AMRO Country Report
ACR/20-01

# AMRO Annual Consultation Report

## Cambodia - 2019

The ASEAN+3 Macroeconomic Research Office (AMRO)

January 2020

**Acknowledgements**

1. This Annual Consultation Report on Cambodia has been prepared in accordance with the functions of AMRO to monitor and assess the macroeconomic status and financial soundness of its members; identify relevant risks and vulnerabilities; report these to member authorities; and if requested, assist them in mitigating these risks through the timely formulation of policy recommendations. This is being done in accordance with Article 3(a) and (b) of the AMRO Agreement.

2. This Report is drafted on the basis of the Annual Consultation Visit of AMRO to Cambodia from 10 – 18 September 2019 (Article 5 (b) of AMRO Agreement). The AMRO Mission team was headed by Dr. Seung Hyun Hong (Group Head and Lead Specialist). Members include Dr. Abdurohman (Specialist), Dr. Dan Lu (Economist), Dr. Tanyasorn Ekapirak (Researcher), Ms. Vanne Khut (Researcher), Ms. Sovanney Chey (Associate) and Ms. Chanvanny Dy (Associate). AMRO Director Dr. Toshinori Doi and Chief Economist Dr. Hoe Ee Khor also participated in key policy meetings with the authorities. This AMRO Annual Consultation Report on Cambodia for 2019 was peer reviewed by Dr. Sumio Ishikawa (Group Head and Lead Economist) and Mr Paolo Hernando (Senior Economist) and Ms. Wanwisa Vorranikulkij (Specialist); and approved by Dr. Hoe Ee Khor, AMRO Chief Economist.

3. The analysis in this Report is based on information available up to 31 October 2019.

4. By making any designation of or reference to a particular territory or geographical area, or by using the term “member” or “country” in this Report, AMRO does not intend to make any judgements as to the legal or other status of any territory or area.

5. On behalf of AMRO, the Mission team wishes to thank the Cambodian authorities for their comments on this Report, as well as their excellent meeting arrangements and hospitality during our visit.

**Disclaimer**: The findings, interpretations, and conclusion expressed in this Report represent the views of the ASEAN+3 Macroeconomic Research Office (AMRO) and are not necessarily those of its members. Neither AMRO nor its members shall be held responsible for any consequence of the use of the information contained therein.

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## Executive Summary

1. **Cambodia's economy has continued to grow strongly while inflation has remained subdued.** Real GDP growth hit an eight-year high of 7.5 percent in 2018 primarily driven by a strong rebound in the garment manufacturing sector, robust construction activities and buoyant domestic demand. In 2019, growth is expected to moderate to 7.1 percent reflecting weaker external demand. Meanwhile, inflation moderated to 2.5 percent in 2018 and is projected to remain subdued in 2019 with relatively stable food and energy prices.

2. **Despite a wider current account deficit, the balance of payments has remained in surplus.** The widening current account deficit was fully covered by a higher surplus in the capital and financial accounts, in particular FDI inflows. As a result, the overall balance of payments has continued to record a surplus, leading to a further accumulation of international reserves.

3. **Financial sector indicators have remained broadly sound.** After moderating in 2016 and 2017 due to the implementation of stricter prudential regulations, credit growth picked up speed again from H2 2018, led by stronger FDI inflows and robust economic activities. The financial sector have remained well buffered, as CARs in both commercial banks and MFIs have continued to be above the regulatory minimum levels amid a rising trend in banks' profitability despite a slight uptick in the non-performing loan (NPL) ratios of banks.

4. **The fiscal position has strengthened on the back of continued strong revenue collection.** With the successful implementation of the Revenue Mobilization Strategy 2014-2018 (RMS I), domestic revenue reached a record high in 2018. As the rapid increase in public-sector wages has abated, the overall fiscal deficit narrowed. Rising current budget surplus led to a further build up in government deposits that can be used as a fiscal buffer.

5. **Cambodia's major risks stem from its high dependence on only a few markets.** Given the country's high reliance on the E.U. market, the suspension of its Everything But Arms (EBA) status, will have a significant impact on Cambodian exports. In addition, China's dominant share in FDI and tourist arrivals has raised concern over Cambodia's increasing vulnerability to any negative developments in China, such as a sharp growth slowdown or sudden policy changes.

6. **Rapidly rising cost of production poses a structural challenge to the Cambodian economy.** Amid relatively high non-labor production costs, such as logistics and electricity, rapidly increasing minimum wages would weaken the cost competitiveness of Cambodia's labor-intensive garment industry. The monthly minimum wage in the garment sector has risen from USD80 in 2013 to USD182 in 2019, and is scheduled to increase to USD190 in 2020, which is higher than neighboring peers.

7. **Risks to financial sector stability stem mainly from rapidly rising credit expansion in the real estate-related sector.** The sector's steadily rising credit share and continued strong credit growth have heightened concerns about credit risks, in which disorderly adjustments in the property market and a sharp correction in property prices could undermine financial sector stability.

8. **Enhancing competitiveness and diversifying the economic base are critical to maintaining Cambodia's strong growth potential.** To sustain its strong growth momentum,

Cambodia must address its structural challenges, especially the relatively poor infrastructure, limited supply of skilled labour and rapidly rising minimum wages. In addition, the risk of a suspension of its EBA status hangs over the Cambodian economy, which could further erode its external competitiveness. In this regard, AMRO welcomes the government's recent 17-point strategy, announced in March 2019 to strengthen competitiveness and partially offset the losses arising from the potential EBA suspension.

9. **It is essential to further reprioritize fiscal resources to support structural reforms amid rising spending needs.** Prudent fiscal policy has led to a build-up of fiscal space which provides room for more resources to be allocated to support infrastructure development and structural reforms. While welcoming the launch of a new revenue mobilization strategy, RMS II, AMRO also recommends that more resources be directed towards public spending on long-term development projects, so that the structural weaknesses would not be a binding constraint on efforts to sustain strong growth over the longer term.

10. **Additional measures should be introduced to help contain credit risks in the real estate sector.** The authorities' significant progress in implementing international regulatory standards is commendable. To better curb the risks associated with credit concentration and speculative investments in the real estate sector, further macroprudential measures, such as the introduction of a ceiling on debt service to income ratio and stricter control of credit concentration risk, should be considered, while relevant government agencies should coordinate to introduce regulations to curb speculations in the real estate sector.

## A. Recent Developments and Outlook

### A. 1. Real Sector Developments and Outlook

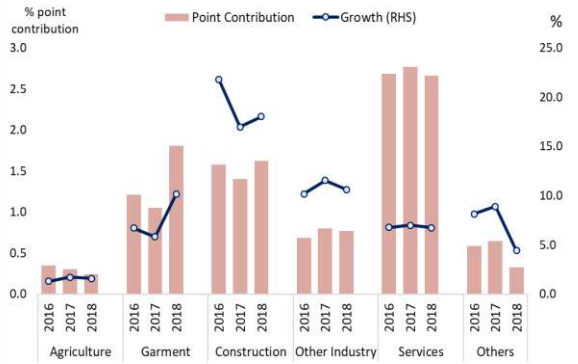
1. **Cambodia's economy grew faster than expected in 2018, mainly driven by a strong rebound in garment manufacturing.** Real Gross Domestic Product (GDP) growth hit a ten-year high of 7.5 percent in 2018, exceeding expectations. The garment manufacturing sector rebounded strongly on the back of surging exports after slowing down for two consecutive years. Meanwhile, rapid growth in the construction sector continued, owing to the robust property market and infrastructure development. Buoyant domestic demand also contributed to the strong growth in 2018, supported by higher wages, both in the public and private sectors, and robust inflows of foreign direct investment (FDI).

**Figure 1. GDP Growth**


Note: 2019P refers to AMRO staff projection

Source: National Institute of Statistic (NIS), AMRO staff estimates

**Figure 2. GDP Growth by Sector and its Contribution**




Source: NIS; AMRO staff calculations

2. **Garment manufacturing rebounded sharply while construction continued its robust expansion.** Garment manufacturing which contributes more than two thirds of total manufacturing sector grew by 10.1 percent in 2018, up from 5.8 percent in 2017, with the support of strong garment exports, especially to the United States (U.S.) and European Union (E.U.) markets. Garment export growth surged in 2018 to 17.3 percent, reaching a record high in the last four years; in particular exports to the U.S. rose from 4.7 percent in 2017 to 29.1 percent in 2018.[1] Meanwhile, the persistently buoyant property market and infrastructure developments sustained construction sector expansion. As the number of approved construction projects increased considerably in the past two years, the sector continued its strong growth momentum in 2018.[2] FDI inflows and bank loans to the construction and real estate sector also contributed to the robust construction activities in 2018.

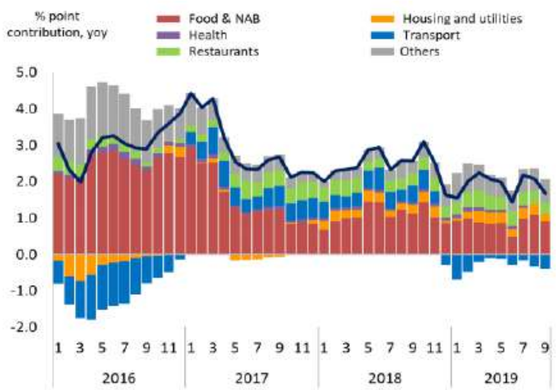
[1] On June 30, 2016, the Office of the U.S. Trade Representative (USTR) announced a major expansion of its trade preference scheme, the Generalized System of Preferences, allowing Cambodia to export travel goods to the U.S. duty free. For more details, https://kh.usembassy.gov/duty-free-access-travel-goods-made-cambodia/

[2] The construction sector grew by 18 percent in 2018, up from 17 percent in 2017. The value of approved construction projects climbed to a record high of USD8.5 billion in 2016, followed by USD6.8 billion in 2017, respectively equivalent to 42.6 percent and 30.6 percent of GDP.

3. **Robust domestic demand also provided a strong boost to growth in 2018**. Higher wages in both the public and private sectors, combined with low inflation, fueled household purchases, partly reflected in the rapidly rising imports of consumption goods. In particular, imports of motor vehicles increased by 21.4 percent in 2018, in parallel with soaring fuel imports. Investment, primarily private investment, accelerated on account of strong FDI inflows.[3] Robust investment activities also boosted import demand for construction materials, which surged by 53.5 percent in 2018.

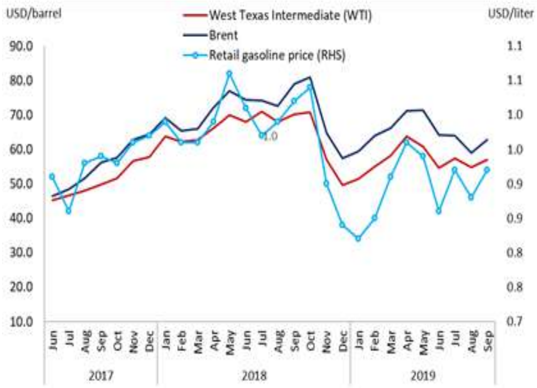
4. **The economic growth is projected to remain robust in 2019 underpinned by solid domestic demand.** The global growth momentum weakened in 2019, dragged down by a broad-based slowdown in major economies including China, the E.U. and U.S., amid increasing uncertainties in trade and geopolitical tensions. Cambodia's exports moderated slightly in the first nine month of 2019, in particular to the E.U. market which dampened growth. However, Cambodia's economy is forecast to hold up well as domestic demand will likely remain strong on the back of robust construction activities, strong domestic credit growth, and buoyant consumer spending. Real GDP growth is projected to moderate to about 7.1 percent in 2019 and 2020 reflecting weaker external demand.

**Figure 3. CPI Inflation and Components**




Note: NAB: Non-alcoholic beverages
Source: NIS; AMRO staff calculations

**Figure 4. International Oil Prices and Domestic Retail Gasoline Prices**




Source: NIS; AMRO staff calculations

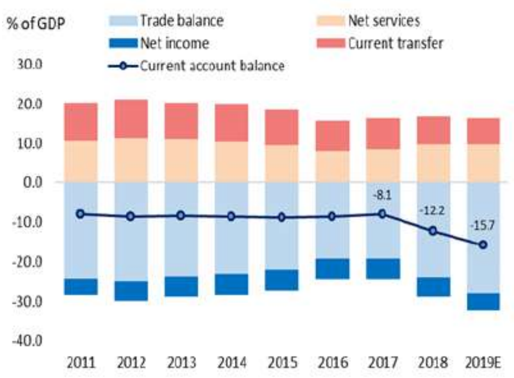
5. **Headline inflation has moderated in 2018 and 2019, led by lower energy prices.** Headline inflation averaged at 2.5 percent in 2018, down from 2.9 percent in 2017, supported by broadly stable food and beverage prices. In response to the rising transportation costs, the authorities adopted some administrative measures in H2 2018, and falling global oil prices in November also contributed to the lower inflation in 2018. During the first nine months of 2019, inflation has moderated further, averaging 1.9 percent year on year (yoy), as energy prices continued to fall while food prices has remained relatively stable. Headline inflation is projected to edge down to 2.1 percent in 2019 and to remain subdued in 2020, albeit slightly higher.

[3] In 2018, FDI inflows reached USD3.1 billion, or 12.6 percent of GDP, up from USD2.8 billion in 2017.

## A. 2. External Sector and the Balance of Payments

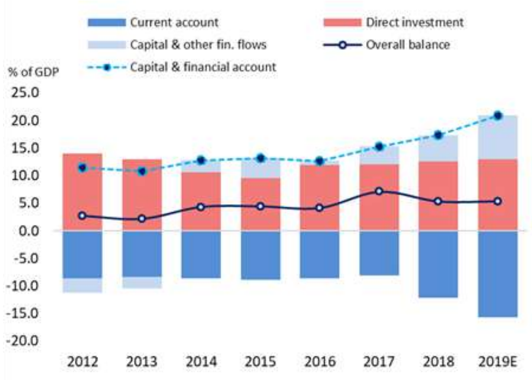
6. **The current account deficit widened sharply on the back of a strong increase in imports.** While exports rebounded strongly to reach USD12.9 billion on surging garment exports in 2018, imports grew even faster, hitting USD18.8 billion due to the high import content of garment and growing domestic demand for consumer goods and construction materials. As a result, the trade deficit widened to USD5.8 billion in 2018 from USD4.3 billion in 2017. Although the services account remained in surplus on the back of strong tourist arrivals, the current account deficit widened to 12.2 percent of GDP in 2018, up from 7.9 percent in 2017. In H1 2019, imports growth continued to outpace exports, and the current account deficit is projected to widen further to 15.7 percent of GDP for the whole year 2019.

**Figure 5. Current Account Balance**




Note: 2019E refers to AMRO staff estimates
Source: NBC; AMRO staff estimates

**Figure 6. Balance of Payments**




Note: 2019E refers to AMRO staff estimates
Source: NBC; AMRO staff estimates

7. **Despite the wider current account deficit, the overall balance of payments has remained in surplus, reflecting strong FDI inflows.** The widening current account deficit was fully covered by a higher surplus in the capital and financial accounts. With strong FDI inflows, the capital and financial account surplus increased from 15.3 percent of GDP in 2017 to 17.3 percent in 2018, and the overall balance of payments continued to record a surplus. Gross international reserves increased from USD12.2 billion in 2017 to USD14.6 billion in 2018, and to USD16.8 billion as of August 2019, sufficient to cover about eight months of goods and services imports[4].

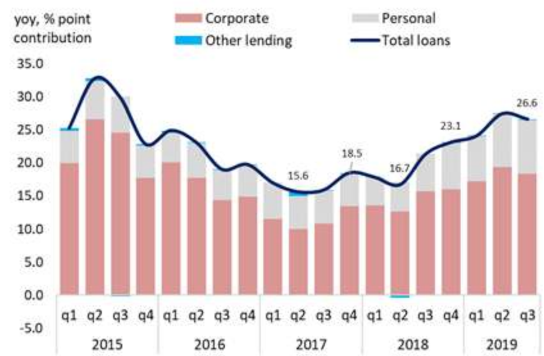
8. **FDI inflows have remained strong, especially into financial sector and construction and real estate related activities**. In 2018, FDI inflows climbed to a new record high of USD3.2 billion or 12.8 percent of GDP, from USD2.8 billion in 2017. The FDI flowed largely to the financial and construction and real estate sectors, which together accounted for about 51.8 percent of total FDI inflows in 2018. In terms of the country of origin, China is the biggest investor in Cambodia, accounting for about 40 percent, followed by Korea (7.8 percent), Singapore (7.1 percent) and Japan (6.2 percent) (see Annex 2).

[4] International reserves include foreign currency assets from banks' unrestricted deposits with the central bank.

## A. 3. Banking and Financial Sector

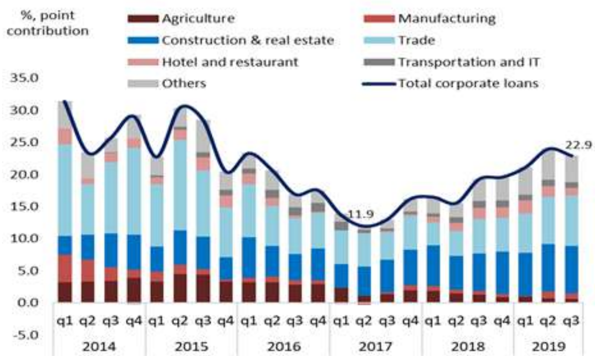
9. **Credit growth in the private sector rebounded strongly.** In 2016 and 2017, banks' credit growth to private sector trended down amid stricter prudential regulations. However, led by strong FDI inflows and robust economic activities, credit growth rebounded from 18.5 percent in Q4 2017 to 23.1 percent in Q4 2018, and accelerated further to 26.6 percent as at Q3 2019 (Figure 7). Bank' loans to the corporate sector, which accounted for more than 80 percent of total outstanding loans, grew by 19.6 percent in Q4 2018 and accelerated to 22.9 percent in Q3 2019, primarily driven by credit to trade and construction and real estate sectors (Figure 8). The micro finance institutions (MFIs) loan growth also remained robust at around 30 percent in H1 2019. With the rapid credit growth, in both banks and MFIs, total outstanding credit in percentage of GDP rose from 86.1 percent in 2016 to 109.5 percent as at June 2019, widening the credit to GDP gap above the conventional threshold of 10 percent of GDP.[5]

**Figure 7. Credit Growth in Private Sector**




Source: NBC; AMRO staff calculations

**Figure 8. Credit Growth in Corporations by Sector**



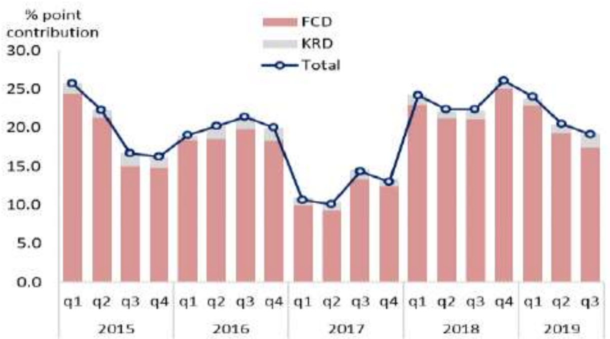

Source: NBC; AMRO staff calculations

10. **The rapid credit growth has been well supported by expanding bank deposits.** After slowing down in 2017, bank deposit growth picked up and reached 26.0 percent in 2018, mainly driven by foreign currency deposits as FDI inflows strengthened. Foreign currency deposits expanded markedly by 26.5 percent in Q4 2018, higher than the 13.1 percent in Q4 2017 and making up about 95 percent of total bank deposits (Figure 9). Amid the accelerating credit growth, the rapid expansion of bank deposits lowered the loan to deposit (LTD) ratio from 95 percent as at end-2017 to 92 percent by the end of 2018. It edged up slightly to 94 percent in June 2019, as bank deposit growth saw a slight slowdown while bank loan growth continued to accelerate.

11. **Credit growth in construction and real estate activities accelerated.** Credit to the construction and real estate sectors have continued to expand rapidly, averaging around 34.7 percent between Q1 2015 and Q3 2019. This rapid expansion increased the concentration of credit in construction and real estate sector to around 28.8 percent of total credit as at June 2019 (Figure 10). In contrast, the proportion of credit provided to the agriculture and manufacturing sectors steadily shrank, reaching 13 percent in September 2019.

[5] According to Drehman et al. (2010), a credit to GDP gap above 10 percent is considered a strong signal of an impending financial stress.

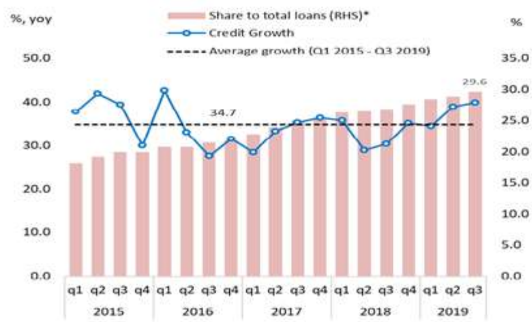
**Figure 9. Bank Deposit Growth**




Note: FDC refers to foreign currency deposit and KRD refers to Khmer riel deposit

Source: NBC; AMRO staff calculations

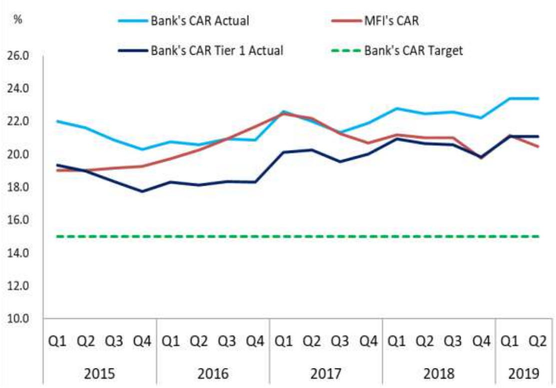
**Figure 10. Credit to Construction and Real Estate-related Activities**




Source: NBC; AMRO staff calculations

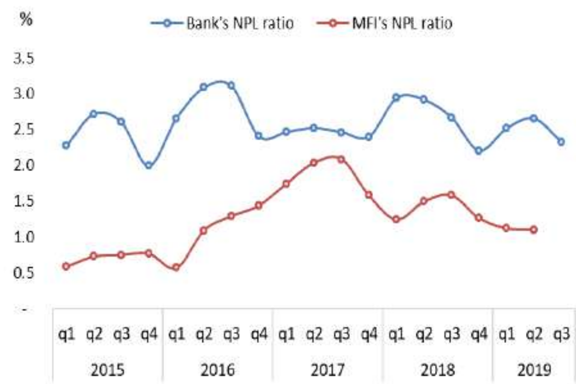
12. **Overall, financial sector indicators have remained sound.** Capital adequacy ratios (CARs) for both commercial banks and MFIs have been improving with the implementation of new minimum capital requirements. As at March 2019, the banks' and MFIs' capital ratios stood at 23.4 percent and 19.8 percent, respectively, well above the regulatory minimum of 15 percent (Figure 11). In addition, the liquidity coverage ratio (LCR) and solvency ratio of banks have been trending up, reaching 164 percent and 25.3 percent, respectively, as at June 2019, well above the regulatory minimum levels of 90 percent[6] and 15 percent. The non-performing loan (NPL) ratio of banks, which had fallen in H2 2018, also edged up slightly to 2.5 percent, on average in the first three quarters of 2019, due in part to a stricter loan classification regime[7] and the adoption of IFRS 9[8] (Figure 12). In contrast, MFIs' NPL ratio has been trending down since H2 2017, which is partly attributable to the introduction of the interest rate cap policy on MFI loans in April 2017.

**Figure 11. Banks and MFIs Capital Adequacy**




Source: NBC; AMRO staff calculations

**Figure 12. Banks and MFIs NPL**




Source: NBC; AMRO staff calculations

[6] The minimum LCR is 90 percent as of June 1, 2019, and will be increased to 100 percent as of January 1, 2020.

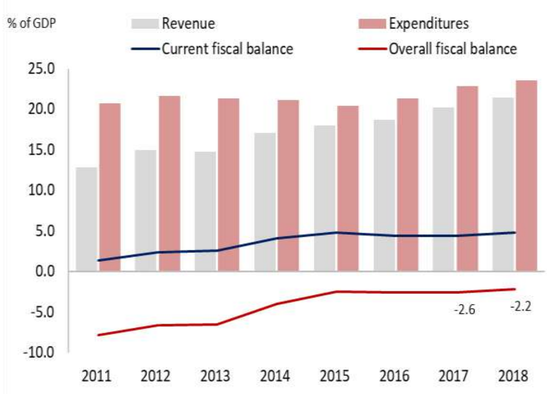
[7] Prakas on Credit Grading and Impairment Provision took effect on January 1, 2019.

[8] A detailed discussion on the IFRS 9 implementation can be found in Box A (page 19) of the AMRO Annual Consultation Report on Cambodia – 2018.

## A. 4. Fiscal Sector

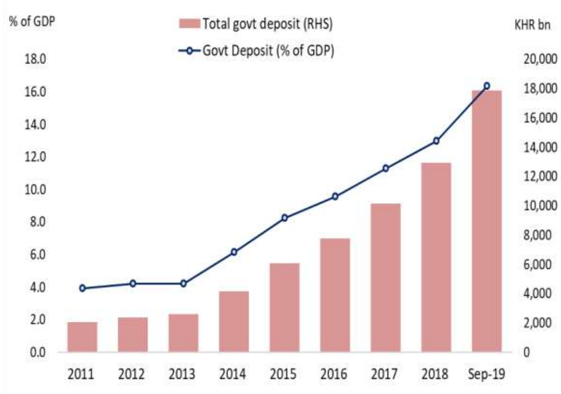
13. **The fiscal position has strengthened further on the back of persistently strong revenue collection.** In 2018, domestic revenue reached a record high of 21.4 percent of GDP, up from 20.2 percent in 2017. As the rapid increase in public-sector wages has abated, the overall fiscal deficit narrowed to 2.2 percent of GDP in 2018, down from 2.6 percent in 2017. In addition, the current budget surplus rose to 4.8 percent of GDP from 4.4 percent in 2017 (Figure 13), allowing the government to continue to build up its fiscal deposits, which reached 16.3 percent of GDP in September 2019 (Figure 14). As the strong revenue collection is expected to continue and government spending to remain contained, fiscal deficit in 2019 is projected to narrow further to 1.8 percent of GDP.

**Figure 13. Government Budget Position**




Source: MEF; AMRO staff calculations

**Figure 14. Government Deposit**




Source: MEF; AMRO staff calculations

14. **Revenue collection has remained strong on the back of a sustained increase in tax revenue.** The successful implementation of the Revenue Mobilization Strategy 2014-2018 (RMS I), focusing on improvement in tax administration and compliance, had increased tax revenue collection from 12.5 percent of GDP in 2013 to 18.3 percent of GDP in 2018 (Figure 15). The sustained increase in tax collection was broad-based. Indirect taxes (VAT and excise) collection increased from 8.4 percent in 2015 to 12.1 percent of GDP in 2018, while direct taxes (salary tax, profit tax, and land and property tax) rose from 3.4 percent of GDP to 3.9 during the same period. As strong revenue collection continued in the first eight month[9], the tax revenue in 2019 is projected to rise again to 19.3 percent of GDP.

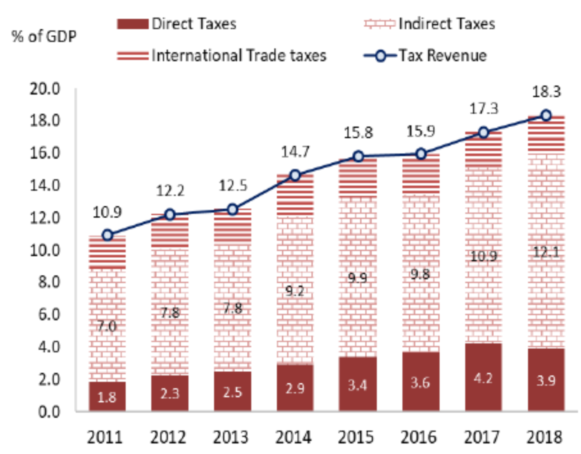
15. **Government current spending has continued to grow robustly.** After steadily rising an average of 1.0 percentage point of GDP per year during 2015 - 2017, government current spending rose to 16.3 percent of GDP in 2018 (Figure 16). The public-sector wage bill was the main driver, growing at an average 21.0 percent during 2015 to 2017. As the public-sector minimum wage has almost reached the target level in 2017[10], public sector wage bill

[9] In the first eight months of 2019, tax revenue increased by 23.3 percent yoy, equivalent to 75.3 percent of the target set out in the 2019 Budget Law.

[10] To fulfill its promise, the government had increased the monthly minimum wage of the public sector to at least KHR1 million (about USD250) by 2018. As an integral part of public administrative reform, the increase covered both the basic salary and functional allowances. In 2017, the minimum wage was USD210, nearly hitting the target level of about USD250.

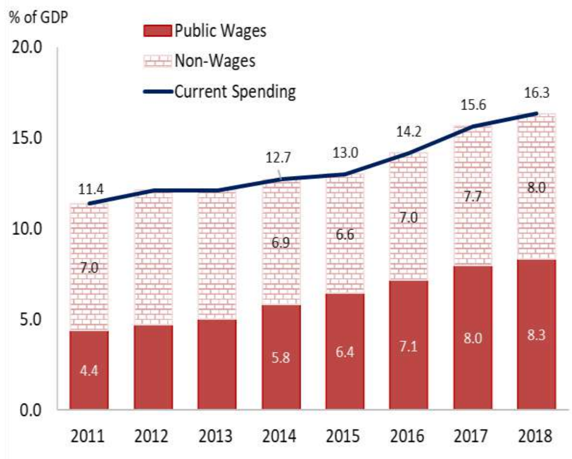
growth has slowed down since 2018. In the first eight months of 2019, current spending growth moderated further, growing at 6.4 percent yoy, compared with 16.0 percent in 2017.

**Figure 15. Composition of Tax Revenue**




Source: MEF; AMRO staff calculations

**Figure 16. Government Current Spending**




Source: MEF; AMRO staff calculations

16. **Public investment spending has trended down with a gradual decline in external funding.** Capital spending, having trended down from the peak of 9.5 percent of GDP in 2012, has remained stable at about 7.2 percent since 2017, reflecting changes in external funding [11] (Figure 17). External funding declined steadily from 7.1 percent of GDP in 2012 to 4.6 percent of GDP in 2018, while the domestic funding hovered around 2.4 percent of GDP. In 2018, the government had planned to scale up domestic funding to 3.2 percent of GDP, but this was unsuccessful due to weak budget execution. As of August 2019, capital spending disbursement has been very low, at around 30 percent of the budget, or 13.8 percent lower than the same period last year.[12]

17. **The government's consolidation efforts have continued in 2019.** In the 2019 Budget Law (BL), the government lowered its budget deficit target to 5.3 percent of GDP from 5.8 percent in the 2018 BL, reflecting its stance of continued consolidation. Its conservative revenue target[13] and well-contained government spending, both budgeted and realized, greatly facilitate the ongoing consolidation process.

18. **The government debt ratio has edged down, reflecting the strengthening fiscal position.** As the budget deficit narrowed, government debt edged down from 30.1 percent of GDP in 2017 to 28.7 percent in 2018.[14] Almost all (99.96 percent) the government debt is in the form of concessional external loans. Therefore, the debt service burden, covering both

[11] Total capital spending fell short of the targets set out in the National Strategic Development Plan 2014-2018 — 7.3 percent of GDP in 2014, 7.4 percent of GDP in 2015 and so on.

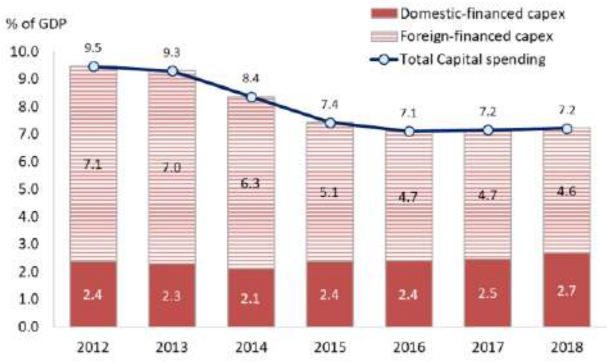
[12] While the disbursement of foreign-funded capital spending rose by 22.3 percent yoy, domestic-funded capital spending contracted by 51.1 percent.

[13] The 2019 BL targets collecting domestic revenue equivalent to 19.3 percent of GDP, up from 18.7 percent in the 2018 BL, despite the 2018 target being much lower than the actual 2018 revenue collection, which reached 21.4 percent of GDP.

[14] In terms of net present value of public external debt is 21.4 percent in 2018. The Cambodia Public Debt Management Strategy 2014-2019 sets the maximum threshold of the present value of public external debt at 40 percent of GDP, and annual borrowing at between SDR1.5 billion and SDR2 billion.

principal and interest payments, remains relatively low at 4.7 percent of total government revenue in 2018, far below the maximum threshold of 20 percent set by the government (Figure 18).

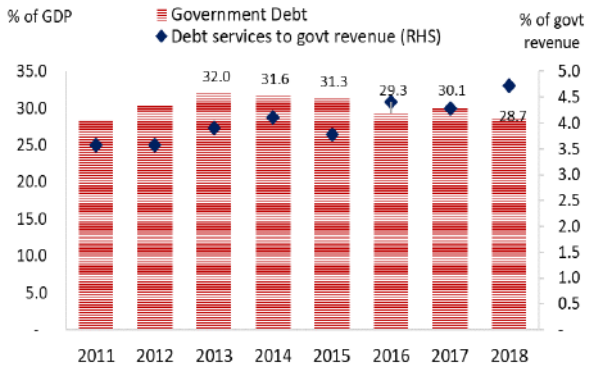
**Figure 17. Government Capital Spending**




Note: Domestic-financed capex refers to the government funded capital expenditure which is mainly from tax revenue.

Source: MEF; AMRO Staff calculations

**Figure 18. Government Debt and Debt Services**




Source: MEF; AMRO Staff calculations

## B. Risks, Vulnerabilities and Challenges

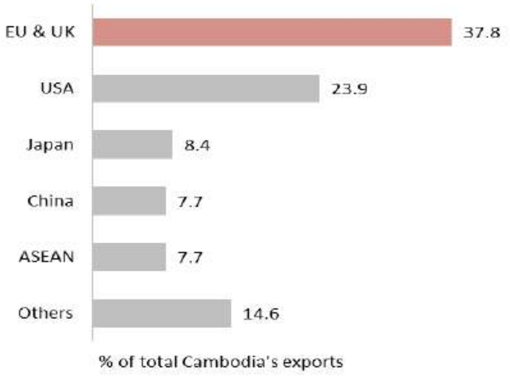
19. **Given Cambodia's high reliance on the E.U. market, a suspension of the Everything But Arms (EBA) status would have a significant impact on Cambodia's exports**. The E.U. market, including the United Kingdom, absorbs almost 40 percent of Cambodian exports, mainly garments, rice and bicycles. The EBA scheme allows Cambodia tariff- and quota-free access to the E.U., which has become Cambodia's major trading partner in the last decade, generating the country's largest trade surplus.[15] Thus, if the E.U. were to suspend the EBA status in February 2020, a significant negative impact is anticipated in Cambodia's exports to the E.U. market. Preliminary estimates by AMRO staff suggest that the direct effect on exports will not be overwhelming[16] (see Annex 1), but the indirect impact through investment sentiment and employment could be substantial.[17]

[15] In 2018, Cambodia's trade surplus with the E.U. was USD3.7 billion, equivalent to 15.1 percent of GDP. In contrast, Cambodia recorded sizable trade deficits with China, Singapore and Thailand, totaling USD5.8 billion (23.5 percent of GDP), USD2.9 billion (11.9 percent of GDP) and USD2.3 billion (9.4 percent of GDP), respectively.

[16] AMRO's preliminary estimates show that the EBA withdrawal would decrease Cambodia's exports to the E.U. market by about 17 percent, equivalent to USD0.8 billion, causing a 0.4 percentage point drop in GDP growth.

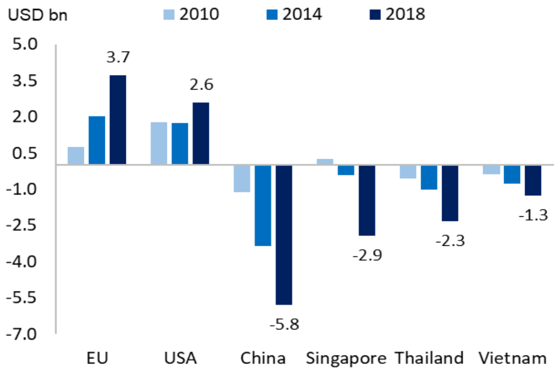
[17] According to the Cambodia Development Council (CDC), total investment in the garment industry, comprising clothing, footwear and bags, in 2018 was around USD4.5 billion in terms of stock, contributing around 83 percent of total investment in the manufacturing sector. The latest available data on labor shows that the industry also absorbed around 760,000 workers.

**Figure 19. Cambodia's Export Market (2018)**




Source: GD Custom and Excise, MEF

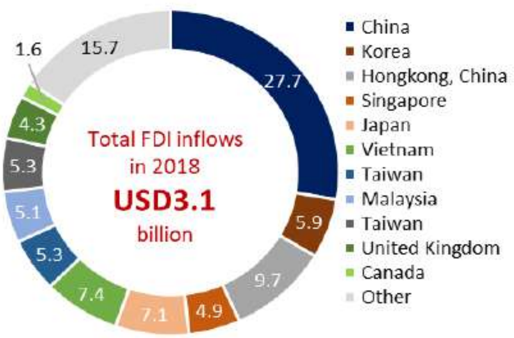
**Figure 20. Cambodia's Trade Balance with Major Trading Partners**




Source: IMF Direction of Trade Statistic

20. **China's increasing contribution to Cambodia's economic development has raised concerns over Cambodia's vulnerability to investment and market concentration risks.** Over the last decade, China's role in Cambodia's economy has increased significantly. China has been the top FDI contributor, making up about 36 percent of total FDI inflows to Cambodia (Figure 21), and it is also the biggest source of tourist arrivals, accounting for 32.6 percent of total arrivals. In addition, China has been the largest creditor to Cambodia, accounting for almost half of total public debt, largely to support infrastructure development. China absorbs less than 8 percent of total Cambodian export, but ships more than 40 percent of total Cambodian imports, leading to a sizable trade surplus with Cambodia. Given such high and increasing Chinese contributions to Cambodia's recent economic growth through various channels, a sharp slowdown of the Chinese economy or sudden policy changes on FDI or trade could pose significant risks to Cambodia's economy (see Annex 2).

**Figure 21. FDI Inflows by Country of Origin (2014-2018 average)**




Source: NBC; AMRO staff calculations

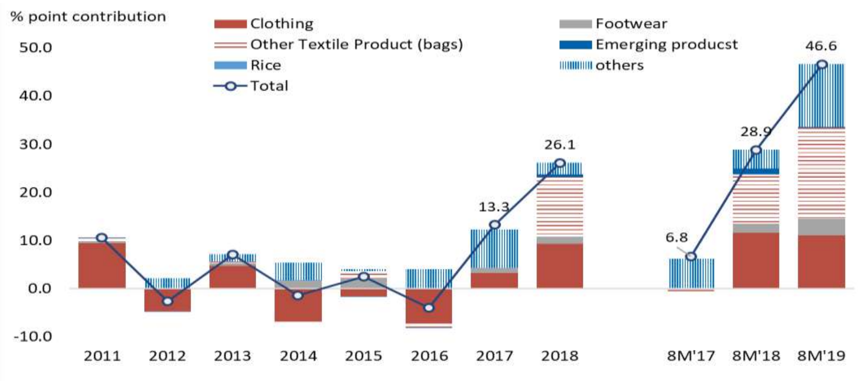
**Figure 22. Chinese Tourist Arrivals**


Source: CEIC; AMRO staff calculations

21. **Another external risk to growth could stem from the escalation of the U.S. – China trade war.** Thus far, Cambodia appears to have benefited from the trade conflict

through manufacturing relocation and trade diversion.[18] However, further escalation of the trade war coupled with a slowing global economy, could trigger a sharper economic slowdown in China, which would adversely impact Cambodia's growth prospects, particularly through tourism and FDI inflows. In addition, Cambodia's external position is becoming increasingly vulnerable to unfavorable changes in U.S. trade policy toward Cambodia.[19] Its burgeoning exports in 2018 and the first eight months of 2019 were largely driven by an upsurge in orders bound for the U.S., mostly under the GSP facilities[20] (Figure 23). The U.S. is the second largest and a fast-growing export destination for Cambodia, accounting for around 24 percent of total Cambodian exports. Thus, adverse changes in U.S.' trade policy toward Cambodia would dampen its manufacturing exports and weaken its growth prospects going forward.

**Figure 23. Cambodia's Exports to the U.S.**




Source: GD Custom and Excise, MEF

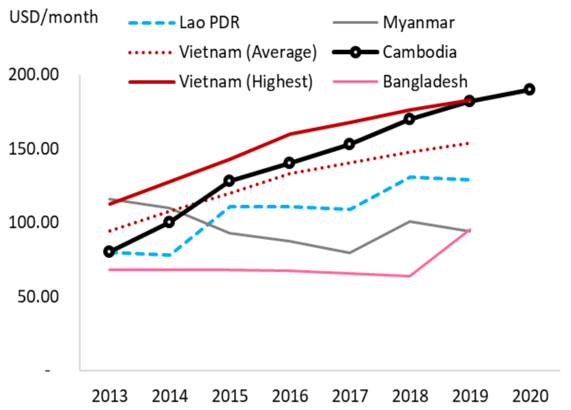
22. **Given relatively high logistic costs, a continuously rising minimum wage combined with a strengthening U.S. dollar, could erode Cambodia's external competitiveness.** Rapidly increasing minimum wages would weaken the cost competitiveness of Cambodia's labor-intensive garment industry as non-labor production costs have remained relatively high. The monthly minimum wage in the garment sector has increased from USD80 in 2013 to USD182 in 2019, which is higher than most neighboring competitors, and is scheduled to rise further to USD190 in 2020 (Figure 24). In addition, owing to the high level of dollarization, a stronger U.S. dollar would reduce Cambodia's external competitiveness. As the Khmer riel has been stable against the U.S. dollar, Cambodia's nominal effective exchange rate (NEER) has appreciated against the currencies of competing countries on the back of the stronger U.S. dollar in the past few years (Figure 25).

[18] According to the CDC, 103 new Chinese manufacturers of garments, footwear and bags received Cambodia's approval from early 2018 to June 2019 to invest in the country. The total investment is expected to be worth around USD480 million. Of the 103 Chinese manufacturers, 36 will produce bags and bag accessories to meet a surge in demand from the U.S. market.

[19] In mid-July 2019, the lower house of the US Congress, the House of Representatives, voted unanimously to pass the Cambodia Democracy Act of 2019. If the bill is approved by the Senate (the upper house) and signed off by the U.S. President, it would oblige the U.S. government to impose sanctions. Although this is not directly related to the GSP yet, U.S. trade policy toward Cambodia might be affected together with the E.U.'s EBA decision.

[20] In 2018, Cambodia's exports to the U.S. grew strongly by 26.1 percent, up from 13.3 percent in 2017. The first eight months of 2019 have witnessed an even faster export growth to the U.S., of 46.6 percent.

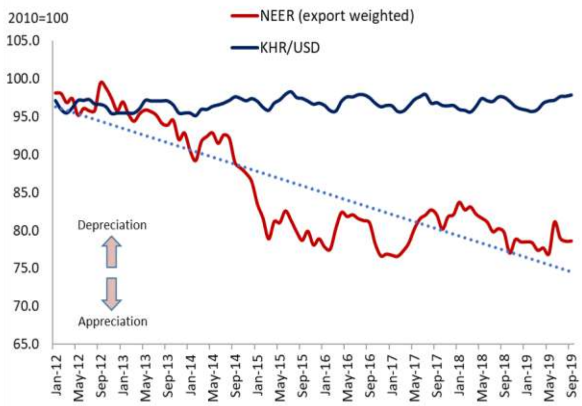
**Figure 24. Minimum Wages in Garment Industry**




Note: The minimum wage is set on a daily basis in Myanmar, while in the other countries it is on a monthly basis.

Source: Data for Cambodia is gathered from the Cambodian Development Research Institute and the Phnom Penh Post. For Vietnam, the data is available from CEIC. As for Myanmar and Lao PDR, the data is compiled from local newspapers.

**Figure 25. KHR Exchange Rate and NEER**




Note: The share of exports is used to calculate the NEER.

Source: CEIC, AMRO staff calculations

23. **Rising credit exposure to the real estate-related sector, along with continued strong credit growth, has raised concerns about financial sector stability.** A strong rebound in credit growth has pushed up the credit to GDP ratio, which is already relatively high, and the rapid expansion of loans to the real estate-related sector has heightened the credit concentration risk. Within a decade, Cambodia's bank credit to GDP ratio has more than tripled, from 28.6 percent in 2011 to 92.3 percent in September 2019. Including MFI loans, the total credit to GDP ratio is around 115 percent in September, among the highest in the region (Box 1). In addition, the share of credit to the real estate-related sector to total outstanding loans, has risen steadily from 17.2 percent in 2011 to 31.6 percent in September 2019.[21] The extended period of construction boom and potential oversupply in the real estate market, especially of medium to high-end condominiums, has increased the risk of disorderly adjustments in the property market and a sharp downturn in property prices, which could undermine the stability of the financial sector.

**Box 1. Credit to Private Sector in Selected ASEAN Countries[22]**

**Bank credit in Cambodia has expanded rapidly, faster than its regional peers.** After moderating in 2016 and 2017, credit growth has accelerated strongly in Cambodia even as it continues to moderate in neighboring countries (Figure 1.1). Led by rising deposits on the back of stronger FDI inflows and robust economic activities, bank loans expanded by 23.1 percent in 2018 and advanced further to 27.9 percent as at Q2 2019. The pace of Cambodia's credit growth has now largely exceeded Myanmar's credit growth, which was historically the fastest in the region.

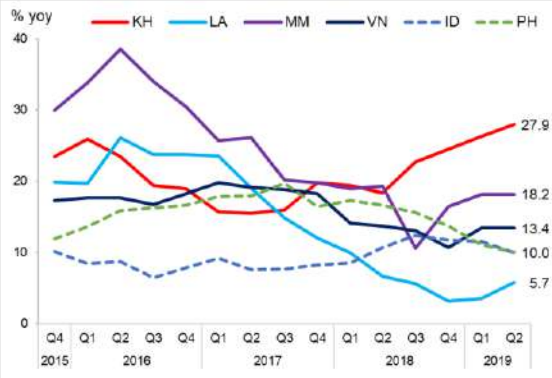
**The rapid expansion of bank credit in Cambodia has led to a higher credit to GDP ratio.** As the credit growth has risen to nearly three times nominal GDP growth, bank credit as a percentage to GDP has steadily risen in tandem, increasing from nearly 60 percent in early 2015 to about 90 percent

[21] These statistics do not include the credit provided by the shadow banking system such as real estate developers.

[22] Prepared by Sovanney Chey

as at June 2019 (Figure 1.2), which is more than three times that of Myanmar. Compared to the peers in the region, only Vietnam has a higher credit to GDP ratio than Cambodia.

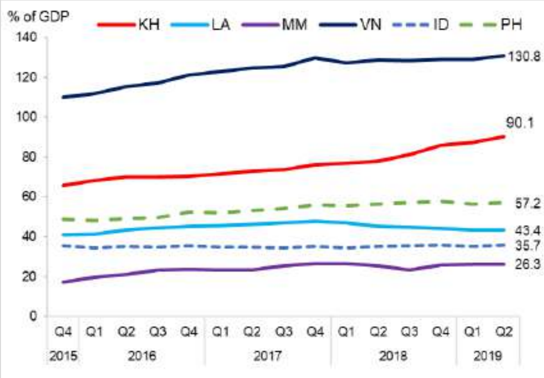
**Figure 1.1. Credit Growth in Selected ASEAN Countries**




Note: KH refers to Cambodia, LA is Lao PDR, MM is Myanmar, VN is Vietnam, ID is Indonesia, and PH is the Philippines. The credit data does not include credit provided by MFIs.

Source: CEIC; NBC

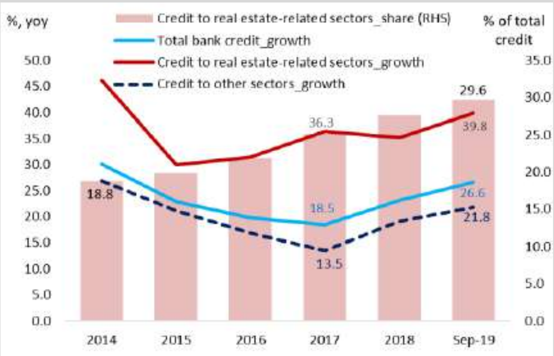
**Figure 1.2. Credit to GDP in Selected ASEAN Countries**




Source: CEIC; NBC

**In Cambodia, amid the strong credit expansion, the credit share of real estate-related activities in total outstanding credit has significantly increased.** The recent strong momentum in credit growth has been primarily driven by credit expansion to the real estate-related sector.[23] Credit to this sector rose to 35.1 percent in 2018 and expanded further to nearly 40 percent in September 2019 (Figure 1.3), far outpacing the growth of total bank credit (26.6 percent). During 2015 to 2017, while total bank credit growth decelerated, credit growth in the real estate-related sector continued to strengthen rapidly, growing at above 30 percent annually and accounting for 29.6 percent of total bank credit in September 2019, a jump from 19.9 percent in 2015.

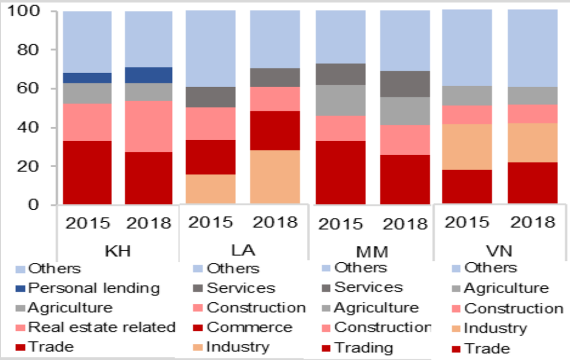
**Figure 1.3. Bank Credit: Real Estate-related Sector vs Other Sectors**




Note: Total bank credit comprises only credit to non-financial sectors

Source: National authorities, AMRO staff calculations.

**Figure 1.4. Sectoral Share of Credit in Selected ASEAN Countries**




Source: CEIC; NBC; AMRO staff calculations

**Compared with regional peers, bank loans in Cambodia are more concentrated in the real estate-related sector.** As at June 2019, bank loans to the trade and real estate-related sectors accounted for about 57 percent of total bank loans, up from 53.7 percent in 2015. In contrast, bank loans in the regional peers were less concentrated in the real estate-related sectors, instead recording sizable proportions in the industry sector in Lao PDR and Vietnam and the agriculture sector in Myanmar (Figure 1.4). It is also notable that while the share of credit to the real estate-

[23] It includes credit to construction and real estate, as well as mortgages.

related sector has been relatively stable in the regional peers, it has risen to a high level in Cambodia on account of fast expansion of bank credit to that sector.

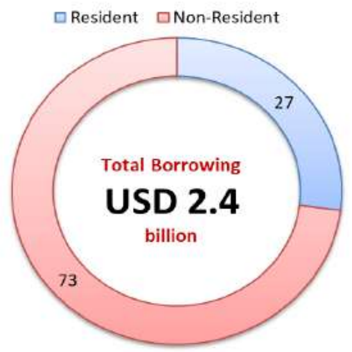
24. **The fast-growing role of MFIs in the financial system could also pose risks to financial-sector stability.** The number of licensed MFIs rose more than threefold from 25 institutions (six MDIs[24] and 19 MFIs) in 2010 to 81 institutions (seven MDIs and 74 MFIs) in June 2019 (Table 1). As at June 2019, total assets of MFIs, including MDIs, hit a record high of USD7.7 billion, with some MDIs having larger assets than some commercial banks[25]. MFIs are subject to less stringent regulations and registered much faster credit expansion than commercial banks, hovering around 30 percent even after the adoption of the interest rate cap policy in April 2017. While the number of borrowers has not increased much since 2015, the average loan size per borrower has increased substantially, reaching around USD2,585 in June 2019, nearly twice of Cambodia's GDP per capita. In term of the funding sources, MFIs rely heavily on foreign funding, which makes up about 73 percent of their total funds (Figure 26).

**Table 1. Selected Figures of MFIs*) in Cambodia**

| Description | 2010 | 2015 | 2018 | June'19 |
|---|---|---|---|---|
| Number of Licensed MFIs | 25 | 59 | 80 | 81 |
| MDIs | 6 | 8 | 7[26] | 7 |
| MFIs | 19 | 51 | 73 | 74 |
| Assets (USD billion) | 0.5 | 3.6 | 6.6 | 7.7 |
| Assets growth | 38.3 | 48.0 | 31.8 | 35.6 |
| Share to total assets in banking system | 7.2 | 15.3 | 15.8 | 16.6 |
| Outstanding loans (USD billion) | 0.4 | 3.0 | 5.4 | 6.4 |
| loans growth (%, yoy) | 42.5 | 49.9 | 27.2 | 34.6 |
| Share to total assets in banking system | 11.6 | 20.6 | 21.0 | 22.0 |
| Number of borrowers (thousand) | 1,020 | 2,193 | 2,113 | 2,231 |
| Average loans per borrower (USD) | 417 | 1,379 | 2,569 | 2,858 |
| Lending rates, KHR (% per annum) | 34.6 | 36.6 | 20.7 | 18.2 |
| Lending rates, USD (% per annum) | 28.4 | 28.5 | 19.3 | 17.7 |

Note : MFIs includes MDIs
Source : NBC; AMRO staff calculations

**Figure 26. MFI' Source of Funding (%, 2018)**




Note : MFIs includes MDIs
Source : NBC; AMRO staff calculations

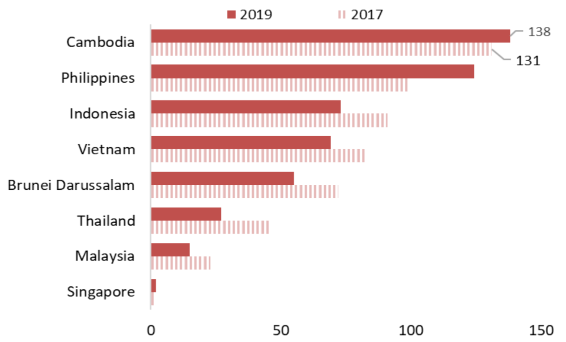
## C. Policy Discussions and Recommendation

25. **Enhancing Cambodia's competitiveness and diversifying its economic base to strengthen resilience are critical to maintaining its strong growth potential.** To sustain its growth momentum, Cambodia must address structural challenges, such as the relatively

[24] Microfinance Deposit Taking Institutions (MDIs)
[25] In terms of assets, Prasac is the largest MDI in Cambodia with total assets of KHR9.5 trillion. Among 42 commercial banks in the country, three commercial banks have greater assets than Prasac, namely Canadia Bank (KHR24.1 trillion), Aceleda Bank (KHR22.5 trillion) and Advanced Bank of Asia Limited (KHR10.9 trillion). The other six MDIs also have more assets than some small- to medium-size commercial banks in Cambodia.
[26] An MDI, Sathapana, was converted to a commercial bank in 2016.

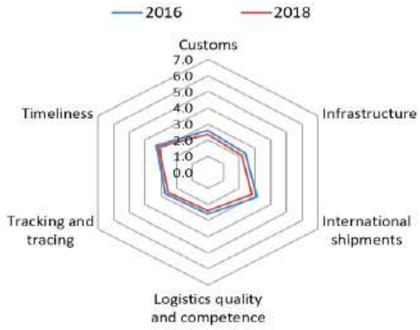
poor infrastructure, low levels of educational attainment, and limited supply of skilled labor, institutional weaknesses, and rapidly rising minimum wages. Cambodia's ranking on the global Ease of Doing Business Index[27] confirms that its overall competitiveness has declined (Figure 27) and its logistics conditions have made no significant improvement (Figure 28). In addition, the country faces the risk of a suspension of its EBA status, which could further erode its external competitiveness. In this regard, AMRO welcomes the government's recent 17-point strategy, which is expected to partially offset the losses arising from the EBA suspension and improve competitiveness (Box 2). Furthermore, the government's adoption of the National Strategic Development Plan (NSDP) 2019-2023 is a welcome development as effective implementation of the NSDP is essential to enhance Cambodia's productivity and facilitate the diversification of its growth drivers and the move up the value chain.

**Figure 27. Cambodia's Ranking in Ease of Doing Business Index**




Source: World Bank, 2019 Ease of Doing Business Report

**Figure 28. Cambodia's Logistics Performance Index**




Source: World Bank, 2018 Logistic Performance Index.

**Box 2. Cambodia's 17-point Strategy to Strengthen Competitiveness and Diversify Economy[28]**

**The Cambodian government unveiled a 17-point strategy, mostly aimed at facilitating trade and reducing the cost of doing business, during the 18th Public Private Sector Forum held on 29 March 2019.** The policy package was expected to help private businesses save up to about USD400 million a year. It involves a number of key money-saving initiatives, including reducing logistic and electricity costs, strengthening railway operation management, and decreasing the number of public holidays (Table 1.1). These measures, if successfully implemented, would enhance Cambodia's export competitiveness, and help offset some losses arising from the EBA withdrawal.

**Table 2.1. 17-point Strategy Announced in March 2019**

| 17-point Strategy | Key Measures |
|---|---|
| 1. Withdrawing the inspection role of Camcontrol and abolishing Kamsab | The government ended the permanent inspection role of the Camcontrol (Cambodia Import Export and Fraud Repression Directorate General) at international gateways, land border checkpoints, airports and sea and river ports, and also abolished the Kamsab (Kampuchea Shipping Agency and Brokers). |

[27] Cambodia's ranking in the World Bank's Ease of Doing Business Index 2019 dropped from 131 in 2017 to 135 in 2018 and further to 138.

[28] Prepared by Khut Vanne

| | |
|---|---|
| 2. Eliminating Certificate of Origin (CO) for countries where it is not required | A joint inter-ministerial Prakas No. 1627 MoEF Br.K., signed between the Ministry of Commerce (MoC) and Ministry of Economy and Finance (MEF), relaxes the blanket rule that Cambodian exporters must produce COs for their products |
| 3. Reducing logistics costs, including Lift-On/Lift-Off (LOLO) costs and service fees, at Sihanoukville Autonomous Port (SAP) and Phnom Penh Autonomous Port (PPAP) | The Ministry of Public Works and Transport (MPWT) has studied the possibility of reducing costs at both public ports and negotiated with major shipping companies. The major charge reductions are as follows:<br>• Terminal handling charge: reduced by USD5 per 20-foot equivalent unit<br>• Container imbalance charge: reduced from USD120 to USD100 per 20-foot container, and from USD240 to USD200 per 40-foot container<br>• Ocean freight charge: reduced by 50 percent for rice exports to China, as agreed by SITC Logistics Cambodia<br>• Emergency bunker charge: eliminated by SITC Logistics Cambodia; the charge used to be USD15 for a 20-foot container and USD30 for a 40-foot container<br>• LOLO charge: reduced by 10 percent at SAP. Bonus charge: reduced from USD7.50 to USD5 per box. Ship shifting: free of charge<br>• Stevedoring charges, gate fees, export container fee and LOLO scan fee: still under PPAP's consideration. |
| 4. Reducing electricity costs | Electricity tariff rates are reduced from 2019 onwards. The rate goes down by USD0.20 per kilowatt-hour for industrial consumers that are connected via the sub-transmission lines and medium-voltage lines of a distribution area. |
| 5. Developing small and medium enterprises (SMEs) | A new policy package for SME development will provide tax incentives, customs incentives, rate adjustments to customs, special tax and export tax, and the establishment of the SME Bank and Entrepreneurship Fund. The priority sectors include:<br>• Water production and supply<br>• Agricultural and agro-industrial production<br>• Food production and processing<br>• Manufacturing goods for export, tourism, domestic consumption, and waste processing<br>• Manufacturing finished or semi-finished products or parts, components, and accessories to supply to other manufacturing businesses<br>• Innovative research and development of information and communications technology (ICT)<br>• Development of SME clusters. |
| 6. Trade facilitation measures under customs | New measures seek to improve trade facilitation while reducing time and costs:<br>• Prakas No. 1608 MoEF Br.K on the Provision of Public Services of the GDCE: All services shall be issued with an automated receipt to ensure transparency<br>• Container-scanning charges will be halved from USD20 to USD10 for 20-foot containers, and from USD32 to USD16 for 40-foot containers<br>• Risk-based container scanning will be implemented. |
| 7. Business facilitation measures under General Department of Taxation | New measures will improve VAT refunds and eliminate overlapping auditing by:<br>• Introducing online VAT refunds and VAT credit<br>• Issuing a Prakas on Tax Audit No 270 MoEF Br.K to eliminate overlapping auditing; reduce the tax audit review period to three years from 10 years; and reduce the monthly interest rate on late tax payments from 2 percent to 1.5 percent. |
| 8. Reducing the number of public holidays | The number of public holidays will be cut by seven days from the current 28-30 days starting from 2020. |
| 9. Reviewing and developing lists of institutions and factory inspection schedules | • The many teams that conduct factory inspections will be consolidated into a single team and the number of inspections will be reduced to once a year.<br>• The inspections will be assessed in terms of their importance and necessity. |
| 10. Determining co-payment rates for the pension scheme | A new obligatory pension scheme will require employers and employees to make co-payments to a joint fund with the agreed co-payment rate at 4 percent of the employee's salary of which 2 percent is paid by employers. |
| 11. Determining the duration and number of days for seniority indemnity payments | Some tax exemptions have been approved[29]:<br>• Tax exemptions that apply to pre-2019 seniority indemnity back payments and to new seniority indemnity payments from 2019 onwards are implemented starting from 2019 in the garment sector and in end-2021 for the other sectors<br>• All seniority indemnity payments and back payments are considered tax-deductible. |

[29] As stipulated in the new Article 89 of the Law on Labor, seniority indemnity shall apply to workers and employees with contracts of undetermined duration only. For those with fixed-duration contracts, the employer shall provide severance pay which is proportional to both their wages and the contract duration, and the amount of their severance pay will be determined under a collective bargaining agreement.

| | |
|---|---|
| | • VAT exemptions apply to job-matching and training operations as well as the sending and managing of workers and interns abroad by private recruitment agencies. |
| 12. Reviewing the Law on Labor in line with the new economic context | The Ministry of Labour and Vocational Training is required to consult with relevant stakeholders to revise the Law on Labor. |
| 13. Determining minimum wages in the garment sector | To address investor's concern on the pace of wage hike while ensuring a proper living standard of workers and employees, the MLTV is tasked to develop an appropriate methodology to calculate minimum wages (including by regions) as well as to forecast labor productivity, standard of living of workers and employees, and minimum wage increments over the medium term. |
| 14. Developing the agricultural sector | Major additional measures for agricultural-sector development include granting temporary VAT exemption until 2023 on the supply of goods and services to domestic-supply enterprises or exporters of paddy, rice, corn, bean, pepper, cassava, cashew nut and rubber.<br>• Those enterprises and exporters are also exempted from withholding tax obligations on the supply of services by individuals not under the self-assessment regime until 2023. |
| 15. Transforming Rural Development Bank to Rural and Agricultural Development Bank | The government has injected an additional USD50 million into this bank. |
| 16. Improving railway transportation | The MPWT is tasked to manage railway operations, develop operational management procedures, improve railway transport from Poipet to SAP, and invest more in rice storage facilities in certain locations accessible by train. |
| 17. Other reform measures still underway | • Expediting amendments of the Law on Investment and finalizing the draft Law on Special Economic Zones<br>• Reviewing and studying the feasibility of harmonizing and facilitating business registration<br>• Further diversifying export markets: The MoC is assigned to engage in negotiations for bilateral free trade agreements, accelerate negotiations for the RCEP and the Eurasia Economic Union, and consider acceding to the Comprehensive and Progressive Trans-Pacific Partnership. |

Source: 17-Point Strategy delivered by Cambodian Prime Minister during 18th Public Private Sector Forum held on 29 March 2019.

26. **It is essential to prioritize fiscal resources to support structural reforms and continue efforts to enhance public-sector efficiency amid rising spending needs.** Prudent fiscal policy has led to a substantial build-up of fiscal space, which provides room for more resources to support infrastructure development and structural reforms. In addition to the recent reform packages, the authorities are encouraged to further expand public spending on long-term development projects in line with the NSDP, so that the structural weaknesses would not be a binding constraint on sustaining strong growth over the long term.[30] The required resources could be mobilized through further reprioritization of spending and greater use of fiscal savings to complement donor aid and concessional loans. Improving public-sector efficiency can also greatly facilitate this process by optimizing the use of resources. The authorities should continue their efforts to upgrade public-sector capacity and strengthen the implementation of the Public Finance Management Reform Programs (PFMRP).

27. **While the fiscal position is relatively strong, efforts to improve revenue collection should continue.** RMS 2014-2018 (RMS I) has been very successful in boosting

[30] For example, spending on education and health needs to be increased to enhance the labor supply with appropriate skills. A large amount of investment in transport networks is required to improve logistic competitiveness. Expansion of social spending is essential to support social stability and cohesion.

revenue collection over the past few years. AMRO welcomes the launch of RMS 2019 – 2023 (RMS II) in May 2019, which focuses on modernizing tax and non-tax revenue administration and policy (Box 3). Consistent implementation of RMS II is essential where efforts to modernize the tax administration, such as the introduction of internet-based services, continue to be important by providing faster and simpler procedures to tax payers. In addition, AMRO welcomes the authorities' plan to extend the Non-Tax Revenue Management Information System to the sub-national administrations while also introducing the State Asset Register Management Information System (SARMIS) offline by 2020 and online by 2023.

**Box 3. Revenue Mobilization Strategy**[31]

**After the successful implementation of RMS I, the Cambodian government has launched RMS II.** These five-year strategic documents set out a series of revenue reform measures to enhance revenue administration and strengthen domestic revenue collection. This box aims to summarize and compare key aspects of the two strategies, focusing on the newly launched RMS II.

**Revenue Mobilization Strategy 2014-2018 (RMS I):**

**During the last five years, three core objectives of RMS I have recorded significant progress:** (1) The tax compliance culture has improved significantly. The ratio of on-time tax payment[32] increased to 94 percent from 91 percent in 2013, supported by better service quality, better taxpayer education, and more convenient tax payment methods. (2) Efficiency of the revenue administration has improved as the implementation of reform measures in tax and non-tax revenue administration has mostly been completed. (3) Revenue mobilization has been highly successful, exceeding the target by a large margin every year. The current revenue increased at an average 1.4 percentage points of GDP, nearly triple the target of 0.5 percentage points, reaching 22.0 percent of GDP in 2018 from 15.1 percent in 2013.

**Revenue Mobilization Strategy 2019-2023 (RMS II):**

**RMS II focuses on modernizing the tax revenue system and strengthening non-tax revenue administration and policy**. The national revenue system is to be modernized so that it can better respond to the evolution of the national social-economic structure and development needs.

- **Tax policies: The tax policies governing selected tax items[33] are to be rationalized under four principles[34].** This rationalization is to ensure alignment with national development policies, enhance the business climate, re-orient investment directions, strengthen economic competitiveness, and collect revenue to its full potential.
- **General Department of Taxation (GDT): RMS II is to modernize the existing three functions of GDT[35] in RMS I.** This modernization is expected to improve operational efficiency, voluntary compliance, service quality, and KPI-based monitoring and evaluation. Key measures include separating the roles of central agencies and implementing units to ensure the check-and-balance mechanism is sound, improving the business process and organizational change management, and integrating the tax administration through a fully automated and integrated ICT system.
- **General Department of Customs and Excise (GDCE): RMS II is to further facilitate trade and increase revenue collection** by trade facilitation, improving and strengthening of

[31] Prepared by Chanvanny Dy

[32] The on-time tax payment rate is one of the key performance indicators (KPI) of monitoring and evaluation under the RMS I, showing the percentage of active large taxpayers that pay tax on time.

[33] The selected tax items are: 1. Excise, 2. Property Tax, 3. Value Added Tax, 4. Public Lighting Tax, 5. Personal Income Tax, 6. Tax on E-commerce, 7. Tax Incentive, and 8. Other Tax Types.

[34] The four principles are: 1. to ensure the sustainability of economic growth, 2. to maintain the sustainability of revenue collection at optimal level, 3. to ensure fairness in tax policy implementation and revenue collection, and 4. to ensure social equity in order to reduce the tax burden on the low-income cohort, enhance social welfare and protect the environment.

[35] These three functions are; institutional and governance framework function, core function (business process and administration of tax collection) and support function (data supporting system, taxpayer services system, and human resource development).

governance, and strategic management. Key measures to be implemented include promoting the implementation of National Single Window Phase II and III, promoting the implementation of comprehensive customs audit mechanisms, further strengthening customs incentive mechanisms for SMEs, and strengthening the ICT system.

**Efforts to strengthen non-tax revenue administration and policy will focus on ICT management system modernization and key revenue source measures.** For ICT modernization, the government plans to expand the Non-Tax Revenue Management Information System to the sub-national administration by 2020 and to introduce the State Property Inventory Management System offline by 2020 and online by 2023. For key revenue source measures, the government has specific measures, such as establishing a blueprint and regulations, strengthening the implementation procedures and principles, and updating the contract and state-enterprise compliance standards.

**Table 3.1: Main Differences Between RMS I and RMS II**

| | RMS I | RMS II |
|---|---|---|
| **Objective** | - Increase by 0.5 percentage points of GDP per year | - Increase by 0.3 percentage points of GDP per year<br>- Improve the quality and productivity of services provided to taxpayers and non-taxpayers |
| **Vision** | - Collect domestic revenue efficiently and effectively to meet demand for sustainable socio-economic development | - Modernize the national revenue system in response to development needs and changes in the socio-economic structure |
| **Goals** | - Strengthen tax and non-tax administration<br>- Promote a healthy tax-paying culture and compliance | - Modernize tax and non-tax revenue administration and policy to ensure effective and efficient revenue collection<br>- Improve the investment climate and re-orient investment directions<br>- Strengthen competitiveness and promote economic diversification |
| **Approaches** | - Collect existing revenue to its full potential<br>- No new tax is to be created<br>- No increase in tax rates and VAT, except to offset any revenue loss and for health and/or environmental protection<br>- Ensure simplicity, equity and justice through efficient, transparent and accountable revenue management and collection | - Ensure sustainable economic growth<br>- Sustain an optimal revenue level<br>- Ensure fairness in implementing tax and non-tax policies as well as in collecting revenue<br>- Ensure social equity by helping to ease the tax burden on low-income people, enhance welfare and protect the environment |

28. **The progress in upgrading regulatory standards is commendable, while additional policy efforts are advised to help contain the credit risk in the real estate sector.** The full implementation of new capital requirements for both banks and MFIs, a continued phase-in of the minimum liquidity coverage ratio, as well as the newly adopted capital buffer requirement have enhanced the soundness and resilience of the financial system. Meanwhile, to better curb the risks associated with credit concentration and speculative investment in the real estate sector, further prudential measures should be considered, such as lower thresholds for the loan to value ratio, the introduction of ceilings on

debt service to income ratios, and stricter control of concentration risks in the property sector. In addition, relevant government agencies should coordinate to introduce regulations on developers' lending activities and direct policy measures to curb speculation in real estate.

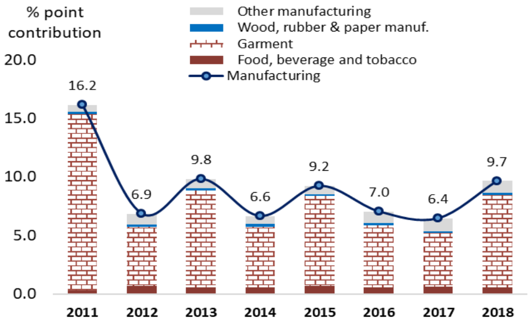
29. **Efforts to strengthen the supervisory capacity of the financial sector should continue, so as to cope with the fast-growing size and complexity of the financial sector.** Given the high and growing credit to GDP ratio, a proper management of credit risks through robust micro-prudential supervision is recommended to maintain financial-sector stability. Continuing efforts to strengthen supervisory capacity in line with the growing size and sophistication of the financial sector are important to provide timely risk assessments, effective market communication and appropriate policy responses. Efforts to develop forward-looking supervisory tools, such as an early warning system, stress tests and a thematic assessment, are also encouraged to strengthen the risk assessment capacity of supervisory staffs.

30. **A continued build-up of foreign reserves is recommended.** Despite significant improvement in its foreign reserves buffer, Cambodia's economy remains relatively vulnerable to external shocks, given its narrow export base and high dependence on external funding for investment. Therefore, it will be prudent for the authorities to continue building up foreign reserves as a buffer against both external shocks and domestic liquidity shocks, as the U.S. dollar remains the main currency used for domestic financial transactions.

## Appendix 1. Selected Figures for Major Economic Indicators

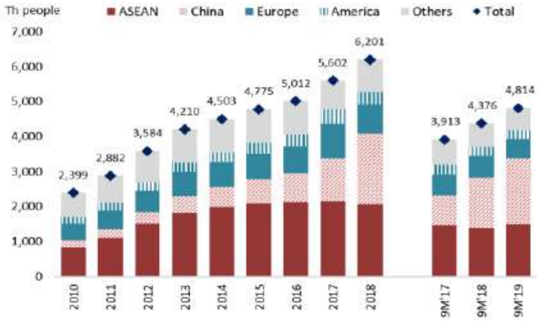
### Figure 1.1. Real Sector

The manufacturing sector rebounded strongly, mainly driven by the garment industry, comprising clothing, footwear and other garment products.



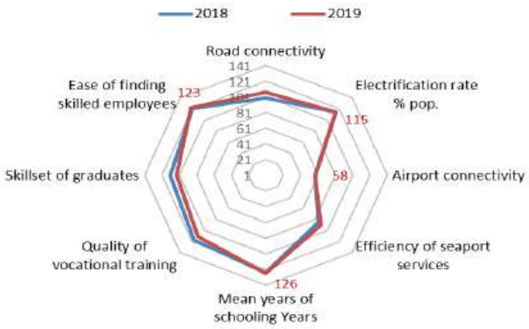

Source: NIS; AMRO staff calculations

Tourist arrivals continued to rise and recorded around 6.2 million in 2018, mainly driven by the influx of Chinese tourists.




Source: Minsitry of Tourism; AMRO staff calculations

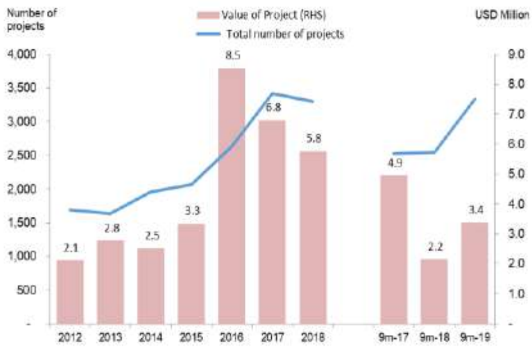
Cambodia's infrastructures and skills ranked very low in the latest Global Competitiveness Report, with no significant improvements.




Note: The numbers refer to Cambodia's rankings in some selected indicators under Pillar 2 (Infrastructure) and Pillar 6 (Skills) of the Global Competitiveness Report 2019.

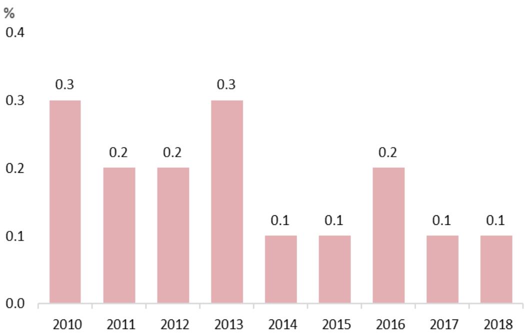
Source: World Bank; AMRO staff calculations

After slowing down in 2018, the value and number of approved construction projects rose sharply by 56.6 percent and 31.2 percent, respectively.



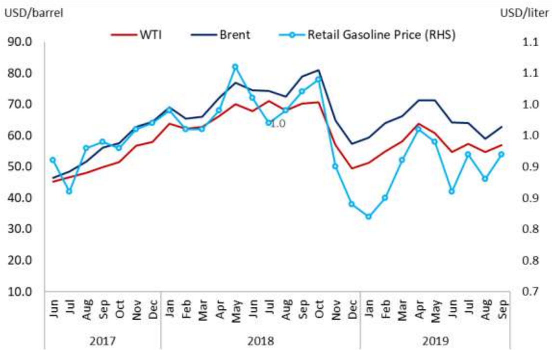

Source: Ministry of Land Management, Urban Planning, and Construction (MLMUPC); AMRO staff calculations

The unemployment rate has been very low in Cambodia.




Source: NIS; AMRO staff calculation

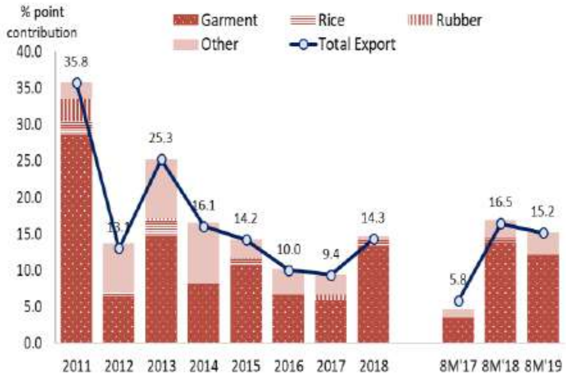
Despite a slight rebound in April, domestic retail gasoline prices in 2019 were lower in 2018, reflecting the movement of global oil prices.




Source: CEIC; AMRO staff calculations

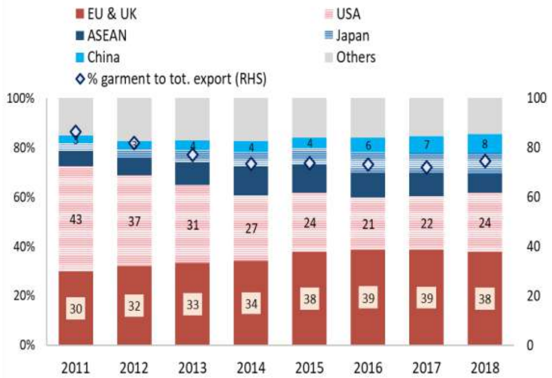
## Figure 1.2. External Sector

Exports growth rebounded in 2018 and remained strong in the first eight months of 2019, mainly driven by garment products, comprising clothing, footwear and travel bags.



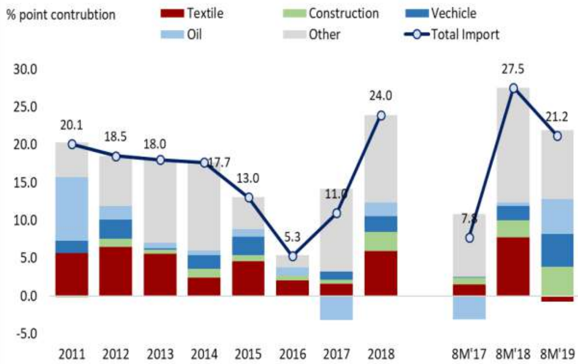

Source: GD Custom and Excise; AMRO staff calculations

The E.U., including the UK, and the U.S. remain Cambodia's key export markets



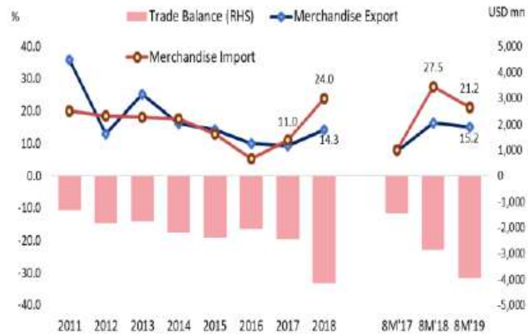

Source: GD Custom and Excise; AMRO staff calculations

Imports surged in the first nine months of 2018, mainly driven by garment-related materials and consumption goods



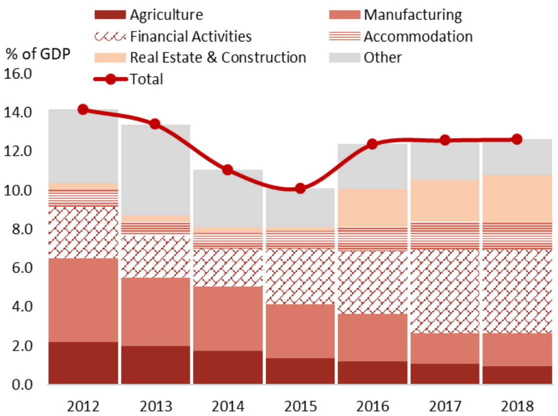

Source: GD Custom an Excise; AMRO staff calculations

The trade deficit widened as imports continued to outpace exports.




Source: GD Custom and Excise; AMRO staff calculations

FDI inflows remain strong, especially in the financial, real estate, construction, and accommodation sectors.



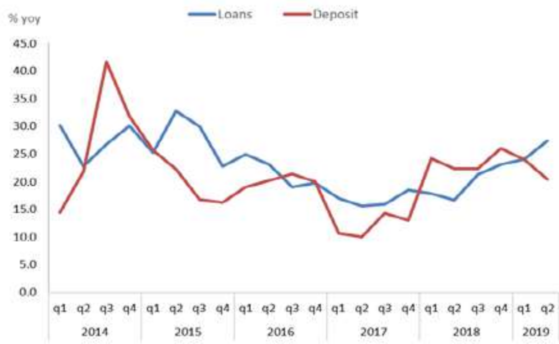

Source: NBC; AMRO staff calculations

The continued surplus in the overall balance of payments led to an accumulation of international reserves.


Source: NBC; AMRO staff calculations

## Figure 1.3. Monetary and Financial Sector

In line with bank loans, deposit growth has trended up since early 2017, although there is some slowdown in 2019.

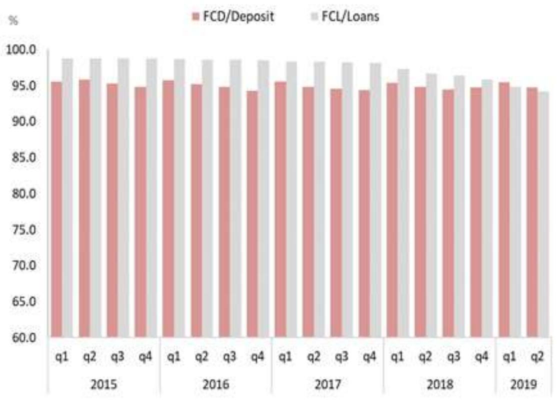



Source: NBC; AMRO staff calculations

MFI's lending rate in KHR has declined approaching the maximum regulatory rate of 18 percent per annum, which has pushed down bank's lending rate.


Source: NBC; AMRO staff calculations

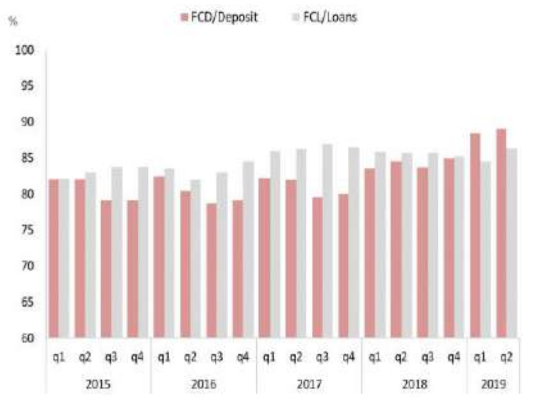
Around 94 percent of bank deposits and loans are in foreign currency.




Note: FCD refers to foreign currency deposits while FCL stands for foreign currency loans.

Source: NBC; AMRO staff calculations

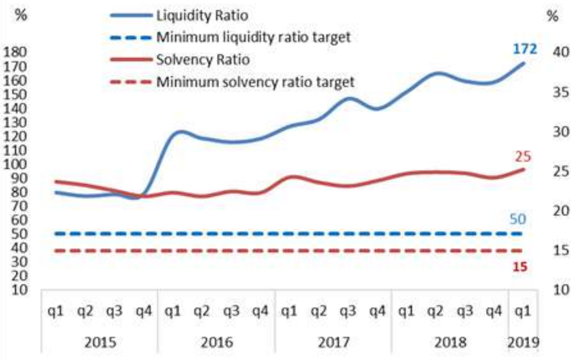
The proportion of FCDs and FCLs in the total deposits and loans of MFIs are also relatively high at 89 percent and 86 percent, respectively.




Note: FCD refers to foreign currency deposit while FCL refers to foreign currency loans.

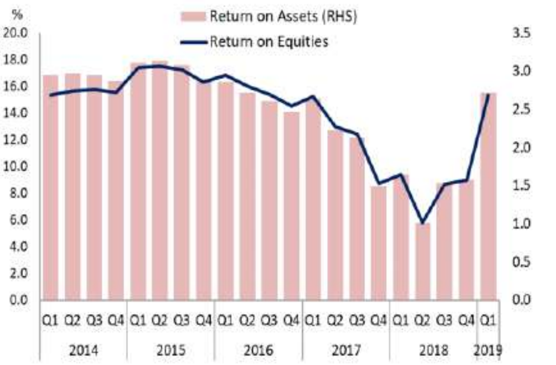
Source: NBC; AMRO staff calculations

The liquidity and solvency ratios of banks have been trending up, well above the minimum regulatory levels.




Source: NBC; AMRO staff calculations

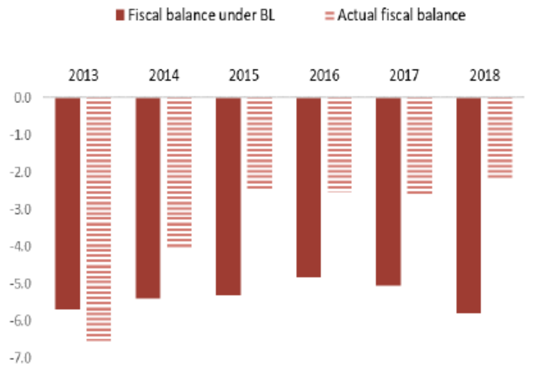
Banks' profitability has picked up since H2 2018 as credit growth strengthens.




Source: NBC; AMRO staff calculations

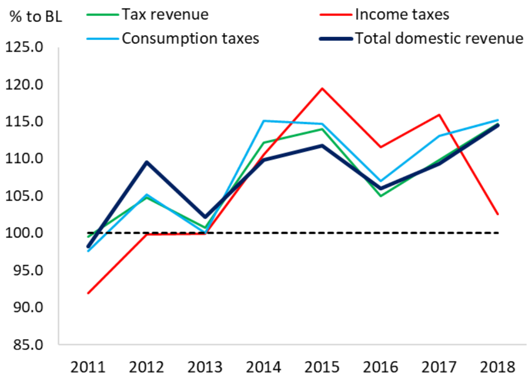
## Figure 1.4. Fiscal Sector

Since 2014, the actual fiscal deficit has been smaller than the target set out in the Budget Law.




Source: MEF; AMRO staff calculations

Revenue collection outperformed its target with the successful implementation of Revenue Mobilization Strategy 2014 – 2018 (RMS I).




Source: MEF; AMRO staff calculations

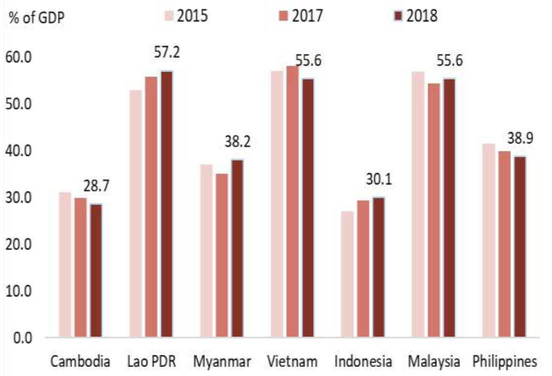
Since the introduction of RMS I, tax revenue has grown by double digits, with a tax buoyancy of more than 1


Source: MEF; AMRO staff calculations

The steady growth of public-wage spending slowed in 2018 and is expected to further decline in 2019.

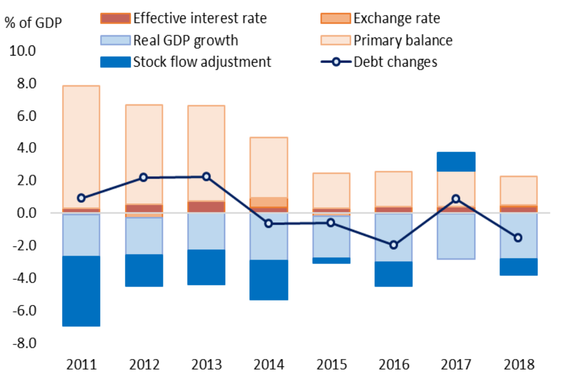

Source: MEF; AMRO staff calculation

Cambodia's government debt ratio has been among the lowest in the region, with the declining trend supported by stronger revenue collection.




Source: MEF; AMRO staff calculations

The debt to GDP ratio edged down in 2018 with a higher GDP growth rate and improvement in the primary balance deficit.




Source: MEF; AMRO staff calculations

## Appendix 2. Selected Economic Indicators for Cambodia

| | 2015 | 2016 | 2017 | 2018 | Projection 2019 | Projection 2020 |
|---|---|---|---|---|---|---|
| **National income and prices** | (Annual percentage change unless otherwise specified) | | | | | |
| Real GDP | 7.0 | 7.0 | 7.1 | 7.5 | 7.1 | 7.0 |
| Agriculture | 0.2 | 1.3 | 1.7 | 1.7 | 1.2 | 1.1 |
| Construction | 19.2 | 21.8 | 18.0 | 18.1 | 18.4 | 18.7 |
| Garment manufacturing | 9.8 | 6.7 | 5.8 | 9.8 | 6.6 | 5.9 |
| Private consumption | 5.9 | 6.7 | 4.6 | 5.8 | 5.3 | 5.1 |
| Government consumption | 4.4 | 5.7 | 6.5 | 7.9 | 7.7 | 7.5 |
| Investment | 9.9 | 10.0 | 6.0 | 13.2 | 13.3 | 12.6 |
| Consumer price inflation (average) | 1.2 | 3.0 | 2.9 | 2.5 | 2.1 | 2.3 |
| | | | | | | |
| **Balance of payments** | (In millions of U.S. dollars unless otherwise specified) | | | | | |
| Trade balance | -3,949 | -3,846 | -4,278 | -5,844 | -7,572 | -8,776 |
| Services, net | 1,712 | 1,602 | 1,863 | 2,407 | 2,613 | 2,974 |
| Current account balance | -1,598 | -1,733 | -1,797 | -2,992 | -4,250 | -4,826 |
| In percent of GDP | -8.9 | -8.7 | -8.1 | -12.2 | -15.7 | -16.3 |
| Capital and financial account balance | 2,382 | 2,531 | 3,382 | 4,260 | 5,650 | 5,796 |
| In percent of GDP | 13.2 | 12.6 | 15.3 | 17.3 | 20.9 | 19.6 |
| Foreign direct investment | 1,735 | 2,397 | 2,673 | 3,089 | 3,514 | 4,114 |
| In percent of GDP | 9.6 | 12.0 | 12.1 | 12.6 | 13.0 | 13.9 |
| Overall balance | 831 | 873 | 1,631 | 1,445 | 1,445 | 1,014 |
| Gross international reserves | 5,007 | 6,599 | 8,613 | 9,821 | 11,866 | 12,880 |
| In months of imports of goods & services | 3.9 | 4.8 | 5.7 | 5.4 | 5.5 | 5.2 |
| External debt | 9,037 | 10,072 | 11,490 | 13,239 | 13,473 | 14,832 |
| In percent of GDP | 48.2 | 48.7 | 51.6 | 49.8 | 49.9 | 50.1 |
| **General government** | (In percent of GDP) | | | | | |
| Revenue | 19.9 | 21.0 | 21.9 | 23.1 | 23.6 | 24.2 |
| of which: tax revenue | 15.8 | 15.9 | 17.3 | 18.3 | 19.4 | 20.0 |
| Expenditure | 20.9 | 21.8 | 23.4 | 24.3 | 24.4 | 25.4 |
| Current Expense | 13.0 | 14.2 | 15.6 | 16.3 | 17.0 | 17.6 |
| Net Acquisition of Non-Financial Assets | 7.4 | 7.1 | 7.2 | 7.2 | 7.4 | 7.8 |
| Current balance* | 4.8 | 4.4 | 4.4 | 4.8 | 5.4 | 5.5 |
| Primary balance* | -2.1 | -2.1 | -2.2 | -1.8 | -1.3 | -1.6 |
| Overall fiscal balance* | -2.4 | -2.5 | -2.6 | -2.2 | -1.8 | -2.1 |
| Government Debt | 31.2 | 29.2 | 30.0 | 28.9 | 29.4 | 30.1 |
| Fiscal reserves (government deposits) | 8.3 | 9.6 | 11.3 | 13.0 | 16.3 | 19.4 |
| | | | | | | |
| **Monetary sector** | (Annual percentage change unless otherwise specified) | | | | | |
| Domestic credit | 24.3 | 21.9 | 15.6 | 21.1 | 24.4 | 24.9 |
| Private sector | 27.1 | 22.5 | 18.5 | 23.2 | 24.3 | 24.8 |
| Broad money | 14.7 | 17.9 | 23.8 | 24.0 | 24.4 | 24.5 |
| **Memorandum items:** | | | | | | |
| Nominal GDP (in billions of riels) | 73,423 | 81,242 | 89,831 | 99,630 | 109,478 | 120,070 |
| Nominal GDP (in millions USD) | 18,050 | 20,017 | 22,177 | 24,593 | 27,000 | 29,586 |
| GDP per capita (USD) | 1,163 | 1,270 | 1,386 | 1,495 | 1,618 | 1,641 |

Note: *) Excluding grant. All figures for 2019 – 2020 are AMRO Staff projections.
Sources: MEF, NBC, NIS, AMRO staff projection.

## Appendix 3. Balance of Payments

| Items | Unit | 2015 | 2016 | 2017 | 2018 |
|---|---|---|---|---|---|
| **Current account** | **USD mn** | **-1,598** | **-1,733** | **-1,797** | **-2,992** |
| Trade balance | USD mn | -3,949 | -3,846 | -4,278 | -5,844 |
| Exports, f.o.b. | USD mn | 9,336 | 10,273 | 11,224 | 12,963 |
| Imports, f.o.b. | USD mn | 13,285 | 14,119 | 15,502 | 18,806 |
| Services, net | USD mn | 1,712 | 1,602 | 1,863 | 2,407 |
| Receipts | USD mn | 3,955 | 4,033 | 4,608 | 5,451 |
| Payments | USD mn | 2,242 | 2,430 | 2,745 | 3,044 |
| Primary income, net | USD mn | -998 | -1,050 | -1,138 | -1,277 |
| Receipts | USD mn | 354 | 377 | 442 | 578 |
| Payments | USD mn | 1,352 | 1,427 | 1,580 | 1,855 |
| Secondary income, net | USD mn | 1,636 | 1,561 | 1,756 | 1,722 |
| of which: official tranfer | USD mn | 526 | 506 | 550 | 452 |
| Others | USD mn | 1,110 | 1,056 | 1,206 | 1,270 |
| **Capital and financial account** | **USD mn** | **2,382** | **2,531** | **3,382** | **4,260** |
| Capital account | USD mn | 265 | 283 | 279 | 293 |
| Financial account (net) | USD mn | 2,117 | 2,247 | 3,104 | 3,967 |
| Direct investment | USD mn | 1,735 | 2,397 | 2,673 | 3,089 |
| Other investment | USD mn | 397 | -147 | 436 | 921 |
| Errors and omissions | USD mn | 47 | 75 | 107 | 177 |
| Overall balance | USD mn | 831 | 873 | 1,631 | 1,445 |
| Changes in reserves (- = increase) | USD mn | -831 | -873 | -1,631 | -1,445 |
| | | | | | |
| **Memorandum items:** | | | | | |
| Exports of goods and services | USD mn | 13,291 | 14,306 | 15,832 | 18,414 |
| Imports of goods and services | USD mn | 15,528 | 16,550 | 18,247 | 21,851 |
| Trade account (% GDP) | % of GDP | -21.9 | -19.2 | -19.3 | -23.8 |
| Current account (% GDP) | % of GDP | -8.9 | -8.7 | -8.1 | -12.2 |
| Capital and financial account (% of GDP) | % of GDP | 13.2 | 12.6 | 15.3 | 17.3 |
| Overall Balance (% of GDP) | % of GDP | 4.4 | 4.1 | 7.1 | 5.3 |
| International reserves (In millions of USD) | % of GDP | 7,377 | 9,123 | 12,201 | 14,629 |
| In months of imports of goods and services | No of months | 5.7 | 6.6 | 8.0 | 8.0 |
| GDP (In millions of USD) | USD mn | 18,050 | 20,017 | 22,177 | 24,593 |

Source: NBC, AMRO Staff calculation

## Appendix 4. Statement of General Government Operations

In percent of GDP

| Items | 2015 | 2016 | 2017 | 2018 | 2019BL |
|---|---|---|---|---|---|
| **Total Domestic Revenue** | 18.0 | 18.7 | 20.2 | 21.4 | 19.4 |
| Current Revenue | 17.8 | 18.6 | 20.1 | 21.2 | 19.2 |
| Tax revenue | 15.8 | 15.9 | 17.3 | 18.3 | 16.7 |
| *Domestic Taxes* | 12.2 | 12.5 | 14.0 | 14.7 | 13.2 |
| Direct Taxes | 3.4 | 3.6 | 4.2 | 3.9 | 4.0 |
| Indirect Taxes | 8.4 | 8.9 | 9.7 | 10.8 | 9.3 |
| Other Dom. Taxes | 0.4 | 0.0 | 0.0 | 0.0 | 0.0 |
| Local Govt Taxes | 2.6 | 2.5 | 2.2 | 2.4 | 2.2 |
| *Trade Taxes* | 2.5 | 2.4 | 2.1 | 2.3 | 0.0 |
| Import taxes | 0.1 | 0.0 | 0.1 | 0.1 | 0.0 |
| Export Taxes | 2.0 | 2.6 | 2.8 | 2.8 | 2.5 |
| Non-tax revenue | 0.2 | 0.1 | 0.2 | 0.2 | 0.2 |
| Capital Revenue | 1.9 | 2.3 | 1.7 | 1.8 | 1.0 |
| **Grants** | 20.4 | 21.3 | 22.8 | 23.5 | 24.0 |
| **Total Expenditure** | 20.9 | 21.8 | 23.4 | 24.3 | 24.8 |
| Current Expenditures | 13.0 | 14.2 | 15.6 | 16.3 | 16.4 |
| Wages and Salaries | 6.4 | 7.1 | 8.0 | 8.3 | 7.6 |
| Non-Wages and Salaries | 6.6 | 7.0 | 7.7 | 8.3 | 9.1 |
| Interest Payment | 0.3 | 0.4 | 0.4 | 0.4 | 0.5 |
| Domestic | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Foreign | 0.3 | 0.4 | 0.4 | 0.3 | 0.5 |
| Other Spending | 0.0 | 0.0 | 0.0 | 0.3 | 0.4 |
| Capital Expenditures | 7.4 | 7.1 | 7.2 | 7.2 | 7.6 |
| Domestic Financed | 2.4 | 2.4 | 2.5 | 2.6 | 2.8 |
| Foreign Financed | 5.1 | 4.7 | 4.7 | 4.6 | 4.9 |
| Current fiscal balance | 4.8 | 4.4 | 4.4 | 4.8 | 2.8 |
| Primary balance | -2.1 | -2.1 | -2.2 | -1.8 | -4.2 |
| Overall fiscal balance (Excl. Grants) | -2.4 | -2.5 | -2.6 | -2.2 | -4.6 |

Notes: 2019BL refers to Budget Law. Fiscal balance (GD Budget) refers to fiscal balance calculated by the GD Budget which excludes grant and loan in the revenue, but it includes amortization in the spending side.

Source: GD Budget (Table 1 as of 21 May 2019), MEF and AMRO Staff calculation.

# Appendix 5 Data Adequacy for Surveillance Purposes: A Preliminary Assessment

| Criteria/ Key Indicators for Surveillance | Availability(i) | Reporting Frequency/ Timeliness(ii) | Data Quality(iii) | Consistency(iv) | Others, if any(v) |
|---|---|---|---|---|---|
| National Accounts and Labor Market | - GDP numbers on the production and expenditure side have been made available<br>- Unemployment and labor market data are available on the website | - The dissemination of GDP data is on an annual basis with a time lag of three to seven months<br>- Data on the labor market has a lag of about one year | National Accounts statistics are compiled broadly in accordance with SNA93 standards. Data collection techniques remain weak due to resource constraints.<br>The authorities plan to release the GDP data based on SNA 2008. | Revisions are frequent but becoming less significant. Officially, the statistical discrepancy is also shrinking | - The data quality of the National Accounts data could be improved using a more comprehensive Supply Used Table (SUT) based on the latest survey<br>- The GDP data on the expenditure side remains relatively weak with underestimated gross fixed capital formation |
| Balance of Payments (BOP) and External Position | - BOP data is published on the NBC website<br>- Import and export data is published by the MEF<br>- Import data breakdown by category, destination and origin is not yet available<br>- Time-series detailed data on external debt and international reserves is not yet available | - BOP data is released on a quarterly and yearly basis with a time lag of one to three quarters<br>- Trade data is released on a monthly basis with a time lag of one to three months | - Since 2019, the BOP has been published in conformity with the BPM6 but some coverage limitations exist<br>- Import data published by the MEF is incomplete, as it covers only major items | - | - |
| State Budget and Government/ External Debt | - Budget implementation data is released on the MEF website<br>- Budget implementation data does not include local government budget operation<br>- Contingent government liability statistics are not yet available | Budget implementation statistics are published on a monthly basis with a time lag of one to three months | The data coverage is limited to the budget and is not fully integrated with activities related to the disbursement of external loans and grants | The breakdown of budget implementation data from TOFE is different from the one provided by the GD of Budget. | - |
| Money Supply and Credit Growth | - CPI data for Phnom Penh is published by the NIS<br>- National CPI data is yet to be made available<br>- Monetary statistics have been released on the NBC website<br>- Data on credit breakdown by sector is also available | - CPI data is released on a monthly basis with a time lag of one to three months<br>- Monetary and credit data is published on a monthly, quarterly and yearly basis with a time lag of three to six months | - The compilation of the CPI suffers from insufficient coverage<br>- The authorities plan to release CPI data with much wider coverage<br>- The actual amount of dollars and other foreign currency-denominated bills circulating in the economy has not been captured in the official monetary statistics | - | Regular and timely (schedule-based) publication of headline and core inflation would strengthen economic monitoring |
| Financial Sector Soundness Indicators | - Some annual indicators are published by the NBC<br>- Foreign assets and liabilities for the banking sector in aggregate are published by the NBC<br>- A regular and detailed breakdown of the composition of foreign assets and liabilities of the banking sector is not yet available | Yearly data is released on the NBC website with a time lag of three to six months | - Indicators are generally based on reports from banks and MFIs<br>- In addition to banking indicators, data on microfinance activities is lacking | - | The availability of more comprehensive and more frequent data, including a detailed breakdown of assets and liabilities, would help in the analysis of financial-sector soundness as a whole |

Notes:

(i) Data availability refers to whether the official data is available for public access by any means.
(ii) Reporting frequency refers to the periodicity with which the available data is published. Timeliness refers to how up-to-date the published data is relative to the publication date.
(iii) Data quality refers to the accuracy and reliability of the available data taking into account the data methodologies.
(iv) Consistency refers to both the internal consistency within the data series itself and its horizontal consistency with other data series of either the same or different categories.

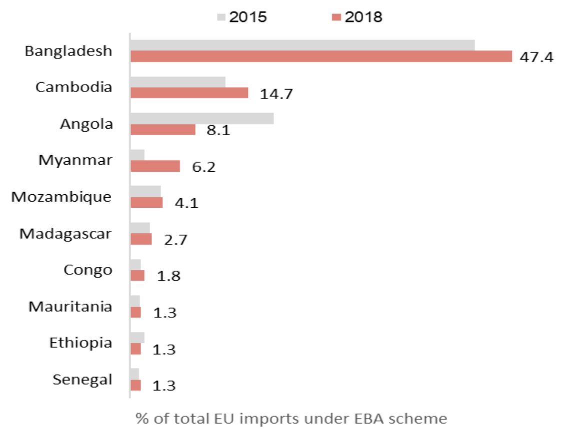
Source: AMRO staff calculations. This preliminary assessment will form the "Supplementary Data Adequacy Assessment" in the EPRD Matrix

## Annexes: Selected Issues

### Annex 1. Impact of EBA withdrawal on Cambodian Economy[36]

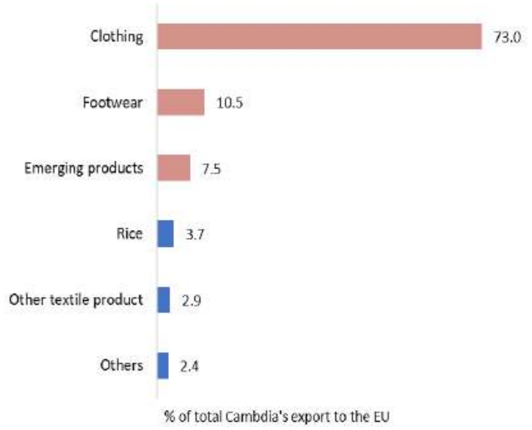
1. **The European Union (E.U.) is a long-time key trading partner of Cambodia.** As a small open developing economy, Cambodia has focused on external trade as one of its main growth drivers. Its economy has expanded rapidly in the past decade, averaging above 7.0 percent per annum, on the back of a strong performance in exports, especially to the E.U. market. This is largely due to a preferential trade arrangement – the Everything But Arms (EBA) scheme – that Cambodia has enjoyed with the E.U. for nearly 20 years.[37] Among the 48 EBA beneficiary countries, Cambodia is the second largest exporter after Bangladesh, accounting for nearly 15 percent of total imports under the trading scheme (Figure A1.1). Cambodia's exports to the E.U. market are mainly garment-related products such as clothing, footwear and travel goods (Figure A1.2).

**Figure A1.1. Top Exporters under EBA Scheme**




Source: Trade Map; International Trade Centre

**Figure A1.2. Composition of Cambodia's Exports to the E.U. (2018)**




Note: Based on 2018 data
Source: National authorities

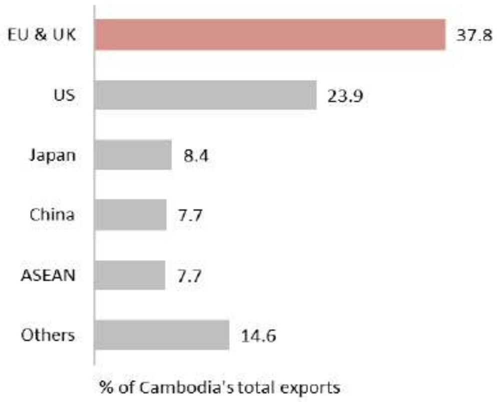
2. **Cambodia's exports continue to rely heavily on the E.U. and United States (U.S.) markets.** Over the past two decades, garment products have dominated Cambodia's exports, with the E.U. and U.S. markets as the major destinations, which absorbed about 38 percent and 24 percent of Cambodia's total exports in 2018, respectively. (Figure A1.3) The other major export destinations are Japan, China and ASEAN, which together absorb nearly one fourth of Cambodia's total exports. The E.U. and the U.S. are also the two main sources of Cambodia's trade surplus, contributing around USD3.7 billion (15.1 percent of GDP) and USD2.6 billion (10.6 percent of GDP), respectively, in 2018. On the other hand, Cambodia's trade deficits with the other major trading partners have widened over the past few years. In

[36] Prepared by Abdurohman and Khut Vanne.

[37] The EBA scheme is part of the E.U. generalized system of preference, which allows 48 least developed countries (LDCs) to import all kinds of products, except arms and ammunition, into the E.U. market while enjoying both duty-free and quota-free facilities.

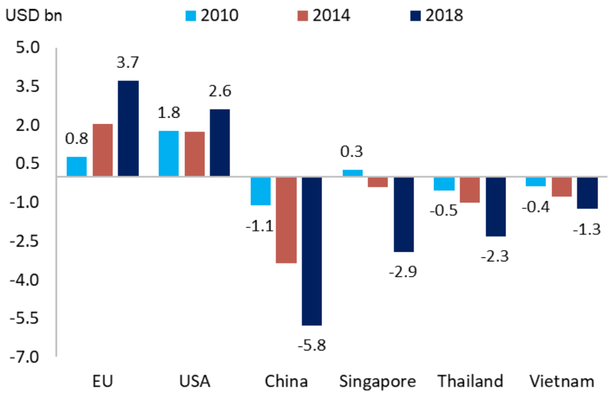
particular, its trade deficit with China surged to around USD5.8 billion (23.5 percent of GDP) in 2018, up from USD1.1 billion (10.0 percent of GDP) in the previous year (Figure A1.4).

**Figure A1.3. Cambodia's Export Markets (2018)**




Source: National authorities; AMRO staff calculations

**Figure A1.4. Cambodia's Trade Balance with Major Trading Partners**




Source: IMF Direction of Trade Statistics; AMRO staff calculations

3. **While its reliance on the E.U. market remains high, Cambodia faces the risk of losing its EBA status.** Together with the other 48 LDCs, Cambodia has benefited from the EBA scheme since the early 2000s. This preferential trade status, however, is at risk after the European Commission (EC) began a formal process of review in February 2019 which could lead to the suspension of Cambodia's EBA status.[38] The EBA status has no expiry date, and eligibility is based on each beneficiary country's status as an LDC. It can be withdrawn temporarily in exceptional circumstances.[39] It is believed that Cambodia's EBA status, if suspended, will have a significant negative impact on its exports to the E.U., the largest export market for more than a decade.

4. **This study aims to estimate the potential impact of an EBA withdrawal on Cambodia.** Using the "preference margin" concept[40], this study examines how an EBA withdrawal may affect Cambodia's exports. The change in export value is evaluated by breaking it down into export quantity change and export price change. (Box A1) Further, in order to assess the impact on economic growth, a shock simulation is carried out using the multiplier coefficient derived from the Input-Output (IO) Table.

[38] The whole process takes 18 months, starting with six months of intensive monitoring and engagement with Cambodian authorities, followed by another six months to produce a report based on the findings. At the end of the 12 months, the EC concludes the procedure with a final decision on the EBA status withdrawal as well as the scope of withdrawal. Any withdrawal will become fully effective after a further six-month period.

[39] Please refer to Box B, AMRO's Cambodia Annual Consultation Report 2018.

[40] This is a partial equilibrium approach and does not take into account second-round effects. Therefore, two assumptions are made: Cambodia is unable to divert its exports to other markets in the short run, and exporters will not lower their profit margins despite higher tariffs.

**Box A1. Preference Margin Erosion and Export Losses**

According to GATT (The General Agreement on Tariffs and Trade), the term "preference margin" is defined as the absolute difference between the most-favored nation (MFN) tariff rate and the preferential rate under a particular trade agreement. An upward revision of the preferential tariff will, therefore, erode the preference margin of the beneficiary countries, which in turn affects their export prices and ultimately the demand for their products. Assuming that the market is perfectly competitive with no product differentiation, the unit price ($P_i^{EU}$) that an exporter in beneficiary country *i* receives from exporting a product to the E.U. market can be expressed as:

$$P_i^{EU} = P_{MFN}^{w}(1 + m_i^{EU}) \quad (1)$$

where $P_{MFN}^{w}$ is the unit price for exporters from other MFN countries and $m_i^{EU}$ is the preference margin under the EBA scheme. By expressing all trade protection measures in the form of ad valorem tariff, the preference margin can be defined as the difference in tariff rates, $T_{MFN}^{EU} - T_i^{EU}$

$$P_i^{EU} = P^{w}(1 + T_{MFN}^{EU} - T_i^{EU}) \quad (2)$$

Note that the percentage change in the value of exports can be expressed in terms of price changes for a given price elasticity ($\varepsilon$) of the export demand.

$$\frac{\Delta X}{X} = \frac{\Delta P}{P} + \varepsilon\frac{\Delta P}{P}\left[\frac{\Delta P}{P} + 1\right] \quad \text{where } X \text{ is the value of exports and } \varepsilon = \frac{\Delta Q}{Q}\Big/\frac{\Delta P}{P} \quad (3)$$

Since an EBA withdrawal will change the preference margin, the resulting change in the price can be expressed as follows.

$$\frac{\Delta P}{P} = \frac{\Delta P^{w}}{P^{w}} + \frac{\Delta m_i}{1 + m_i} \quad (4)$$

Assuming no change in the world price, denoted as $\Delta P^{w} = 0$, the export value change in equation (3) becomes:

$$\frac{\Delta X}{X} = \frac{\Delta m_i}{1 + m_i} + \varepsilon\left[\frac{\Delta m_i}{1 + m_i}\right]\left[\frac{\Delta m_i}{1 + m_i} + 1\right] \quad (5)$$

In equation (5), the first component on the right gives the direct price effect on the export value changes. An EBA withdrawal will reduce both the preference margin and the export value, as the unit export price received by the Cambodian exporter becomes lower. The second component shows the impact on export values due to changes in export volume (demand for export products) as a result of price changes – in other words, the demand elasticity with respect to price changes. This study uses demand elasticity estimates from Ghodsi, Grubler and Stehrer (2016) to quantify the impact of changing export volumes (see Annex A1.1 for elasticity estimates).

The impact of an EBA withdrawal is estimated based on the product-specific preference margins of 97 different product categories. For product category $k$'s share in Cambodia's total exports to country $n$ in the E.U. ($w_{EU,k}^{kh}$) and country n's share in Cambodia's exports the E.U. ($w_n$), Cambodia's preference margin can be written as:

$$m_{kh}^{EBA} = \sum_{n\in EU} w_n \sum_{k=1}^{97} w_{n,k}^{kh}\left(T_{n,k}^{MFN} - T_{n,k}^{kh}\right) \quad (6)$$

where $kh$ refers to Cambodia, $n$ refers to the countries in the E.U. market, and $k$ corresponds to specific product category.

This study uses the trade data of products with two-digit HS codes and the corresponding tariff rates taken from the World Integrated Trade Solution database.

With estimated changes in export value due to the EBA withdrawal, the IO Table can be used to assess its impact on gross value added (GVA), which can then be translated into GDP growth.

$$Y = GVA * (I - A)^{-1} * X \tag{7}$$

$Y$ refers to the output, $GVA$ refers to the coefficient matrix of gross value added, and $X$ refers to the coefficient matrix of export, whilst $(I - A)^{-1}$ refers to the matrix of multiplier derived from the IO Table.

5. **Once the EBA scheme is suspended, Cambodia's exporters will face higher tariff rates.** If Cambodia's EBA status is fully withdrawn, its exporters will have to pay MFN tariff rates, which vary across different products. The effective tariff rates (weighted average rates) will rise from zero to a range of approximately 0 to 31.2 percent under the current MFN scheme (Table A1.1). Food products are expected to face the highest tariff rates, of 8.4-21.3 percent, since these are the most protected sectors in the EU[41] Among garment products, Cambodia's main exports, footwear (HS64) will incur the highest tariff rate, of 12.4 percent, followed by knitted apparel and clothing (HS61), with 11.8 percent. Bicycles (HS87) will see a new effective tariff rate of 8.5 percent, while travel goods (HS42), another major Cambodian export, will face 4.9 percent. The higher effective tariff rates will erode the competitiveness of Cambodian products in the E.U. market.

**Table A1.1. The MFN Tariff Rates**

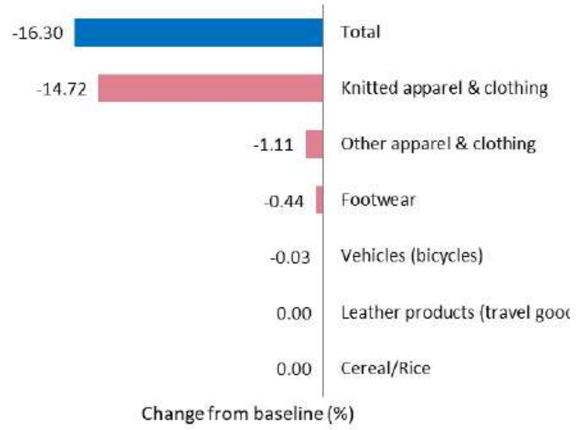
| HS Code | Product | Weighted Average Tariff |
|---|---|---|
| 24 | Tobacco & tobacco products | 31.2 |
| 16 | Prepared meat & fish | 21.3 |
| 20 | Prepared vegetables & fruits | 17.2 |
| 4 | Dairy products | 16.8 |
| 17 | Sugars & sugar confectionery | 13.3 |
| 64 | Footwear | 12.4 |
| 61 | Apparel & clothing, knitted | 11.8 |
| 62 | Apparel & clothing, not knitted | 11.6 |
| 63 | Other textile articles | 10.4 |
| 3 | Fish and crustaceans | 10.1 |
| 19 | Prepared cereals, flour, starch or milk | 10 |
| 21 | Miscellaneous edible preparations | 9.8 |
| 11 | Products of the milling industry | 9.2 |
| 8 | Edible fruit and nuts | 8.8 |
| 7 | Edible vegetables | 8.5 |
| 87 | Vehicles other than railway (bicycles) | 8.5 |
| 2 | Meat and edible meat | 8.4 |
| 60 | Knitted or crocheted fabrics | 8 |
| 57 | Carpets and other textile floor coverings | 7.8 |
| 58 | Special woven fabrics | 7.2 |
| 6 | Live trees and other plants | 6.9 |
| 59 | Impregnated, coated, covered or laminated textile | 6.9 |
| 69 | Ceramic products | 6.8 |
| 36 | Explosives products | 6.5 |
| 76 | Aluminum & aluminum products | 6.2 |
| 39 | Plastics & plastic products | 6.1 |
| 54 | Man-made filaments | 6.1 |
| 42 | Article of leather (including travel goods) | 4.9 |

Note : Only selected products are listed
Source : World Trade Integrated Solution, World Bank

[41] To safeguard domestic producers, the E.U. imposed a tariff rate of €175/ton on Cambodian rice imports in 2019, although this will be reduced by €25/ton per annum until the rate falls to €125/ton in 2021.

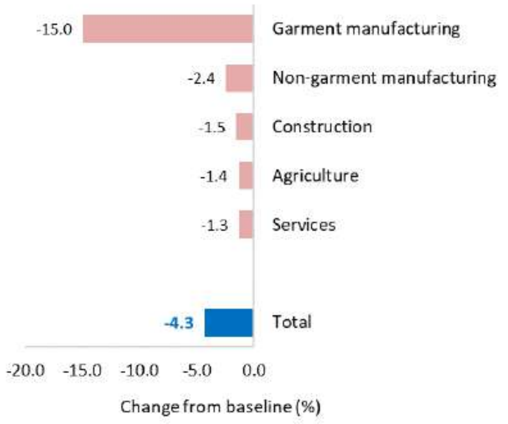
6. **An EBA withdrawal will affect the garment sector the most severely.** A reintroduction of tariffs will raise the prices of Cambodia's exports in the E.U. market, which will drive down demand for Cambodian products. The estimation results suggest that Cambodia's exports to the E.U. will contract by 16.3 percent in value terms should MFN tariff rates be imposed (Figure A1.5). Given the high export concentration, garment products are estimated to suffer the biggest contraction because of the higher tariff rates.[42]

**Figure A1.5. Impact of EBA Withdrawal on Export Value**




Source: AMRO staff estimates

**Figure A1.6. The Impact of EBA Withdrawal on Gross Value Added (GVA)**




Source: AMRO staff estimates

7. **Export contraction as a result of an EBA withdrawal will dampen GDP growth.** Assuming that there is no trade diversion nor structural adjustment in Cambodia's economy, falling exports to the E.U. will have a direct impact on exports related production, which will in turn spill over to other sectors and ultimately affect GDP growth. This impact of export contraction on nominal GVA is assessed using multiplier coefficients derived from the IO Table. The magnitude of the impact on GVA depends largely on the extent of the impact of an EBA withdrawal on each sector's exports and production. As shown in Figure A1.6, the GVA of the garment manufacturing sector will be hit the most by an EBA withdrawal, falling 15 percent from the baseline, followed by the non-garment manufacturing sector, whose GVA is estimated to drop by 2.4 percent. The agriculture and services sector will also be indirectly affected through a multiplier effect. In aggregate, an EBA withdrawal will reduce nominal GVA by 4.3 percent from the baseline, and in real terms cutting GDP growth by 0.4 percentage points compared with the baseline.

[42] The magnitude of the impact of MFN tariff rates varies slightly across sub-categories. The estimation results show that, among garment products, exports of knitted apparel and clothing (HS61) will decrease the most, by around 14.7 percent, followed by non-knitted apparel and clothing (HS62), by around 1.1 percent. Footwear (HS64) exports are estimated to drop by around 0.4 percent. The impact on Cambodia's emerging products, such as travel goods and bicycles, is found to be negligible as their effective tariff rates are relatively low.

## Annex A1.1. Import Demand Elasticity

| Product | Import demand elasticity |
|---|---|
| Agriculture, hunting, forestry and fishing | -0.95 |
| Mining and quarrying | -1.01 |
| Food, beverages and tobacco | -0.95 |
| Textiles and textile products | -0.99 |
| Leather, leather and footwear | -1.00 |
| Wood and products of wood and cork | -1.01 |
| Pulp, paper, printing and publishing | -0.94 |
| Coke, refined petroleum and nuclear fuel | -1.18 |
| Chemicals and chemical products | -0.93 |
| Rubber and plastics | -0.94 |
| Other non-metallic minerals | -0.97 |
| Basic metals and fabricated metal | -0.94 |
| Machinery | -0.88 |
| Electrical and optical equipment | -0.84 |
| Transport equipment | -0.92 |
| Manufacturing; recycling | -0.91 |
| Electricity, gas and water supply | -2.64 |

Note: All figures are weighted average elasticities

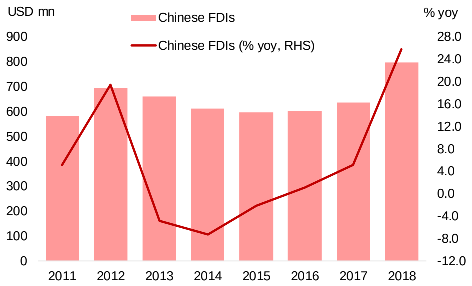
Source: Ghodsi, Grubler and Stehrer (2016)

## Annex 2. China's Growing Presence in Cambodian Economy[43]

1. **China's contribution to Cambodia's economic development has increased substantially over the last decade, but this has also raised concerns about the vulnerabilities it creates.** The current selected issue examines the diverse channels through which China's presence on Cambodia's economy is growing and how this phenomenon/trend could make Cambodia's economy more susceptible to China's growth slowdown or changes in economic policy.

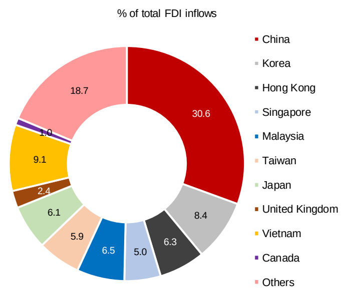
2. **China has been the largest source of foreign direct investment (FDI) inflows into Cambodia.** Over the past decade, China has been the top FDI contributor, investing in a wide range of sectors, especially in hotels and resorts, garment manufacturing, waste recycling, together with plantation and processing (Figures A2.2, A2.3). The recent rebound in China's FDI inflows reflects in part the increase in factory relocation from China to Cambodia as a low-cost manufacturing hub (Figure A2.1). The decade-long robust FDI inflows have led to the current strong economic presence of China in Cambodia, contributing to Cambodia's economic development and poverty reduction, especially through job creation. Data on approved FDIs suggest that Chinese FDIs alone absorbed around 57.1 percent of the total manpower from total approved FDIs in 2018, mostly concentrated in garment sector (Figure A2.4).

**Figure A2.1. Actual FDI Inflows from China**




Sources: National Bank of Cambodia; AMRO staff calculations

**Figure A2.2. Top 10 Actual FDI Inflows by Country, 2008-2018**




Sources: National Bank of Cambodia; AMRO staff calculations

**Figure A2.3. Approved FDIs from China by Sector**

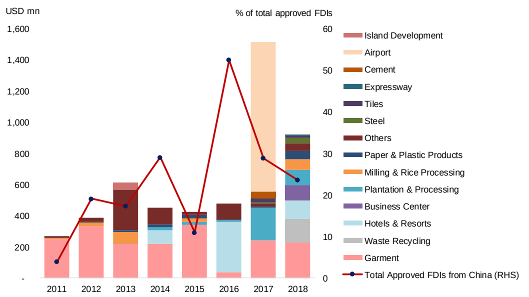
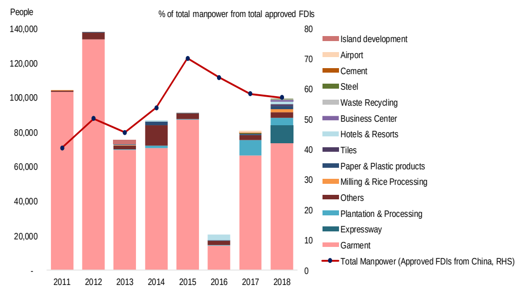



**Figure A2.4. Manpower from Approved Chinese FDIs**




Notes: Data refer to approved FDIs. China's approved FDIs include those with Chinese share from 10 percent. Actual FDI disbursement data of each country by sectors and by manpower are not available.

Sources: The Council for the Development of Cambodia; and AMRO staff calculations.

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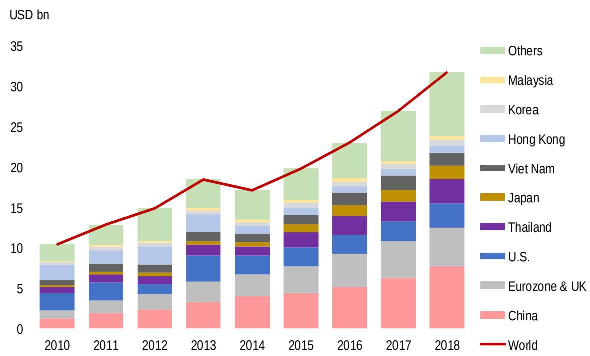
[43] Prepared by Khut Vanne.

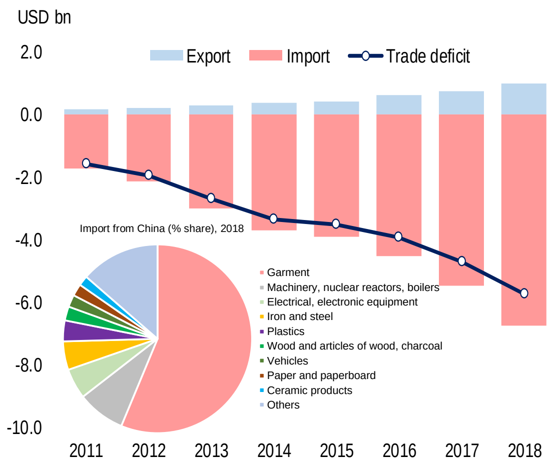
3. **Imports from China have increased significantly, contributing to a fast-widening trade deficit between Cambodia and China.** The total bilateral trade volume reached a record high of USD7.7 billion in 2018, of which Cambodia's imports from China accounted for USD6.8 billion, causing a huge trade deficit (Figure A2.6). On the positive side, China has been the second largest buyer of Cambodian rice (Figure A2.8), which partially offsets Cambodia's loss of market share in the European Union (E.U.) following the E.U.'s imposition of safeguard measures on Cambodian rice.[44] Rice exports to China surged significantly in the first eight months of 2019 by 65.5 percent yoy, relative to a 3.6 percent increase in the same period of last year. China's raised quota on rice imports from Cambodia – from 300,000 tonnes in 2018 to 400,000 tonnes in 2019 – may also have contributed to the increase.

**Figure A2.5. Cambodia's Total Trade Volume by Country**



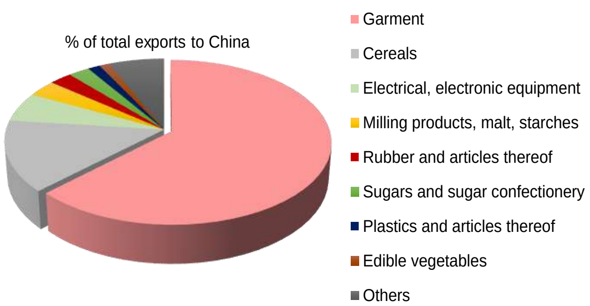

Sources: IMF; AMRO staff calculations

**Figure A2.6. Cambodia-China Trade Relations**



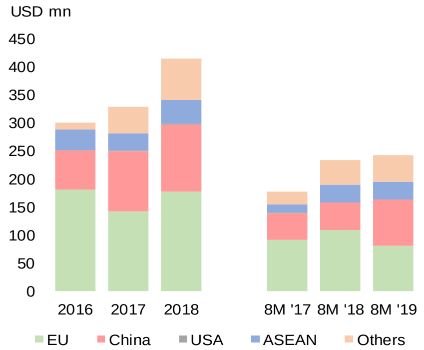

Sources: IMF; AMRO staff calculations

**Figure A2.7. Cambodia's Exports to China by Product, 2018**




Sources: Ministry of Economy and Finance; AMRO staff calculations

**Figure A2.8. Cambodia's Rice Exports by Destination**



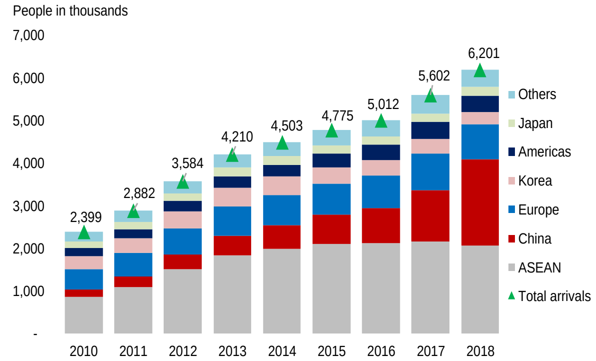

Sources: Ministry of Economy and Finance; AMRO staff calculations

4. **Over the last few years, China has become the largest contributor to the increase in tourist arrivals**. The total number of tourist arrivals grew 10.7 percent yoy in 2018, thanks to the large influx of Chinese arrivals (Figures A2.9, A2.10). Around two million Chinese

[44] On 16 January 2019, the European Commission announced the re-introduction of import duties on Cambodian rice to be effective on 18 January 2019. The normal customs duty on rice import is reinstated but will be steadily reduced over three-year period: €175 per tonne in year one, €150 per tonne in year two, and €125 per tonne in year three. In the first eight months of 2019, rice exports to the E.U., including the United Kingdom, registered a contraction of 25.4 percent yoy, down from an increase of 18.6 percent in the corresponding period last year, reflecting the adverse effects of the safeguard measures.

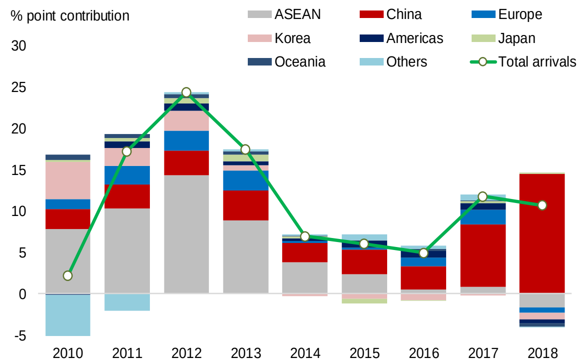
tourists visited the Kingdom in 2018, accounting for 32.6 percent of the total tourist arrivals (Figure A2.9). Growing economic relationship between two countries, increased direct flights[45] and Cambodia's supportive policies[46] greatly facilitated the rising Chinese middle class to visit the Kingdom. The tourism industry – growing at 5.5 percent and accounting for 5 percent of GDP in 2018 – has been playing an important role in Cambodia's socio-economic development, especially through investment and job creation.[47]

**Figure A2.9. Tourist Arrivals**



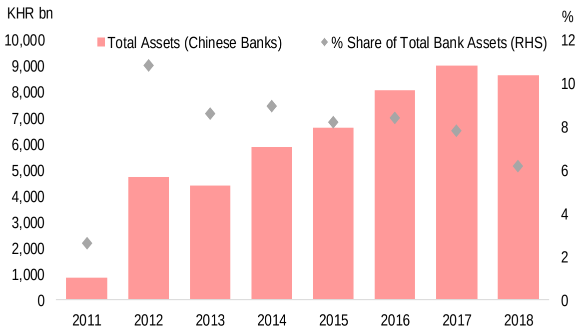

Sources: Ministry of Tourism; AMRO staff calculations

**Figure A2.10. Contribution to Tourist Arrival Growth**



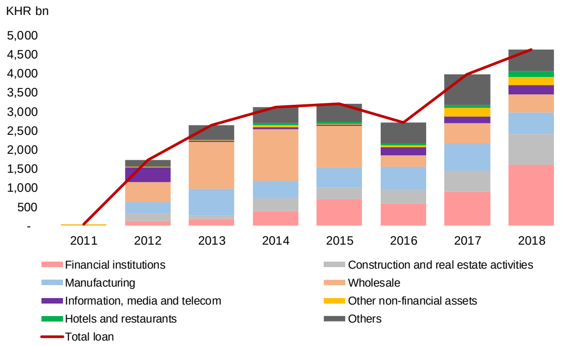

Sources: Ministry of Tourism; AMRO staff calculations

**Figure A2.11. Chinese Banks' Assets**




Sources: National Bank of Cambodia; AMRO staff calculations

**Figure A2.12. Chinese Banks' Loans**




Sources: National Bank of Cambodia; AMRO staff calculations

5. **Albeit remaining small in terms of market share, Chinese banks continue to expand in Cambodia's financial sector.** Currently, there are two Chinese banks – Bank of China and ICBC – with the total assets of around KHR 8,618 billion (USD 2.1 billion), accounting for 6.2 percent of the total bank assets, increasing from KHR 4,705 billion in 2012. In tandem with the increase in assets, loan size also grew rapidly from around KHR 1,718 billion in 2012 to KHR 4,621 billion in 2018, taking up 5.5 percent of the total bank loans. The

[45] At present, there are 25 airlines operating 636 direct flights per week between Cambodian cities and Chinese cities. (Source: Xinhuanet's news "Number of Chinese tourists to Cambodia up 37 pct in first 4 months", dated 06 June 2019)

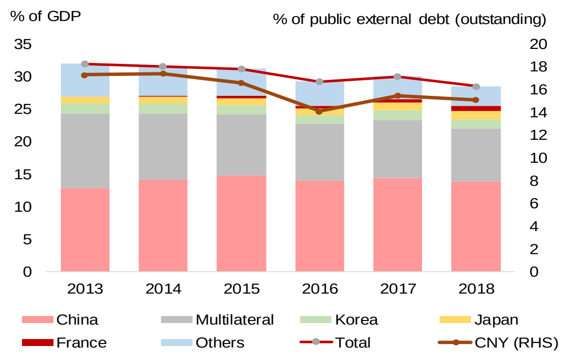
[46] Aiming at attracting 2 million Chinese tourists per year by 2020, "China Ready" policy was adopted in May 2016, involving many key strategies, such as increasing the number of Chinese-speaking employees in tourism sector, facilitating visa process for Chinese visitors, as well as installing signage in Chinese language.

[47] According to the World Travel and Tourism Council, travel and tourism industry in Cambodia created 2,663,500 jobs (30.4 percent of the total employment) in 2017 which is estimated to increase by 2.5 percent in 2018. Employment in this sector is estimated to rise to 3,642,000 in 2028, about 35 percent of the total employment. (Travel & Tourism Economic Impact 2018 Cambodia, March 2018)

largest share of credit goes to financial institutions, followed by construction and real estate activities, manufacturing and wholesale (Figure A2.12).

6. **China also plays a key role in financing Cambodia's national development projects.** China has become the top external creditor to the Cambodian government, accounting for about half of the public external debt (Figure A2.8). In addition, China's participation in various projects, including those under the Belt and Road Initiative (BRI), has helped the government to address some key development challenges of Cambodia. (Table A2.1). Besides, China has made the largest official development assistance (ODA) worth USD 334 million during 2014 – 2018, or 47 percent of the total ODA support for the implementation of the Cambodia's Industrial Development Policy (IDP).

**Figure A2.13. Public External Debt (Outstanding)**




Sources: Ministry of Economy and Finance; AMRO staff calculations

**Table A2.1. Selected Major Infrastructure Development Projects under BRI**

| Projects | Purpose |
|---|---|
| **Expressway from Phnom Penh to Sihanoukville**<br>• Length: 190 km<br>• Cost: USD 2 billion | To improve both goods transportation and traffic along National Road 4, which has been frequently affected by floods leading to road closures |
| **Lower Sesan II Dam**<br>• Capacity: 400 mw<br>• Cost: USD 800 million | To reduce power shortage, lower electricity costs, and promote social development |

Sources: Ministry of Economy and Finance; AMRO staff calculations

7. **Notwithstanding the substantial economic gains, Cambodia's growing dependence on China for investment, trade and financing, could be a source of instability to its economy.** Recent strong economic performance has been supported in part by China's growing contribution in various areas. This increased economic exposure to China has made Cambodia's economy more vulnerable to shocks emanating from China. In particular, amid the heightened U.S. – China trade tension, uncertainties around China's economic performance has been growing. Even though Cambodia has benefited from factory relocation and trade diversion so far, a sharper slowdown of the Chinese economy could have negative impact on Cambodia's economy because of the close linkages. In particular, given the dominance of Chinese investments in Cambodia's construction and real estate sector[48], a sudden policy shift such as stricter capital controls could also affect the sector's development and hence the growth outlook for the economy.[49]

[48] Chinese investment is reported to account for roughly one third of the capital investment in Cambodia's construction and real estate sector in 2018. (Source: Cambodia's condo-ridden housing crisis, https://www.eastasiaforum.org/2018/08/08/cambodias-condo-ridden-housing-crisis/ accessed October 10, 2019)

[49] China's restrictions on foreign real estate investment in 2017 and a tightening real estate lending last year, for instance, caused Chinese purchases of overseas properties to tumble by 63 percent in 2018, while around USD 12 billion Chinese-owned overseas properties were put up for sale. (CNBC's news article "Beijing's capital controls are weighing on Chinese investors looking to buy property abroad", dated 26 February 2019)

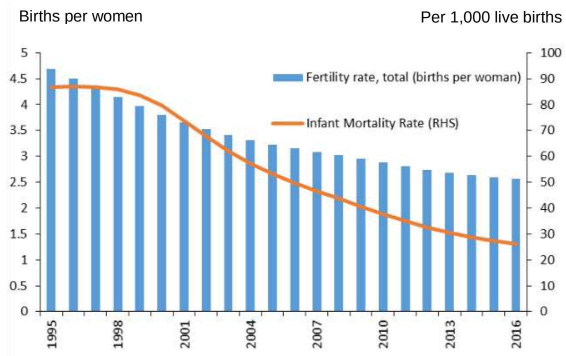
8. **In this regard, policy efforts to mitigate concentration risks and to broaden the domestic economic base are essential to ensure resilient economic development in the long run.** The government's continued efforts in negotiations for bilateral and multilateral Free Trade Agreements (FTAs) are commendable, while greater integration with the regional economies would allow Cambodia to increase its resilience to shocks. In addition to strengthening external cooperation, further policy efforts to diversify and broaden the domestic economy would help reduce the concentration risks and enhance economic resilience to external shocks in the long-run.

## Annex 3. Cambodia's Demographic Dividend: Opportunities and Challenges[50]

1. **Cambodia's young demographic structure provides great opportunities to improve growth potential.** Cambodia has one of the youngest populations in the ASEAN region[51] with its growing working-age population (15-64 year old). Cambodia is expected to enjoy its demographic dividend[52] for many years to come. Working-age population with more disposable income can spur consumption, production and investment, which will accelerate growth.[53] Therefore, this favourable demographic structure could provide a window of opportunities to boost economic growth and help the country address its development challenges.

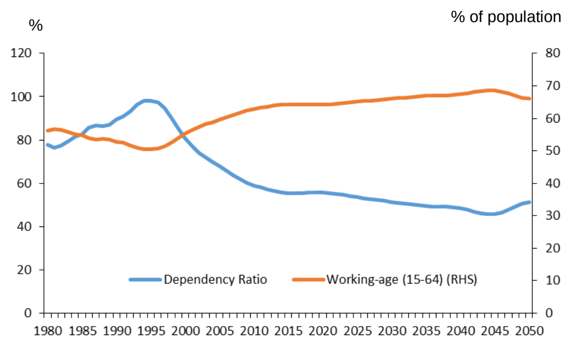
2. **A declining fertility rate and a relatively young demographic profile set the stage for a growing proportion of the working-age population.** During the 1990s, known as the baby boom period, Cambodia experienced its greatest population growth with high fertility rates, but also high infant mortality (Figure A3.1). Since then, the total fertility rate per woman had declined significantly from 4.69 in 1995 to 2.56 in 2016, along with a corresponding decline in the infant mortality rate from 86.8 to 26.3 in the same period. This development has led to subsequent changes in the population age structure with a fast-growing working-age population and a sharp drop in total dependency ratio[54] (Figure A3.2). With people below the age of 30 accounting for 59 percent of the total population in 2018 (Figure A3.3), Cambodia's population had grown robustly at an average 1.7 percent per year in 2000-2017, during which working-age population grew faster by 2.4 percent per year, reaching 64 percent of the population in 2018.

**Figure A3.1 Fertility and Infant Mortality**




Source: United Nations World Population Prospects

**Figure A3.2 Total Dependency Ratio and Proportion of Working-age Population**




Source: United Nations World Population Prospects

[50] Prepared by Tanyasorn Ekapirak

[51] Old-age dependency ratio is the proportion of 65-year-olds and above to the working-age population, while young dependency ratio is the proportion of 0-14-year-olds to the working-age population. In Cambodia, these ratios are 7.1 and 48.6 respectively. The corresponding average ratios are 9.6 and 38.4 in ASEAN, and 9.6 and 36.8 in the CLMV, respectively.

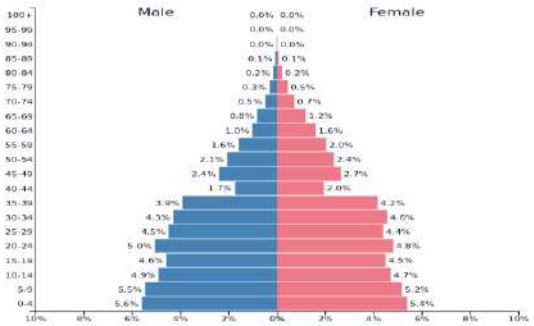
[52] The United Nations Population Fund defines the demographic dividend as "the economic growth potential that can result from shifts in a population's age structure, mainly when the share of the working-age population (15 to 64) is larger than the non-working-age share of the population (14 and younger, and older than 64)."

[53] MENA Generation 2030 (https://www.unicef.org/mena/media/4141/file)

[54] Sum of old-age dependency ratio and young dependency ratio.

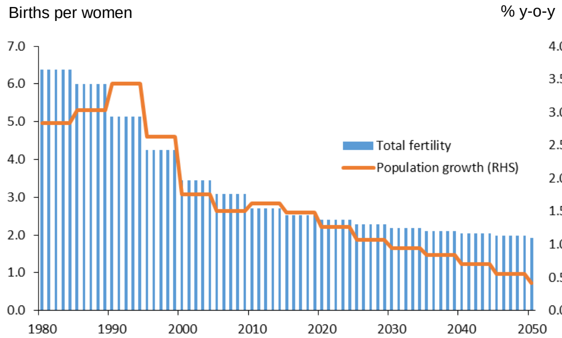
3. **Cambodia's favorable demographic structure is expected to continue for a few more decades.** The fast-increasing young population has led to a sharp decline in the under 15-years of age proportion while the proportion of the elderly has remained low although it is slowly rising.[55] With the fertility rate projected to remain above the replacement rate of 2.1 children per woman until 2039, the share of working-age population is projected to continue to rise, peaking at about 70 percent in 2045 (Figures A3.2, A3.4). Given the projected future population trends, Cambodia's demographic structure is likely to remain favourable until 2045, and the entry of local youth into the labour market will continue to serve as an important resource for strong growth.

**Figure A3.3 Population Pyramid by Sex, 2018**



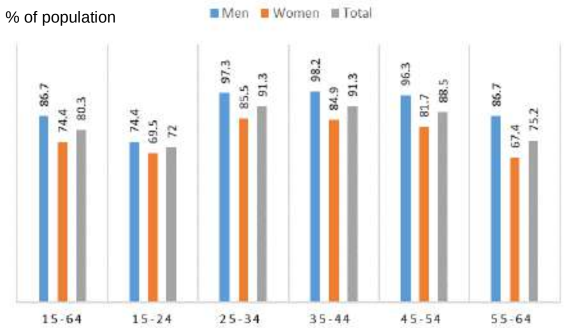

Source: United Nations World Population Prospects

**Figure A3.4 Fertility and Population Growth Projection**



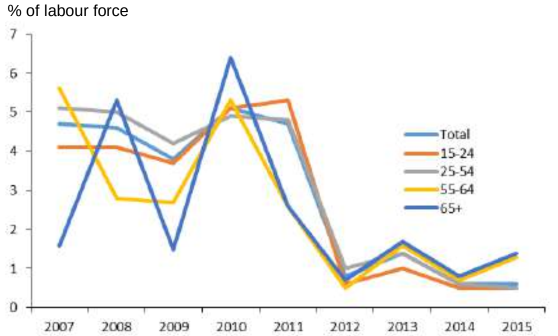

Source: United Nations World Population Prospects

**Figure A3.5 Labor Force Participation Rate by Age and Sex, 2016**




Source: International Labor Organization

**Figure A3.6 Unemployment Rates by Age Group**




Source: International Labor Organization

4. **The fast-growing working-age population provides opportunities but strong policy supports are needed to maximize the benefits.** So far, Cambodia has been successful in creating enough jobs to absorb the growing working-age population, including youth and women employment (Figures A3.5, A3.6). However, to better exploit the benefits of the demographic dividend[56], upgrading its economic structure will be essential in addition to

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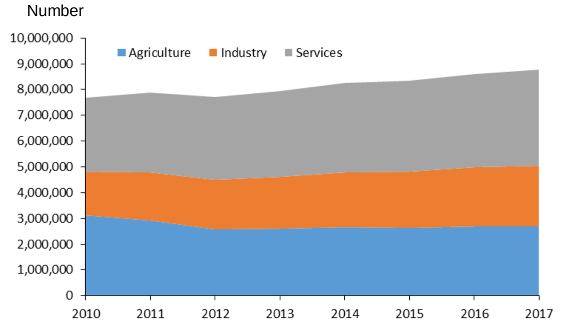
[55] The proportion of under 15-years of age declined from 46.5 percent in 1995 to 31.6 percent in 2015, and is projected to fall further to 22.3 percent in 2045. On the other hand, the proportion of elderly rose from just 3.0 percent in 1995 to 4.1 percent in 2015 and is projected to rise to 8.6 percent by 2045.

[56] Demographic dividend refers to the accelerated economic growth with changes in the age structure of a country's population as its transitions to relatively low children and elderly dependence rates and abundant labor force.

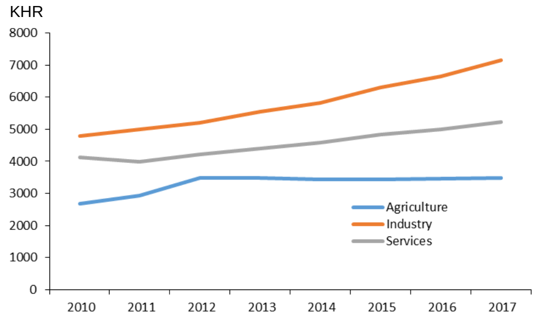
robust economic growth. Existing low-productivity sectors, like traditional agriculture, have limited capacity in creating new jobs and adding high values. Structural transformation toward more productive sectors and a diversification of the economic base will help to increase the benefits of a growing young population by creating more job opportunities in higher value-added sectors[57] (Figures A3.7, A3.8). While creating conducive environments to facilitate structural transformation, additional policy supports are required to enhance quality labour supply to facilitate this transformation process. Producing a sufficient supply of quality labour requires long-term planning and costly investment in human capital, and the benefits of taking early policy action could be magnified under Cambodia's current favourable demographic trend. Policy measures to improve education and skills training which are better aligned with the growing job opportunities will help the new generations of workforce to better meet the evolving requirements of employers (Box A3).

**Figure A3.7 Employment by Sector**




Source: International Labor Organization

**Figure A3.8 GDP per Worker by Sector**




Source: National Institute of Statistics of Cambodia

**Box A3 Closing the Gap: Cambodia's Human Capital Investment**

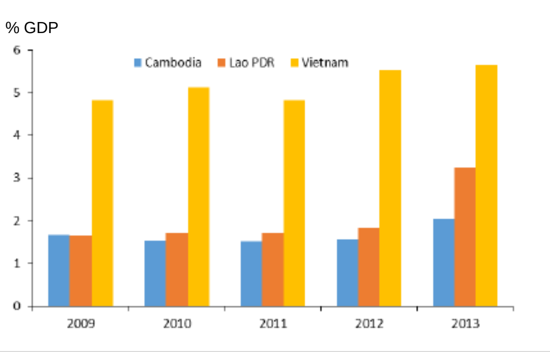
**Cambodia's education and training of its citizen are rated relatively poor.** The World Economic Forum[58] ranked Cambodia 92nd out of 130 countries in terms of human capital development in 2017, up from 100th in 2016. Although slightly improved, Cambodia's ranking is still relatively low and fell behind its regional peers. Myanmar improved to 90th from 109th in 2016, and Laos also made significant progress, improving from 106th to 84th.

**Cambodia's relatively low labor productivity reflects its low human capital base and low-value-added economic structure.** Low levels of education are increasingly restricting economic diversification and upgrading. Cambodia's economy still relies heavily on low-value-added industries, mainly agriculture, garments, and construction. With low public investment in human capital (Figure A3.1) and the attraction of short-term pecuniary gains in working, most employees have only primary or secondary education. Therefore, while the number of industry jobs is increasing, Cambodia's labor productivity level and its growth have remained relatively low compared with neighboring peers (Figure A3.2). To accelerate economic growth and structural transformation, Cambodia needs to invest more in capacity building and enhance its human resource development while creating sufficient employment opportunities.

[57] The Okun coefficients (the elasticity of employment growth to real GDP growth) estimated for Cambodia are -0.54, 0.42, and 0.36 for the agriculture sector, the industry sector, and the service sector respectively.

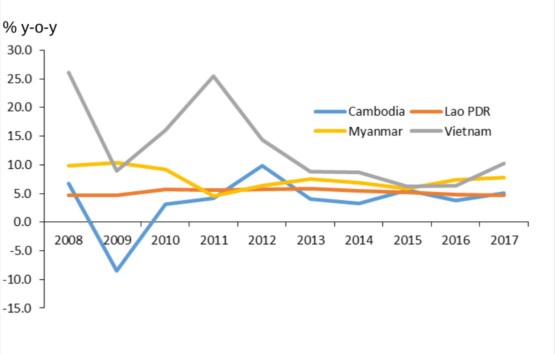
[58] The World Economic Forum's Global Human Capital Report (2017). The World Economic Forum gave Cambodia the poorest score in ASEAN for educating and training its citizens to develop a competitive workforce and put their skills to productive use.

**Figure A3.1. Government Expenditure on Education[59]**



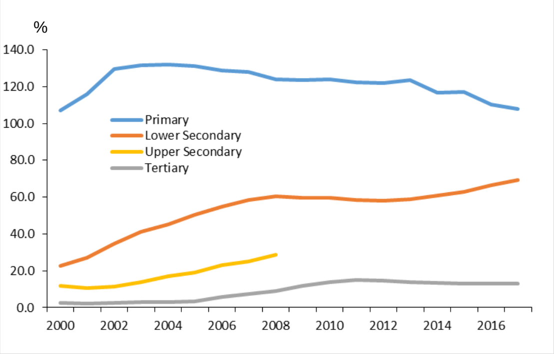

Source: UNESCO

**Figure A3.2. Labor Productivity Growth**




Source: CEIC

**Figure A3.3. Education Enrollment Rates**

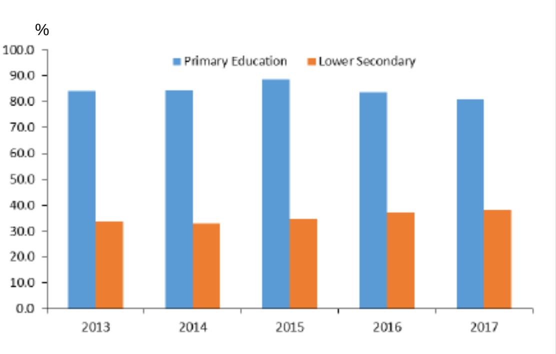



Note: 1/ The primary school enrollment rate exceeds 100% due to the inclusion of overage and underage students who started school either later or earlier than their peers. It also includes repeat students.

2/ Upper secondary school enrollment rate data was discontinued in 2008.

Source: UNESCO

**Figure A3.4 Gross Graduation Ratio**




Source: UNESCO

**Better education and training are essential.** Given the importance of better education, enhancing the education enrollment rate is becoming more challenging as the economic returns of education in Cambodia have been diminishing.[60] Although the net secondary enrollment ratio increased significantly from 22 percent in 2000 to 69 percent in 2017, the rate is still below other low- and middle-income economies[61] (Figure A3.3). Amid the low enrollment rate, the graduation rate has also remained low, at less than 40 percent of lower secondary enrollment (Figure A3.4). In addition to general education, workforce with proper skills is another area in need of improvement, where on the job training can play an important role to enhance the productivity at work. According to surveys, more than 40 percent of workers lacked sufficient education and training to complete their work well[62] and only 13.5 percent have received appropriate training.[63]

[59] Data for Myanmar is available only in 2017 (2.16 percent).

[60] Montenegro, C. E. and Patrinos, H. A. "Comparable Estimates of Returns to Schooling around the World". The World Bank Group: Policy Research Working Paper 7020, 2014. September 2015.

[61] According to the World Bank, the average net secondary enrollment ratio for low- and middle-income economies is 71 percent in 2017.

[62] ADB & ILO (2015). Cambodia Addressing the Skills Gap: Diagnostic Study.

[63] Ministry of Planning (2015).

**Technical and vocational education and training (TVET) needs to be upgraded to properly address the human resource gap.** Supported by development partners[64], the government has established a task force to develop new curricula and strategies to improve TVET. A national training fund was allocated to expand the coverage of TVET, establishing technical and vocational centers in all provinces. However, TVET's effectiveness in promoting youth employment is limited by the low perception of parents and students, the ineligibility of many young people for TVET certificate courses[65], high dropout rates, and insufficient industry engagement. According to the ADB[66], the TVET system currently provides an annual supply of suitable graduates of less than 0.1 percent of vacancies (2,500 qualified graduates per year). In order to enhance the effectiveness of TVET, the government should focus on strengthening collaboration between the private and public sectors in developing and implementing capacity-building programs that are more responsive to labor market demand. Changing the negative image of TVET will take time and can be reversed only by improving the quality of the programs.

[64] ILO, UNDP and JICA.

[65] The minimum entry requirement for a TVET certificate training course is successful completion of lower secondary school.

[66] ABD (2016). Policy Priorities for a More Responsive Technical and Vocational Education and Training System in Cambodia.