

The Competitiveness of Cambodia 2006-2007:

Building a Favorable Business Environment for Sustainable Growth

To maintain and enhance the national competitiveness, Cambodia will primarily need to place greater attention on the basic requirements such as ensuring long-term macroeconomic stability, improving infrastructure and establishing more reliable public institutions.

Cambodia has enjoyed relatively high economic growth, with an average GDP growth rate of 9 percent per annum for the last five years. Nonetheless, the country's economy appears to remain vulnerable, mainly due to its high dependence on just a few sectors and external influences. In 2005, garment exports alone reached 75 percent of Cambodia's total exports, with all most all the material needed for these garments being imported.

The country's export portfolio concentrates on a limited number of products, whilst various types of commodities, ranging from old cloth products to automobiles, are imported for local consumption. As a result, the country's trade balance has represented a fairly high deficit over the last few decades, signifying Cambodia's weak ability to take advantage of free trade in the context of globalization. It is necessary thus for Cambodia to be more competitive to compete at the international level.

The annual assessment by the WEF has become an important reference for cross-country comparison of factors affecting national competitiveness and growth. Each year the WEF produces its competitiveness index which ranks a large number of countries by their competitiveness. Since 2004, the Global Competitiveness Index (GCI) has been developed and used for this purpose.

Cambodia was not considered in this assessment until 2005, this year being the second time that Cambodia appears in the WEF's GCI, thanks to the partnership between WEF and EIC. The index has been the outcome of the Executive Opinion Survey, conducted every year in February-March by WEF and its partner institute in respective countries. For 2006, around 100 leading companies were selected

for the survey in Cambodia.

This article attempts to analyze Cambodia's competitiveness, based on the results of the WEF's GCI 2006-2007. It identifies the shift of Cambodia's competitiveness within the last year. In addition, a number of specific countries: Bangladesh, China, Indonesia, Thailand and Vietnam are chosen to benchmark Cambodia's national competitiveness given their nature as main competitors or as potentially countries of influence on the Cambodian economy.

How Competitive is Cambodia?

The WEF views national competitiveness as a set of factors, policies and institutions that determine the level of productivity of a country. Raising productivity is, according to WEF, the driving force behind the rates of return on investment which, in turn, determine the aggregate growth rates of an economy. This means that a more competitive economy will be

one which will grow faster in a medium to long-term perspective. Based on this perspective, the WEF defines three stages of economic development: the factor-driven stage, efficiency-driven stage and innovation-driven stage. With GDP per capita of about US\$450, Cambodia is undoubtedly treated as a factor-driven economy which competes based on factor endowments, primarily unskilled labor and natural resources.

Cambodia remains among the least competitive countries in the world. This year's ranking, the WEF's GCI 2006-2007, places Cambodia at 103rd among 125 countries in the assessment. The country's performance is slightly behind Bangladesh (99) but lags far beyond its neighboring countries such as Thailand (35), Indonesia (50), China (54) and Vietnam (77). Switzerland is the world's most competitive country, while Angola is at the bottom of the WEF's GCI 2006-2007.

Cambodia's low ranking

Table 1: Countries' Ranks in the Global Competitiveness Index (GCI)

Countries	GCI 06-07		GCI 05-06		Changes in Rankings	
	Rank	Score*	Rank	Score*		
Switzerland	1	5.81	4	5.67	↗	3
Finland	2	5.76	2	5.73	→	0
United States	6	5.61	1	5.85	↘	-5
Thailand	35	4.58	33	4.59	↘	-2
Indonesia	50	4.26	69	3.96	↗	19
China	54	4.24	48	4.26	↘	-6
Vietnam	77	3.89	74	3.91	↘	-3
Bangladesh	99	3.46	98	3.45	↘	-1
Cambodia	103	3.39	111	3.20	↗	8
Angola	125	2.50	n/a	n/a	n/a	n/a

Source: WEF, Global Competitiveness Report 2006-2007

*Note: 1: The least competitive, 7: The most competitive

results mainly from the failure to establish a sustainable healthy macro-economic environment, having an inefficient higher education and training and being unable to absorb the latest technology. However, Cambodia's national competitiveness balance sheet shows that the country has a competitive advantage with its stable real effective exchange rate, high primary education enrollment, supportive agricultural policy and incentives of tax policy to encourage investment. These competitive strengths could be the basis on which Cambodia could build a more competitive economy.

Compared to last year, Cambodia's ranking went up by 8 ranks from 111th last year, reflecting to some extent government efforts to reform the investment climate and trade facilitation. According to the WEF's assessment, remarkable improvements have been seen in the areas of business sophistication, innovation and private institutions.

Basic Requirements for Growth

As Cambodia falls in the factor-driven stage of development, it is important to address issues and challenges related to basic requirements for a sustained growth. These include such factors as institutions (public and private), infrastructure, macroeconomy, health and primary education all of which are considered critical elements for maintaining national competitiveness of a country in the factor-driven stages. In this regard, Cambodia is unlikely to perform better than the other benchmarked countries such as Bangladesh, Vietnam, Indonesia, China and Thailand, which received higher scores for their basic requirements.

Private and Public Institutions

Overall, Cambodia's institutions are seen as healthier than those of Bangladesh, but somewhat less healthy than those of China and Vietnam. Thailand and Indonesia seem to have well-functioning institutions. In

the area of private institutions, Cambodia's biggest disadvantage is the extremely weak auditing and accounting standards for businesses. Although the Cambodian law requires all Cambodian enterprises to comply with the national accounting standard and auditing system, the implementation is not easy due to the country's many small-sized and informal enterprises.

When raising issues about institutions, business people in Cambodia are more concerned with public institutions, which are usually rated below the average score. The perceived non-independent judiciary and inefficient public services to protect businesses are the two main weaknesses in Cambodia. Almost 78 percent of the business people surveyed have less confidence in the current judiciary system. In addition, the private sector feels that gov-

ernment regulations place some burdens for their business. Approximately 60 percent of the respondents estimated that the overall tax burden on their enterprise (including all associated costs) is more than 15 percent of a company's net revenue. However, threat of terrorism does not impose significant costs on business as perceived by many investors in Cambodia.

Interestingly, the country's institutions have seen some improvement, with its ranking going up to 95 from 105 last year. This improvement is the result of the private sector's better performance, not from public institutions.

Physical Infrastructure

Poor infrastructure has been another competitive disadvantage.

Box 1: The Global Competitiveness Index

Since 2001, the World Economic Forum (WEF) has been using the Growth Competitiveness Index (Growth CI) developed by Jeffrey Sachs and John McArthur to assess the competitiveness of nations. However, with the aim of incorporating many other factors into a broader measure of competitiveness, Professor Xavier Sala-i-Martin, a leading expert on growth and economic development, has developed a new comprehensive competitiveness model for the WEF.

The new Global Competitiveness Index (GCI) and a full description of its main methodological underpinnings was first presented in the Global Competitiveness Report 2004–2005 (Sala-i-Martin and Artadi, 2004). The GCI extends and deepens the concepts and ideas underpinning the earlier Growth Competitiveness Index. With this year's Report, WEF complete the move to the Global Competitiveness Index as the main competitiveness indicator to be used by the Forum.

As noted above, the GCI, albeit simple in structure, provides a holistic overview of factors that are critical to driving productivity and competitiveness, and groups them into nine pillars:

- 1st Pillar: Institutions
- 2nd Pillar: Infrastructure
- 3rd Pillar: Macroeconomy
- 4th Pillar: Health and primary education
- 5th Pillar: Higher education and training
- 6th Pillar: Market efficiency
- 7th Pillar: Technological readiness
- 8th Pillar: Business sophistication
- 9th Pillar: Innovation

The selection of these pillars as well as the factors that enter each of them is based on the latest theoretical and empirical research. It is important to note that none of these factors alone can ensure competitiveness.

Source: Compiled from the World Economic Forum's Global Competitiveness Report 2006-2007

Again, Cambodia has more efficient infrastructure than Bangladesh but a less developed one compared to Thailand, China, Vietnam and Indonesia. The quality of Cambodian infrastructure is evaluated as quite low, while 68 percent of interviewees consider it as underdeveloped, requiring substantial investment. Railroads, power supplies and the postal system are just some examples of the country's poor infrastructure. Telecommunication is the only sector viewed as acceptable due to the private sector's considerable involvement in this sector.

In general, improvement in the quality of ports and air-transport have been observed but the quality of electricity supply remains under par. The electricity prices in Cambodia are the highest in the region and some of the highest in the world. According to data from 2005, the average tariff for industry ranked from US\$0.12 to US\$0.14 Cents/kWh, almost 65 percent higher than average tariffs in Vietnam. Further development of physical infrastructure is thus essential for Cambodia to support its private sector. This would not only reduce the production costs but also connect Cambodia to overseas markets that offer greater business potential.

Macroeconomy

In the long term, macroeconomic stability is an important precondition for sustained growth. Although Cambodia has a relatively high economic growth, the country's macroeconomy is assessed to be among the less favorable in the world, lagging far behind its neighboring countries, including Bangladesh. Among the benchmarked countries, China has the most stable macroeconomic environment due to its big size economy, followed respectively by Thailand, Bangladesh, Vietnam and Indonesia.

The WEF's assessment suggests that Cambodia is unable to establish a stable macroeconomic framework due to the high interest rate spread, low national savings rate and

high government deficit. Data from the IMF shows that the interest rate spread in Cambodia was as high as 15.4 percent when the national savings rate accounted for only 11.2 percent of GDP in 2005. Moreover, Cambodia saw a significant increase in inflation in 2005, negatively affecting the country's competitiveness. The average percentage change in consumer price index accounted for 5.8 percent in 2005 as opposed to 2 percent in 2004, according to the IMF World Economic Outlook Database, April 2005.

Notwithstanding the above, Cambodia's macro-economy has strengths in its relatively stable effective exchange rate and the comparatively low government debt as a percentage of GDP. In 2005, the gross public sector debt as a percentage of GDP for Cambodia represented 41 percent, against 47 percent for Thailand and 54 percent for Vietnam. It is also worth highlighting that the private sector is more pessimistic about the country's economy as many of them (66 percent of the respondents) agree with the fact that the Cambodian economy will probably have a strong growth rate in the coming year.

Health and basic education

Cambodia is ranked last out

of the selected studied counties for health and primary education. China and Vietnam are almost at the same position, and ranked higher than Indonesia, Thailand and Bangladesh.

For Cambodia, health problems have become a particular concern for business, hampering national competitiveness. In 2004, Cambodian life expectancy was estimated at merely 54 years and the prevalence rates of diseases such as malaria, tuberculosis and HIV/AIDS in Cambodia are some of the highest in the world. Concretely, the World Health Statistics has revealed an increase in tuberculosis prevalence in Cambodia from 508/100,000 in 2003 to 708/100,000 in 2004. This relatively short population life expectancy and high prevalence rates of the above diseases could potentially have a negative impact on businesses in the medium-term as well as the whole society.

As far as basic education is concerned, Cambodia has a high net primary education enrollment rate, reaching 97.6 percent in 2004. Acknowledging its importance, the government has set many strategic plans, to ensure that most of, if not all, school-aged children can access basic education free of charge. As a result, the primary enrollment increased remarkably during the past years. The

Table 2: Countries' Ranks of the Nine Pillars in the Global Competitiveness Index 2006-2007

	Bangladesh	Cambodia	China	Indonesia	Thailand	Vietnam
GCI 2006	99	103	54	50	35	77
Basic Requirements	96	100	44	68	38	71
1-Institutions	121	95	80	52	40	74
2-Infrastructure	117	97	60	89	38	83
3-Macroeconomy	47	101	6	57	28	53
4-Health & Primary Education	90	98	55	72	84	56
Efficiency Enhancers	108	110	71	50	43	83
5-Higher education & training	108	110	77	53	42	90
6-Market efficiency	83	99	56	27	31	73
7-Technological readiness	114	105	75	72	48	85
Innovation Factors	104	102	57	41	36	81
8-Business sophistication	96	100	65	42	40	86
9-Innovation	109	98	46	37	33	75

Source: WEF, Global Competitiveness Report 2006-2007

increasing primary enrollment ratio is considered a competitive factor because it would increase the possibility of citizens to participate in the country's development process. However, the quality of public education remains a challenge as a vast majority (77 percent) of the interviewees think that Cambodian public schools are of poor quality.

Efficiency Enhancers for Growth

Besides the basic requirements for maintaining national competitiveness, a country needs to consider ways to increase productivity gains in a more sophisticated economic framework. This process is defined by WEF as efficiency enhancers, which are comprised of three pillars: higher education and training, market efficiency and technological readiness. For the efficiency enhancer subindex, Cambodia and Bangladesh are not far different but they are both less even than the other benchmarking countries.

Higher education and training

Higher education and training in Cambodia and Bangladesh are rated among the world's poorest. Even though Cambodia has a high primary education enrolment, the ratio of enrollment decreased sharply in secondary (29.4 percent in 2004) and tertiary education (3 percent in 2004). Therefore, the ratio of university enrollment is even less. Data from the Ministry of Education, Youth and Sport shows that roughly 11,000 students received their bachelor degrees in 2005. This number represents less than 5 percent of the estimated 250,000 new entrants in the labor market each year.

Besides, the Cambodian educational system is perceived too weak to meet the needs of a competitive economy. The quality of higher education is evaluated fairly low by many business executives. In particular, some 68 percent of the business executives surveyed agree that math and

science education in Cambodia lag far behind most other countries and 56 percent of the samples conclude that business schools in Cambodia are of poor quality. The limited number of university students coupled with the poor educational system means that it is not easy for Cambodia to support the development of advanced industries, which require a sophisticated skilled labor force.

In addition, Cambodia lacks appropriate on-the-job training mechanisms. Specialized research training services are almost unavailable or of poor quality. The survey further highlights that companies in Cambodia tend not to invest heavily in staff training and development. This is not a healthy long-term approach to improve human development.

Market efficiency

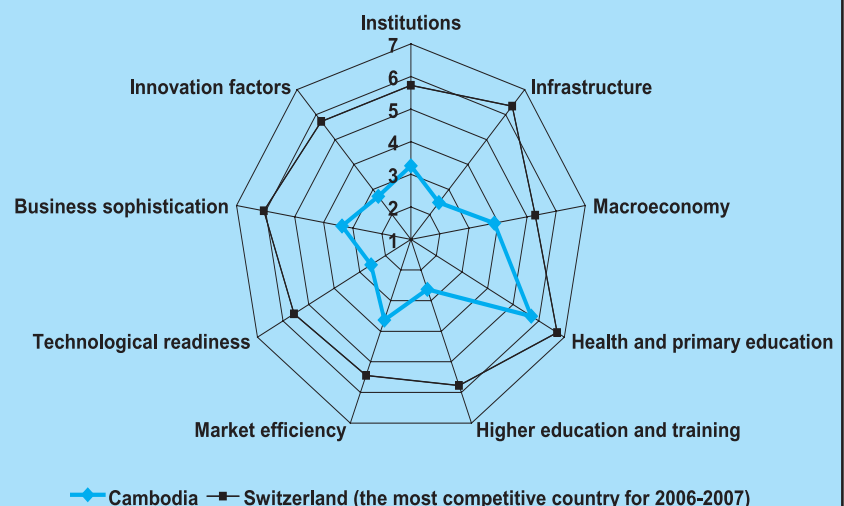
Cambodia apparently has the weakest market efficiency among the benchmarked countries. Indonesia leads in this category, followed respectively by Thailand, China, Vietnam and Bangladesh. Concerning the goods markets, Cambodia is evaluated low for its prevalence of trade barriers, inefficiency of legal framework to protect business and a poor antitrust policy to promote local competition. It has, nonetheless, a supportive agricul-

tural policy and taxation policy, which offer substantial incentives for investment in the country. For example, the Government has provided incentives such as import tax exemptions and significant holiday tax for profit, for garment investment and investment in certain agriculture-related sectors.

As for the labor market, hiring-firing practices and labor-employer relations are perceived to be worsening, which requires much attention to sustain the long-term competitiveness. An example is the good status of labor compliance in Cambodia's garment industry, which keeps the industry on a growing trend even in the post-quota environment, since January 01, 2005. This good practice can later become a major concern in the future for the industrial competitiveness since it might impose invisible costs if labor unions over execute their rights. Hence, the culture of negotiation and conciliation should be developed to ensure good relations between employees and employers. Brain drain and productivity-based payments are noticeably good points for Cambodia in the area of market efficiency.

Finally, the primitive financial markets limit the country's competitiveness. The Cambodian financial market is among the least sophisticated in the world. Raising money on the local stock market is impossible,

Figure 1: Competitiveness Score for Cambodia



Source: WEF, Global Competitiveness Report 2006-2007

whilst access to loans is uneasy and requires high costs. A large proportion (80 percent) of respondents feel that it is almost impossible to obtain a bank loan with only a good business plan and no collateral.

Technological readiness

Cambodia lags far behind the benchmarking countries except Bangladesh in terms of technological readiness, although the ability of technological absorption at the firm level is perceived to have somewhat improved. Around 64 percent of the people surveyed rate Cambodia's level of technological readiness behind most other countries in the world.

The low rate of computer use and Internet partly contribute to this poor assessment, while the perceived unavailability of a law related to the use of information technology (IT) also contributes. Undeniably, the use of personal computers and the Internet are not yet widespread throughout the country. Hard data indicates that only 0.3 percent either accessed the Internet or used personal computers in 2004, while the cellular phone user rate was 6 percent in the same year. More than three-quarters of the respondents emphasize that IT-related law is not well developed and enforced.

However, Cambodia still has a great potential to absorb new technology through foreign direct investment (FDI) given the aggressive firm-level technology absorption. Due to the lack of scientific research institutions, FDI is believed to be an important source of new technology currently used in the country, highlighted by 70 percent of respondents. Encouraging FDI would thus help advancing Cambodia's technological readiness.

Innovation and Sophistication Factors for Growth

For the most advanced economies, business must compete through innovation, producing new and different goods using the most

sophisticated production process. Two factors considered important at this stage of development are business sophistication and innovation. There is still a long way for Cambodia and Bangladesh to reach this stage of development. Vietnam and China are moving forward, while Thailand and Indonesia are pioneering in this area among the six countries.

Business sophistication

The lack of a supporting industry reduces national competitiveness, making Cambodia less competitive vis-à-vis its counterpart countries. Cambodia's business sophistication, which is assessed to be quite close to that of Bangladesh, has seen some development according to the business community's perceptions; This was principally by having a more extensive value-chain presence and an improved quality of local supplies. However, local suppliers are still comparatively limited in quantity and quality.

Meanwhile, the country's reliance for international distribution and unsophisticated production process are identified as key challenges for Cambodian firms to compete internationally. The results of the Executive Opinion Survey 2006-2007

clearly support the fact that the international distribution of Cambodian products is highly dependent on foreign companies and the production process uses labor-intensive methods rather than efficient process technology. Moreover, Cambodia's markets for exports concentrate on just a limited number of foreign markets, mainly the EU and US for garment products and Vietnam and Thailand for some agricultural products.

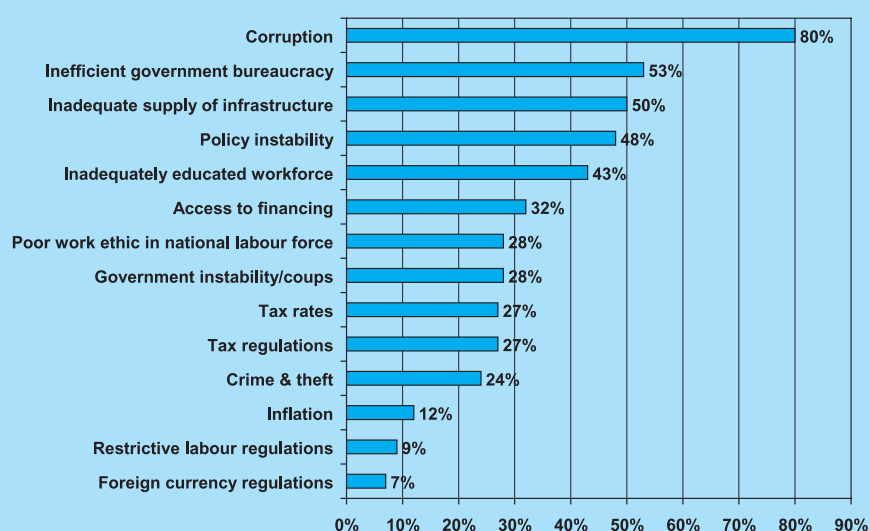
Also worth noting is the fact that international competitiveness of companies in Cambodia derives primarily from low cost or local natural resources, which is rather risky because natural resources cannot be a source for long-term competitiveness. Additionally, the extent of marketing in Cambodia is not yet as sophisticated as most countries.

Innovation

In terms of innovation, Cambodia performs well against Bangladesh but stands fairly far behind its neighboring countries. Thailand and Indonesia are ranked high for the innovation factor, followed by China and Vietnam.

Cambodia's innovation capacity is pretty limited at both the firm

Figure 2: The Most Problematic Factors for Doing Business



Source: EIC, Executive Opinion survey 2006-2007 in Cambodia.

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

and national level. Several factors may explain this weakness. Explicitly, the availability of scientists and engineers is perceived as insufficient in order to speed up the country's development process. The perceived low quality of scientific research and weak intellectual property protection are another two factors, discouraging the innovation process in Cambodia. Yet, 65 percent of the interviewees gave negative views on the quality of scientific research institutions.

Notwithstanding the above, some improvements have been observed in this area, specifically in relation to business-university collaboration and the willingness of companies to spend on research and development (R&D). Indeed, more respondents reported that companies in Cambodia tend to invest more heavily in R&D. For these reasons, the overall ranking of Cambodia for the innovation factor moves up slightly to 98th this year from 110th last year.

Constraints and Reforms for Businesses

Results from the Executive Opinion Survey conducted in Cambodia by EIC highlight that corruption remains the biggest impediment facing Cambodia's private sector. An overwhelming 80 percent of the business executives interviewed acknowledge corruption among the five most problematic factors for doing business in Cambodia. This percentage has not changed since last year's survey. Corrupt practices have been observed in connection to the use of public services, more particularly to receive favorable judicial decisions and to receive import-export permits.

Besides corruption, inefficient government bureaucracy is identified as the second major constraint for business, followed by inadequate infrastructure, policy instability; and inadequately educated workforce. It is worth highlighting that access to financing, which was among the top 5 constraints last year, stands at the 6th

most problematic factors for doing business in the country this year.

In order to overcome the above constraints, reforms in specific areas are viewed as necessary. The main three critical reforms suggested by the business community include: legal/judicial reform, customs/trade facilitation reform and public administrative reform. The majority (55 percent) of respondents agree with the first two reforms and approximately 50 percent cite public administrative reform as critical for their business.

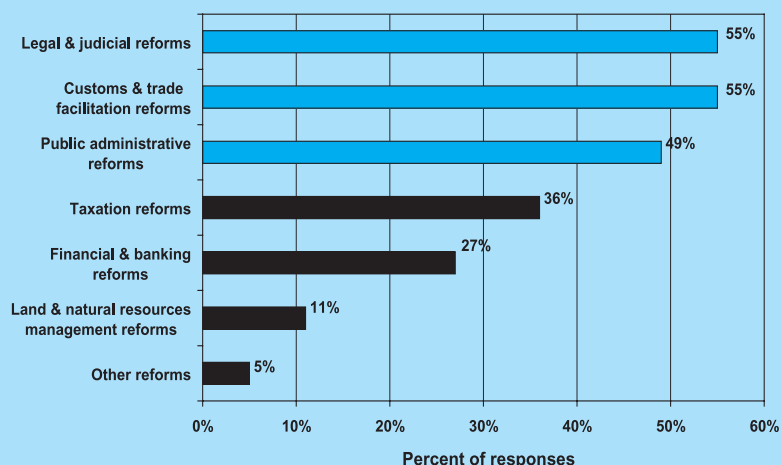
Regarding the Government's commitment to improve the national investment climate, concrete reforms such as the Twelve-Point Action Plan for investment climate reform have been put in place. The implementation of these reforms has delivered, to some extent, positive results. The World Bank's Doing Business 2007 suggests that Cambodia is a country, which has carried out reforms to have a better business climate. Further government commitments to implement the reforms are, however, required to promote the private sector and thus enhance the country's national competitiveness.

Concluding Remarks

Chan Vuthy

The WEF assessment shows

Figure 3: Critical Reforms for Business in Cambodia, 2006-2007



Source: EIC, Executive Opinion Survey 2006-2007 in Cambodia

Note: From a list of 7 factors, respondents were asked to select the three most reforms critical for their business