

Economic Development in Post-War Cambodia Outline

¹Sophanarith KIM, ²Nophea KIM Phat and ³Masao KOIKE

Summary

A centrally planned economic was adopted in Cambodia from 1980s until 1991 when all political factions came to a peace agreement in France. Although attempts at reform start modestly in 1985, momentum was made after 1992, Initial reform was supported by the fund called Systemic Transportation Facility and the later under the Enhanced Structural Adjustment Facility. Progress has been made in moving toward a free market-oriented economy, with state owned enterprises now accounting for less than 10% of GDP. To accelerate economic development in Cambodia, the government adopted their first social economic development plan (1996-2000) with a view to consolidating the development progress. This report tries to outline the major economic development and reforms in Cambodia, based primarily on reports of the International Monetary Found (IMF).

Key words : macroeconomic, economic reform, structural economy and Population growth

1. Introduction

Cambodia has land area of 181,035 square kilometers in the southwestern part the Indochina peninsula, about 20% of which are used for agriculture. The capital is Phnom Penh. International border is shared with Thailand, Laos on the west and on the north and Vietnam on the east and the southeast. The country is bounded on the southwest by Gulf of Thailand. In comparison with it are neighbors, Cambodia is geographically compact country administratively composed of 21 provinces, three of which have relatively short maritime boundary, 2 municipalities, 172 districts, 1,547 communes. The country has coastline of 435 km. With an estimate 11.8 million people⁵⁾, approximately 85-90% of the population lives in rural areas. Ethnically the population consists of about 90% Khmer, 5% each of Chinese and Vietnamese and small number of hill tribes (Chams and Burmese). Khmer is the country's official language. Since the Paris Peace Accord in 1991, Cambodia has made great efforts to reform and develop the economic structures in Cambodia. This report tries to outline the major economic development and reforms in Cambodia, based primarily on reports of the IMF and World Bank (WB).

2. Economic Reforms in Cambodia

2.1. Macroeconomic development

The Cambodian economy is at a critical pass. To the strain caused by the transition from central planning to a market economy, which the country shares with all economic transition, the burden of the war has been added. It is macroeconomic development reflects the country emergence from almost two decades of armed conflict and isolation to the changing world economy. While most of the farmer

¹ Research Student. Faculty of Agriculture. Shinshu University

² Doctoral Program in Agricultural Science. United Graduate School of Agricultural Science. Gifu University/Laboratory in Shinshu University

³ Faculty of Agricultural Science, Shinshu University

centrally planned economics have had access to various forms of foreign assistance to smooth the impact of the reform on output and living standards, Cambodia was cut off from foreign financial support and has had to fend for itself. It has seen an inordinate proportion of its resource and income directed toward financing conflict. The Cambodian economy has until recently also labored under the constraints imposed by the centrally planned, command and control approach to economic management. Although in many respects the progress made during the past decades in recovering from the devastation of the 1970s has been impressive, in the effect, a quarter of a century of progress has been lost.

2.1.1. Macroeconomic management

A program for economic and monetary policy—the policy framework paper and the Enhanced Structural Adjustment Facility (ESAF) for 1994–96—has been established by the royal government in cooperation with the IMF and WB in the order to reinforce the management capacity of public finances and to increase efficiency in the management of the state. Accordingly, macroeconomic stability has been largely restored through coherent and well defined economic, fiscal and monetary policies, while public sector reforms and the establishment of a legal and institutional framework continue. There are intended a favorable environment for the development of the private sector, and to enable it to become the driving force of for sustained and balanced economic growth as well as the springboard for improvement in the well being of the population.

2.1.2. Economic and financial situation

The Cambodian economy has witnessed strong growth since 1989, which facilitated the signing of the Paris peace accord in 1991 and has assisted its implementation since. Foreign investment has flowed in, mainly to construction and services but, increasingly, to manufacturing and processing. However, the departure of United Nations personnel at the end of 1993, and the natural disasters that occurred in the second half of 1994, both served to check earlier progress. Thus, Gross Domestic Products (GDP) rose by 3.6% in real forms in 1993 and by 5.2% in 1994, after the robust increases of 7.6% in 1991, and 7% in 1992. The GDP growth in 1994 of 5.2% instead of the 7–8% expected was a direct result of calamities in late 1994, and destruction of much of the rice crop. However, the growth that has taken place has been both uneven and unsustainable. During the period 1991–94, for instance, the productive sectors contributed little to development per se. While population increase averaged 3% a year, for example, food production declined by 2% a year²⁾. Similarly, the manufacturing sector has not exhibited the growth expected of it, despite the importance resumption of foreign investment in the last two years. The satisfaction of domestic needs is still largely dependent on supplies from abroad.

2.1.3 Prices

Prior to the election of 1993, Cambodia witnessed three digits inflation under greater control, despite the increase in the price of foodstuffs attendant upon the drought and floods of late 1994. In 1994, inflation was some 30%, higher than the 18% originally expected, although it would have been far more moderate if the government had had the mean to maintain stable rice prices³⁾. In fact, according to ministry of economy and finance estimate inflation during 1994 would have been only 7.2% if the price of rice had not exploded during late 1994: below target of cent fixed jointly by the government and IMF. In 1995, the royal government is projecting an increase in retail prices of 10%.

2.1.4. Money and banking

Success on the inflation is the direct result of pursuing tight monetary and budgetary policy. In 1994, increase in liquidity and the other main monetary aggregates was well within established targets. There

was again no net recourse to the banking system to finance the budget and, despite certain political events, meeting monetary target has help to allow the Riel to appreciate against the dollar since, mid-1993 and to depreciate just 5% during 1994. The performance of the balance of payments has been better than expected. The reserves of the National Bank of Cambodia and the foreign trade bank has reached the equivalence of 3 months of imports of goods and services by end 1994, compared with the forecast of 2 months. The Royal government will continue to pursue a monetary policy designed to curb inflation by significantly reducing the rate, of increase in liquidity and net domestic credit, and continuing to avoid recourse to the banking system to finance the budget.

2.2. Structures of the Cambodian economy

2.2.1. Agriculture

The main domestic activity on which most rural household depend is agriculture and its related sub-sectors. Agriculture contributes about half of the country is GDP and employs about 80% of the labor force. Agriculture has been growing at an average rate of 2% over 1991-94. Not only is agriculture the largest primary sector of the Cambodian economy (compared with industry and services), but in the last few years its pace of development has been satisfactorily in creasing. Not surprisingly, however, because of the long term influence of administered pricing and output targeting arrangements, the current value performance of deferent commodities is mixed. In the time of the record current of both gross and net output, crops (63%), livestock (26%), fishing (8%) and forestry (3%)²⁾.

2.2.2. Industry and mines

Industrial value added remains at relatively low 17% of GDP ³⁾, although it is growing at a more rapid pace than agriculture (over 10% on average over the last four years). Mining activities are minimal. In the early 1970s, the following were being mined: clay (for ceramics), dolomite (for glassmaking), gold, and limestone (for cement, phosphate, quartz, sapphire, ruby, silica sand, and other precious stones Extraction was on a very small scale. With the exception of gemstones (Pailin mine) and gold, exploitation of most of these minerals has now reverted to artisan, method and goes largely unreported. The only exploration on any significant scale is that of oil and gas off the Gulf of Thailand and possibly in the mainland.

2.2.3. Services

The service sector has shown robust growth over the last four years. It accounts for about 35% of GDP, and s heavily concentrated on trading activities (15% of GDP) and on catering related services⁴⁾. The growth has been driven by the expansion in wholesale and retail trade as the economy has moved toward a more open market system. Somewhat surprisingly, the increase on output of the transport and communication sector (over 10% per year in the 1991-93) did not keep pace with distribution services, tending instead to develop almost exactly in line with trend in real GDP. Physical supply constraints, the lack of security, or simply under reporting may account for this. The government, although a major employer, contributes comparatively little to GDP (roughly 4%), partly because salaries, which form a large share of total official outlays have remained depressed

2.3. Reform measures to sustain growth

The key reform measure was probably the restoration of private ownership in 1989, which resulted in the abandonment of collective reduction in non-plantation agriculture organized under solidarity groups. In addition, the role of prices in the economic allocation system as changed and all prices have been brought closer to international prices. The two-tier price system for rice, introduced in 1984, under which farmers were taxed indirectly by being compelled to sell a portion of their output to the state at below market prices, was abolished on 1989. Market prices were formally decontrolled and enforced

official procurement came to an end, although the state continued to purchase rice, but at considerably higher prices. Commodity prices are now essentially market determined (although sometimes under monopoly control), and are open to the influence of international prices. Direct subsidies for commodity purchases have been virtually eliminated.

2.3.1. Changing role of public and private sectors

From 1975 to 1979, private property rights were abolished and property records were destroyed. Faced with the challenge of rebuilding the economy, the administration that inherited this situation in 1979 kept real estate, natural resources, and all substantial enterprises under state ownership. In 1989, it launched a broad reform program which gave state enterprises greater autonomy and strict budget constraints, allowing for the privatization of state enterprises and other assets under close supervision, and encouraged foreign and local private investment. In Phnom Penh and other center urban centers the mushrooming of dynamic private business is evident, in particular in construction, commerce, cottage industry, and miscellaneous services. State enterprises have also been withdrawing from downstream activities and are even leaving areas such as the retail distribution of energy (in Phnom Penh) to private wholesalers. Foreign investors have bought or leased most of the privatized enterprises (most of these are medium-scale industrial ventures).

2.3.2. Public financial reform

The primary reform concerns the management of public finance initiated during the preparation and execution of the 1994 budget, with technical assistance from WB and accord with IMF recommendation. The accounting unit responsible for administering government revenue and expenditure is in place. And a new operational classification corresponding to accepted international practice has been adopted. The new budgetary system has optimized the availability of public resources, guaranteed an efficient allocation of resources, and reinforced control over the use of public resources. It has also become an important instrument for economic and financial policy, in that it supports the proper functioning of public services and the implementation of government programs on the one hand, and the maintenance of fundamental balance in the country accounts on the other. In order to increase domestic receipts and to optimize the reorganization of the country's revenue, reforms in the area of taxes, customs legislation and duties, and the budget control system have thus been started. Income tax, company profits tax and property tax have been introduced, while customs reforms have included reforms in the customs code and of the tariff system.

- Money and banking reform

For money and banking, the key elements of reform pertain to the autonomy of the National Bank of Cambodia. Modern tools allowing the National Bank to intervene in the exchange rate market in order to control fluctuations will be established. Minimum reserve requirements, and rules concerning the determination of interest rates as well as banking supervision, will also be introduced. In the coming years, the Royal government will continue with its reform processes, aiming at the dedollarization of the national currency and strengthening the development of the banking sector. An autonomous National Bank will be established, and treasury Bonds as well as other monetary instruments will be introduced.

- Exchange rate reform:

The official rate has moved within 5% of the market rate and government has successfully taken steps to further narrow the spread by just 1%. Since September 1993, the royal government has been implementing a vast program of reform in the public sector, and such efforts will continue in order to foster a better

environment for macroeconomic stability and the country into the regional and world economic community.

2.3.3. Limits to macroeconomic reform

These reforms will be effective only if economic growth can be maintained, with the speedy implementation of assistance programs to make state institution more effective instruments of public policy, and in the area of infrastructure projects.

This relates to determining the nature of national priorities but, in Cambodia, project choice has also to be exercised by our partners following their own institutional or national mandates. But, since June 1992, while this country has nevertheless witnessed extreme difficulty in trying to improve basic living conditions and provides education and primary health care to the population. Moreover, infrastructure projects for the transportation of people and goods in the provinces, as well as projects to diversify family employment opportunities, have sometimes been blocked by the local funding limits imposed by the national budget.

2.4. Concepts underlying Cambodian development

After the Pol Pot's genocidal regime and almost two decades of warfare, Cambodia urgently needs to rehabilitate and develop all sectors of its economy and society. As every sector and sphere is as important as the others and as they are inter-kinked in the a complex way. There are a need to develop a comprehensive strategy for economic and social development to assure self-sustainability, coherence, complement in the well being of the people complementary and synergy among them. To ensure the development of the country and an improvement in the well being of the people, the Royal Government has committed itself to a long-term undertaking, an undertaking that will fundamentally change our ways and require the mobilization of all the national resources.

In the context of developing the rural areas of the country, the royal government is attaching priority to increase in agricultural output, the rehabilitation of irrigation and drainage systems : reconstruction of the transport and communications networks to facilitate the flow of goods : the provision of universal access to primary education and basic health care, including demeaning, to ensure the development of human resource base : and the management of sustainable resource use.

The Royal government needs to strengthen security and social equity to achieve its development objectives whole, in the long term, it needs development to guarantee continuing security, political stability and social cohesion. In the meantime, the Royal government's military action to address security problems is merely a temporary solution to the issue.

3. Conclusion

Cambodia is an integrated territory under one government for the first time in three decades. In this more stable political environment, the government formed in November 1998 is now in a posotion to renew its economic and structural reform program, with substantial support from the international community. Progress was made in the half of the 1990s resulting in financial stability and start of economic reconstruction. However, much remains to be done to build basic economic and social institutions and attain their sustainable development. As legacy of the past, administrative and institutional capacities are weak, and Cambodia's need for external support remained considerable. The goals of the government's reform program are poverty alleviation and the achievement of sustainable economic growth. Building on recent initiatives, the government's medium-term strategy will focus in achieving lasting improvements in the

structure of the public finances and in public resource management, in particular forestry, all in close collaboration with international financial institution, bilateral donors, and civil society. The program will also aim at rebuilding basic institutions, and undertaking related structural reforms, to create a secure environment for the private sector. The government has recently taken additional measures to attain a sustainable economic development.

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