

Chapter 2

Trade, Investment and Productivity

2.1. External Trade and Capital Movement

Imports and exports of goods and services reveal how well Cambodian industries perform both at home and abroad. The main foreign currency earners are garments and textile, tourist-related services, foreign assistance and loans. Cambodia has to pay for the imports of raw materials for the garment industry, imports of oil and gas, and most other manufactured goods. Moreover, outflows of currencies reflect the repatriation of interest payment on foreign debts, returns on investment, and salaries of foreign workers, whereas inflows are remittances from Cambodians overseas, FDI, and other transfers.

Data compiled from the government, IMF and EIC revised estimates reveal that total exports of goods in 2004 made up 47.8 percent of nominal GDP while the imports were 64.5 percent, leading to a trade deficit at 16.7 percent of GDP. The biggest exports of garments and textile reached about US\$2 billion up from US\$1.6 billion in 2003. Imports of goods also increased at the same pace amounting to US\$3.1 billion in 2004, about US\$500 million higher than that of 2003. The main import components are US\$1.3 billion of garment and textile raw materials and finished products and more than US\$800 million estimated imports of petroleum (including smuggling), US\$200 million higher than the amount estimated by the NIS¹⁰.

Higher arrivals of foreign tourists in 2004 contributed to a surplus in the balance of services, in spite of deficits in the balance of transportation as most of the air-transport to Cambodia is carried out by foreign airlines. The income balance was in deficit reflecting larger income payments to foreigners for their profits, interests and compensation of employees. However, Cambodia enjoyed huge inflows of current transfers from foreign grants and some remittances. These surpluses compensated for the trade deficit so that the current account deficit was 7.5 percent of GDP in 2004. With access to foreign borrowings and an increase in FDI, the overall balance of payment improved and stabilized. The surplus also strengthened the country's foreign reserve.

¹⁰ National Institute of Statistics. (2005). NATIONAL ACCOUNTS OF CAMBODIA 1993 – 2004. Bulletin No.9. Table 8a.

Table 2.1: Cambodia's Balance of Payments (% GDP)

	2002	2003	2004e	2005e	2006p
<i>Exports of Goods</i>	42.9%	47.0%	47.8%	47.2%	47.1%
<i>Imports of Goods</i>	56.7%	59.6%	64.5%	67.6%	65.0%
Trade Balance	-13.8%	-12.6%	-16.7%	-20.5%	-17.9%
Agriculture	2.4%	4.1%	1.8%	1.8%	2.0%
Textiles & Garments	10.3%	11.9%	13.3%	13.4%	13.4%
Oil & Gas	-11.3%	-12.7%	-16.8%	-19.6%	-17.9%
Other Goods	-15.3%	-15.9%	-15.1%	-16.0%	-15.5%
Balance of Services	5.6%	3.0%	4.1%	5.1%	5.9%
Transportation	-3.1%	-3.5%	-4.3%	-5.2%	-6.1%
Travel (Tourism)	10.2%	8.1%	10.3%	12.5%	14.3%
Others	-1.5%	-1.6%	-1.9%	-2.1%	-2.3%
Balance of Incomes	-4.1%	-4.2%	-4.6%	-5.3%	-5.6%
Current Transfers (net)	11.0%	10.9%	9.7%	9.4%	9%
Private Transfers ¹	4.8%	4.7%	4.3%	4.1%	3.8%
Government Transfers ²	6.2%	6.2%	5.4%	5.3%	5.1%
Current Accounts	-1.3%	-2.9%	-7.5%	-11.3%	-8.6%
Capital & Financial Accounts	7.0%	7.4%	7.8%	7.8%	6.7%
Official Loans ³	3.8%	3.4%	2.8%	2.7%	2.5%
Foreign Direct Investment	2.0%	2.9%	4.0%	4.1%	3.4%
Others (net)	1.1%	1.1%	1.0%	0.9%	0.9%
Change in Foreign Reserves⁴	5.6%	4.5%	0.3%	-3.5%	-1.9%
<i>At the National Bank</i>	2.8%	1.7%	0.9%	0.4%	0.3%
<i>Outside the National Bank</i>	2.8%	2.8%	-0.5%	-3.8%	-2.2%

Source: IMF-EIC Balance of Payments Statistics for 2002-2003, EIC model projection for 2004-2006.

¹ Money transferred by Cambodian overseas.

² Grants provided by donors to the government.

³ Net of debt amortization.

⁴ Overall balances reflect change in country's foreign reserves. As Cambodia is a dollarized economy, and private individuals and institutions can hold foreign currencies, the overall change of the balance of payments not only affects the foreign reserves of the National Bank, but also other economic agencies, such as private financial institutions, businesses and households.

For 2005, however, exports are still dominated by garments and textile but with lower growth rates. Projected total exports of goods and services for 2005 are US\$2.5 billion, 7 percent higher than 2004, and imports are expected to be 14 percent higher, reaching US\$3.6 billion in 2005. The higher value of imports is due to higher prices, especially of petroleum, that will cause a wider trade deficit gap to 20.5 percent of GDP in 2005. Moderate surpluses from other accounts, especially from the services, FDI, and foreign assistance, will not be sufficient to cover trade deficits so the overall balance of payment will deteriorate.

For 2006, both imports and exports are expected to grow but at a slower rate. Exports of garments and service incomes from tourism will grow at the same pace compared with 2005. Exports of goods and services will continue to increase. Large deficits in trade will worsen the foreign reserve due mainly to an increasing demand for a higher amount of foreign currencies to finance the deficits. As inflows of FDI and foreign aid may not be strong enough, the deficits would threaten foreign reserve and put pressure on the depreciation of the Riel.

2.2. Private Investment and Stocks of Capital

Private investment is one of the country's determinants for growth prospects. EIC's estimates reveal that Cambodia needs no less than US\$1 billion of productive funds including loans and grants to boost both private sector and public infrastructure development and to achieve 7 – 8 percent annual growth of GDP.

EIC estimates that actual implemented private investment in 2004 totaled US\$540 million, 1/3 of which was FDI. Because of limited savings, private domestic investment was flat, whereas FDI picked up more than 50 percent in 2004 compared with that of 2003. The surge in registered projects and fixed assets of investments in garment factories and hotels in 2003 and newly-established factories in 2004 led to higher actual implementation of investment projects in 2004. According to the Council for the Development of Cambodia (CDC), however, newly registered investment projects were less in 2004 than in 2003, both in terms of number of projects approved and fixed assets.

Table 2.2: Private Investment Projects Approved, 2000-2005

	2000	2001	2002	2003	2004	Jan-Jun 2005*
Number of Investment Projects Approved						
Total	96	188	37	66	54	56
Garment	52	76	16	31	28	31
Hotel	10	4	4	11	3	2
Others	34	108	17	24	23	23
Fixed Assets Approved (millions of dollars)						
Total	266	217	240	314	217	347
Garment	77	100	18	75	68	50
Hotel	71	71	47	114	24	42
Others	119	46	174	126	125	255

Source: CDC, Cambodian Investment Board, * excluding registered investments of 3 mega projects in oil refinery, iron and steel mining, and aluminum melting whose combined fixed asset is more than US\$3.5 billion.

Data from the first 6 months of 2005 suggests that registered investment projects and fixed assets soared, exceeding the total figure of the whole of 2004. The figure excluded three mega projects whose registered fixed assets are over US\$3.5 billion. However, these projects are long term so that they will not affect the growth prospects of the economy in the short-run. The increase may come after the elimination of the 2 percent of registered-fixed-asset as investment guarantee deposit from early 2005. This would open opportunities for speculative investors¹¹, with the ability not to commit to the approved investment projects.

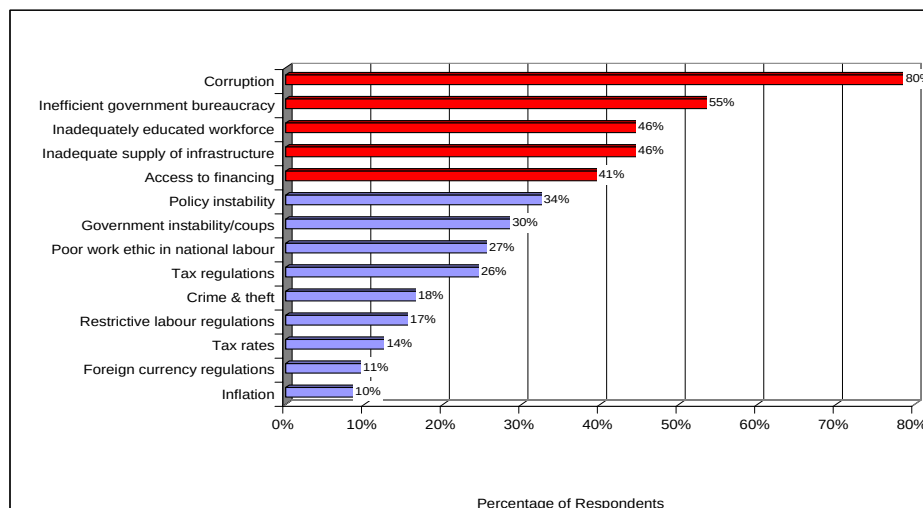
EIC estimates that actual private investment for 2005 will continue to be strong even though construction of new hotels will decline. The garment factories to be built in 2005 are expected to double the number established in 2004 as the safeguard measures taken by the US and EU continue to curb Chinese garment exports from flooding their markets.

Nonetheless, Cambodia will face stiffer competition from Vietnam in both attracting FDI and promoting exports of garments and textile should it become a full member of WTO. Moreover, the slow progress of

¹¹ Those investors who have no genuine incentives to invest but to get investment licenses and then resell to others in order to make short term profits, commonly known in Khmer as “tver num at msau or making cakes without powders”.

legal, judicial and public administration reforms are still the main obstacles to doing business in Cambodia, according to EIC's study on the country's competitiveness. These areas have fostered "corruption as a way of life" and must be dealt with.

Figure 2.1: The Most Problematic Factors for Doing Business in Cambodia



Note: From a list of 14 factors, respondents were asked to select the five most problematic factors for doing business in Cambodia.

Source: EIC, Cambodia Competitiveness Report 2005-2006.

EIC estimates that the stock of capital continues to increase across the sectors but with lower rates for most, except for garments and textile, and tourism the two most dominant and attractive for investment in the country. While the capital stock in agriculture increased by merely 1 percent in 2004 compared with 2003, that of industry and services grew by 8 percent and 10 percent respectively at the same time. Capital stock of garments and textiles increased more than 14 percent and that of hotels and restaurants was 27 percent. The total growth in capital accumulation was 7 percent in 2004.

For 2005, the stock of capital continues to increase due to an exceptional influx of investments in the garment and textile industry even though construction of new hotels will decline. The overall capital stock is expected to increased by 8 percent, 1 percentage point higher than growth in 2004. However, the situation will reverse for the year 2006. While tourism continues to be strong, the garment and textile industry will face uncertainty due to fiercer competitions from rival countries and the uncertain commitment of the government to reducing transaction costs to keep the industries afloat.

2.3. Productivity

With low capital stock, Cambodia must maintain a high labor productivity to attract investment such that incremental capital investment would yield higher production and returns. Continuous expansion in garments and tourism has demonstrated the attractiveness and profitability for both domestic and foreign investors.

Table 2.3: Productivity of Workers (% Increase, US\$2000 price)

	2002	2003	2004	2005e	2006p
Agriculture	-2.5%	9.1%	-4.6%	-1.4%	1.2%
Paddy	-7.1%	19.0%	-14.7%	-3.1%	2.9%
Industry	8.9%	6.8%	8.1%	5.6%	5.0%
Textile & Garment	14.2%	10.9%	11.4%	9.1%	8.5%
Private Services (*)	2.0%	-0.9%	6.8%	4.2%	4.9%
Tourism	10.3%	-7.7%	8.3%	6.5%	5.2%
Total (*)	2.4%	4.0%	3.7%	2.9%	3.8%

Source: EIC Estimates.

(*) Excluding Public Administration.

According to EIC estimates, productivity of industry and services has been improving gradually over the years. But agricultural productivity on average, especially in paddy rice, fluctuated greatly due to its almost complete dependence on weather conditions. Total productivity increased by more than 3 percent annually during 2002 – 2004 led by productivity gains of the garment and textile industry.

Labor productivity is expected to grow in 2005 but at a lower rate due to a slow down in both garments and textile and tourism sectors. The drought will again dampen the productivity of the agricultural sector. Therefore, labor productivity growth of the whole economy in 2005 will be 2.9 percent, about 1 percent lower than that of 2004. However, the total productivity of labor will recover and grow in 2006 due to better performances across the economy.

The most recent study on the garment industry¹² reveals that among garment factories in Cambodia, the degree of technological and managerial sophistication varies widely. Only 7 percent of Cambodian factories

¹² Measuring Competitiveness and Labor Productivity in Cambodia's Garment Industry, EIC Economic Review, Volume 2, No.2, April – June, 2005.

surveyed operate what could be considered world-class enterprises; more than three-fourths have significant potential for upgrading; and the rest lag behind enough that they will find it difficult to thrive in the post-quota environment of heightened global competition.

However, most factories require both technical and managerial training. Cambodia's apparel factories have tremendous potential for increased productivity provided that they apply sufficient interest, effort, and resources to basic production techniques and managerial disciplines. Improvements in productivity of 15 to 20 percent can be achieved. Along with this productivity gain, Cambodia can move up the value chain to produce higher-quality and higher-value garments.