FOREIGN ECONOMIC TRENDS

CAMBODIA

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Foreign Economic Trends Report for Cambodia

Table of Contents Page

Foreign Economic Trend Report, Cambodia

I. Major Trends and Outlook

Cambodia is a developing country with a market economy. GDP in 1999 was 11.96 trillion Cambodian Riel (about $3.1 billion), or $268 per capita, among the lowest levels in the world. Informal estimates in terms of purchasing power parity put the standard of living in the range of $1500 per year. Once one of south east Asia's most stable and prosperous countries, Cambodia's social and economic institutions were severely disrupted by the agrarian collectivist policies of the Khmer Rouge regime from 1975-79, and the period of communist central planning that followed under the Vietnamese-backed People's Republic of Kampuchea. The Cambodian government officially adopted market economics in 1989, but it was not until after the 1991 Paris Peace accords, which led to the re-establishment of the constitutional monarchy in 1993, that the economy began to grow.

From 1993 to 1996 Cambodia's GDP grew at an average rate of 7.2% from $1.9 to $3.1 billion. However, GDP growth slowed substantially in mid-1997 following the July 5-6 factional fighting in Phnom Penh and the onset of the Asian financial crisis, increasing by just one percent in real terms in 1997 and 1998. The slowdown in economic growth coupled with continued high population growth led to a decline in Cambodia's per capita GDP from $292 in 1996 to $252 in 1998. Political stability returned to Cambodia in late 1998 with the establishment of the current coalition government, and economic growth resumed at a rate of 4.3% in 1999, exceeding government expectations. The Ministry of Economy and Finance (MEF) forecasts a higher rate of 5.5% for the year 2000.

Since 1993, the Royal Government of Cambodia has undertaken a serious program of economic reform with assistance from the IMF, World Bank, ADB, UNDP and other bilateral and multilateral donors. Even during the period of political disruption and poor economic performance in 1997-98, the government maintained macroeconomic stability through generally tight monetary and fiscal policies. Although inflation increased from its 1995 low of 3.5 percent, it remained under control at 9 percent in 1997 and 13.5 percent in 1998. MEF reports that there was zero inflation in 1999. Cambodia's currency has been relatively stable since 1993, with the exception of a sharp depreciation in 1997-98. The annual average exchange rate for 1999 was 3,800 riels/US$1. Maintaining a stable exchange rate is a priority of Cambodia's current IMF program. Cambodia's economy is also heavily dollarized, with the U.S. dollar accounting for an estimated 70 percent of total liquidity in the country.

The Cambodian government's reform program is highly detailed and closely monitored by the donor community. Cambodia made considerable progress in 1999 in improving control of the forestry sector, beginning with a successful crackdown on illegal logging which the government has sustained into 2000. The Cambodian government is now in the process of re-defining its entire forestry management system. Cambodia also made considerable progress toward reducing the size of its military. A pilot demobilisation in May 2000 kicked off a three-year effort to demobilise over 30,000 soldiers, a step, which is necessary in order to free up budgetary resources for social sector spending. The government improved its revenue collections through the successful implementation of a value added tax in early 1999, but at about 12% of GDP Cambodian government revenues are low even by developing country standards. This impediment to increased public spending investment means that Cambodia remains heavily reliant on foreign assistance for every aspect of national reconstruction. In October 1999, Cambodia secured the first installment of an $81.6 million IMF Poverty Reduction and Growth Facility loan, and the World Bank approved a Structural Adjustment Credit worth $30 million in February 2000.

At a donors' Coordinating Group meeting in May 2000, donors pledged $548 million in support for the Cambodian government's reform program for the coming year. The subject of "good governance" became a major theme of the reform process in 1999, and the government has produced an action plan to address such issues as civil service reform, judicial and legal reform, improving the quality of public services and attacking corruption. Donors will monitor progress on these issues, as well as the more traditional aspects of economic reform, as conditions for their continued assistance.

Cambodia ran a trade deficit of $341 million in 1999. With no energy and little domestic industry, Cambodia's major imports include petroleum products, cement and construction materials, vehicles, tobacco and broad range of consumer products. Garments dominate Cambodia's exports, accounting for over $640 million in 1999, or 89% of total exports. More than three-quarters of Cambodian garment exports go to the United States. The garment industry has been Cambodia's greatest success, growing from seven factories exporting $4 million in 1994 to about 200 factories today, employing roughly 100,000 workers, mostly young women. Other principal Cambodian exports include timber and wood products, latex and rubber, and fishery products.

Cambodia and the U.S. have full and expanding trade relations. The U.S. lifted the embargo on trade with Cambodia on January 2, 1992. After legislative action by Congress in September 1996, Normal Trade Relations (NTR) were established between the U.S. and Cambodia in October 1996 upon the signing of a comprehensive Agreement on Trade Relations and Intellectual Property Rights Protection. President Clinton subsequently designated Cambodia as a Least Developed Beneficiary Developing Country under the U.S. Generalized System of Preferences (GSP) program on May 30, 1997. Cambodia and the U.S. signed a three-year bilateral textile agreement on January 21, 1999 that sets export limitations on 12 categories of textile and apparel products. This textile agreement is likely to slow the growth of Cambodian apparel exports to the United States. U.S. exports to Cambodia are likely to remain modest for the near term. The U.S. exported approximately $37.5 million worth of goods to Cambodia in 1999, including used vehicles and spare parts, cigarettes, and used clothing.

A key component of the Cambodian government's reform program is to improve Cambodia's attractiveness as a destination for foreign direct investment (FDI) in order to enhance economic growth. Although Cambodia's Law on Investment establishes an open and liberal foreign investment regime, FDI dropped substantially with the political instability of 1997, and has not fully recovered. The Council for the Development of Cambodia, the government's investment agency, reports that new investment commitments dropped significantly to only $482 million in 1999, compared to over $800 million per year between 1996 and 1998, and that figures for the first three months of 2000 totaling $31.6 million, are far below commitments in the same period of 1999. Some analysts attribute at least some of this decline to the CDC's improved screening of investment licenses, but a particularly steep drop in new garment factories is also evident, a result of the U.S. decision to impose quota on Cambodian garment products.

According to the MEF, Cambodia attracted $160 in FDI flows in 1999, an improvement over 1998, which probably reflects a surge of investment in the tourism industry. U.S. investment in Cambodia to date has been modest, with the largest investors including Caltex for a chain of service stations and a terminal in Sihanoukville, Northbridge Associates for an international school and residential property, and Shelby corporation for a glove manufacturing facility. There are currently over 100 U.S. companies and companies representing U.S. products and services operating in Cambodia.

Cambodia is a member of ASEAN and the Asian Free Trade Area. Cambodia has begun the process of accession to the WTO.

II. Principal Growth Sectors

Agriculture: The agricultural sector, including rice farming, livestock, forestry, and cultivation of other crops, provides direct employment to more than 75 percent of Cambodia's labor force. According to the MEF, agriculture accounted for 37% of GDP in 1999. Excellent rice harvests in 1999 contributed to Cambodia's better-than-expected economic growth. With its large amount of arable land, ample rainfall, and close proximity to the major ASEAN markets of Thailand and Vietnam, Cambodia has strong growth potential in the agriculture sector. A number of plantation agriculture projects are already underway in the areas of palm oil, cashew, coffee, tea, and vegetable production.

The Government has taken note of the growth potential of the sector as well as the important role increased agricultural production can play in reducing rural poverty in Cambodia, and has designated the Ministry of Agriculture, Forestry, and Fisheries as one of four priority ministries to receive expanded budgets. Factors limiting agricultural production include unclear land ownership, a lack of irrigation infrastructure, inadequate transportation infrastructure, inefficient marketing, poor farming practices and poor public sector support services.

Services: The services sector represented an estimated 43.2 percent of GDP in 1999, and grew by 8.1 percent during the year, and the government forecasts continued strong growth in the services sector for 2000. The Cambodian tourism industry is still relatively undeveloped, but the Ministry of Tourism estimates that tourist arrivals in Cambodia will grow by 20 percent annually from 1999-2000 and 35 percent annually from 2001-2002. Tourist arrivals increased 11% in 1999 over the previous year. Tourism is a preferred sector under Cambodia's foreign investment regulations.

Industry: Industrial growth has been dominated by the expanding garment manufacturing industry. As noted above, growth in the sub-sector is likely to slow in 2000 with the imposition of quota on Cambodian garment imports to the United States in 1999. Construction is also a strong player in the industrial sector, accounting for about a third of all industrial activity. Although construction only grew 4.9% in 1999, the MEF projects that the sub-sector will grow by about 12% a year for the next several years. Spending for infrastructure projects and for office and residential construction and rehabilitation will continue to fuel the growth of this sub-sector.

III. Government Role in the Economy

Cambodia has a free market economy. It has eliminated most non-tariff barriers to trade and screens investments only to award investment incentives. Cambodia's legal structure and government policies are intended to promote exports and attract investment.

Even in the communist era, the state-owned industrial base was never extensive, and the government began to sell and lease government assets as early as 1989. Under the terms of a privatisation agreement worked out with the IMF in 1994, a few additional state-owned enterprises were sold and many more were leased. The role of state-owned enterprises in the economy is not significant today.

Since its establishment in 1993, the Royal Government of Cambodia has adopted a budget statute and significantly increased the transparency of Government budget operations. On the other hand, more than 30 years of conflict have left Cambodia with a government budget heavily skewed toward defense and security expenditures, which together accounted for 42.7% percent of government spending in 1999. Freeing budget resources to address poverty reduction is the overriding goal of the government's reform program, and the Government has committed to significantly increase spending on the priority social sectors of health, education, agriculture, and rural development. However, line ministries complain that budgetary disbursements in these sectors lagged significantly in 1999, especially at the provincial level.

Cambodia is still in the process of developing a regulatory framework that will assure the health, safety, and wellbeing of individuals and companies operating in the free market economy. In the health sector, Cambodia has legislation regulating pharmacies and pharmaceuticals. In May 2000, the national assembly passed a law on quality of goods and services, comprising food safety, consumer protection and product liability. Government priorities for 1999 include passage of a new Land Law, a new Forestry Law, a Business Organisation Law and a Trademark Law by the end of the year.

IV. Balance of Payments

According to MEF, Cambodia's 1999 current account deficit, excluding official transfers (grant aid) was $362 million, or 11.6% of GDP. The deficit was financed mainly by official development assistance grants ($191 million) and loans ($45 million), and foreign direct investment ($160 million). As of the end of 1999, Cambodia's gross official reserves were equivalent to 3.5 months of imports.

Cambodia's foreign debt is equal to approximately $1.3 billion, the majority of which it owes to Russia for debts incurred to the countries of the former Council for Mutual Economic Assistance, including the Soviet Union. Cambodia has not yet reached agreement with the Russian Federation on repayment of its debt. Cambodia's second largest creditor is the United States. Cambodia signed a Terms of Reference with the Paris Club of creditor nations in 1995 awarding Cambodia's official debt the Club's most favorable terms (Naples terms). Based on these terms, the U.S. Government presented a draft bilateral debt rescheduling to the Cambodian government in 1995, but Cambodia has not yet signed the agreement.

The Cambodian government follows a market-oriented exchange rate policy. The National Bank of Cambodia (NBC) performs periodic foreign exchange auctions. Since the first auction in 1993, the spread between the official and free market rates has been kept to no more than 2 percent.

V. Infrastructure

Cambodia's infrastructure, which was almost completely destroyed after more than 20 years of warfare, civil strife and neglect, is slowly being restored. Power supply to the city of Phnom Penh has improved dramatically since 1993, and approximately 50 megawatts of power were added to serve the city during 1995 and 1996. Plans for Cambodia's first independent power production project, scheduled to provide another 60 megawatts of electrical power to the city, are nearing completion. According to the Cambodia Power Sector Strategy (1999-2016) developed by the Ministry of Industry, Mines, and Energy (MIME), annual electricity demand in Cambodia is projected to rise from 522GWh in 1998 to 2,634 GWh in 2016. To meet this demand, the government plans to develop $1 billion worth of hydro, gas turbine thermal, and combined cycle base load thermal generating plants in Phnom Penh, Sihanoukville, Battambang, and other cities from 2000 to 2010. The Cambodian government also plans to build a nation-wide transmission system during the same period. How Cambodia will finance development in the energy sector remains an open question.

The Cambodian government has not allocated significant budget resources to repairing the country's roads, nor has it worked out plans for private financing of road construction and repair. The highway system is therefore being rehabilitated through bilateral foreign assistance projects and multilateral loans, as they become available. Completion of the USAID-funded Route 4 rehabilitation project in late 1996 improved links between Phnom Penh and the deepwater port of Sihanoukville. Japan has rebuilt portions of routes 6 and 7 between Phnom Penh and Kampong Cham and is constructing a $57 million bridge over the Mekong River at Kampong Cham. The Asian Development Bank (ADB) has provided a $40 million loan to reconstruct Route 1 from the Neak Luang Ferry to the Vietnamese border by 2002. Other plans are in the works to rehabilitate portions of routes 3, 5, 6 and 7 with loans from the ADB and

World Bank. The Cambodian government also seeks investors to repair other portions of the national highway system under build-operate-transfer (BOT) terms. A Thai contractor is currently repairing route 5 between Poipet, on the Thai border, and Sisophon on BOT terms.

The river port of Phnom Penh has been upgraded, and Japan has provided assistance to improve the cargo terminal at the deepwater port of Sihanoukville. The upgrade will include a new, 1000-meter-long, 12-meter-deep pier designed for oil tankers up to 30,000 tons.

Reliable fixed line and mobile telephone service are available in Phnom Penh and most provincial cities, but is expensive compared to other countries in the region. Fixed-line service is provided by the Ministry of Posts and Telecommunications, where as three cellular and one wireless local loop systems compete for mobile service. There is one international gateway, the operation of which MPTC has licensed to Telstra of Australia. In October 2000, MPTC intends to open a second international gateway. Long distance telephone rates have fallen, with calls to the U.S. now costing approximately $3.80 per minute.

MPTC maintains a monopoly on Internet service in Cambodia, which it has licensed to two operators; its own subsidiary, Camnet, and a Bigpond, a joint venture with Telstra. The cost of Internet service has fallen to about $3 per hour, but still remains far above the means of most Cambodians. The potential for e-commerce in Cambodia is further constrained by the relative unreliability of the postal system, and fact that few Cambodians have credit cards.

VI. Economic Prospects:

Cambodia has resumed its economic expansion, and is working with donors to develop the economic, legal and government institutions to support an investment-friendly open market economy. This transformation should continue, as long as political stability is maintained, and the government remains willing and able to implement the reform program it has committed to.

VII. Key Economic Indicators:

Population: 11.7 million (1999)
Population Growth Rate: 2.9% (1999)
Land Area: 181,035 sq. kms
Religion: Buddhist (96%), Muslim (3%)
Government System: Constitutional Monarchy
Economic Style: open market economy
Language: Khmer. (English, Chinese, French widely spoken)

Growth and Production:
(Source: Ministry of Economy and Finance. All figures in US$ millions unless otherwise indicated.)

Item	1996	1997	1998	1999	2000*

Nominal GDP	3,123	3,033	2,868	3,131	3,430
Nominal GDP (billions of Riel)	8,250	9,100	10,900	11,960	13,034
Real GDP growth (annual increase)	7.0%	1.0%	1.0%	4.3%	5.5%
GDP per capita (US$)	292	276	252	268	279

Percentage of GDP by sector:
(Source: Ministry of Economy and Finance. All figures in US$ millions unless otherwise indicated.)

Sector	1996	1997	1998	1999	2000*
Agriculture	40.2%	41.1%	39.3%	37.0	35.8
Industry	18.2%	17.7%	17.5%	19.8%	21.0%
Services	41.5%	41.2%	41.2%	43.2%	43.5%

Growth rates of GDP sectors:
(Source: Ministry of Economy and Finance. All figures in US$ millions unless otherwise indicated.)

Sector	1996	1997	1998	1999	2000*
Agriculture	.8%	1.4%	-0.8%	n/a	2.6
Industry	17.9%	2.4%	7.8%	6.7	10.9
Services	10.7%	-0.1%	0.3%	8.1	6.2

Money and Labor
(Source: Cambodia Development Resource Institute, CDRI)

Items	1996	1997	1998	1999	2000*
Inflation (in Riel, final quarter basis)	9.0	9.1	12.6	0.0	4.0
Exchange rate (Riel per US$, annual average)	2,641	3,000	3,800	3,820	3,800
Population (million)	10.7	11.0	11.4	11.7	12.0
Labor force (% of population)	47.4	47.1	46.7	46.3	45.9

Balance of Payments:
(Source: Ministry of Economy and Finance. All figures in US$ millions unless otherwise indicated.)

Year	1996	1997	1998	1999	2000*
Trade Balance	-529	-356	-345	-361	-443
--domestic export	347	517	612	720	737

--retained import	875	873	957	1080	1188
--re-export	361	250	130	120	110
Service Balance	-11	12	-9	-31	-29
Other	23	25	30	30	30
Current Balance	-517	-319	-324	-362	-442
--official transfer	299	200	195	191	195
Net Current Balance	-218	-119	-129	-171	-247
Capital Account	257	135	139	185	277
--net loans	56	38	46	45	107

Balance of Payments (cont'd)

Year	1996	1997	1998	1999	2000*
--net private	240	150	120	160	180
--FDI	240	150	120	160	180
Overall Balance	39	16	10	15	31

Foreign Investment

(Sources: CDC for Investment Commitments, MEF for FDI)

Year	1995	1996	1997	1998	1999
Investment Commitments	2,641	862	811	833	482
FDI	151	240	150	120	160

* Forecast