

Cambodian Economic Background

Cambodia went through many critical developments, the “year zero” from 1975 – 1979 during which the country was plunged into the darkest pages of its history, facing disaster and genocide. But people’s expectations are now high, wanting to move on from poverty and achieve prosperity and national pride on the international stage. After the 1993 peace settlement, Cambodia has undertaken various reforms to change from a planned to a market economy. The country has become a member of ASEAN and recently became a member of WTO.

With a population of around 14 million people and a per capita GDP of about \$350¹ in 2004, Cambodia is seen as a small-scale economy in South-East Asia. As a developing country, Cambodia enjoys large inflows of foreign assistance and preferential treatments from many trading partners, especially the US and EU. With cheap labour costs and natural resources, the country attracts many foreign direct investment projects. Many industries and services have emerged. The most dynamic industries, however, are garment and textile, with tourism being one of the most promising services.

Average economic growth was 6 – 7 percent per annum during 1994 – 2004. High economic growth performance in Cambodia in the past decade is no longer pleasant news since there is no automatic mechanism to ensure simultaneous growth and poverty reduction. The growth is not concomitant with social improvement such as poverty, health and education.

Growth in the last few years remains strong but volatile due to the high concentration on garment, tourism and foreign assistance. FDI has been declining from its early peak in the first half of the 90s. The slow reforms of critical areas in conjunction with a global environment, especially with the uncertainties of the garment industry, are the key factors of growth imbalance. To note, garment exports have grown dramatically in recent years, accounting for nearly 80 percent of the country’s merchandise exports in 2004.

Agricultural production is sluggish due to the near total dependence on weather conditions and poor irrigation renovation as well as poor results from natural resource management reforms. Growth in the industrial and service sectors are dependent on multi-faced reforms in trade and investment, in public finance, and in the legal and judicial systems.

Besides the three principal formal activities (garment industry, tourism and public administration) informal activities represent a large proportion of the economy. EIC estimates that 85 percent of the Cambodian workforce activities are in the

¹ National Institute of Statistics, 2005

informal sector, which contributes to 62 percent of the country's GDP². The growth of informal enterprises leads to employment and income generation, especially for rural people.

In 2004, the budget deficit dropped by 2 percentage points of GDP and was mainly financed by foreign assistance. Loans accounted for about 21 percent of total foreign aid disbursed during the last twelve years and Cambodia's outstanding foreign debts were estimated at US\$ 1.2 billion at the end of 2004. Moreover, the socio-economic gap between urban and rural areas is wide, while rural incomes are fragile and seasonal³.

Reforms are critical to improve the country's competitiveness in order to attract more investments needed for growth diversification. The direct impact on competitiveness is to reduce transaction costs. This can be done by eliminating unnecessary bureaucracies and costs from business start-ups to import-export activities. Moreover, a predictable legal environment and enforcement are key to protect and promote investment confidence in the country.

² EIC's *Economic Review*, Volume 2 No. 1

³ *Cambodia Economic Watch*, April 2005