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PRESENTED BY H.E. SOK SIPHANA, SECRETARY OF STATE
ROYAL GOVERNMENT OF CAMBODIA

I. BACKGROUND

In order to better understand the economic environment in Cambodia, one needs to look at the broader image of the Cambodian situation, its past, its expectations, potentials and promises.

For several centuries well into the beginning of this millennium, Cambodia was the seat and centre of political and cultural influence for all its surrounding areas. Famous monuments like the Angkor Wat bear testimony to Cambodia's past glory. Even during the colonial period till the middle of this century, Cambodia was a prized jewel with its beauty and natural resources, minerals and abundant fertile land, not to mention its friendly people and their enduring traditions and culture. However, since the mid-fifties the cold-war induced international climate and tensions caught Cambodia unawares, making it a pawn in power struggles and spawning disastrous forces inside resulting in tragic consequences.

In mid-1970 unprecedented trauma and catastrophe struck Cambodia. In just three years, a genocidal regime destroyed the country's long established traditions, as well as its political, financial and social institutions. The intelligentsia, the educated, trained and skilled work-force were virtually and systematically wiped out. Emerging from this darkest period of its history, and caught in the misperceptions of the cold war, Cambodia encountered international neglect and isolation for more than another decade. However, with the peace accord of 1991, and with international assistance, general elections were held in 1993 followed by the establishment of the Royal Government of Cambodia later that year. Cambodia was thus reborn for a fresh and robust lease of life.[2]

After the General Elections in 1993, Cambodia has entered a new period of development. The first and most important achievement has been the dismantling of the political and military organizations of the Khmer Rouge, integrating their forces into the mainstream of the society and accomplishing peace for the first time in many decades, thereby creating a conducive environment for economic development.

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1 Paper version 17 May 2004

2 Speech of Sr. Minister and Minister of Economy and Finance Keat Chhon to the visiting World Economic Forum Group, Sofitel Cambodiana Hotel, Phnom Penh, April 1996.

Since 1993 Cambodia has initiated fundamental reforms in many crucial areas and significant progress has been made in promoting economic recovery, and reducing inflation to low levels. However, much remains to be done to rebuild a society and economy shattered by almost three decades of civil strife and to address the country's areas of vulnerability. Sustained development, and the alleviation of pervasive poverty, will critically hinge upon continued implementation of broad based actions aimed at strengthening governance, deepening fiscal and bank restructuring, and establishing a sound legal framework.

a. ***Current Economic Status:*** At present, the reality is that Cambodia is still a very poor nation. The UNDP's Human Development Report placed Cambodia 136th out of 174 nations on its Human Development Index.[3] Measured in US dollars, annual GDP per capita at current price has barely changed since the mid-1990s – from approximately $284 in 1995 to $266 in 2000. This reflects slow growth during the years 1996 and 1997 in particular as well as rapid population growth throughout the 1990s.[4] Cambodia's poverty is rooted in its large agricultural sector: agriculture has low productivity and low growth, but maintains the overwhelming majority of Cambodia's population. Poverty can be seen by many social indicators.[5]

Measured by income or other social indicators, Cambodia is among the poorest countries in the world, ranking 136th of 174 in the UN's Human Development Index. According to the recent National Poverty Reduction Strategy, 4.5 million Cambodians, 36 percent of the total population is in poverty, living on less than US$0.46-0.63 per day, and 50.3 percent of children under age five are underweight. Economic growth averaged 5.6 percent between 1993 through 2000, increasing to 6.3 percent in 2001, and declining back to 5.5 percent in 2002.[6] Cambodia's low Gross National Income (GNI) per capita in 2002 of US$280 was in fact lower than that of Lao PDR (US$310), Vietnam ($430/capital), and Thailand (US$1,980).[7] Half of Cambodia's poor would be lifted out of poverty if 6 percent growth could be sustained for eight years.[8] Roughly 250,000 Cambodians enter the job market each year, including 30,000 demobilized soldiers. Many of these are currently absorbed by the informal sector.

At a growth rate of about 2.1% per year the Cambodian population has exactly doubled in 36 years. Rapid population and labor force growth, insufficient employment creation, low per-capita income level, as well as low growth in per-capita income level are surely part of the poverty equation in Cambodia. The slow 2.75 percent growth of GDP in the agricultural

3 This is a composite index which includes such items as per capital income, life expectancy, education, and adult literacy. Cambodia was just above the "low human development" category.

4 United Nations Development Programme, *Human Development Report, 2000* and International Monetary Fund, *Cambodia: Statistical Annex*, IMF Staff Country Report No. 99/33, April 1999.

5 Definition of Poverty. Different indicators are used to measure poverty. The poor can be defined differently and priority is given to different groups of the poor. Poverty is sometimes defined as a lack of income or consumption and lack of opportunities. Broader dimensions include poor education and health outcomes (low capabilities), vulnerability (livelihood insecurity), powerlessness and discrimination against women and ethnic groups. Moreover, people move in and out of poverty, which makes definition of poverty lines and better knowledge about cyclical, seasonal and unexpected shocks important (IPRSP, 2000)

6 Source: World Bank estimates.

7 National poverty line is measured at a daily subsistence level of US$0.50 per day.

8 UNDP (2001), *United Nations Development Goals: Cambodia 2001*.

sector must be compared to the nearly 3 percent annual rate of growth of the labor force – an overwhelmingly rural phenomenon. SEDP-II estimates that Cambodia will need to create 150,000 or more new jobs each year over the next five years in order to absorb young people entering the labor market and redeploy demobilized soldiers. The economy, in recent years, has not been able to produce jobs at such a high rate and the results have been a tripling of official unemployment rates (1.9 percent in 1994 to 7.1 percent in 2000) and, more significantly, a considerable increase in rural underemployment.[9] Simply put, more and more rural workers are working to produce an almost unchanged agricultural output. The overall result has been the stagnation in total output per capita.

b. Overview of Economic Policies of Cambodia: The Government's long term vision for development are reflected in a series of policy documents such as the 1994 National Programme to Reconstruct and Develop Cambodia (NPRD), the 1995 Implementing the National Programme to Rehabilitate and Develop Cambodia (INPRD), the Socio-Economic Development Plan (SEPD I (1996-2000) and SEDP II (2001-2005), the Triangle Strategy; the Royal Government Platform for the Second Term 1998-2003; and the Policy Framework Paper (PFP). They all provide for the establishment of a democratic political system, a liberal market economy, sustainable economic and human development, social justice and poverty reduction lie at the heart of the national consensus to rehabilitate and develop Cambodia.

II. TRADE LIBERALIZATION, ECONOMIC INTEGRATION, AND TRANSITION

a. Motives for economic reforms: In the process of transforming its economy from one that was organized along central planning lines to one that is market-oriented, Cambodia faces many challenges. Economic development will inevitably be a long process in this country because of the legacy of more than two decades of war and internal strife and the extensiveness of the national rebuilding required. Moreover, the rebuilding must be carried out in the face of very poor starting macroeconomics conditions – less developed state of the country's social, institutional and physical infrastructure, underdeveloped financial system, an inability to meet the basic needs of the population witnessed by a generally low level of income and domestic saving, accompanied by an absolute dearth of funds and materials, to name a few. Despite all these constraints, the government recognizes that Cambodia's development potential can best be realized within the framework of external sector policies that are aimed at fostering its reintegration into the regional and world economy.

b. Economic policies: Since the outset the policies of the Government have been unambiguous with regards to economic integration and economic liberalization. One key thrust of the *"National Programme to Rehabilitate and Develop Cambodia (NPRD and INPRD)"* relates to the reintegration of the Cambodian economy into the regional and world economies, which involves opening the country to international trade and private foreign investment. The *Socio-Economic Development Plan (SEDP II)* pronounces in particular the government's commitment to fight poverty and emphasizes the need to foster broad based-sustainable economic growth with equity, with the private sector playing the leading role and to improve the governance environment through effective implementation of the Governance

9 Estimates of unemployment are from CDRI, *op.cit., i*n footnote 2. Underemployment is notoriously difficult to measure.

Action Plan[10]. The Government's *"Triangle Strategy"* called for Cambodia's integration into the region and normalization of its relationships with the international community, thus allowing Cambodia to attract more foreign assistance and FDI to support the country's ultimate objectives of development. The *National Poverty Reduction Strategy (NPRS 2003-05)* has been adopted as a comprehensive framework for poverty reduction. At the core of the anti-poverty strategy lie measures to maintain macroeconomic stability, shift resources to more efficient sectors, and promote integration within the global economy.

c. Economic liberalization measures:

Trade Reforms: Until 1987, all foreign trade was under state monopoly and most transactions were governed by annual protocols with CMEA countries.[11] By July 1989 the private sector was free to establish trading companies with a maximum foreign participation of 49 percent. By mid-1993 there were over 500 trading companies registered with the Ministry of Commerce (MoC) including five specialized state-owned trading companies. State-owned trading companies continue to be responsible for foreign trade in major commodities. Until recently, licenses were required for all imports and exports. Most quantitative restrictions and licensing of imports were eliminated in 1994. A few state trading companies continue to operate but compete with private companies on the same equal footing. The tariff regime was again reformed in 2001. High rates were reduced from 120 per cent to 35 per cent. And the system was simplified with the number of bands being reduced from 12 down to 4.[12]

Changing Role of the Public and Private Sectors: From 1975 to 1979, private property rights were abolished and property records were destroyed, former proprietors were, decimated or had been displaced, productive assets had largely been devastated, and urban properties had been laid waste. Faced with the challenge of rebuilding the economy, the administration that inherited this situation in 1979 kept real estate, natural resources, and all substantial enterprises under state ownership. Only slowly did it accept a larger role for private initiative, in particular by relaxing the collective organization of agriculture and by officially recognizing, in 1985, private enterprises beyond mere household production. In 1989 it launched a broad reform program which gave state enterprises greater autonomy and strict budget constraints; allowed for the privatization of state enterprises and other state assets under close supervision; and encouraged foreign and local private investment.

The number of state enterprises was substantially reduced through privatization and long-term leases to the private sector. A Public Enterprise Law was adopted which lays out the responsibilities of enterprises and the state and puts public enterprises under the same legal framework as the private sector. Foreign investors have bought or leased most of the privatized enterprises: most of these are medium-scale industrial ventures.[13]

10 The GAP is a rolling strategic framework that provides for a consistent and transparent approach to coordinate efforts better, in what were then eight priority areas of reform such as Legal and Judicial Reform, Administrative Reform and Deconcentration, Decentralization and Local Governance, Public Finance Reform, Anti-corruption, Gender Equity, Demobilization and Reform of the Armed Forces, and the reform of Natural Resources Management.

11 World Bank, *Cambodia: From Recovery to Sustained Development*, Washington, D.C. 1996.

12 Royal Government of Cambodia, *Replies to Questions on the Memorandum for Foreign Trade Regime* as submitted to the WTO Secretariat, Phnom Penh, January 4, 2001. WTO Doc. (WT/ACC/KHM/3-January 4, 2001).

13 *Ibid.*

<u>*Monetary and Banking Reform:*</u> The financial sector in Cambodia essentially consists of the banking sector. The Riel was reintroduced as the domestic currency in March 1980. Since 1989, several reforms have been implemented to transform Cambodia's banking system from a monobank that combined central and commercial banking responsibilities into a system that distinguishes between these two layers. In 1990, the National Bank of Cambodia (NBC) was created from the monobank and responsibility for public accounting was assumed by the Treasury. Two public banks, the Municipal Bank and the Foreign Trade Bank (FTB), took over NBC's commercial activities. By 1994, the NBC was divested of its commercial responsibilities and now functions fully as central bank and monetary authority, managing the supervision and regulation of the growing commercial banking sector. In addition, the Government has opened up the banking sector to competition from foreign banks, which have been encouraged to establish their presence in Cambodia.[14]

<u>*Exchange Rate Reform:*</u> Since an earlier system of multiple official exchange rates was unified in the 1980s, Cambodia has followed a market-oriented exchange rate policy with the official exchange rate adjusting to movements in the parallel market rate with a lag. The official rate has moved within 5 percent of the market rate and the Government is taking steps to further narrow the spread to the minimum level. Cambodia has pursued a managed floating exchange rate policy since 1993, and has relied on tight financial policies to ensure stability in the foreign exchange market. Mirroring the monetary policy stance, the riel has been relatively stable in US dollar and real effective terms since late 1998; and official international reserves have increased to about three months of imports of goods and services. The external current account deficit has remained broadly stable at around 10 per cent of GDP (excluding official transfers), due to the strong performance of garment exports. The country's exchange system is free from restrictions on payments and transfers for current international transactions.[15]

<u>*Foreign Investment:*</u> A liberalized investment law was passed which has contributed to substantial increases in FDI flows. Since the adoption of the 1994 Investment Law, numerous investment regulations were reviewed and proposals and assessments of the implications of these proposals have been prepared. Policy merging between the trade regime and foreign direct investment regime was developed to bring better coherence and efficiency. One area of concern to the foreign investor is the protection of their investment. Cambodia has to date signed bilateral agreements to protect and promote foreign investments with many countries such as USA, Malaysia, Thailand, Switzerland, Korea, Singapore and China, France, and Germany.

<u>*Public Finance Reform:*</u> Since September 1993, the Government has been implementing a vast programme of reform in the public sector, and such efforts will continue in order to foster a better environment for macroeconomic stability and the integration of the country into the regional and world economic community. The primary reform concerns the management of public finances.[16] Moreover, in order to increase domestic receipts and to optimize the reorganization of the country's revenues, reforms in the areas of taxes, and customs legislation and duties have thus been started. Income tax, company profits tax and

14 World Bank, *Cambodia: Rehabilitation Program: Implementation and Outlook*, Washington, D.C. 1995.

15 World Bank, *Cambodia: Progress in Recovery and Reform* Washington, D.C. 1997.

16 World Bank, *Cambodia: From Recovery to Sustained Development*, Washington, D.C. 1996.

property tax were introduced. Customs reforms have included reforms in the customs code and in tariffs. Treasury reform continues with assistance from France, the World Bank and IMF.

d. Economic integration: Cambodia successfully joined the ASEAN Free Trade Area (AFTA) in 1999. AFTA was a potentially important step in the development of the country and a stepping stone for further integration. It has opened new markets and will raise the efficiency of firms by exposing them to greater competition.

Accession of Cambodia to the WTO is part of the country's general trade strategy directed at an effective integration of the country into the world economy and global trading system. The Government believes in the role that trade can play in promoting growth and reducing poverty. Increased trade, promoted by liberalization policies, acts as a powerful stimulus to economic growth, and such an open trade regime will lead to higher rates of economic growth. Trade may facilitate international diffusion of knowledge, thereby speeding up growth. In many ways, trade may even occasionally substitute for aid in the development process.[17]

More specifically, membership in the WTO will enable Cambodia to reap the full benefits of global market access through the following:

(i) Application of best practices and non-discriminatory conditions for access of Cambodian goods and services to foreign markets;
(ii) Promoting development of export opportunities of the country and diversification of the country's exports;
(iii) Ensuring a sufficient degree of protection of domestic producers within the framework of an open economy and on the basis of norms and rules of the WTO.

In his introductory presentation at the Globalization Conference, the Secretary of State for Commerce Sok Siphana made the following remarks:

"…..Globalization is here to stay. Countries and companies alike must accept that reality. Cambodia has long enjoyed its natural resources without having derived much benefit from them in term of economic development. It is time now to seek wealth through the market place. The massive restructuring of political boundaries, the opening of new consumer markets, historic trade agreements, and the new World Trade Organization have created unprecedented opportunities for opening new marketplaces and there has never been a more opportune time for Cambodian companies to capitalize on these globalization trends. Countries should not forget that their best chance of development is to be part of an integrated world economy. I believe that Cambodian political leaders are quite conscious of this reality, particularly during the second term of the Royal Government. With peace restored and the economy stabilized, we can perceive throughout the accession process a strong political commitment coming from the very top, the Prime Minister himself, to achieve this ultimate policy objective, that is to become a member of the WTO."[18]

17 Speeches made by Commerce Minister Cham Prasidh on the IF in Geneva and Monterrey, 2002.

18 Conference Proceedings: Globalization Conference: Business and Law, Preparation for WTO Accession: Experiences and Lessons Learned, June 27-28, 2001, Phnom Penh

III. IMPACTS OF TRADE LIBERALIZATION, ECONOMIC INTEGRATION, AND TRANSITION

a. Impacts of trade liberalization: The economy has demonstrated a comparative advantage in the production of labor-intensive manufactures for export, and the potential exists for further growth, through diversification of markets and production. Exports of garments dominate the sector (nearly $1,303 million in 2002 out of the total foreign trade of $1,467 million) followed by three or four products and services – tourism, sawn timber, remittances of expatriate Cambodian workers, and rubber. Other exports are small, though a number show strong promises (e.g. shoe manufacturing, rice, fish, specialty agriculture and agro processing, handicraft.) Destination markets of current exports are also limited: the United States, the European Union, Singapore, Thailand, Malaysia are the dominant destinations.

One of the most recent newcomers in the international trade of garments has been Cambodia– a non-WTO member country and an LDC. It has been one of the fastest growing garment exporters over the past 8 years – in 1995 the exports of garments were about USD 26 million and in the years 2000 to 2002 the corresponding annual figure exceeded USD 1 billion. In early 2002 Cambodia ranked number 16 amongst the top suppliers of garments into the U.S. market. Cambodia is today an established supplier of low price, medium quality garments, employing around 220,000 workers in 185 factories, out of which only 23 are Cambodian-owned. Almost 90 per cent of the garment manufacturers are foreign-owned, coming from Hong Kong (China), P. R. China, Singapore, Taipei, South Korea, Malaysia, Thailand, Indonesia, Bangladesh, England, Germany, Australia, Canada and the United States. These investors also operate companies in other Asian, African and Latin American low-cost countries.

b. Impact of Dollarization: Cambodia's monetary system is characterized by a high degree of dollarization and cash transactions. In large parts of Cambodia the US dollar and the local currency — the riel — co-exist smoothly. In Phnom Penh either currency is widely accepted for everyday transactions. Large commercial transactions and asset building are invariably conducted in US dollars. In the countryside everyday transactions are more likely to be in riel. In border areas the Thai baht is also widely used.

Dollarization in Cambodia is the direct legacy of the destruction of economic and financial institutions after the 1970s, economic mismanagement in the 1980s, and the large inflows of US dollars in the early 1990s. After gaining independence in 1953, Cambodia experienced a peaceful period of steady economic growth for 17 years, with the riel as the main currency used in transactions and assets. In contrast, the period 1970–75 was plagued by a civil war that brought the Khmer Rouge regime to power in April 1975. The radical economic experiments launched during 1975–79 led to bans on private property, money and banking, and trade. Monetary transactions resurfaced in 1979, under the new regime, and the riel was reintroduced as the domestic currency in 1980.

The period 1980–92 was still affected by the unsettled political structure and the security situation. Substantial monetization of budget deficits during 1988–92 resulted in triple-digit inflation, leading to deep erosion of public confidence in the domestic currency. Large foreign exchange inflows associated with the return of refugees from abroad in the early

1990s and in 1991-92 with extensive operations of the *United Nations Transitional Authority in Cambodia (UNTAC)* largely fueled soaring bank foreign currency deposits.

Increasing confidence since late 1998 has been reflected in increased bank foreign currency deposits, with their share in broad money exceeding the pre 1997 level. Three separate phases in Cambodia's dollarization process are highlighted. In an initial phase (1991–96), the steady rise of dollarization largely reflected accelerated monetization and formal financial intermediation, against the background of increased capital inflows. In a second phase (1996–97), increased political uncertainties and economic mismanagement led to capital outflows and a decline in foreign currency deposits, resulting in a measured decline in dollarization. In the third phase (1998–2000), dollarization increased again in line with economic recovery.

c. Impacts of trade liberalization and poverty reduction: Trade liberalization, combined with dollarization, since 1993 has resulted in significant expansion of exports and narrowing of the current account deficit. Currently, however, the benefits derived from export growth are too narrowly based to produce any major impact on poverty reduction. The main beneficiaries of trade liberalization have been those directly involved in the activities, which are largely in the urban areas, and the limited auxiliary service activities that have developed around these activities. Even in the provinces, due to the lack of infrastructure there has been limited redistribution from urban to rural areas. By far the most important export commodities have come from the garment industry, although tourism has also shown recent rapid growth. However, these have remained restricted to urban enclaves and, due to high import content, they have contributed relatively little value added.

The absence of backward and forward linkages has also meant that employment generation as a result of rapid export expansion has been minimal. To enable equitable distribution of the benefits of trade, there need to be opportunities for the rural population to participate in trade-oriented activities. There are currently many obstacles preventing such participation. The delay in addressing these constraints will further increase the already existing inequities in access to resources and work against poverty reduction.

d. Impacts of economic liberalization, ODA and Debt: Trade as well as aid are both needed. Greater access for Cambodian exports to markets in rich countries - for agriculture, clothing and textiles - would significantly accelerate growth and create jobs, thereby fostering human development and reducing poverty. But, by itself, more trade will not generate enough resources to enable Cambodia to attain the goals.

Annual Official Development Assistance (ODA) pledges in support of Cambodia's development efforts amount to approximately US$ 600 million. On the occasion of the Consultative Group meeting held in Phnom Penh in June 2002, aid pledges were higher than in previous years. Nonetheless Cambodia's resource envelope is limited in the medium term. Only modest increases in public resources can be expected through growth in the tax base and efficiency improvements in the medium term. Domestic resource mobilization through domestic borrowing is also not feasible in the medium term. Further, Cambodia is heavily dependent on concessional donor finance for its development investments. This raises concerns regarding future debt service ratios. The present and projected grant: loan portfolio makes it imprudent for government to significantly seek additional development assistance without reckoning on a concomitant rise in its future debt service obligations. Any future adverse change in the grant: loan ratio would exacerbate this fiscal constraint.

This limitation on Cambodia's resource envelope means that Cambodia runs the risk of falling into a severe low level equilibrium trap with significantly negative consequences for poverty reduction, if the chief growth engine in Cambodia's future economy – private sector development – fails. The greater the shortfall in expectations from the private sector in terms of contributing to GDP growth, the tighter will be the fiscal constraint and the lower the chances of redressing low private sector growth through fiscal stimulation or, indeed, direct public investment.

e. Impacts on economic integration and export diversification: Diversification of exports is a national priority to reduce vulnerability to external market shocks and spread risk. The agriculture sector has great potential to lead national economic growth and to reduce poverty. The sector directly employs about 80% of the workforce and over 70% of the poor gain their livelihoods from agriculture. Tourism has substantial development potential that is based on both natural and cultural assets.

Cambodia has worked hard both to boost the productivity of its current exports and to move up the value-chain. For example, improvements in rice seeds, irrigation, and farming methods would go a long way in increasing both labor and land productivity and strengthening Cambodia's export capacity in this product. Likewise, Cambodia has begun making a shift to higher value agricultural production (spices, nuts and seeds, fruits, etc.) and more processing (e.g. milling of exported rice, extraction of essential oils, processing of wood, etc.) which would also bring more value from exports to the country. In this regard, bringing the country trade regime in line with the WTO rules and disciplines, lowering the costs of trade facilitation, strengthening the trade promotion capacity, improving the investment environment are some of the areas Cambodia needs to look at carefully, to implementing its export led growth strategy.

IV. OUTCOMES OF LIBERALIZATION ON THE DEVELOPMENT PROCESS

a. Economic Growth: Since the establishment of the Royal Government of Cambodia in 1993 average GDP growth was 5.6 percent and during the last three years it was 7 percent. Agriculture is the most important sector, accounting for 40 percent of GDP, and employing more than 70 percent of the labor force. The sector is growing on average by 3.6 percent, but agricultural output experiences large year-to-year fluctuations, reflecting insufficient investment in the sector, over-exploitation of natural resources, and precarious weather conditions.

National Income and Growth, 1993-2001

INDICATORS	1993	1994	1995	1996	1997	1998	1999	2000	2001
Absolute size									
GDP at current prices (in billions of riels)	6,545	6,812	8,111	8,886	9,778	11,364	12,587	12,932	13,357
GDP at current prices (in millions of USD)	2,252	2,644	3,273	3,386	3,319	3,011	3,300	3,351	3,404
Annual Change in real terms %									
REAL GDP	-	7.7	5.9	4.6	4.3	2.1	6.9	7.7	6.3
Agriculture	-	10.4	4.4	2.3	5.5	3.0	0.0	-0.3	3.9
Industry	-	6.0	20.9	9.9	21.3	7.3	13.2	34.6	15.5
Services	-	-0.5	5.7	3.6	-2.6	0.7	7.1	5.8	2.7
REAL GDP excluding:									
Agriculture	-	5.3	7.3	6.6	3.3	1.4	12.9	13.9	7.9
Textile	-	5.3	5.7	3.8	2.1	0.4	4.9	2.1	3.5

Note: These shares of GDP do not add to 100% because net taxes and imputed bank charges are not included.
Source: Ministry of Planning, National Institute for Statistics, and IMF.

The Industrial sector has been the main engine of growth, increasing annually by average of 16 percent. The sector consists mainly of the manufacturing sub-sector (78.5 percent) and the construction sub-sector (18.8 percent). The textile and garment sub-sector led this spurt, displaying a remarkable dynamism. Cambodia's garment industry has displayed a dramatic growth in its exports during the last four years, following the US granting the Most Favored Nation (MFN) status in 1996 and the Generalized System of Preferences (GSP) in 1997. During 1996-98, garment exports increased by 70-90 percent, but slowed down to 13-75 percent in 1999-2001 after the US imposed quotas on 12 categories of garment products. Employment in garments and textiles has been a major stabilizing force for the population and the economy in recent years, as the sector has absorbed a large number of skilled and semi-skilled labor, especially poor female workers who would have otherwise been unemployed or underemployed.

The output share of services sector's output has contracted gradually as the industrial sector has expanded. It fell from 39 percent of GDP in 1993 to 31 percent in 2001. Tourism related activities – hotels and restaurants – grew at an average annual rate of 30 percent over the 1994-95 period. It slowed down during 1996-98, but picked up again in 1999 when it grew by 20 percent.

Over the last few years, the development in the tourism industry has made a significant contribution to economic growth by attracting foreign investments, creating jobs and generating income for the local people.

b. Economic Performance[19]**:** Three phases characterize economic growth in Cambodia over the 1990s:[20]

- Growth has been particularly rapid since the beginning of the decade, with a peak at 7.6% in 1995, and an average yearly rate of 6.6% over the first four-year phase;

- The drop was just as steep with growth rate of 3.7% in 1997 and 1.8% in 1998; but it does not seem to have deeply affected the high rate trend, since the average yearly rate for the six years between 1993 and 1998 remained at around 4.7% with the exception if the manufacturing sector which have reached 6.3%.

- Then, Cambodia experienced a clear upturn, - the economic growth rate bounced back to 5% in 1999, as high as 5.5% in 2002, and slowing to 4.8% in 2003 with the Iraq war, SARS, and other shocks. Predictions for 2004 are for up growth to return to 5.5%.

Even if the overall growth record has been good in the 1990s (with the exception of 1997-8 following the Asian financial crisis and domestic political problems), sectoral distribution of growth has been quite uneven.

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19 See the following documents: World Bank, *Cambodia: Rehabilitation Program: Implementation and Outlook*, Washington, D.C. 1995; World Bank, *Cambodia: From Recovery to Sustained Development*, Washington, D.C. 1996; World Bank, *Cambodia: Progress in Recovery and Reform* Washington, D.C. 1997; Ministry of Commerce, *Cambodia Business/Investment Handbook*, Phnom Penh, 1996, 1997-98, 1999-2000; Royal Government of Cambodia, *Interim Poverty Reduction Strategy Paper (IPRSP),* Phnom Penh, October 2000; Royal Government of Cambodia, *Cambodia: Integration and Competitiveness Study,* Phnom Penh, 2001.

20 Ministry of Economy and Finance. *Macro-Economic Management*, Phnom Penh, 2000.

Share of Nominal GDP by Sector, 1993-1999

Sector	1993	1994	1995	1995	1997	1998	1999
AGRICULTURE	**46.4**	**47.2**	**49.4**	**46.1**	**46.0**	**45.8**	**42.8**
Of which: Crops	17.3	19.1	24.5	22.1	21.3	21.3	19.8
Fisheries	17.3	14.0	12.8	13.2	12.6	13.1	12.8
INDUSTRY	**11.6**	**12.0**	**12.4**	**13.7**	**15.2**	**16.1**	**17.1**
O.w.: Manufacturing	07.5	07.7	07.2	08.4	10.2	11.8	11.8
Food, Beverage & Tobacco	03.2	03.2	03.1	03.4	03.4	03.4	03.3
Textiles & Garments	01.1	00.7	00.8	01.5	03.1	04.5	05.7
Other Manufacturing	02.0	02.0	01.8	01.9	01.8	01.7	01.8
Construction	03.5	03.8	04.6	04.7	04.4	03.7	04.8
SERVICES	**39.3**	**36.1**	**34.2**	**35.5**	**34.6**	**34.0**	**34.5**
O.w.: Trade	14.8	13.1	12.3	12.4	12.1	11.5	11.2
Hotels, Restaurants	02.3	02.8	02.9	02.8	02.9	02.8	03.1
Transport & Communications	05.7	05.9	05.5	06.0	05.8	05.6	06.2

Source: Ministry of Planning

1. *Agriculture:* Cambodia is by far an agricultural country, evidenced by the largest share of the agricultural sector in the GDP (46.8% over 1993-98) and the highest level of absorption of employment. About 80 percent of the population earned their living from agricultural occupation. Rice farming and the cultivation of other crops were and remain the major activities of the rural people, followed by fisheries.

Trade liberalization supported by an export-oriented policy introduced since 1993 had contribute to substantially reduce the relative importance of agriculture in the economy. Agriculture's share of GDP decreased from 46.4 percent in 1993 to 42.8 percent in 1998. This sector, however, has a good prospect for growth due to the potentially rich agricultural resource base, a vast land area for cultivation and human resource endowment, provided there will be sufficient attention for increased investment and for improved efficiency and productivity.

2. *Industry:* The industrial sector still displays a remarkable dynamism, which illustrates the country's openness. The average growth rate was 8.9% in 1993-96 and continues until 1998 (7.0%), in spite of internal events in Cambodia and the financial crisis in the region. Overall, the industry sector contributes about 17% to domestic production with garment industry, construction, electricity and water as the most dynamic sub-sectors. With the influx of FDI associated with the government policy to support exporting industry, the industry sector as share of GDP has been on the increasing trend, moving upward from 11.6 percent in 1993 to 17.1 percent of GDP in 1999.

Construction – which accounts for more than third of the industrial sector – is the sub-sector with the highest growth, with an average annual rate of 13.1% in 1993-96. The relative important of this sector is explained by the fact that the country came out from a total devastation during the civil war, which emphasized the need to rebuild everything, including private house, administrative and commercial building.

3. *Services:* Services follow the dynamic experienced by the country since 1992 - equivalent average growth in 1993-96 (7.1%) and 1999-02 (7.6%), against 1.8% in 1988-91. The service sector accounts for about 40 percent of GDP, and is heavily concentrated on trading activities (15 percent of GDP) and on tourism-related services. Combined with transport and communications, and tourisms-related services, these three components comprised more than 50 percent of the total services sector.

V. LESSONS LEARNED FROM THE LIBERALIZATION REFORM PROCESS

Starting with fundamental deficits: At the onset of the implementation of the first reform program supported by the international community in 1993, Cambodia faced seemingly insurmountable obstacles of social, institutional, economic, and political nature. From the point of view of the economic elements, the country is confronted with fundamental deficits. Nonetheless the following lessons could be drawn as experiences to learn from:

a. Lessons learned on the financial and banking sector liberalization: The new Central Bank Law, promulgated in 1996, represented an important step in establishing a modern legal framework for the financial system by giving the NBC the primary mandate of maintaining price stability and providing a number of monetary policy instruments. The period of political stability coupled with the liberalization of the banking sector has allowed steady progress in the Government's efforts toward financial sector development. In November 2000, the commercial banking system consisted of 31 banks, including two Government-owned banks, 22 locally incorporated banks, and 7 foreign bank branches. However the banking system, which provides only limited services and has not contributed to overall economic activities, is in need of deep restructuring.

With the passage of the Financial Institutions Law in mid 1999, the NBC conducted a bank relicensing program based on increased capital requirements and rating system. Since the beginning of the restructuring effort, 29 commercial banks have been subject to a relicensing process, and 11 of these have been declared nonviable and had their licenses revoked. A restructuring process has begun for 14 potentially viable banks, while the remainder comprises viable banks. In addition, the restructuring process legally separated the state owned Foreign Trade Bank from the National Bank of Cambodia and led to the recapitalization of the former in mid 2001.[21]

b. Lessons learned on trade liberalization, ODA and debt: The fact remains that Cambodia is highly aid-dependent with all possible distortive developmental effects. It should remain a priority for the country to pursue its commitments to sustained policy reforms, including greater attention to actual reform implementation. Indeed, greater aid conditionality would be otherwise counterproductive and have a devastating impact on Cambodia's development efforts. Given the size and pervasiveness of ODA the efficient use of aid will be critical. More efficient and better-targeted aid, in line with national priorities, is crucial. By initiating development in key sectors of Cambodia that do not attract much private investment and that cannot afford to borrow extensively from commercial sources, ODA can, with the appropriate pro-poor policies, leverage domestic reforms and result in the achievement of the MDGs.

21 Royal Government of Cambodia, *Cambodia Integration and Competitiveness Study, Overview*, Phnom Penh, January 2002, Part B

Though the debt burden has been manageable up to now, it is rapidly growing and there is a danger that debt service will absorb more and more public resources, thereby crowding out resources to invest in development. In addition, there is a need to increase the productivity of public investments to ensure that loans generate sufficient returns to sustain future repayment. A related issue is the proportion of ODA received as grants versus loans. There is a need to come to a consensus to increase the grant share in ODA and to use loans for investments that are expected to have higher economic returns.

c. Lessons learned on trade liberalization and poverty reduction: Trade liberalization in Cambodia will not contribute to poverty reduction if other macroeconomic policies are not supportive. In reality, the impact so far has been rather narrow, in terms of its impact on employment, income distribution and contribution to GDP. The narrow range of products being exported and the high import content needs to be addressed, since they restrict the benefits to the local economy that come with trade liberalization.

Trade liberalization will benefit the poor if policy is structured to develop products for local markets that will eventually have the capacity to compete in international markets. The division of labor, domestically as well as internationally, should benefit from increasing the extent of the domestic market. Addressing the immediate constraints in the country in the areas of governance, infrastructure and poor human capital, will go further in addressing pro-poor trade growth since it will expand the number of products that can be exported and widen the proportion of the population that can benefit from trade liberalization, and thus establish a conduit for the re-distribution of growth.

d. Lessons learned on Institutional Strengthening: Institutional strengthening must address several major problems that constrain Cambodia development:

Dealing with overstretched human and financial resources in the public sector: This has several implications. *First*, basic services to be delivered by the Government are lacking, and the scarcity of those services (electric power, water, etc.) is an important feature of the business environment since the scarcity is reflected in pricing. *Second*, in part because salaries are necessarily lower than would be without a severe budget constraint, many civil servants appear to be exploiting opportunities to seek rents, which further complicate the business environment and link progress to civil service reform. *Thirdly*, any strategy going forward to improve the business environment must consider, wherever feasible, better targeting of public resources. Broadly, this may take the form of redefining the role of the state away from resource-intensive roles and towards policy setting and protecting service delivery standards.

External forces to consolidate the domestic legal reforms: The challenges of initiating and completing regulatory reform are familiar. Vested interests in public and private sectors, fears of the consequences of change, and the complexity and uncertainty of reform in dynamic economic and social environments must be dealt with effectively if reform is to succeed. External pressures of the WTO accession process have been very instrumental in the speed of the reform process. At the top of the agenda of the Legal and Judicial Reform Strategy are issues which the Government needs to accelerate, i.e. implementation of coordination mechanism: (i) Coordination with and within Government, the Legislative Branch, the Private Sector, and the Civil Society; Consultations with stakeholders throughout the law making process; and capacity building in the law making process.

Rebuilding the legal framework to meet the needs of WTO accession: The Cambodian legal framework has had to be almost entirely rebuilt from scratch and numerous new laws were recently adopted, or are being drafted, to implement notably future WTO requirements. In general, for other accessing countries, the main emphasis is reforming their existing legal framework to comply with WTO requirements. However, in the particular context of Cambodia, the main emphasis for the Government will be to adopt and implement new laws and regulations to complete the current deficient legal framework and, at the same time, to implement the provisions of the various WTO Agreements.

Tackling the issue of transparency and predictability: Bearing in mind that the present system did not offer businesses adequate legal protection and that an effective, low-cost dispute settlement mechanism is considered critical for attracting foreign investment, Cambodia has committed to establish a Commercial Court system with trained judges and staff essential to create a climate of transparency and predictability, complemented by a commercial arbitration enforcement mechanism.

Strengthening the role of the Private sector: Reform is not, however, a task only for governments. Other stakeholders such as firms and workers have roles in helping to build support for reform and in sharing information across borders. With the exception of the financial and banking sector, the tourism sector, and the legal and accounting professional services sector, there were no strong private sector organizational structures capable of interacting effectively with the Government, or of translating their sector-specific business interests into Cambodian policy stances to be defended in regional and international trade negotiations.

Therefore, enhancing Cambodia's private sector participation in trade policymaking has been one of the main objectives of Cambodia initial trade mainstreaming efforts. After Cambodia's accession to the WTO, it is urgent that the Cambodian private sector fully understands implications from their country's WTO membership. Without such understanding, it is very unlikely that they will be able to design business strategies that take advantage of international trade rules and to draw benefits from their country's accession to the WTO. Likewise, the Cambodian Government, on its side, will need inputs from the Cambodian private sector, in order to be able to define Cambodian positions on the basis of clear interests and to participate substantially in the Doha Round.

Capitalizing on Participation in International Bodies: Putting reform into the international arena attracts higher levels of political attention. The perceived "fairness" of multilateral action can help to reduce resistance to reform, compared to going it alone. International rules and disciplines aimed at improving regulations and regulatory processes help promote reform at the national level. International co-operation, commitments, guidelines, policy recommendations, and other international approaches, both reflect but also stimulate reform at national levels.

Of relevance to the services sector, Cambodia is a member of many international organizations, *inter alia*: International Civil Aviation Organization; World Health Organization; International Maritime Organization; International Telecommunications Union; United Nations Educational, Scientific and Cultural Organization; World Tourism Organization; Multilateral Insurance Guarantee Agency.

Participation in Regional Integration Agreements: Cambodia obtained its membership in ASEAN in 30 April 1999. Cambodia's membership in ASEAN and its involvement in the implementations of the various agreements have allowed it to draw the necessary synergy and experiences in dealing with specific sectoral issues.

e. Lessons learned from export diversification: With the impending expiry of the MFA in January 2005, Cambodia may loose its competitive edge in the garment export sector, and risks the loss of thousands of jobs. While the Government is committed to export diversification, there are still many hurdles to overcome before one can see the positive impact of the new trade policy. A number of trade-related issues of pressing concern are yet to be settled. First, there is a need to increase the efficiency of key export sectors. Second, it is important to diversify the export base by promoting sectors where Cambodia is likely to have a comparative advantage. Third, the negative development impacts of trade reforms must be identified and mitigated. Fourth, the need to build appropriate capacities both on the policy formulation and implementation and on the supply side. The success of Cambodia in implementing the Integrated Framework for Trade Related Technical Assistance for least Developed Countries (IF) can be considered as a key advancement in surmounting to these hurdles.

f. Lessons learned from the Labour standards linkage: In 1999, Cambodia signed and ratified all the core ILO conventions, and entered into a bilateral Textiles Agreement with the US in which provisions for the protection of Labor were included. It is worth noting that Cambodia is the first LDC to have signed such a textile agreement with the US linking trade and labour conditions, and as such created a precedent in the annals of textile negotiations.

Cambodia has been performing very well according to the instructions given by the buyers and the steady growth of exports indicates that Cambodia has become a credible supplier of garments in international markets. The garment sector in particular has clearly indicated the potential impact of a thriving private sector, growing from $20 million in exports in 1995 to over $1.4 billion in 2002.

Nonetheless Cambodia is an example which will be hard to duplicate in another country because Cambodia started from scratch, with little vested interests from any sphere of influence; their leaders have the political will and commitment to enforce the Labour Law; and the society is still very open to democratization, i.e. strikes and street demonstrations occurred frequently and have been tolerated.

g. Lessons learned from sequencing of reforms: Cambodia has adopted a very comprehensive economic reform package which addresses fiscal and monetary discipline, tax/customs reforms, public expenditure rationalization, financial liberalization, liberalized foreign exchange regime, trade and investment liberalization, and legal and judicial reforms. Nevertheless, by taking into account a proper sequencing of reforms, Cambodia could ensure that integration will deliver expected benefits instead of creating chaos or eventual economic crisis. As an illustration, Cambodia has sequenced its trade liberalization reform by:

(i) first decontrolling essential imports of inputs for the manufacturing as well as for the agricultural sector;

(ii) adopting a managed floating exchange rate regime with a view to move to unification of the exchange rate and considering steps to gradually de-dollarize the economy;

(iii) committing to accept the Article VIII of the IMF;

(iv) moving ahead with trade facilitation measures; and

(v) not taking commitment on capital account liberalization before putting in place a consistent monetary and exchange rate policy that is sustainable over time, having a good system for prudential management, a healthy and sound banking system, auditing, accounting and disclosure standards, developing indirect monetary instruments, and promoting infrastructure for financial market development.

VI. EMERGING CHALLENGES: FACING THE TRANSITION TO A FREE-MARKET ECONOMY

A decade after the elections of May 1993, Cambodia faces a historically important opportunity. As recently as 1989, all enterprises were state-owned, prices were controlled, and economic planning was centralized. During the initial decade of democracy, pricing and exchange rates have been liberalized, macroeconomic stabilization has been largely achieved, a two-tier banking system has been introduced and subsequently reformed, trade liberalized, prices freed, and the number of state enterprises substantially reduced through privatization and leases. A public enterprise law was enacted that legislated a level playing field between state and privately-owned firms, and many of the most obvious examples of direct state ownership have given way gradually to private investment. In 1994, the creation of an investment climate open to foreign investment was signaled through the passage of the Law on Investment, resulting in a substantial increase in FDI.[22]

During this time, the Cambodian economy has withstood a number of shocks, including political violence, particularly in 1997, the Asian financial crisis, floods, anti-Thai riots, and SARS, and generally exceeded 5 percent growth. The year 1997 appears in retrospect to have been a turning point, to the extent that FDI has declined progressively since that point.

Challenge 1: Building on peace, stability, and international recognition: Cambodia needs to build on its relatively smooth elections,[23] new acceptance into the international community through WTO accession, security in the sub-region, an absence of economic crisis, signs of growth in all major markets, and increasing partnership among donors. These are many of the pillars on which a new platform of economic growth can be built. What remains to be achieved is a credible program of reform that addresses the most fundamental issues impacting the private sector.

Challenge 2: To accelerate and broaden the process of establishing formal private enterprise and integrate into global markets. As World Bank Country Economist Nick Stern advised the Cambodian authorities, "the lesson from countries that gain from integration – improve the investment climate and invest in people. For Cambodia, addressing governance can raise productivity and integrate the informal sector."[24] While it

22 World Bank (1999a), *Cambodia Public Expenditure Review*.

23 The elections, while considered fair by international observers, were followed by a protracted period of negotiation to form a new government. At time of writing, these negotiations have not been completed.

24 "Building a Climate for Investment, Growth & Poverty Reduction in Cambodia." Presentation by Nicholas Stern, Vice President and Chief Economist, World Bank, May 2003.

is widely known that a variety of administrative and market-based barriers impede the development of the private sector in Cambodia, very little baseline data currently exists, particularly regarding the performance of the private sector, to help guide the Government in making sound policy decisions. Cambodia needs to identify specific administrative and market-based barriers to growth, quantify the impact of these barriers on the competitiveness of companies operating in Cambodia, and to shed light on possible policy options to help remove distortions that impede the development of the economy.

Challenge 3: Making private sector development a strategic choice: Institutional development and structural reform call for considerable financial and managerial resources. It is important, therefore, that considerable effort be invested in deciding which institutions are most important, and sequencing and focusing these in a way that is most conducive to sustainable reform. That means evaluating the potential consequences of various reform options on Cambodia's strategic goals, sustainable private sector-led growth with equity/broad-based employment growth, in order to provide a coherent path most likely to provide a payoff. At an aggregate level, there are many impediments that face the entire private sector, for which the decision to prioritize is non-controversial. However, with many policy or institutional investment options, particularly at the sectoral level, there will be tradeoffs: equity vs. efficiency, rural vs. urban, short-term investment vs. sustainability, human capital vs. physical capital.

Challenge 4: Pressing on Governance and transparency issues: While initial performance under the reform effort is commendable, there is little room for complacency given Cambodia's vulnerability and pressing need to alleviate poverty. Significant actions will be needed in the period ahead to firmly establish a basis for promoting sustainable growth and reducing poverty. Governance and transparency issues are at the forefront of Cambodia's reform agenda. Facilitating independent operations of the National Audit Authority and establishing a modern legal and judiciary system that provide for a clear rule of law and modern commercial laws and regulation are crucial.

Challenge 5: Aggressive revenue mobilization: Further fiscal restructuring will be required in the period ahead and the main challenge to that end is to improve revenue mobilization and reorient spending away from defense and security toward social sectors. Significant official financing on concessional terms and debt relief will continue to be required over the medium term.

Revenue Structure, 1994 - 2002
(in percent of GDP)

	1994	1995	1996	1997	1998	1999	2000	2001	*2002*
Total revenue	***8.7***	***7.9***	***8.4***	***9.0***	***8.3***	***10.6***	***11.1***	***11.7***	***12.9***
Current revenue	8.7	7.8	8.0	8.9	8.0	10.4	10.7	11.3	12.8
Tax revenue	*5.4*	*5.5*	*6.0*	*6.1*	*6.0*	*7.6*	*7.9*	*8.1*	*8.9*
Direct taxes	0.1	0.3	0.3	0.4	0.5	0.7	1.1	1.0	0.9
Indirect taxes	1.1	1.3	1.8	2.1	2.2	3.5	3.9	4.3	4.9
Trade taxes	4.1	4.0	3.9	3.5	3.3	3.4	3.0	2.8	3.1
Non-tax revenue	*3.3*	*2.3*	*2.0*	*2.8*	*2.0*	*2.8*	*2.8*	*3.2*	*3.8*
Capital revenue	0.0	0.1	0.4	0.1	0.3	0.1	0.2	0.1	0.2

Expenditure Structure, 1994 - 2002
(in percent of GDP)

	1994	1995	1996	1997	1998	1999	2000	2001	2002
Total expenditure	***14.6***	***15.4***	***14.9***	***13.0***	***13.8***	***14.5***	***16.3***	***17.6***	***19.0***
Current expenditure	9.7	9.1	8.9	8.3	8.2	8.7	9.4	10.3	11.3
Wages	4.2	4.3	3.9	3.9	3.9	4.1	4.0	3.7	3.8
Civil administration	1.5	1.4	1.4	1.4	1.3	1.5	1.7	1.6	1.9
Defence & security	*2.8*	*2.8*	*2.5*	*2.6*	*2.6*	*2.6*	*2.3*	*2.1*	*1.9*
Non-wage	5.5	4.8	5.0	4.4	4.0	4.6	5.4	6.6	7.6
O.W: Operating exp	4.7	3.8	3.8	3.3	3.0	3.2	3.9	4.3	4.2
Civil admin	1.8	1.4	1.8	1.7	1.6	2.2	2.9	3.6	3.6
Defence	*2.9*	*2.4*	*2.0*	*1.6*	*1.3*	*1.1*	*1.0*	*0.7*	*0.6*
Transfers	0.7	0.8	0.8	0.8	0.7	0.9	1.1	1.2	1.3
Interest	0.0	0.0	0.1	0.1	0.1	0.2	0.2	0.2	0.2
Capital expenditure	4.9	6.3	6.0	4.6	5.5	5.8	6.9	7.3	7.6

Challenge 6: Facing a garment quota free world in 2005: Cambodia is facing serious challenges in the coming years. The phasing out of the quotas under the WTO Agreement on Clothing and Textiles (ACT) in 2005 will mean massive changes in the Cambodian garment industry. Fundamentally, the abolition of quotas would leave Cambodia without a guaranteed market for its garments exports. Cambodia faces several constraints in dealing with the abolition of garments quotas including: (1) declining competitiveness; (2) reliance upon quota categories (60 percent of garment exports fall under the quota and only 40 percent are outside of quota); (3) high concentration on a few markets; and (4) heavy reliance on imported inputs/materials. While the "cheap, productive workforce" approach will be used to maintain and attract new foreign investments, Cambodia will face great difficulties in competing with large-scale producers such as India or China.

Challenge 7: Dollarization vs. De-dollarization: While Cambodia has largely benefited from widespread dollarization of transactions and financial assets, this situation may not be desirable in the long run, as the lack of a more flexible exchange market could obstruct further regional integration and affect the country's competitiveness. However, any reversing of dollarization is a long term process and would require continued stabilization and completion of key structural reforms, especially financial sector reform. The continuation of dollarization raises however important issues of export competitiveness especially in the context of minimum wage regulation.[25]

Challenge 8: Preparing for the external shocks: Even if the above challenges are successfully addressed, there remain downside risks for growth including a significant global economic downturn, the global war on terrorism, the abolition of quotas (discussed above), climatic risks (like flooding) and reduced foreign direct investment (FDI) in Southeast Asia in favor of China.

25 *Ibid.*

VII. THE WAY FORWARD: PURSUING PRO-POOR POLICIES TO ACHIEVE THE MILLENNIUM DEVELOPMENT GOALS (MDGS)

During the past decade Cambodia has experienced steady economic growth, nevertheless poverty has not declined significantly. Rural growth has barely kept pace with population growth and there are worrying trends of rising rural unemployment and lack of growth in non-farm employment. If past trends continue, poverty incidence will decline to 27.6 percent by 2015. Clearly, this falls short of the set target of 19.5 percent.

Addressing deprivation in basic human needs remains the primary challenge for Cambodia. It is clear that poverty and hunger eradication require a multi-faceted response incorporating economic, social and governance issues. In terms of economic policies, there is a need to ensure that the growth process is increasingly pro-poor, generating benefits for those in most need. Democratic reforms must be pursued, along with a progressive decentralization. On the social front, measures of effective social protection need to be strengthened and human capacities reinforced. More generally, changes in the institutional environment are required to strengthen the role of civil society and the private sector in the development process.

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