

Cambodia's Economy in the Election Year 2003

Far from securing prosperity, 2003 sets to be another difficult year for the Cambodian economy due to SARS outbreak in the region and, perhaps, a local political deadlock.

It is obvious that the current delay in forming a new Government in Cambodia after the July 2003 election is becoming a factor that can affect the economic growth for the year. Though the impact is not yet objectively clear, a drawn out deadlock can only be detrimental to the economy.

Production

Up to September 2003, the Cambodia's economy has been characterised by a sharp decline in the tourism activity, and unexpected strong growth of the garment export. Agriculture production seems to be better off than that in 2002, due to better weather conditions. However, the July elections and persistent weak governance have had adverse impacts on the Government revenue collection and investment. Therefore, the Economic Institute of Cambodia (EIC) estimates that the economic growth for 2003 would reach 5 percent, a decline of a percentage point compared to that of 2002.

The agriculture sector, accounting for only a quarter of the GDP yet providing employment to 80 percent of the workforce, has staged a recovery from the previous year's contraction to post a growth of 4.3 percent in 2003. Due to sufficient rainfall and absence of natural disasters, the rice production for the year is expected to increase to 4.1 million tons from 3.8 million tons in the previous year. Rice plantation makes up a very large proportion of agriculture, and is heavily dependent on weather. Currently, according to the Ministry of Agriculture, Forestry, and Fisheries, rice plantation with irrigation system covers only about 270 thousand hectares, or 12 percent of the total rice plantation area. Of course, as expected, the irrigated rice fields produce better yields, which amount to about 24 percent of the total rice output. It seems therefore a rice plantation with irrigation sys-

tems would produce higher yields.

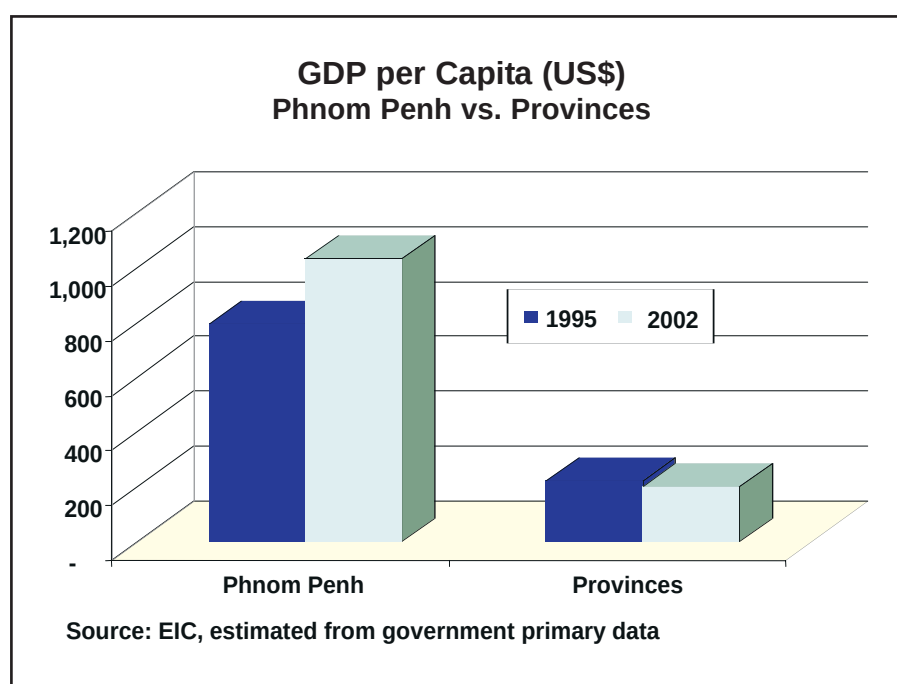
Nevertheless, the increase in agriculture production does not necessarily mean that rural livelihood will improve. Based on an EIC preliminary survey at some rural villages in Kompong Cham Province, prices of crops seem to decline slightly due to a possibility of over supply. Better access to the international markets for Cambodia's crops is perhaps essential to improve rural livelihood.

The textile and garment industry has unexpectedly remained strong in 2003. Garment exports, for the first six months of 2003, amounted to US\$646 million representing a 29.2 percent increase compared to the same period in 2002, according to the Ministry of Commerce. Exports to the US market, which represent about 70 percent of the total garment export, has increased by 33.4 percent, while exports to the European market, which accounts for 27 percent of the total garment export, rose only 8.1 percent. The robust growth has mainly resulted from the Normalised-Trade Relationship agreement with the United States and European Union in 1996 and 1997, which accorded

Cambodia the Most Favoured Nation (MFN) and Generalised System Preference (GSP) trading status. In the meantime, the war in Iraq has also boosted the Cambodian garment export, as some of US merchants switched their purchases from some Muslim countries to Cambodia, due to fears of terrorist activities.

The industry is, however, facing a crucial challenge ahead. The US, which has been a major export market for the Cambodian garments for the past few years, will lift its quotas by the end of 2004 for all World Trade Organisation (WTO) members. The removal of the quotas means the Cambodian garments will be able to freely flow into the US market without the current quotas barrier. The Cambodian membership of the WTO obtained in early September 2003 will oblige the country to comply with policies of free trade and investment. To put it simply, Cambodia would need to be able to face fierce competition, especially from China and India, for the international market.

Although the Cambodian labour cost is comparatively low, its competitiveness may be hindered by



the “unofficial” administration costs many investors have been complaining about for some time. High political risk is another factor that can only discourage long-term investments. Until now, there has been no sign showing that the Government will take concrete actions to address the issue. Therefore, it is not likely that Cambodia will be ready to face stiffer competition from 2005, placing at great risk the Government’s poverty reduction policy.

The construction sector is expected to be overall flat in 2003, while residential constructions in the cities remain robust. The whole sector has played an important role in boosting the country’s economy, given a large number of programs of reconditioning and reconstruction after years of war and destruction. In 2003, it is estimated that the construction sector accounts for 5.8 percent of the GDP. Of this amount, nearly half are the non-residential public constructions, 36 percent are non-residential private constructions, and the rest are for residential construction.

Since 1999, non-residential private construction has experienced a sharp decrease due to a dramatic decline in fixed assets of foreign direct investment (FDI). During 2000-2002, fixed assets of foreign direct investment amounted to less than US\$ 100 million per year, which is a severe decline from an average of US\$ 200 million per year during the 1990’s. The FDI is expected to remain low due to the decline in investment in the tourism sector.

The tourism industry is likely to go down dramatically in the first eight months of this year. It is the second time in the last decade that the industry has shown a negative growth in tourist arrivals. The first was when there were crises in the Asian economies and internal conflicts in Cambodia in 1997. This time, in the first half of this year, the SARS outbreak, the anti-Thai riots in Phnom Penh, and the Iraq war have had an adverse impact on the number of tourist arrivals in Cambodia.

In the first eight months of this year, the number of arrivals

dropped by 18.5 percent compared to the same period last year. According to the Ministry of Tourism, it decreased from 518 to 422 thousand persons. The decline in the arrivals to Phnom Penh has been more severe than that to the Angkor city of Siem Reap. The former suffered a drop of 25.7 percent, while the latter only 8.6 percent.

The tourism enjoyed a constant growth for four years up to 2002. The annual number of foreign visitors to Cambodia doubled from 368 thousand persons in 1998 to 806 thousand persons in 2002; the revenue reached US\$ 340 million last year.

However, from the end of March this year to the end of July, when SARS began to spread in the region, it is estimated that the country’s tourism industry has lost about US\$ 48 million in revenue. The average hotel occupancy rate in May was down to nearly 10 percent from an over 50 percent earlier this year. There have been significant staff lay-offs in the hotel industry as some hotels are struggling to stay afloat by cutting costs; some new hotel constructions have either been stopped, or at least postponed. For the whole 2003, it is estimated that the number of foreign tourists may reach only about 700 thousand persons, a decline of some 100 thousand compared with 2002’s.

The constant growth of the GDP per capita in the capital city will continue to encourage further migration from provinces, even though the provincial GDP growth is expected to somewhat staged a recovery in 2002. There have been plenty of economic incentives for an influx of migration from rural areas into the capital city. The GDP per capita in Phnom Penh is five times higher than those for the provinces. In 2003, the GDP per capita estimated for Phnom Penh tops the rank with an average income of US\$ 1,000 per person. It is nearly twice as much its 1993 average level, or five times higher than the GDP per capita of the other provinces. The second highest is Sihanoukville with an income of around US\$ 600 per person. The strong development in industrial

and service sectors in the city has attracted a large labour force from the rural areas. Better job prospects with higher income, access to housing, water supply, electricity, and security has seen Phnom Penh swelling with a population explosion in the last few years.

Though all provincial economies depend more or less on the agriculture that has kept their income per capita low, development in the provinces varies. A few, led by Sihanoukville and Kompong Cham, are becoming better off, while others stay mired in poverty. Nevertheless, the rural poverty has been compounded by a rapid natural growth of population bringing about additional socio-economic problems in housing, water supply, electricity, and security.

Investment

Investment and trade figures in the first eight months point to an optimistic view of the future. According to the Council for Development of Cambodia (CDC), the number of approval projects and the amount of potential fixed assets by private investment in the first eight months of 2003 amounted to US\$ 219 million representing a 36.3 percent increase compared to the same period in 2002. Typically, over a third of them were capital intensive investments in the tourism sector, and about 14.3 percent was labour intensive investment in the garment sector. As expected, most of the investment are in Siem Reap and Phnom Penh. Permits for construction projects in Phnom Penh for industry and commercial use such as factory, warehouse, and hotel were issued for 66 projects; this represents a 6.5 percent increase compared to the same period in 2002.

On the Government side, it invested around 811 billion riels (US\$ 204 million) in the first eight months of 2003, which represented 44 percent of the total state budget expenditure. Although public investment remains the most important factor of investment in infrastructure such as roads,

bridges, water supply, and irrigation systems, foreign grants and loans have been the main funding sources. Cambodia simply does not have either domestic savings or foreign exchange reserves to fund much needed imports of capital and intermediate goods.

Due mainly to the rapid pace of World Bank and the Asian Development Bank project aid disbursements, Cambodia received in the first eight months project loans totalling 347 billion riels (US\$ 87 million), or 16 percent over the budgeted loans target in 2003. In addition, donor funds of about 240 billion riels (US\$ 60 million) were also released as part of their project grants to Cambodia. Therefore, the Cambodian people received in the first eight months of 2003 about US\$ 11 per person in foreign grants and loans.

Price and Exchange Rate

The subdued economic activities have perhaps helped keep the overall Consumer Price Index (CPI) more or less stable. In August 2003, according to National Institute of Statistics, the CPI increased by a mere 0.2 percent from the previous month's level; and from December 2002, it has posted an increase of only 0.6 percent.

Though the overall Index shows price stability for the first eight months of this year, prices of major consumer items in the basket of goods and services used for the calculation of the Index have fluctuated quite erratically. Food prices and other non-food commodities remained fairly stable in the above period, whereas oil prices have fluctuated. Gasoline and diesel prices went up to 2,500 riels and 1,700 riels per litre respectively in April, and then steadily decreased to 2,300 riels and 1,650 riels per litre in July, perhaps due to the decline in the crude oil price in international markets. However, motorcycle transportation fare increased by 4.9 percent, from 1,620 to 1,700 riels per 8 km.

The offsetting factors are prices for food items, including rice, meat, fish, and vegetables, which have

been stable, and those of some non-food commodities that have steadily declined. These items are mainly imported goods such as wooden furniture, electronic equipment, and some medical supplies.

Local financial markets reacted rather nervously to the recent election. Foreign currency deposits have declined by 10 percent in July alone. The value of the Cambodian riel currency has been sliding for the past nine months, posting an overall loss of 2.0 percent against the US dollar. In December 2002, the value of the US dollar was 3,940 riels; by October 2003, the amount dipped to 4,020 riels. A sharp depreciation was in May when the riel dropped its value to 4,035 riels/dollar. The depreciation may be attributable to the July national election that attracted more than usual spending for the election campaigns, and low Government revenue.

Fiscal Development

The Government has actually faced budget difficulty during the year, and urgently needed to fund the budget deficit. Due to ineffective governance, it has had limited success in raising revenues through taxation. It has, therefore, relied on the National Bank of Cambodia (NBC) to help pay for the deficit. Statistics from the Ministry of Economy and Finance shows that in the first eight months of 2003 the Government withdrew 122 billion riels (about US\$ 31 million) from the NBC. To further fund the budget deficit, the Government issued three-month Treasury bills and twenty-year Government bonds raising a total of 38 billion riels (about US\$ 9.5 million), and accumulated arrears of 58 billion riels (about US\$ 14.5 million) with private companies. Meanwhile, statistics from the National Bank of Cambodia in July indicates that the amount of riels in circulation increased by 9.8 percent from 766 billion riels (US\$ 192 million) in December 2002 to 841 billion riels (US\$ 210 million).

The Budget operations in

2003 have had difficulties in reaching the planned target. According to the Ministry of Economy and Finance, for the first eight months of 2003, the current revenue achieved only 1,049 billion riels (US\$ 262 million), which is about 21 percent below the year-to-date budget. The decline in revenue occurred in all economic sectors, except the revenue from garment quotas auctions. The most affected sectors were the tourist income and civil aviation revenue, which were down below the monthly budget significantly by 58 percent and 51 percent, respectively. The former plummeted to 12 billion riels (US\$ 3 million) and the latter to a mere 15 billion riels (US\$ 3.8 million).

On the expenditure side, the Government has disbursed a sum of 1,159 billion riels (US\$ 290 million) for current expenditures and public investment in the first eight months of 2003; this represented an increase of 22.5 percent compared to the same period in 2002. However, the actual disbursement for the period fell below budget, and the shortfall was not uniform for all sectors. Expenditures on defence and security accounted for about 238 billion riels (US\$ 59.8), representing an increase of 7.7 percent compared to the same period in 2002. The budget expenditure shows an increase of 8.9 percent in the priority sectors of education, health, agriculture, and rural development, if compared to that in 2002.

Overall, the Government posted a budget deficit of 765 billion riels (about US\$ 192 million) in the first eight months of 2003. About a quarter of the deficit was funded by Treasury bills, Government bonds, and domestic financial institutions, including the National Bank of Cambodia. The remaining three quarters were financed by foreign grants and loans. It should be noted, however, the Financial Law has restricted bank financing for budget deficit since 1994. The restriction was disregarded, for the first time, in 1998 when the national election was held.

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