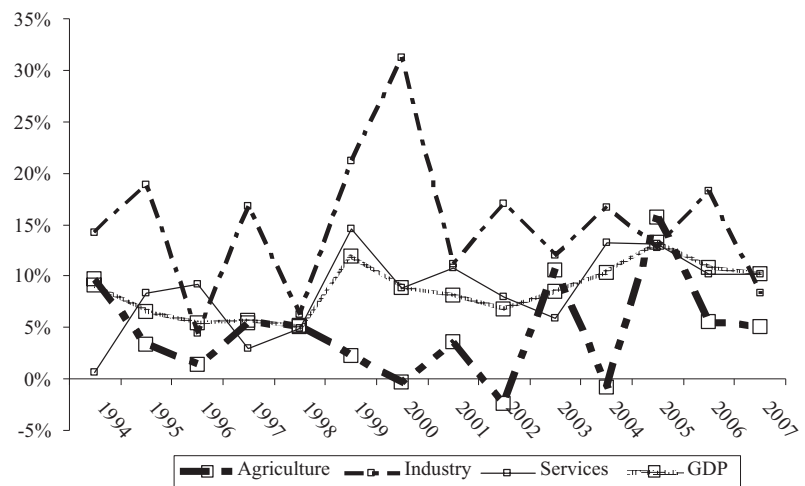
Impact on Growth

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

Over 1994–2007, Cambodia experienced a GDP growth rate averaging around 10 percent. Most of this is attributed to the substantial growth in industry and then services. Industrial growth was driven by the considerable growth of garments and construction. Services sector growth is due to tourism.

Both industry and services have made considerable contributions to GDP growth;

Figure 1: Sectoral Growth in Cambodia 1994-2007



Source: Based on NIS data

agriculture's contribution, as shown, has been rather limited until recently. Growth in the case of agriculture has also been more unstable.

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

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

¹ Hossein Jalilian is the director of research of CDRI.

Figure 2: Sector Contributions to GDP Growth in Cambodia

Source: NIS

Impact on Poverty

There is a direct relationship between growth and poverty reduction. Given the recent impressive growth, poverty reduction should have been much higher than the 10 percentage point reduction achieved over the period. The reason for this lies in the limited linkages between the growth poles and the rest of the economy. The greatest contribution that the growing sectors make is in employment generation; otherwise they are not much linked to the rest of the economy. This is less the case for tourism.

To consider more fully the impact of reduced growth on poverty, it would be useful to distinguish between the growth effects transmitted through the labour market and the impact on overall consumption and investment expenditure. Given the limited linkages between the growth poles and the rest of the economy, the direct effects of reduced growth on poverty that are transmitted through the labour market are not likely to be as severe. However, loss of employment would have knock-on effects not only on the welfare of the unemployed but also on the larger families that these individuals support. Large proportions of rural migrants to urban areas send remittances back to their villages.

In addition to rural-urban migration, about a quarter of a million workers in Cambodia migrate to other countries, mainly Thailand. A large portion of these migrants are likely to lose their jobs due to

the effects of the crisis in host countries. Migrants to Thailand are likely to face a more serious problem. More than 80 percent of Cambodian migrants to Thailand are illegal. Thai authorities have announced that they will send illegal migrants back to their home country. This would have serious implications for remittances and, subsequently, the well-being of households supported by remittances. Remittances cover not only part of consumption of households but also their expenditures on physical and human capital.

Reduced growth, especially to the extent predicted by the most recent forecasts, would also have a considerable impact on households through its effects on consumption and investment. A large portion of the population is living close to the poverty line; any small decline in their income is likely to push them below the line. The Moving Out of Poverty study, which CDRI published last year, shows this vulnerability very clearly. In some of the study villages, a change of income of a few hundred riels a day would make a considerable difference to the severity of poverty. The same study also shows significant change in the poverty ratio and its depth between dry and wet seasons. This indicates that the poor have very limited coping mechanisms in dealing with seasonal variations in their earnings.

In addition to the adverse employment effects of the crisis, poor and vulnerable groups are likely to

be hit hard because of the slowdown in economic activities. The crisis will adversely affect the relatively well off and the rich as well. They are likely to reduce their consumption and particularly their investments. This reduced demand and expenditure will affect a much larger section of the population. As is normally the case, the groups most at risk of losing part or all of their livelihood are those with no or limited human and physical capital, that is, the poor and relatively poor.

Overall therefore, Cambodia is likely to face an increased level and severity of poverty. How severe these and other consequences are will be determined by Cambodia's main trading partners, such as the US and EU, and how well they cope with the crisis, and importantly by the reaction of the government and its development partners.

Policy Options to Cope with the Adverse Effects

A study just published by the IMF classifies Cambodia among the most exposed of the low-income countries. The exposure is measured as vulnerability of households to the increased risk of poverty and hardship. In this case, it is important that policy reduce the impact of the crisis on the poor in the immediate to short run and reverse the downward pressures on growth and poverty reduction in the medium to long term.

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

However, a number of constraints make such a contribution less likely. Although relatively well placed in terms of its monetary and fiscal policies, the government does not have sufficient fiscal and monetary capabilities to adopt the expansionary policies required. The exchange rate policy considerably reduces the role that monetary policy can play. The government also has limited options in applying expansionary fiscal policies. Its capacity is limited in both funds and capacity to implement such policies. Other actors, such as development partners, could play a more significant role. Given the economic environment at present, however,

that may not be forthcoming, although there are regional and international efforts to support poor countries.

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

Conclusion

Although the adverse effects of the crisis on Cambodia are likely to be severe, it also offers an opportunity to the government to consider its development strategy. A core component should be a more effective and cohesive agricultural development—a strategy that addresses serious limitations and constraints in that sector. These limitations include insufficient investment in physical and social infrastructure; lack of linkages between agriculture and the rest of the economy; and problems associated with marketing in general and agricultural products in particular.

These strategies are all interlinked. Addressing them would have considerable impact on both growth and poverty. It may be advisable in particular to pay more attention to removing barriers to the production and sale of rice, internally and internationally. The rice surplus in the country is over 2 million tonnes per year. With improved irrigation alone, the surplus could potentially be doubled. Unlike most agricultural products, the price of rice internationally has been increasing continuously over the present decade. In spite of a drop from its recent highs, it is still above what it was last year. Revenue raised through this channel alone could make a substantial contribution to the economy and poverty reduction.