

Sources of Economic Growth in Cambodia

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ABSTRACT

This paper aims to find out the main sources of economic growth, which is main driver for Cambodian economic development in context of globalization. The study found that two main factors: capital development and total productivity. Inside the capital development, official development assistant (ODA), and foreign direct investment (FDI) play important roles in raising fixed capital formation which is the long-run growth. Furthermore, development of education, vocation training, and job experience are core of total productivity growth.

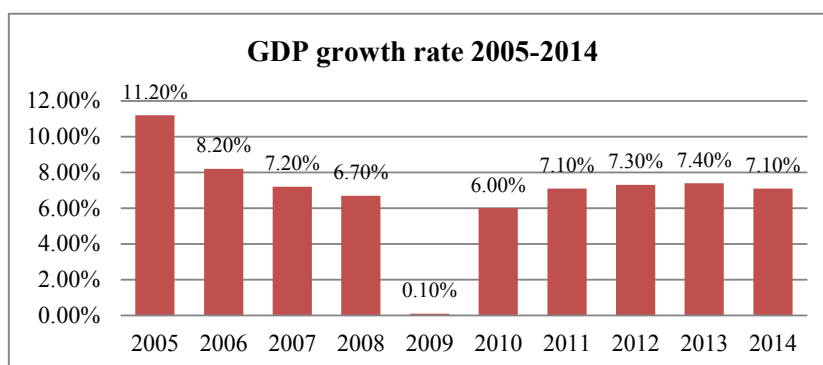
Keyword: growth, development, ODA, FDI, productivity

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1- Introduction

After getting peaceful in 1998, Cambodia has experienced growth of its economy with backing on track to accelerating development. Growth was 11.9% in 1999, which high speed after civil war. The annual average growth rate is 8.8% in between 1999 and 2003¹ with many supports from international community. Despite Cambodia is in aid-dependent status, traditionally plagued by weak governance, corruption and limited institutional capacities (World Bank 2004a), Cambodia's economic development has fared remarkably well during the last decade, even with the slowdown in 2008-2009. Real output growth was rapid growth largely due to Cambodia's macroeconomic and political stability, as well as regional and global prosperity during the period. However, the growth was slow in 2008 and 2009 due to the supply shock inflation causes both food and oil price rise at the beginning of 2008. The driver of growth is mainly the dramatic expansion of the manufacturing industry at an average annual rate of 14.4 percent during 1998-2008 exclusively; includes textile and garment industry, and tourism industry.

After financial crisis in 2008, and world economic downturn in 2009, Cambodia changes the growth rate from 10.2 percent in 2007 to 0.1 percent in 2009, then getting fast recovering by 6% in 2010. According to the Asian Development Bank, the growth rates are estimated to persist between 6.0% and 6.5% in 2011 and 2012 (below figure).



Source: ADB, Asian Development Outlook, 2008, 2010, 2013, and 2015

According to CDC official website,² GDP amount has been steadily grown with 43,057 billion Riels in 2009 and 47,048 billion Riels in 2010 and is projected to be 52,141 billion Riel in 2011 (approximately USD 12.9 billion) and 57,363 billion Riel in 2012 (approximately USD 14.2 billion). Growth is holding up reasonably well despite the adverse effects of political uncertainty and labor unrest since the second half of 2013, while inflation has picked up only marginally. Real economic growth reached 7.4 percent in 2013, driven mainly by the garment and tourism sectors. Due to the confidence and the return of political stability, bolstered by a strengthening global economy, Cambodia's real economic growth rate for 2014 reached 7.1 percent. The banking sector is expanding, and financial sector deepening is continuing to occur. Fiscal performance remains sustainable, although domestic revenue performance has recently slowed.

¹ Hang Choun Narong, *Cambodian Economy: Charting the course of a brighter Future*, 2009, Phnom Penh

² <http://www.cambodiainvestment.gov.kh/investment-environment/economic-trend.html> (accessed on 09 Nov 2015)

This paper aims to find out the main sources of economic growth, which is main driver for Cambodian economic development in context of globalization. To achieve this goal, three objectives is set includes, two main folds which are Capital development includes official development assistant (ODA), foreign direct investment (FDI), and Total Productivity.

Liberalization, deregulation and privatization policies were introduced in Southeast Asian particularly Indochinese countries since 1980s but not really political liberalization (Wah and Ojendal, 2005: 20). Economic development is considered a top priority and the main driving force in Southeast Asian regional integration, as well as for Cambodia. ASEAN leaders have created a roadmap to establish an ASEAN Economic Community in 2015 ahead of the other two pillars of the Community-building project – the Political / Security Community and the Socio-cultural community. At the sub-regional integration level, cooperation and liberalization is the main factor to promote growth and development via openness on ODA, FDI, and Trade.

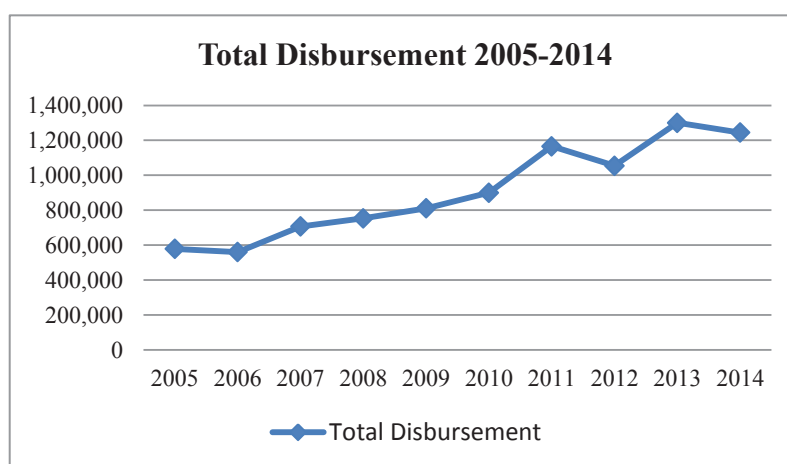
Our paper will follow the sources of growth derived from Cobb-Douglas production function $AK^\alpha L^{1-\alpha}$, where A is total productivity, K is capital stocks, and L is labor force. α and $1 - \alpha$ are the share of capital and labor in the GDP, respectively.

Maintaining macro-economic stability with continued economic reform is necessary for economic development, poverty reduction, and regional economic integration in Cambodia where the consolidation of fiscal policy to finance infrastructure development and human capital are required. Other source of economic transformation is improving low levels of education and productivity of the work force and quality of governance.

2- Official Development Assistance

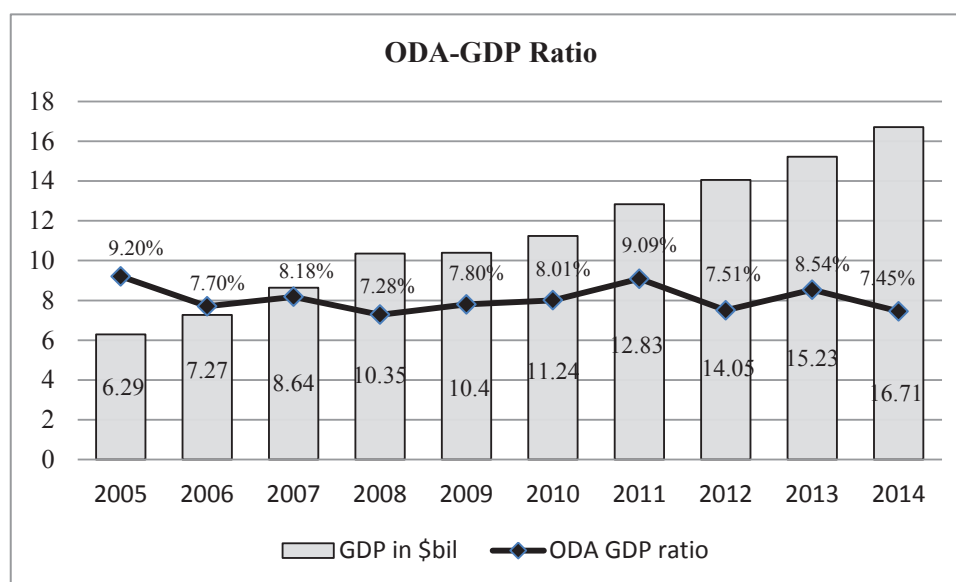
The official development assistance (ODA), especially bilateral one flown to Cambodia was appearing in two terms, grant and loan (Ky and Lee 2011). The top three donor's bilateral ODA to Cambodia are Japan, China, and Korea (Rep.) which provided both grant and loan in order to support the poverty alleviation program via Cambodian millennium development goals (CMDGs)³. The total disbursement in 2011 was \$1,075 million, increased by 20.94% compared to that in 2010 (Cambodian ODA database). The contribution of ODA respected to Cambodia's GDP is about 9.5% of its GDP (MEF 2010) which a huge amount of money for developing Cambodian economy. The public bilateral and multilateral development assistance transferred from one country to another, plays an important role in both less developed and developing countries (Todaro and Smith 2009).

³ CMDGs: 1- Eradicate extreme poverty and hunger; 2- Achieve universal primary education; 3- Promote Gender equality and empower women; 4- Reduce child mortality; 5- Improve maternal health; 6- Combat HIV/AIDS, malaria and other diseases; 7- Ensure environmental sustainability; 8- Develop a global partnership for development; 9- De-mining, UXO and victim assistance.



Source: Author compiles from CDC, (2015), ODA database

An increase in assistance means there is aid effectiveness for achieving the CMDGs. The average annual GDP growth rate is about 7% in the last 10 years except world economic downturn in 2009. Since the total disbursement increase every year, however, the ODA-GDP ratio in the figure below is more or less constant about 8% of the total GDP.

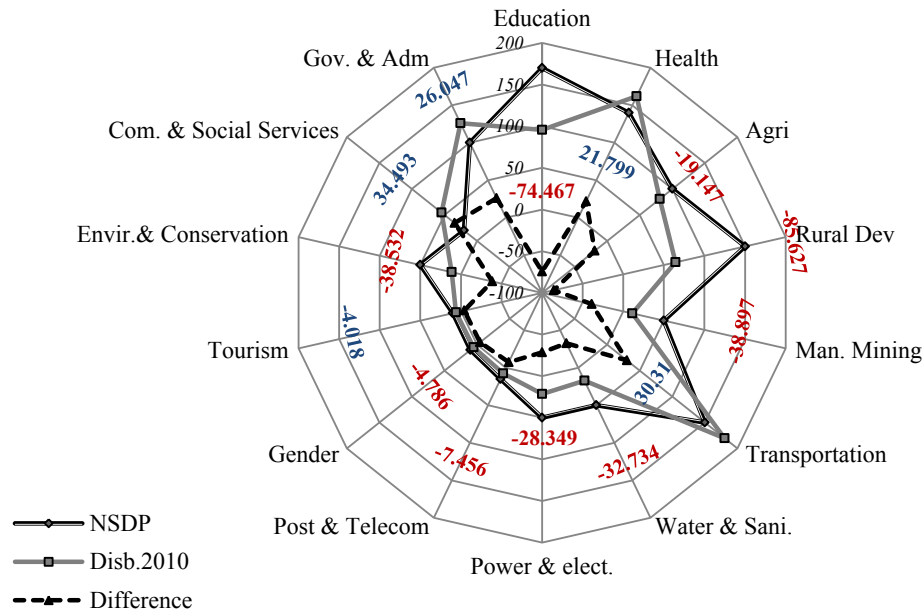


Source: Author calculation from Trading Economics (2015) and CDC (2015)

According the figure above, the ODA GDP ratio seems to be constant for the last decade which means that ODA is a main source of GDP growth in Cambodia since its economy rises almost triple. The total disbursement rises rapidly from 2010 due to an increase in concessional loan from China on national road construction (Ky Lee and Stauvermann, 2012) which is started since 2009. And also, the contribution of the bilateral grant from Japan and others which flows to rural development sector as well as education, capacity building, health care system, and good governance.

According to Ky, Lee, and Stauvermann (2012), the disbursement on some sectors is over the National Strategic Development Plan (NSDP) such as education, health, transportation, governance and administration, and tourism. In addition, some other sectors like agriculture, rural development, power and electricity, environment and conservation is lack of disbursement. In this case, they should be improved in order to reduce the poverty gap and accelerate the GDP growth faster.

Comparison between total disbursement 2010 and NSDP⁴ by Sector (mil \$)

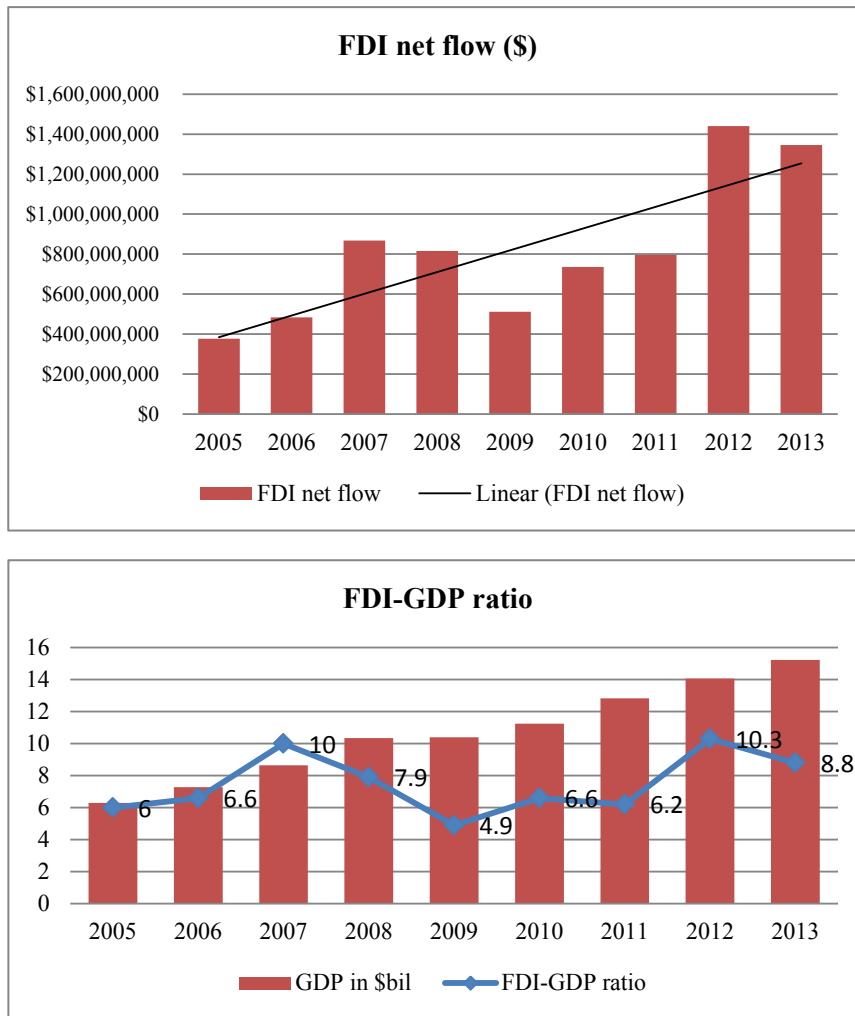


Source: Ky, Lee, and Stauvermann (2012)

3 - Foreign Direct Investment

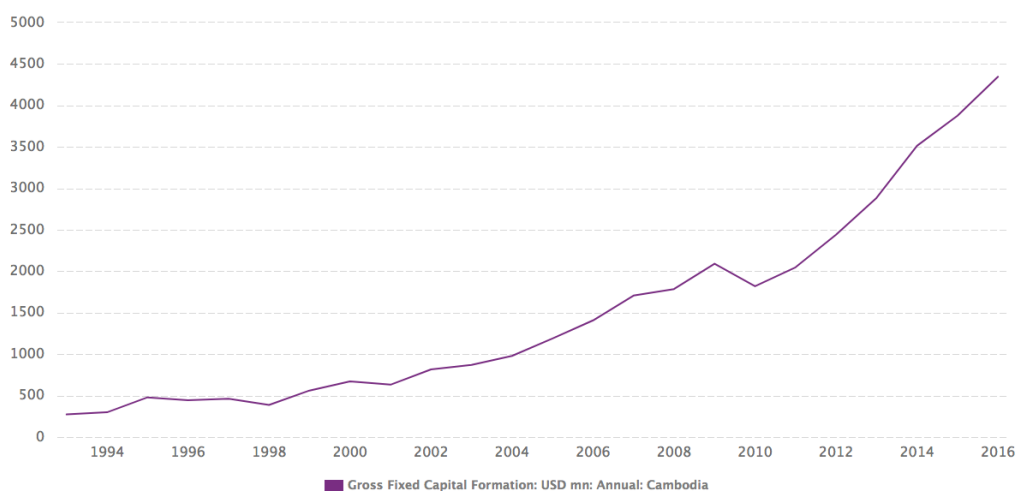
Due to the generation of globalization, foreign direct investment (FDI) inflows Cambodia regarding to the openness of Cambodia to trade with the rest of the world had been done since the country became free-market oriented economy in 1993 while ODA started flowing. After investment law amendment in 2003, there is a rapid growth of FDI net flow to Cambodia as in the figure below. Capital investment from FDI is not only providing job opportunity to Cambodian workers, but also providing skills and technology to the industrial sector, especially, garment sector.

This is another source of economic growth in Cambodia. The flow of FDI to Cambodia contributed to the stability of its economy by keeping high growth rate of GDP by 7% on average. It tries to use the scarce resources efficiently. The use of abundance of unused resources including labors and land is much contribution to the growth. For instant, GMAC (2013) reported that garments and tourism sectors provide job opportunity to Cambodian women account for 500,000 workers in between 2007-2013. These sectors are the big source of growth which covers on average 80 percent of total export of Cambodia.



According to the figure above, the net inflow of FDI to Cambodia seems to be fluctuated from 6 to 10 percent of the total GDP. From 2007, the FDI mostly goes to real estate and banking sector which is an attractive industry for the last 5 years. The net flow of FDI reached 1,400 million US dollar in 2012.

Gross Fixed Capital Formation

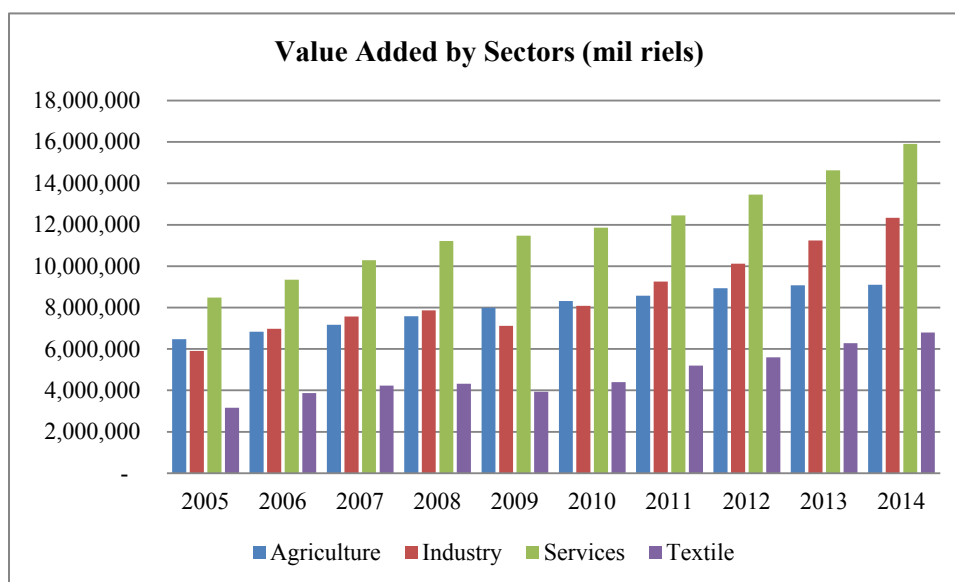


Source: CEIC <https://www.ceicdata.com/en/indicator/cambodia/gross-fixed-capital-formation#.WdcJrY-whmk.link>

4 - Productivity

The other important source of economic growth is total productivity which can be defined as effectiveness with which factors of production are converted into output (Weil, 2012). In this point the try to figure out the value added of the labor in Cambodia to represent the change in productivity.

Between 2004 and 2012, the overall employment rate in Cambodia rose only slightly. The employment rate is highest in rural areas, where agriculture accounts for most jobs, but is increasing more rapidly in urban areas, where industry and services are hiring more workers. According to the report of National Institute of Statistic, the employment in agriculture share 60% of the total employment in Cambodia in 2005 and decrease to 50% in 2012 while that in industrial sector is constant about 30% and increase in service sector from 12% to 19%, respectively. Since the employment is constant in industrial sector, the value added in this sector reaches 12.34 trillion riels where the textile and garment sector totally share 50% of that in industrial sector. This means that the productivity of industrial sector increase accordingly base on general formula of labor productivity which is equal to value added divided by volume of labors.



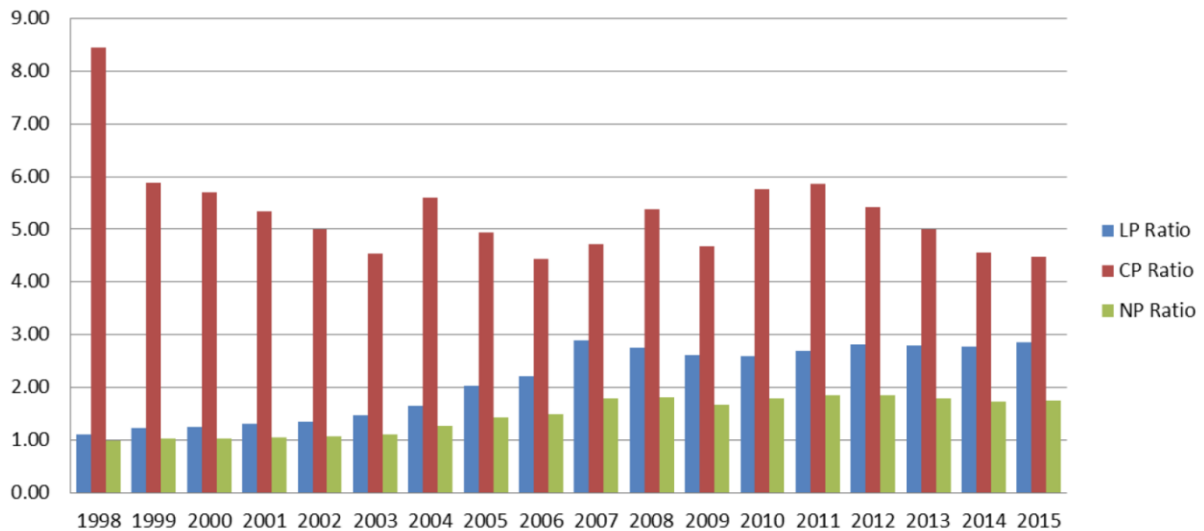
Source: National Institute of Statistic, Cambodia

According to the survey of Committee of Productivity of Cambodia on garment worker productivity, the survey reveals that the workers now become skillful. The total production is effective and efficient. However, the level of education of the workers is at primary school level. World Bank (2008) reported that about 60% of worker can access only primary school and about 30% of them can access up to lower secondary school. This is the challenge of raising labor productivity in Cambodia-“working as machine-not human”- due to lack of innovation and creative. Another challenge to the total labor productivity is trade union strike. Base on LO/FTF Council (2014) in 2012 the strikes went up from 31 in 2011 to 121 in 2012, and 147 in 2013.

However, the national productivity (NP ratio) increase due to the constant rate of increasing labor productivity (LP ratio), even the capital productivity (CP ratio) falls after 2011. The

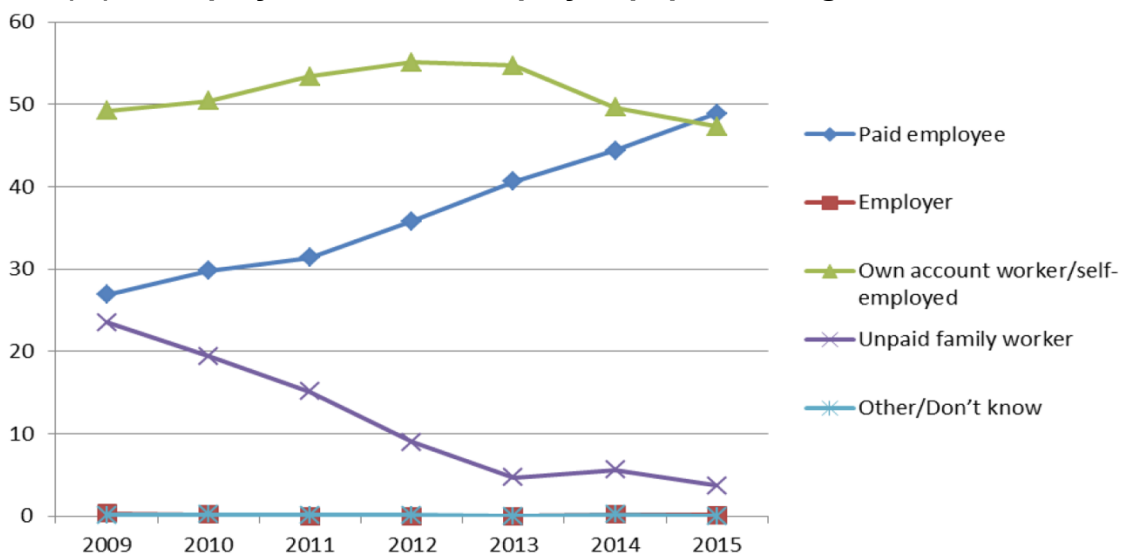
average ratio of Cambodian national productivity is 1.47 (2001-2015), which is the highest in ASEAN member due to the high increase in FDI and increase in number of paid-employee and decrease in unpaid family worker.

Ratios of National Productivity in Cambodia, 1998-2015



Source: NIS presentation by Mr. Nor Vandy

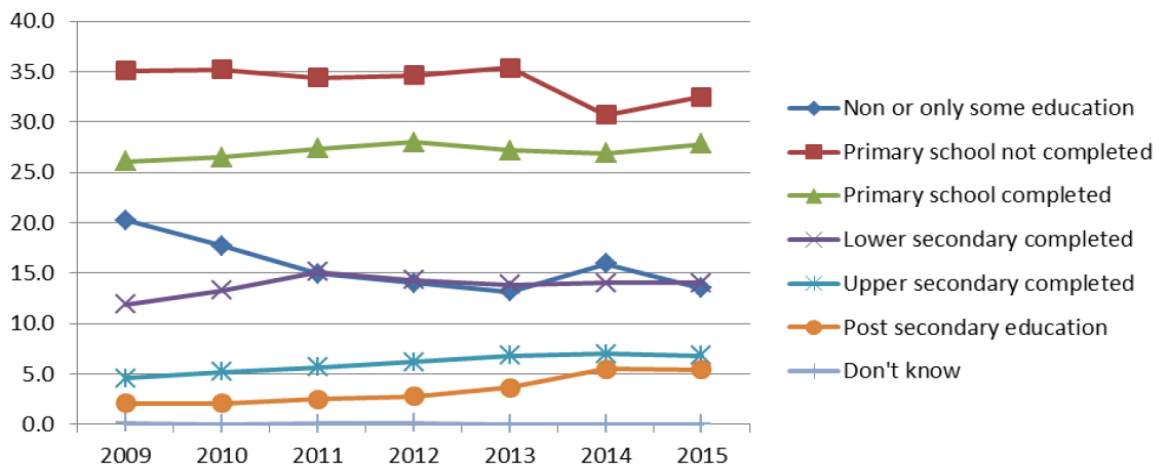
Share (%) of employment status, employed population aged 15-64



Source: NIS/MOP, CSES2009-2015

Moreover, the literate employed population has improved in the secondary/technical diploma and beyond secondary school or technical education over five years, 2008-2013. However, the level of education in lower secondary and primary school seem to be not increased. So, more vocational training is needed to raise paid employee.

Share (%) of education level of labor force aged 15-64 years



Source: NIS/MOP, CSES2009-2015

According to the socio-economic survey by MOP, 80% of labor force are educated up to lower secondary school in which 65% of them are educated up to primary school.

5 - Conclusion

Cambodia keeps its growth rate of GDP by 7% on average due to the three main sources includes, the first capital inflow via official development assistance which help government for its shortage of fiscal policy in public investment, especially on transportation sector. However, there are some other sectors are needed to improve. The second source of sustainable growth is foreign direct investment which accelerate the national income by providing job opportunity to workers as well as providing technology to raise the labor productivity. The last source is labor productivity, which contributes much to national income with the same use of factor of production. However, lack of education and increase in number of trade union strikes are the challenge of labor productivity. So, that vocational training and up-to-high school enrollment should be promoted for long-run economic growth.

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