Development Finance Assessment Snapshot

Cambodia

Financing the future with an integrated national financing framework

Cambodia’s Industrial Development Policy and the modernization of the rural economy
Cambodia: Financing the future with an integrated national financing framework

This report was commissioned by UNDP’s Regional Bureau for Asia and the Pacific as part of the preparations for the China-UNDP ASEAN Symposium on Financing the Implementation of the SDGs in ASEAN, held in Chang Rai, Thailand in August 2017. This report also fed into a regional report on Financing the Implementation of the Sustainable Development Goals in ASEAN. All studies were overseen and supported by UNDP, with generous support from China.

Disclaimer: The views presented in this report do not necessarily represent the views of UNDP or the Government of Cambodia.
# Table of Contents

1. Introduction 1

2. Socio-economic and political context 3

   2.1 Population growth: Opportunities and challenges 7

   2.2 Modernisation of the agricultural sector 7

   2.3 Moving forward 9

3. Policy objectives and overarching development planning framework 11

4. The Industrial Development Policy as a guiding framework for Cambodia’s economic transformation 13

   4.1 The Rice Policy: a complementary effort to modernize the agricultural sector 14

   4.2 The Industrial Development Policy and agro-industry 16

5. Developing special economic zones to support key sectors: manufacturing and agro-processing 18

   5.1 Current performance of Cambodia’s SEZs 18

   5.2 Designing SEZ programmes 19

   5.3 Regional influences 20

6. Financing economic transformation 22

   6.1 Assessing overall future resource availability and investment needs 22

   6.2 Anticipating the impacts of MIC progression and LDC graduation on concessional finance 27

   6.3 Strengthening public investment management 28

   6.4 Using public resources to catalyse private investment 29

   6.5 Stimulating private sector engagement in the IDP and agro-industry 29

7. Roadmap towards an integrated national financing framework 32

   7.1 Incorporating the SDGs into the RGC’s development vision 32

   7.2 Importance of coordinated, results-focused M&E frameworks 33

   7.3 Accountability and dialogue 34

8. Findings and recommendations 36

   8.1 Strategic management of resources and partnerships 36

   8.2 Government reforms 36

   8.3 Mobilising partners and resources 37

Annex 1: Overview of estimates of total expenditure requirements according to the NSDP 2014–2018 39
List of tables

Table 1 Development finance projections 2015–2025 23
Table 2 Cambodia’s performance on LDC graduation criteria for the past two reviews 27

List of figures

Figure 1 Contributors to economic growth in Cambodia (% of GDP) 3
Figure 1.1 Progress towards attaining the Cambodia Millennium Development Goals 4
Figure 1.2 Comparisons between incomes and poverty rates 6
Figure 2 Growth rates for labour force 7
Figure 2.1 Sector growth rates 8
Figure 3 Rectangular Strategy 2014-2018: National development priorities 11
Figure 4 The Rice Policy - Increasing yields and processing rice for export 14
Figure 4.1 The Rice Policy focuses on increasing yields and processing rice paddy for export 15
Figure 5 Available development finance 24
Figure 5.1 Finance flows and 2025 projections (% of GDP) 24
Figure 5.2 Total domestic revenue (% of GDP) 25
Figure 5.3 Regional revenue comparison (% of GDP) 25
Figure 5.4 Government budget and levels of external assistance 26
Figure 5.5 The progress of the private sector 30
Figure 5.6 Comparisons of indebtedness and institutional lending 31
1. Introduction

Across Cambodia and the Association of Southeast Asian Nations (ASEAN) region as a whole, ambitions are high for the sustainable development progress that can be achieved in the era of the Sustainable Development Goals (SDGs). Realizing these ambitions will require mobilizing the right scale and mix of financing, incorporating all resources—public and private, domestic and international. This paper forms part of a project to assess the financing challenges and opportunities that ASEAN countries face and the policies and institutional frameworks that governments can use to address them in implementing the SDGs. It is one of 10 country studies undertaken alongside an ASEAN regional report.

In mid-2016 Cambodia joined the group of lower-middle-income countries, moving up from the low-income country group as its per capita income passed the US$1,045 threshold. As a newly classified middle-income country, Cambodia is seeking to consolidate and maintain its impressive track record of socio-economic progress in order to become a higher-middle-income country by 2030, and a fully developed economy by 2050. Its localization of the SDGs concretizes the commitment to “leaving no one behind”. Delivering the necessary finance to achieve the overarching objectives, including the SDGs, is central to this.

Implementation of the Rectangular Strategy (Cambodia’s overarching framework for development) has been impressive. Economic growth has averaged 7 percent annually over almost two decades and, with high levels of labour participation, this has resulted in high levels of economic inclusion and a dramatic decline in the national poverty rate, from more than 50 percent in 2004 to less than 13.5 percent in 2014. Cambodia has been widely—and deservedly—praised for having made significant progress in reaching many of the Cambodia Millennium Development Goal (CMDG) targets, as the benefits of growth have been widely distributed and service delivery has been strengthened through wide-ranging public sector reform programmes. However, challenges remain, especially in relation to poverty dimensions beyond income; unequal access to basic services—including health and social protection coverage; gender equality; and environmental degradation.

Action at the country level will be key to implementing the SDGs, Financing for Development and other global agendas. The Addis Ababa Action Agenda states: “[C]ohesive nationally owned sustainable development strategies, supported by integrated national financing frameworks, will be at the heart of our efforts.” The Inter-Agency Task Force on Financing for Development notes in its 2017 report that integrated national financing frameworks (INFFs), which take into consideration all financing sources and policies, can provide coherence across strategies and plans designed to implement the SDGs. An INFF is a framework of policies and institutional structures designed to take a holistic approach towards managing and mobilizing all types of financing—domestic, international, public and private—for sustainable development results. It has six building blocks, which work together to align a government’s financing strategy across all available resources. These frameworks provide a structure and a prompt for

---

governments to assess their financing frameworks as a whole and to guide thinking about reforms that are needed to strengthen these frameworks to implement a strategic, holistic, results-driven approach to financing development objectives.

A Development Finance Assessment (DFA) was recently carried out in Cambodia (2017), meaning that there are some differences in the scope of this paper compared with those of other country studies under this project. Building on existing research and studies, including the 2017 DFA, this paper focuses on the country’s economic transformation agenda and provides a concrete application of the INFF building blocks to the policies and processes related to this particular aspect of Cambodia’s overall development strategy. It therefore does not consider broader private sector development issues and aspects of “leaving no one behind” in the same way that other papers do. Additionally, there is less focus on analysis of the overall financing landscape, given the comprehensive review of this already included in the 2017 DFA; instead, the paper draws on the DFA and provides an update of relevant figures to analyse future resource availability against the capital investments needed to succeed in identified economic transformations and to maintain high economic growth rates.

The paper begins by setting out the socio-economic context (Chapter 2) in which the Royal Government of Cambodia (RGC)’s development policies and initiatives are being implemented. These are then described in subsequent chapters, including overarching development policy objectives (Chapter 3), the Industrial Development Policy (IDP), which represents the main policy platform for transforming economic management and production, including in the rural sector, over the period 2015–2025 (Chapter 4), and more focused policies related to key sectors highlighted in the IDP, namely manufacturing and agro-processing (Chapter 5). Chapter 6 then analyses the projected total available development finance against funding needs, and considers the relationship between public and private finance flows in financing economic transformation. In this context, the INFF lens is then applied to the country’s development planning process and existing systems and institutional arrangements for mobilizing the required financing (Chapter 7). Finally, given the importance of complementary public and private roles and partnerships, the paper identifies policy recommendations (Chapter 8) with respect to promoting structural reforms and leveraging public, private and blended finance to deliver on identified development targets.

---

2. Socio-economic and political context

Cambodia has made significant progress in implementing its socio-economic development agenda over the past two decades. Economic growth has averaged 7 percent annually over most of this period and, with high levels of labour participation, this has resulted in high levels of economic inclusion and a dramatic decline in the national poverty rate, from more than 50 percent in 2004 to less than 13.5 percent in 2014.

The main drivers of growth have been the garment sector (which employs 650,000 people and accounts for 75 percent of exports), real estate and construction, and hotels and tourism. Agriculture continues to account for over a quarter of gross domestic product (GDP), while employing almost half of the labour force.

Figure 1: Contributors to economic growth in Cambodia (% of GDP)

Recent international and regional policy developments have influenced the RGC’s policy priorities. Following significant progress made in implementing the CMDGs (Figure 1.1), the RGC is now also fully committed to the localization and implementation of the 2030 Sustainable Development Agenda with its 17 SDGs. At the regional level, Cambodia is fully engaged in the ASEAN Economic Community (AEC), which was formally established at the end of 2015.
A number of analyses agree that AEC membership should benefit Cambodia’s IDP through increasing industrial and trade linkages, as well as deepening physical and institutional connectivity with regional and intra-regional production networks and supply chains. However, the Rectangular Strategy notes: “[T]his will require better coordination and stronger human and institutional capacity as well as further strengthened connectivity in physical infrastructure and regulatory and institutional reform, to ensure that Cambodia will benefit from regional and global integration.”

**Figure 1.1: Progress towards attaining the Cambodia Millennium Development Goals**

---

In addition to halving the poverty rate and meeting CMDG 1, Cambodia has achieved its goals in primary school enrolment (CMDG 2), reducing infant and child mortality (CMDG 4) and reducing maternal mortality (CMDG 5). Excellent progress has been made in the prevention of HIV/AIDS (CMDG 6): in 2014, 89 percent of HIV/AIDS patients had access to antiretroviral treatment, a rate of coverage among the highest in the developing world. With strong mutual interests, both the RGC and donors have supported these impressive improvements in CMDGs 4, 5 and 6.\(^5\) CMDG 9, which focuses on removing landmines, has also recorded significant achievements, resulting in an 80 percent reduction in civilian causalities over the period 1995–2015. Other CMDGs, for example on accessing water and sanitation and on promoting gender equality, are also approaching their 2015 targets.

Advances in human development are consistent with the experience of the CMDGs, and they leave Cambodia well positioned to continue progress on SDG implementation and its commitment to leave no one behind. The country ranked first in the Asia-Pacific region (and seventh in the world) over the 1990–2015 period in terms of improving its human development rating, with its Human Development Index (HDI) value growing at 1.84 percent on average. However, its 2015 HDI value of 0.563 was below

the average for East Asia and Pacific countries, which stood at 0.721. Since 1995, life expectancy at birth in Cambodia has increased from 58 years to 72 years, and expected years of schooling have increased from 6.8 to 10.9 years. The growing number of young workers moving abroad, mainly to Thailand, has boosted remittances, which had a recorded value of over US$400 million in 2015. These advances in human development are reinforced by data on inequality, with the country’s Gini coefficient declining from 0.38 in 2004 to 0.29 in 2016.

Figure 1.2: Comparisons between incomes and poverty rates

Source. Ministry of Economy and Finance (2016), ‘Cambodia’s Macroeconomic Progress, a Journey of 25 Years’

2.1 Population growth: Opportunities and challenges

A demographic dividend (65 percent of the population is aged below 30), and a low level of dependency together with an expanding middle class, will create opportunities for Cambodia to sustain high economic growth over the next three decades (Figure 2). When the labour force grows more rapidly than the dependent population, it can drive economic development and improvements in family welfare. However, it is vital that these transient benefits are fully harnessed before trends are reversed.

Figure 2: Growth rates for labour force

![Graph showing growth rates for labour force]

Source: UN Population Statistics

Moreover, this growing and young population will also put pressure on the RGC to meet expanding employment and education needs. It is estimated that Cambodia's population will grow from 15.6 million to nearly 19 million by 2030, and to 22.5 million by 2050. The share of the working-age population is projected to peak at 48 percent of the total in 2040, representing about 10.5 million people, up from 6.4 million in 2015. This implies that the economy will have to create an additional 4 million jobs by 2050, equivalent to 125,000 new jobs annually. By 2030, an additional 6.5 million children will have gone through the education system.

2.2 Modernisation of the agricultural sector

More than 80 percent of Cambodia's estimated population of 15.6 million live in rural areas, and the sector remains vital for sustaining poverty reduction and securing economic inclusion. Agriculture directly employs about 45 percent of the population.
However, past high economic growth rates and patterns of activity have imposed a high burden on Cambodia’s forests, which are one of its few commercial and agricultural resources. Deforestation between 1990 and 2010 saw the country lose an estimated 22 percent of its forest cover, or around 2,850,000 hectares of forest. Since 2001 Cambodia has lost its forests more rapidly than any other country in the world, according to Global Forest Watch. Failure to address environmental degradation risks exacerbating poverty and undermining political stability, in addition to increasing the incidence of ‘new poverty’ in provinces rich in natural resources, depriving communities of their livelihoods.

The Ministry of Agriculture, Forestry and Fisheries is leading a national effort to increase growth in the agricultural sector to 5 percent annually. Based on the Agricultural Sector Strategic Development Plan (2014–2018), agriculture is to be modernized through efforts to increase productivity, diversify production and markets, commercialize production and promote livestock farming and aquaculture, while also ensuring sustainable management of forest resources. This presents a challenging agenda, as the period 2013–2016 witnessed low levels of growth, in part due to drought. The 2016 Mid-Term Review of the National Strategic Development Plan (NSDP) noted that the negative effects of drought had adversely affected crop production, livestock and fisheries (due to low water levels).

Figure 2.1: Sector growth rates

---


2.3 Moving forward

Despite impressive socio-economic achievements, Cambodia still faces a number of deep-seated challenges, which threaten both the sustainability and inclusiveness of the development process. Risks to future growth are associated with the need to implement major structural reforms. Indeed, Cambodia faces a series of structural constraints, which will need to be overcome if a lasting transformation is to be delivered. Issues include: 1) slowing rates of structural change and economic diversification; 2) low productivity levels, while the rate of improvement also appears to have plateaued in the leading industrial sectors; 3) inadequate infrastructure and connectivity within the country and to its external markets; 4) missing markets, especially within the key financial sector; and 5) high levels of economic informality. Tackling these issues will be a major call on financing in both the public and private sectors.

Many of Cambodia’s social gains are also at risk. Most of those who have moved above the poverty line have done so only by a small margin; this ‘near poor’ population remains vulnerable to social and economic shocks, including weather-related events and falling crop prices. The multidimensional poverty headcount is 31.6 percentage points higher than income poverty, which implies that individuals living above the income poverty line suffer deprivation in education, health and other living conditions. While there has not been any deterioration in income distribution, policymakers must continue to focus on inequality (especially going forward; see below). Moreover, access to social services, particularly to health and education, remains unequal, even as the government continues efforts to implement public sector reforms and improve public services.

The core commitment of the SDGs to “leave no one behind” also puts direct attention on the need to modernize the rural economy and to sustain the focus on improving gender equality. The HDI score for urban areas in Cambodia is about 21 percent higher than for rural areas, while the richest 20 percent of the population have an HDI score that is 40 percent higher than that of the poorest 20 percent. The poorest consumption quintiles have lower levels of human development than the richest quintiles. In addition, human poverty is greater among women than among men across all economic groups. Child malnutrition levels remain high and related pockets of poverty, especially in remote areas. There is a strong positive link between poverty and child malnutrition. In addition, the high proportion of people living in lowland areas and limited national capacities mean that Cambodia is among the top 10 Asian countries in terms of vulnerability to climate change. A scenario of a 2°C rise in temperature by 2050 could reduce its GDP by at least 1.5 percent by 2030, and 3.5 percent by 2050, through drought and floods affecting agriculture (1.42 percent of GDP); an increased burden of diarrhoea and other climate-sensitive diseases (0.85 percent of GDP); more rapid degradation of infrastructure, including roads, irrigation and rural water supply (0.71 percent of GDP); and flood damage to urban infrastructure (0.25 percent of GDP).

---

In the future, pressures leading towards greater inequality are likely to worsen. In common with other middle-income countries (MICs), a globally and regionally integrated Cambodia will face a set of new challenges through exposure to trade, greater foreign direct investment (FDI) and diversification. This process is likely drive differential opportunities and a growing skills premium. Cambodia lacks active mechanisms to rebalance and counter these pressures: regional policy and decentralization remain a work in progress, health and social protection coverage is limited and the system of post-secondary education and training is of variable quality and is too restricted. The government is keenly aware of these challenges and has proactively engaged in formulating a policy response, most notably the IDP (2015–2025). In early 2017, the Ministry of Planning released its latest review of progress and ongoing challenges with the production of the NSDP Mid-Term Review. This recommended the prioritization of seven key themes, to be addressed through a number of interdependent policies, reforms and partnerships:

1. Poverty reduction and inclusive growth
2. Promoting the modernization of agriculture
3. Improving competitiveness
4. Better management of migration and urbanization
5. Addressing climate change and deforestation
6. Improving governance
7. Human resource development.
3. Policy objectives and overarching development planning framework

To support development objectives, a wide range of policy initiatives and reforms has been established under the leadership of the RGC (including the IDP). These are all managed within the framework of Cambodia’s longstanding Rectangular Strategy, now in its third five-year phase. The Rectangular Strategy for the period 2014–2018 prioritizes good governance (institutional and policymaking) across four key pillars: 1) agriculture 2) physical infrastructure 3) private sector development and employment; and 4) capacity building and human resource development.

Figure 3: Rectangular Strategy 2014-2018: National development priorities
To maintain high levels of economic growth while ensuring that its benefits are equitably distributed, a new set of policies for economic transformation has been formulated, including the NSDP and the IDP. The IDP aims to transform Cambodia’s industrial sector from labour-intensive production to one driven by higher productivity and greater use of technology and skills by 2025. Central to the achievement of these plans is the diversification of production and exports that will secure new opportunities and markets for Cambodian producers. In addition, continuing to modernize and strengthen the agricultural sector, which represents approximately 30 percent of GDP and 45 percent of employment, is also a key policy objective of both the NSDP and the IDP. Rural livelihoods and better and higher-paying industrial and urban jobs are both accordingly central to meeting the “leave no one behind” commitments and the principal objectives of the current NSDP and the IDP.

To finance and support this next stage of national development, including the implementation of the IDP and complementary rural development strategies, the government needs to be able to mobilize and manage a diverse range of development resources. It will also need to proactively engage with public and private development actors, including in order to coordinate and direct their resources towards the achievement of development results in line with national plans and priorities. The findings of the recent DFA, commissioned by the government, have complemented ongoing reform efforts to strengthen strategic management of public resources in line with results frameworks. A roadmap towards establishing new partnerships that can support economic transformation and the modernization of the rural sector has been identified.
4. The Industrial Development Policy as a guiding framework for Cambodia’s economic transformation

To further develop industry and the wider economy, including modernization of the agricultural sector, and to strengthen linkages to the global trading system, Cambodia’s first IDP was launched in 2015 to cover the period up to 2025. Recognizing the existence of challenges and opportunities at the regional and global levels, the objective of the IDP is to maintain high levels of sustainable and inclusive economic growth through a shift to higher, skills-based production and economic diversification. Under the government’s leadership and coordination, the IDP aims to increase competitiveness and promote productivity through closer collaboration with a wide range of national and external actors, including donors and the private sector.

The IDP therefore represents the government’s main policy platform for transforming economic management and production, including in the rural sector. Accordingly, the IDP has been presented by government as a “New Economic Growth Strategy”. The policy’s emphasis on diversification, competitiveness and productivity acknowledges multiple underlying constraints (Figure 4) to the industrialization effort that the government has previously attempted to undertake through a number of sector strategies and reforms. The added value of the IDP lies therefore in its role of formulating and implementing a more joined-up, holistic and comprehensive response that can accelerate structural economic reforms and the transition towards higher value-added production and establishing Cambodia as a major manufacturer.
The external context and the domestic environment for pursuing industrialization are considered to be favourable. First, the region is experiencing a high level of growth, providing increased opportunities for Cambodia to transition away from garments and textiles to position itself further up the manufacturing value chain. Second, Cambodia’s young population represents a ‘demographic dividend’. Third, the IDP can serve as a catalyst for modernizing and linking other sectors, including agriculture and services, to a higher-growth model.

The IDP seeks to address five key challenges: 1) overall leadership, coordination and responsibility for addressing cross-cutting challenges and bottlenecks that hamper industrialization efforts 2) increasing the skills and technical know-how of the labour force 3) providing strategic management to the provision of economic infrastructure 4) developing the financial sector to complement private sector development and 5) improving labour market management and regulation, including measures to improve productivity and labour relations.

4.1 The Rice Policy: a complementary effort to modernize the agricultural sector

The IDP is a significant achievement in that it provides for coherent leadership and strategic coordination in developing the industrial sector. But it is also true that many initiatives pre-date the IDP and have therefore played an important role in informing its formulation. One of the most prominent of these initiatives has been the government’s “Policy on the Promotion of Paddy Production and Rice Exports”,

Figure 4: The Rice Policy - Increasing yields and processing rice for export

Doing business indicators cross country comparison (Distance to frontier score 1/)

The global competitiveness index (Score range from 1-7 (better))

Note: 1/ On a scale of 0 to 100; 100 is the frontier and 0 is the furthest from the frontier.

Source: World economic forum, Global competitiveness report 2015-16
more commonly referred to as the Rice Policy. This policy was introduced by the Prime Minister in June 2010 and aimed to export a million tonnes of milled rice by 2015 (from a base in 2010 of only 40,000 tonnes).

**Figure 4.1: The Rice Policy focuses on increasing yields and processing rice paddy for export**

The Rice Policy has been based on: 1) increasing yields (Figure 4.1) through improved technology, inputs and production techniques and 2) developing associated processing, transport and financing services. Rapid progress has been made, with exports of milled rice to 26 countries reaching 542,000 tonnes in 2016. This represents a significant advance, though it falls short of the overall target. However, an estimated 60 percent of total increases in crop production have derived from expanding the area under production, which leaves further scope for improving yields and introducing improved cultivation practices, such as access to dry-season irrigation.

Sources: Ministry of Planning (NSDP Mid-Term Review, 2016); Asian Development Bank (ADB); UN Food and Agriculture Organization (FAO)
Identified challenges include a shortage of capital to purchase rice paddy, high electricity prices (for milling), installation of milling capacity and high transportation costs. Ongoing bottlenecks that constrain implementation of the Rice Policy point to the need for a comprehensive approach to modernizing the rural economy and placing it on a more commercial footing. This is the added value that the IDP brings.

4.2 The Industrial Development Policy and agro-industry

To address the cross-sectoral challenges that constrain the Rice Policy and the broader industrialization effort, the IDP sets out four action plans and contains one additional section spelling out priority measures to be addressed by the end of 2018. These are:

1. **Investment promotion**
   a) Investment climate
   b) Special economic zones (SEZs) and preparation of industrial zones

2. **Expanding and modernizing small and medium-sized enterprises (SMEs)**
   a) Institutional arrangements and incentives
   b) Registration and account ledgers
   c) Promoting agro-industrial development

3. **Improving the regulatory environment**
   a) Trade facilitation and export promotion measures
   b) Industrial standards and property rights
   c) Facilitation of payment of tax and excise
   d) Labour market development and industrial relations

4. **Coordination of supporting policies**
   a) Skills and human resource development
   b) Promoting science, technology and innovation
   c) Industrial infrastructure
   d) Financing measures

5. **Priority measures to be implemented by end-2018**
   a) Electricity coverage increased and energy costs to industry reduced
   b) Master plan for transport and development of logistics system (poles and corridors)
   c) Labour market management and skills
   d) Sihanoukville multi-purpose SEZ developed.

More specialized and intensive agricultural production is recognized as being supportive of industrialization due to its established presence in Cambodia’s value chain, the potential to release labour to other sectors as agricultural productivity and specialization increase and the need to ensure that rural livelihoods are safeguarded as economic transformation policies are implemented. The focus of the IDP with respect to agro-industry is therefore included under the expansion of SMEs. Cambodia’s agricultural potential can be realized with support from the IDP, specifically in the following areas:
1. **Higher productivity:** Improved extension and increased availability and use of high-yielding crop varieties, nutrients and mechanization as part of a broader commercialization programme.

2. **Support for diversification:** Moving into higher-value (and often higher-yielding) cash crops such as rubber, cassava, cashew, pepper, coffee and maize. Livestock production and fisheries also have greater potential.

3. **Off-farm reforms:** Addressing economic constraints such as farm size through continued commercialization of production and complementary policies related to land management, irrigation, transport infrastructure, financial services and trade facilitation.

4. **Premium markets:** Identifying economic opportunities to improve branding and brand awareness based on award-winning quality of Cambodian rice and other products.

According to the IDP, the priority is therefore not to focus exclusively on improving agricultural productivity but also to promote diversification based on the modernization and commercialization of the agricultural sector. The IDP proposes a range of policy initiatives and actions, including: 1) the establishment of agro-processing zones (with incentives provided in line with the Investment Law) 2) providing dedicated financial support for export-led product development 3) improved logistical management and trade facilitation and 4) investing in research that offers opportunities to move up the agricultural value chain.

The approach outlined in the IDP is fully consistent with the Agricultural Sector Strategic Development Plan. This plan also has an SME perspective that targets farmers and smaller-scale producers for training and extension support in the areas of technology adoption, processing, sanitary and phytosanitary standards and post-harvest processing. Off-farm reforms such as strengthening contracts between producers and buyers, securing land tenure and improving financial services are also included in the approach.

Government-directed investment (from the budget or from external sources) plays a critical role in creating the conditions for private sector-led development in rural areas, especially by improving farm-based production, modernizing off-farm processes and developing markets that are central to establishing an agro-industry value chain that benefits rural producers. These are in addition to the more established role of government in providing rural infrastructure, including roads and irrigation services.
5. Developing special economic zones to support key sectors: manufacturing and agro-processing

This paper has a particular focus on SEZs, which are an important part of efforts to create favourable conditions for attracting foreign investment into Cambodia’s manufacturing sector and agro-processing industry. The country’s SEZs aim to diversify its production base and integrate the economy within regional production networks, with a focus on the garments sector, electronics and household furnishings.

In 2005 the Cambodian Special Economic Zone Board was established by the Council for the Development of Cambodia (CDC) to manage the SEZ scheme, and Sub-Decree No. 148 on the Establishment and Management of the Special Economic Zones was issued to govern them. In addition, the Law on the Special Economic Zones was drafted by the CDC in 2008 and is now under examination by the RGC. Most zones are privately developed and managed, with the state providing incentives and regulations.

The IDP’s strategic approach relies on further streamlining the operational procedures for SEZs and developing new industrial parks and industrial clusters. In addition, the RGC’s Trade Integration Strategy (2014–2018) relies explicitly on the SEZs to support the country’s export growth in coming years and to help producers join regional supply chains. It highlights the critical role of SEZs on the borders with Thailand and Viet Nam in allowing producers based in them—for example, in light manufacturing—to quickly integrate into regional production chains in those countries.

5.1 Current performance of Cambodia’s SEZs

Since 2005 the RGC has approved a total of 34 SEZs, though by 2015 only 14 had commenced operations. The main zones are in Phnom Penh, Sihanoukville and Svay Rieng (Bavet); although others exist, they have relatively few investors. Since their creation in 2005, the SEZs’ favourable conditions have attracted a total of $1.89 billion in FDI and have generated an estimated 143,302 jobs.

The industrial base within SEZs is more diversified than in the country as a whole. While garment firms heavily dominate the manufacturing sector, SEZs have a higher proportion of firms producing electronics, electrical products and household furnishings. This reduces the vulnerability of Cambodia’s industrial sector to any downturn in the global garment industry. Investors were initially attracted by low labour costs together with, in some cases, favourable tariff treatment by the European Union and the USA for goods produced in Cambodia. However, the recent real wage increases in Cambodia may signal that this era of cheap labour is approaching its end, and graduation from least developed country

---

16 The UN Industrial Development Organization (UNIDO) (2015) defines a special economic zone as “a designated estate where trade laws such as tariffs, quotas, or duties differ from the rest of the country”.
17 CDC and CRDB (2017), ‘Cambodia Development Finance Assessment’.
Workers in Cambodia’s SEZs can reach productivity levels similar to those of many in neighbouring Thailand and Viet Nam, but they require higher levels of training and longer adjustment periods. This is partly due to low average standards of literacy: 30 percent of new employees have never attended school and are unable to read.

Since the creation of the first SEZs, a number of infrastructure-related constraints have undermined investors’ satisfaction. Investor surveys and research have identified “poor to average” infrastructure and deficient service delivery, notably in terms of water and waste disposal, telecommunications and reliable electricity supply, as the main problems of Cambodia’s SEZs. Corruption, relatively low labour productivity and the slow implementation of tax privileges (i.e. reimbursement of VAT) have been identified as additional constraints to efficient functioning of the SEZs. The RGC’s IDP and Trade Integration Strategy both acknowledge these constraints and put forward policy measures to address them.

5.2 Designing SEZ programmes

SEZ performance, measured by exports, investment and employment, strongly correlates with the investment climate—specifically, infrastructure and customs clearance. In contrast, the traditional sources of competitiveness for export processing zones—low wages, trade preferences and fiscal incentives—are generally not found to be correlated with SEZ outcomes. One study underscores the “importance of a comprehensive approach to the investment climate, with particular attention to delivering high-quality infrastructure (especially reliable power) and facilitating efficient import and export transactions, along with regulatory and business licensing issues”. These findings resonate strongly with previously highlighted concerns from investors in Cambodia’s main SEZs. In addition, considering future reliance on private development finance to meet Cambodia’s capital expenditure needs, this implies an urgent need for further strengthening of the investment climate.

The developmental impact of SEZ programmes is not automatic, however, and there is an established critical literature. Important policy trade-offs may arise in terms of maximizing local development and minimizing revenue impact which warrant careful consideration and planning.

- First, maximizing the benefits of SEZs depends on the degree to which they are integrated with their

---

18 According to an ADB survey based on fieldwork in Cambodia in October 2014, in which SEZs were visited in three locations. The research included one-on-one interviews with representatives of companies operating in various SEZs as well as with managers or operators of the SEZs themselves, followed by a questionnaire-based survey of firms operating within SEZs, conducted in October/November 2014. The ADB team visited 11 SEZ firms in Phnom Penh (three firms), Bavet (four) and Sihanoukville (four), in addition to SEZ administrators in each of these locations.


host economies and the overall trade and investment reform agenda. The absence of sufficiently large domestic business complicates the integration of the domestic economy with the economic activity of SEZs. This is reinforced when existing industries are largely subsidiaries of transnational corporations, which have few incentives to establish upstream or downstream production. This is the case with triangular manufacturing networks, which have locked Cambodian suppliers into second-tier positions, limiting local linkages and spillovers. Supporting domestic investment to help realize the dynamic potential of SEZs and the strong role of local investors in the medium term are two critical factors. Successful SEZs in Malaysia, Korea, Mauritius and China have all managed to shift from a predominance of FDI towards domestic investment. While this process also appears to be under way in Bangladesh and Viet Nam, Cambodia is not following suit. For instance, the minimum investment requirement of $500,000 means that almost all companies in Cambodian SEZs are foreign. Therefore, the RGC can play a leading role in strengthening its SEZs by supporting domestic investment in them by promoting links, training and upgrading, based on a clear strategic integration of the programme with the country’s broader economic development strategy.

- Second, domestic revenue may be negatively affected by SEZ-related tax incentives and expenditures to attract foreign investors who would have invested in the economy even without such incentives. Tax incentives rank low on the list of motivations for investing, in contrast with infrastructure and availability of skills. To operate in an SEZ in Cambodia, a project must first be eligible as a qualified investment project. SEZ investments receive the same benefits as other qualified investment projects and have only a few additional tax arrangements, which are intended to facilitate the import of key components and their re-export.

5.3 Regional influences

The different stages of competitive development of the countries neighbouring Cambodia generate both opportunities and challenges for its general performance and its SEZ programme. Cambodia, along with Myanmar and Lao PDR, is currently at the first, ‘factor-driven’ stage of competitive development. The Philippines and Viet Nam are transitioning from ‘factor-driven’ to ‘efficiency-driven’, while Indonesia and Thailand are already at the ‘efficiency-driven’ stage of development.

The outsourcing of factor-driven production from the Philippines and Viet Nam should provide

---

22 This refers to a process where a buyer/order source in country A is placed with a firm in country B, which then manufactures the goods in country C.
25 Porter (1990), (‘The Competitive Advantage of Nations’, Harvard Business Review) suggests that there are four distinct stages of national competitive development: factor-driven, investment-driven, innovation-driven and wealth-driven. The first three stages involve the successive upgrading of a nation’s competitive advantages and will normally be associated with progressively rising economic prosperity.
26 In this stage, companies draw their advantage almost solely from basic factors of production, whether these are natural resources, favourable growing conditions for certain crops or an abundant and inexpensive semi-skilled labour pool (Porter, 1990).
opportunities for Cambodia’s incipient manufacturing sector. In particular, the existing Greater Mekong Subregion corridors should provide opportunities as industries in Thailand and Viet Nam mature. For instance, there may be opportunities for co-production between Thailand’s Sa Kaeo SEZ and Cambodia’s Poipet O’Neang SEZ, in which the majority of investments are labour-intensive projects from Thailand—for example, garment factories and jewellery box manufacturing. However, competition between Cambodia, Myanmar and Lao PDR, which are all at similar stages of competitive development, to attract mobile capital in order to develop similar economic activities risks undermining the performance of their respective SEZs. The RGC can minimize this risk by focusing its SEZ programmes on specific sectors that link to its existing industries (i.e. agro-processing, garments), resources (agriculture, rubber) and domestic skill sets.

Recent years have seen increasing interest in certain countries in developing agro-specific SEZs or using existing SEZ frameworks to achieve agricultural and agro-industrial growth strategies targeted for export, regional and domestic markets. The successful coffee industry in the Philippines illustrates how existing SEZ frameworks require customization to the needs and constraints of the country’s value chain characteristics. What uniquely differentiates agro-industry from assembly manufacturing is the assumption that value-added operations will source most of their raw materials domestically and/or regionally. This necessitates a policy framework that encourages (market-based) domestic sourcing of raw materials and strong supply chain linkages, by allowing for duty-free access to input materials into SEZs and/or to directly include production enterprises in the SEZ framework. The Philippines, for example, relaxed its export quotas to permit sales to the domestic economy. In addition to making good use of low-skilled labour and effective backward linkages with the domestic economy to reduce factor costs, agro-industrial SEZs should not be established in isolation from other factors dictating supply chain competitiveness.

---

6. Financing economic transformation

6.1 Assessing overall future resource availability and investment needs

The analysis presented in the previous section relates to the Rice Policy and to agro-industry more broadly, and highlights the importance of a coherent and comprehensive approach to addressing industrialization and its financing. Mobilizing finance and allocating resources to their greatest effect is an essential precondition for industrialization. It is therefore identified as a key component of Cambodia’s IDP.

In looking towards financing of the next stage of national development, the government commissioned a DFA in 2016 to produce a consolidated overview of development resources—both public and private—potentially available over the medium term. To inform the government’s future resource mobilization strategy, the DFA reviewed the evolution of major finance flows, identified potential new development finance sources and assessed institutions, partnerships and capacity gaps related to the linking of finance and results.

Significant financing will be required to implement an increasingly wide range of policy initiatives associated with the government’s long-term development goals, including the SDGs. Resources beyond the two main current drivers of national development—domestic finance and external cooperation (official development assistance (ODA))—will be required. Looking to the future, it will be necessary to: 1) increase the development finance resource base; 2) diversify sources of development finance; and 3) strengthen management and coordination of multiple development finance sources.

An update of the 2017 DFA data for this paper finds that total financing potentially available for supporting national development is set to almost double from $11.8 billion in 2015 to $22.7 billion in 2025 (Table 1). As a share of GDP, however, it slightly decreases, by 1.3 percentage points to 63.3 percent. The absolute increase is driven principally by domestic resource mobilization (DRM), private investment (including FDI) and remittances. To provide a better perspective, in 2005 total development cooperation funding (ODA, non-governmental organizations (NGOs) and South–South, principally China) was roughly equal to domestic revenues. In 2025 it is estimated that domestic revenues will be more than five times larger than aid receipts (the latter also being lower than the domestic private sector, FDI and remittances). Assuming the broad validity of the assumptions made for all finance flows, this emphasizes: 1) the likely critical importance of DRM; and 2) the need to maximize and better manage the contributions of key private finance flows to national development priorities.
This projected available development finance needs to be contrasted with planned capital investment requirements to assess the development finance position. The NSDP 2014–2018 provides capital investment requirements to achieve GDP growth targets, broken down by expected sources of funding (public or private). Extrapolating these estimates up to 2025 provides a rough estimate of annual total required spending (Annex 1). These projections indicate that Cambodia's total recurrent and capital expenditure needs in the years to 2025 are broadly in line with increasing available development finance over the same period. The NSDP 2014–2018 expects 28.5 percent of the required capital expenditure to be provided by public finance and the remaining 71.5 percent by private finance. Therefore, meeting Cambodia's total investment needs will rely on the RGC's capacity to align private development finance flows with domestic investment priorities (Table 1).

Economic growth is the main determinant of total available development finance. This scenario is based on an assumption of sustained annual GDP growth of 7 percent, the minimum growth required for Cambodia to become an MIC by 2030 and in line with its recent economic performance. However, downside risks stemming from declining competitiveness, rapid credit growth, fiscal pressures and possible spillovers from an uncertain external environment may affect GDP growth. It is estimated that if GDP growth was just 1 percent lower, it would diminish total development finance in 2025 by 9 percent and would significantly diminish the margin by which available funding covers investment needs. This highlights the importance to Cambodia of duly implementing its new set of policies for its economic transformation to succeed and of maintaining the high economic growth rates that are essential to finance its sustainable development.

Table 1: Development finance projections 2015–2025

<table>
<thead>
<tr>
<th></th>
<th>2015</th>
<th>% GDP</th>
<th>2020</th>
<th>% GDP</th>
<th>2025</th>
<th>% GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Aggregate</strong></td>
<td>Individual flow</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Domestic public</td>
<td>Non-grant government revenue</td>
<td>$3,142.4</td>
<td>17.2%</td>
<td>$5,047.0</td>
<td>19.7%</td>
<td>$7,176.9</td>
</tr>
<tr>
<td></td>
<td>Government borrowing (domestic)</td>
<td>0.0</td>
<td>0.0</td>
<td>89.7</td>
<td>0.3%</td>
<td></td>
</tr>
<tr>
<td>Domestic private</td>
<td>Private borrowing (domestic)</td>
<td>$2,147.5</td>
<td>11.8%</td>
<td>$3,070.2</td>
<td>12.0%</td>
<td>$4,306.1</td>
</tr>
<tr>
<td></td>
<td>Philanthropy (domestic)</td>
<td>$41.5</td>
<td>0.2%</td>
<td>$44.6</td>
<td>0.2%</td>
<td>$44.6</td>
</tr>
<tr>
<td>International public</td>
<td>ODA</td>
<td>$1,464.8</td>
<td>8.0%</td>
<td>$1,328.2</td>
<td>5.2%</td>
<td>$1,328.2</td>
</tr>
<tr>
<td></td>
<td>Other official flows (OOF)</td>
<td>$111.1</td>
<td>0.6%</td>
<td>$112.6</td>
<td>0.4%</td>
<td>$112.6</td>
</tr>
<tr>
<td></td>
<td>Government borrowing (international)</td>
<td>$918.2</td>
<td>5.0%</td>
<td>$1,279.2</td>
<td>5.0%</td>
<td>$1,794.2</td>
</tr>
<tr>
<td>International private</td>
<td>FDI</td>
<td>$1,732.0</td>
<td>9.5%</td>
<td>$2,558.5</td>
<td>10.0%</td>
<td>$3,588.4</td>
</tr>
<tr>
<td></td>
<td>Private borrowing (international)</td>
<td>$1,629.0</td>
<td>8.9%</td>
<td>$1,637.4</td>
<td>6.4%</td>
<td>$2,296.6</td>
</tr>
<tr>
<td></td>
<td>Remittances</td>
<td>$394.2</td>
<td>2.2%</td>
<td>$911.1</td>
<td>3.6%</td>
<td>$1,780.3</td>
</tr>
<tr>
<td></td>
<td>Philanthropy (international)</td>
<td>$216.4</td>
<td>1.2%</td>
<td>$209.6</td>
<td>0.8%</td>
<td>$209.6</td>
</tr>
<tr>
<td><strong>Total development finance</strong></td>
<td>$11,797.2</td>
<td>64.7%</td>
<td>$16,198.5</td>
<td>63.3%</td>
<td>$22,727.2</td>
<td>63.1%</td>
</tr>
</tbody>
</table>

Source: National data from the Ministry of Economy and Finance; projections for 2020 and 2025 based on DFA from CDC.
Domestic revenues will gradually rank alongside international private finance as Cambodia’s main sources of finance (Figure 5.1). The government’s strong track record in macroeconomic management has delivered robust growth as well as improved revenue administration. Consequently, domestic revenue performance has increased to 17 percent of GDP in 2015 and 2016 (VAT, other indirect taxes and those derived from international trade now account for the largest shares of domestic resources).

Overall, Cambodia’s revenue collection is now broadly in line with that of other countries in the region (Figures 5.2 and 5.3). The Revenue Mobilization Strategy, which identifies potential for further increasing the tax effort and improving collection through strengthened institutions and administration, provides cause for optimism that medium-term targets of revenue mobilization of up to 20 percent of GDP will be realized.
Impressive domestic revenue mobilization has provided increased fiscal space for the government. Despite the increased availability of domestic public resources (mostly taxes), an assumption that more funds will be available to support IDP-led investment may not be wholly valid. In the 10-year period to 2015 the government wage bill more than doubled as a share of GDP; moreover, the government continues to borrow only from official external sources and there is no domestic capital market. Public capital investments therefore continue currently to be largely financed by grants (ODA) and concessional loans from international financial institutions (IFIs), bilateral partners and the regional development banks (70 percent of capital expenditure was externally funded in 2015). To date, the fiscal deficit has been almost fully financed by external donor inflows, but as ODA grants and concessional lending decline there will be a need to secure increased sources of domestic revenue, including domestic public borrowing, while also allocating increasing resources to capital investment. The challenge for the IDP therefore, and for agro-industry more broadly, is how to secure and allocate increased private development finance for productive investment in line with the IDP priority areas.
To address this challenge, the government is implementing its Revenue Mobilization Strategy for the period 2014–2018. This sets an ambitious goal of increasing domestic revenue by 0.5 percentage points of GDP annually, from a base of 15 percent in 2014 (the target was exceeded in 2016, with total revenues of nearly 18 percent of GDP).

In spite of progress, the Ministry of Economy and Finance (MEF) emphasizes that full realization of the goals of the Revenue Mobilization Strategy will demand higher levels of coordination and commitment from ministries and other institutions, especially in the area of non-tax revenue collection (fees and charges). The MEF has also noted that a “comprehensive review and re-design of the country’s fiscal incentive scheme…to investment in ‘targeted’ sectors as stated in the IDP is urgently required”. This may include reviewing the provision of tax incentives to private sector investors—e.g. tax holidays, waivers and exemptions—and replacing them with depreciation allowances and tax credits. Reaching the desired revenue targets will also require widening the tax base, including: 1) income tax and other personal taxes; 2) expansion of the property tax base; and 3) further strengthening of the tax administration, as well as strengthening the culture of tax compliance. Public domestic borrowing also remains an important gap, but government plans envisage bond-funded public borrowing before 2025.
6.2 Anticipating the impacts of MIC progression and LDC graduation on concessional finance

In 2016 Cambodia exited the World Bank’s low-income category, moving up to lower-middle-income status, and as a direct consequence began the process of exiting concessional loan privileges afforded by the IFIs and other multilateral lenders. It currently receives blended World Bank and ADB lending but, with time, the level of concessionality will decline further.

Graduation from low-income country status has caused many bilateral donors to reconsider their aid allocation strategy for Cambodia. This is likely to be hastened by the possible loss of LDC status (see below). ODA, although falling as a share of GDP, is disproportionately focused on social sectors, which in 2015 received the largest share of ODA disbursements (37 percent of the total), followed by the infrastructure sector (around 30 percent). Careful planning to take account of declining donor funding to the health and education sectors will therefore be essential to sustain progress towards meeting the SDGs.

In addition, Cambodia’s designation by the UN as an LDC is increasingly in question. In the latest LDC graduation review in 2015, the country was close to meeting two of the three graduation criteria (Table 2). Dramatic improvements in rates of undernourishment, under-five mortality and enrolment in secondary education helped it to meet the Human Assets Index threshold for the first time. There were also strong improvements on the Economic Vulnerability Index sub-indicators of ‘remoteness,’ ‘export instability’ and ‘share of population in low elevated coastal zone,’ though insufficient to meet the graduation threshold.

Table 2: Cambodia’s performance on LDC graduation criteria for the past two reviews

<table>
<thead>
<tr>
<th></th>
<th>2012 review</th>
<th>2015 review</th>
<th>Thresholds 2015 review</th>
</tr>
</thead>
<tbody>
<tr>
<td>GNI per capita, $</td>
<td>880</td>
<td>1,070</td>
<td>Above $1,242</td>
</tr>
<tr>
<td>Human Assets Index</td>
<td>57.9</td>
<td>67.2</td>
<td>Above 66</td>
</tr>
<tr>
<td>Economic Vulnerability Index</td>
<td>50.05</td>
<td>38.3</td>
<td>Below 32</td>
</tr>
</tbody>
</table>

Source: World Bank World Development Indicators.
Note: Red indicators are below the thresholds; green indicators have surpassed them.

Cambodia’s graduation from LDC status can be expected at the soonest in 2024. This would require it to meet the first-time eligibility criteria at the next review in 2018. Conditional on meeting the graduation criteria for a second consecutive time in 2021, the Committee for Development Policy might then recommend that the UN Economic and Social Council (ECOSOC) confirm Cambodia’s graduation,

---

29 Eligibility criteria for graduation from the LDC category must be met over two consecutive triennial reviews. There are three graduation criteria: gross national income (GNI), the Human Assets Index and the Economic Vulnerability Index. Graduation requires meeting either two of three indicators, or GNI per capita to be at least twice the GNI threshold.

30 The Committee for Development Policy was established in 1965 as a subsidiary body of the UN Economic and Social Council (ECOSOC). It provides independent advisory services to ECOSOC on development issues. Its mandate includes undertaking a triennial review of the list of LDCs, on the basis of which it advises the Council on countries that should remain on the list and those that qualify for graduation from it.
followed by the UN General Assembly taking note of ECOSOC’s decision at its next session. Graduation would take effect three years after the General Assembly notification, in 2024, during which time the country would remain on the list of LDCs and would continue to benefit from associated special support measures.

Understanding the development finance implications of graduating from LDC status is essential and needs to be factored into the RGC’s transition strategy. Far more significant than the ODA impact is the impact on trade. Developed and many developing countries provide trade-related special and differential treatment for imports from LDCs, such as zero or reduced tariff rates under the Generalized System of Preferences and the Global System of Trade Preferences among Developing Countries. Losing preferential market access, in particular to EU markets (under the Everything But Arms provisions), will specifically imply a major loss of competitiveness for Cambodia’s garment industry, and will have a significant impact on its wider economic and export base.

6.3 Strengthening public investment management

Institutions are key. To complement efforts on the revenue side, the government is currently developing two policy initiatives that are expected to reinforce ongoing public financial management reforms. In so doing, these initiatives are expected to increase domestic capital expenditure as well as improve the efficiency and impact of publicly funded investments. This should directly benefit implementation of the IDP and efforts to modernize and transform the rural economy.

First, the government is strengthening its investment planning and management processes. Public investment management procedures are considered by the MEF to be underdeveloped. The ministry has found, for example, that “inadequate project preparation, unsatisfactory project implementation and lack of emphasis on maintaining infrastructure once built have plagued most public investment programs”. Underlying this problem is a lack of established guidelines or procedures for preparing, appraising and implementing capital projects together with diverse investment management practices across line ministries. This in turn hinders the ministry in performing its gate-keeping role of coordinating and prioritizing the capital budget as well as integrating capital and recurrent operations.

The MEF is therefore currently preparing new guidelines to manage public investments. These will establish a common framework for public investment management to ensure that such investment is managed efficiently, effectively, transparently and in an accountable manner. A standard project cycle will be formulated to strengthen the link between the three-year rolling public investment programme and short- and medium-term budget preparation. Institutional roles and responsibilities across the project cycle will be clarified.

As the government’s public financial management reform progresses, the integration of recurrent and capital budgeting will link this work on public investment management to ongoing programme budgeting reforms that are being rolled out across all government ministries and agencies. These results-based reforms will further promote the link between capital investments and development results.

31 A reciprocal scheme between developing countries that recognizes the special needs of LDCs.
The second initiative currently being pursued by the government and relevant to the development finance theme is the formulation of a policy on public-private partnerships (PPPs). This is expected to mobilize private sector partners and their funding in line with government investment priorities. The government recognizes the potential of PPPs and the supporting role they can play in the provision of public infrastructure. Of the 20+ PPPs that have been implemented to date, the majority are in the power sector, with others in telecommunications, airports, railways and roads.

The framework for managing PPPs was assessed in 2012 by the Asian Development Bank. Its findings included the observation: “The overall level of PPP outside the power sector is low. The PPP projects being proposed are often quite small and emerge on an ad hoc basis. PPPs are not standardized, and they tend to be issued on a reactive, unsolicited and negotiated basis, rather than through proactive government preparation and competitive tendering. As a result, the amount of funds being raised through PPPs is below potential, and it is unlikely the services provided accurately reflect market needs…and the government currently lacks a credible PPP project pipeline.”

The ongoing policy work will clarify the legal framework as well as assign and strengthen the institutional framework. PPPs, and other forms of blended finance that use private partnerships, will then take their place in a wider strategic framework for managing public investments, in the context of overall national development planning and macroeconomic management.

6.4 Using public resources to catalyse private investment

In a similar vein to PPPs, blended finance provides scope for increasing the availability of development finance. Blended finance, which in other countries has mainly been applied to infrastructure and the productive sectors, entails the use of public funds—domestic or ODA—to underwrite the risk of private investment and thereby facilitate private flows into projects that may otherwise be deemed too risky (commodity export crop production and processing is a frequent example). Blended finance may bring its own risks related to transparency and accountability in the use of public funds or, as with PPPs, it may be considered a public subsidy for profitable private sector activity. Nevertheless, it offers an additional option that may accelerate the modernization of the agricultural sector by transferring risk to the state (or to donors).

6.5 Stimulating private sector engagement in the IDP and agro-industry

The IDP serves as the government’s “New Economic Growth Strategy”. It includes a clear statement on the role of the state in providing an enabling environment for the private sector, including support for the transformation of the agriculture sector to boost agro-industry. From a private sector perspective, there are perhaps three main levels on which the IDP can be viewed: 1) clarification and strengthening of the legal framework that governs private sector activity, including investment and contract laws, property rights, tax incentives and financial sector policies; 2) indications of the level and type of public investment in public infrastructure; and 3) approaches to supporting a wider range of enabling factors, such as the provision of vocational training, access to credit and business development services.

In each of these three categories the IDP identifies a policy response and associated action plan. Many of the anticipated reforms will address issues of competitiveness and productivity that relate to the ease of doing business and that feature in the World Bank’s annual ‘Doing Business’ report. Figure 5.5 shows that progress has been made since 2010, but it needs to be accelerated if Cambodia is to maintain its status as an attractive destination for FDI. In the medium term, structural reform becomes more urgent if the country is to establish itself as a preferred centre for agribusiness, light engineering and other processes that are higher up the value chain.

The first of four components in the IDP action plan is therefore to promote investment by reviewing and amending the Law on Investment. This will include addressing the full range of issues affecting the investment environment, with a focus on vocational training, technology acquisition and improved services and support to investors. SEZs and, for agriculture, the granting of economic land concessions and agro-processing zones provide additional benefits.

**Figure 5.5: The progress of the private sector**

A further constraint to strengthening private sector activities has been Cambodia's financial system, which remains underdeveloped. Rapid growth over the past decade, however, has been associated with growth in credit that could become a downside risk to macroeconomic stability, as it is channelled mainly to consumption purposes as opposed to productive investment. Credit creation has also resulted in high levels of indebtedness, especially in rural areas where microfinance institutions (MFIs) have expanded rapidly over the past decade.
MFIs are an increasingly important source of finance for small producers in the agriculture sector. They now account for 25 percent of total new lending and for 20 percent of outstanding loans. Estimates by the Cambodia Microfinance Association show that by the end of Q1 2016 there were 70 established MFIs lending more than $3 billion to more than two million borrowers. The National Bank of Cambodia is now monitoring MFI debt and in early 2017 imposed interest rate caps on new lending.

Further reforms to the financial sector are set out in the Financial Sector Development Strategy (2011–2020). Additional IDP-related initiatives will be introduced for SMEs in priority sectors such as agribusiness, while improved public investment management, PPPs and blended finance options will also be explored.
7. Roadmap towards an integrated national financing framework

Mandated by the Prime Minister, the Ministry of Planning designs five-year National Strategic Development Plans based on sectoral strategies from line ministries and agencies. Long-term policies and plans such as the IDP, the Climate Change Strategic Plan, the Financial Sector Development Strategy and the PPP policy address cross-sector issues. The Ministry of Planning lays out priority investment needs in its three-year rolling Public Investment Plan. The MEF supervises budgeting and financial planning; its Medium-Term Expenditure Framework projects the RGC’s recurrent expenditures over the next three years, in line with the ministry’s macroeconomic projections and priority policies. The three-year rolling Budget Strategic Framework follows a bottom-up approach based on information collected from RGC institutions on their expenditures and indicative future requirements for the next two years.

Despite significant progress in coordinating and linking policies with available funding following the RGC’s ambitious reforms of public financial management, the 2015 Public Expenditure and Financial Accountability Assessment found that: 1) sectoral strategic plans lack costing estimates (except for education and to a large extent health) 2) recurrent (and externally funded) capital expenditure plans are prepared separately and are not linked and 3) links between aid-funded investment and sector strategies remain weak and supply-driven. These persistent issues risk undermining the optimal use of public resources to harness critical private development finance to supplement Cambodia’s investment needs. Furthermore, the 2017 DFA highlights the government’s limited capacity to address cross-sector prioritization and operational coordination. Strengthening implementation capacity requires the development of a clear implementation plan to link resources, actions and goals and to improve ownership, leadership and coordination arrangements. Finalizing the Cambodia Vision 2050 would ensure consistency and coherence across national policies and strategies during the formulation of the NSDP for 2018–2022.

7.1 Incorporating the SDGs into the RGC’s development vision

Following the adoption of the SDGs in 2015, the RGC created the National Council for Sustainable Development to mainstream sustainable development into policies, plans, programmes and legislation, coordinate the implementation and evaluation of these and lead tasks related to the green economy, climate change, biodiversity and bio-safety. A UNDP rapid integrated assessment highlighted the fact that a minority of SDG targets were still insufficiently addressed by the NSDP. Some specified targets are less ambitious than the SDG targets, while others lack specific policy actions to accompany them. In other cases, the issues are mentioned but the special needs of specific vulnerable groups, such as women, children, people living with disabilities and ethnic minorities, are not specifically addressed. Local authorities and civil society partners can play an essential function in identifying constraints and

---

33 UNDP (2016), ‘Rapid Integrated Assessment’. 
potential solutions to fully addressing the SDGs within national strategic development plans, as well as monitoring progress. Development partners, NGOs and other civil society stakeholders are provided with opportunities to actively participate in defining the results (i.e. the impact) in the process of preparing inputs and targets for the NSDP.

The costing section of the NSDP matches the Ministry of Planning’s Public Investment Plan with the MEF’s estimates of available domestic revenues and development cooperation financing. It thus identifies the shares of annual investments to be financed by either public or private funding (Annex 1). Public finance flows are well integrated into the planning and budgeting process, through the Resource Mobilization Strategy and the Development Cooperation and Partnership Strategy 2014–2018. All mobilization and coordination of ODA grants is managed by the CDC and the Cambodian Rehabilitation and Development Board (CRDB), while the MEF manages all development cooperation loans. A set of 20 joint monitoring indicators based on NSDP and sector goals is used to guide dialogue across technical working groups chaired by senior RGC officials.  

This is not the case for specific private finance flows (i.e. FDI, remittances, domestic credit). While private sector trends are driven by market forces, government can play an important role in influencing investment by private actors in key sectors or locations. Maximizing the contribution of private finance to national development priorities requires the NSDP and respective sector/thematic strategies to influence private resource allocation, and for the government to work backwards from a vision of the type of private sector development it is seeking in order to put in place strategies to mobilize, incentivize and attract the necessary private investments. Dialogue with domestic and international private sector actors is critical, as is establishing monitoring frameworks that allow the government to understand the impact of private finance on all aspects of the NSDP. Dialogue and monitoring will help the government and its partners to find and devise innovative solutions and mechanisms to better align private flows with national development objectives.

In addition, progress in linking budget processes with policies and planning has been slowed down by the MEF’s reluctance to release its financial base to line ministries, which has delayed payments and caused difficulties for the line ministries in implementing their respective development agendas.  

7.2 Importance of coordinated, results-focused M&E frameworks

The RGC has rolled out a Monitoring and Evaluation (M&E) Policy Framework for the NSDP 2014–2018 cycle, which is intended to provide planners and executing agencies with assessments of progress made on sub-programmes, programmes, sectors and the economy as a whole. It foresees engaging all development constituencies (development partners, the private sector, subnational agencies, others) in an effective partnership, coordinated under the leadership of the government. A National Working Group on Monitoring and Evaluation, chaired by the Ministry of Planning, will report on progress in implementing the NSDP 2014–2018. Sectoral strategies each include their respective M&E frameworks and mechanisms.

---

34 CDC and CRDB (2017) ‘Cambodia Development Finance Assessment’.  
35 CDC and CRDB (2017), ‘Cambodia Development Finance Assessment’. 
The NSDP foresees that each line ministry and implementing agency will carry out M&E for both inputs and outputs, i.e. the expenditures that these ministries and agencies make on different programmes and the corresponding results, according to the pre-defined programme structure. There should be close synchronization between the programme structure, the budget and the M&E framework to ensure full harmony. It is important that these results frameworks include financing targets for the contributions of specific financial flows to the results set out in the sectoral strategy. Speedy progress is required on implementing these M&E frameworks during this plan cycle, if the lessons learned from the implementation of the current NSDP are to inform the design and implementation of the next plan cycle and strengthen its M&E framework.

7.3 Accountability and dialogue

The multiple dialogue mechanisms between the RGC and its development partners exclude emerging South–South cooperation. Apart from China, non-traditional development partners are not yet included in the aid coordination mechanism, and even China's participation in coordination rounds is rather passive. Most non-China South–South cooperation is negotiated and managed either by the Ministry of Foreign Affairs and International Cooperation or is negotiated and mobilized directly by line ministries. The resulting limitations in available data on emerging donors' activities and priorities complicate the planning and prioritization of development cooperation finance.

The Government-Private Sector Forum has been supporting public–private dialogue since 1999. Launched by the Prime Minister, with support from the International Finance Corporation, the Forum enables private sector actors to raise and resolve problems with the RGC and to discuss both long-term policy issues and day-to-day operations to support private sector development. According to the World Bank (2009), the Forum has been successful in driving reforms to improve the business environment, yet the private sector requires further strengthening of its advocacy capacity, coordination and analytical skills. The Forum is coordinated by eight business associations and the Chamber of Commerce; however, the Chamber is political: it imposes its views on the smaller organizations, and may 'capture' the agenda over time.

The connections between the government and NGOs are poor or uneven at best. Coordination with civil society happens mainly through government-NGO Consultation Meetings. The capacity of NGOs to contribute to sector-level technical working groups remains limited, though notable exceptions

are the health and education sectors, where multi-stakeholder mechanisms have proved to be quite successful. At the subnational and local levels, there are limited platforms for civil society participation in the development agenda. A significant barrier to strengthening civil society inputs to the RGC’s development planning is the Law on Associations and NGOs, which was promulgated in 2015. The drafting of this law provoked widespread protests from citizens, civil society and the international community regarding both its content and the lack of meaningful public participation in crafting it. According to Transparency International, the law “could be used to effectively stop the ability of NGOs to freely criticize government policies or public officials. It creates mandatory registration requirements for NGOs and gives the government the ability to disallow registration based on unclear criteria. The law also requires informal and grassroots organizations to register as NGOs or associations if they want to conduct activities, a real burden for them.”

---

8. Findings and recommendations

8.1 Strategic management of resources and partnerships

Transforming Cambodia’s agriculture and manufacturing sectors and advancing agro-industry through the IDP are central to achieving the mutually dependent goals of economic transformation and leaving no one behind. Implementing the IDP and addressing associated development challenges will require mobilization and coordination of resources from both the public and private sectors. The government must therefore be able to coordinate and direct resources—both its own and those of other development actors—towards the achievement of development results, in line with national plans and priorities. Policy and institutional solutions will be needed to address the increasingly complex cross-sector priorities outlined in the IDP.

Resourcing the IDP and the agricultural sector plan is more than a question of mobilizing public resources, however. It is also necessary to improve the efficiency of public expenditure while recognizing the role of the public sector in providing an enabling environment for private sector partnerships and finance. In this regard, the government has made a promising start by researching the financing landscape in its DFA. It is now working towards establishing a legal and institutional framework for PPPs. Within government, there is an awareness of a pressing need for improved coordination and collaboration between ministries leading on agriculture, water resources and rural development.

8.2 Government reforms

Leaving no one behind and maintaining high levels of growth through economic transformation will depend on the success of structural reform. This will entail strengthening government institutions, including those with responsibility for development policy, planning, implementation and monitoring. In addition, structural reform of the economy will require continued investments in infrastructure, technology and human capital, combined with improvements to the business environment to boost productivity and competitiveness.

The RGC is taking the lead. Significant progress in implementing the Revenue Mobilization Strategy has resulted in DRM increasing to almost 18 percent of GDP in 2016. Further gains are also anticipated by the MEF, meaning that additional resources for investment in the IDP are expected to become available over the medium term. Complementary reforms of public financial management link budget resources to results frameworks prepared by line ministries under the programme budgeting effort. Institutional improvements in public investment management will provide for similar improvements in the management of the capital budget, with a view to integrating the recurrent and capital budgets over the medium term.

Reforms in the regulation of the business sector are also a priority for the government. Simplification of business registration procedures, trade facilitation and transportation services, and tightening of informal payments have all been recognized as measures promoting the business environment and are reflected in progress in the World Bank’s annual ‘Doing Business’ report. Addressing related challenges
of competitiveness and productivity is now a key area of concern for government and an area for exploring the potential for working with donors and the private sector.

Strengthening policies and institutions responsible for technical and vocational education and training is a further structural reform that must be accelerated. This is primarily a precondition for moving forward both the IDP and the modernization of industry and agriculture. From the perspective of leaving no one behind, it also plays a role in reducing social exclusion, however, by providing opportunities for people who have dropped out of the formal education system, leaving them trapped in low-wage manual labour. This applies in particular to youth, underlining the importance to Cambodia of technical and vocational education in taking full advantage of the ‘demographic dividend’ and simultaneously reducing risks associated with a disaffected youth population. The management of the technical and vocational education system, as well as its funding, is therefore an issue that needs to be urgently addressed.

Focusing more narrowly on the agro-industry sector, there is a need to redouble efforts to promote agricultural growth. Only then can the sector continue to support economic development as well as ensure food security and create livelihood opportunities. There is now relatively limited scope for expanding the land area under cultivation, meaning that improved techniques and increased yields must complement crop selection to boost overall agricultural productivity and output. Government reforms in the business sector must extend to addressing the needs of agribusiness, in particular providing access to inputs and off-farm technologies, as well as improved transportation and trade facilitation. The external environment, which is now increasingly characterized by volatile food and commodity prices, climate change and the competing attraction for migrant labour of working outside the country, presents additional challenges to advancing modernization and commercialization in the rural sector.

8.3 Mobilising partners and resources

Even as Cambodia mobilizes more domestic resources and attracts increasing flows of FDI, the attainment of MIC status and its prospective LDC graduation will continue to affect access to concessional public finance and (the latter specifically) trade access. A smooth transition requires dedicated government leadership and continued strong commitment to implementing the ambitious institutional reforms that have been set out by government.

There is a solid foundation to build on towards becoming an upper-middle-income country by 2030 and to realize the SDGs. The NSDP and the IDP, together with sectoral plans and reforms, lie at the heart of future development programming and resource mobilization. These national policies acknowledge that Cambodia is undergoing a period of significant change. There is a need to set out an ambitious agenda to lead these changes and then to monitor the social and economic consequences over the next decade.
Addressing—and financing—the policy response to these challenges requires a coherent and comprehensive approach to the management of development finance. Impressive progress over the past two decades demonstrates that leadership, commitment and capacity are now well established. There is therefore cause to be optimistic that the government’s ongoing reform and IDP implementation efforts will be rewarded by securing further progress towards national development targets, as well as the SDGs. To further develop its approach and policy in these areas, the RGC could consider continuing the DFA process and moving into the second phase, that of integrated financing solutions.
Annex 1: Overview of estimates of total expenditure requirements according to the NSDP 2014–2018

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>I. Recurrent expenditure</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>1,999.4</td>
<td>2,184.4</td>
<td>2,400.0</td>
</tr>
<tr>
<td>II. Capital expenditure</td>
<td>4,271.1</td>
<td>4,740.2</td>
<td>5,260.0</td>
</tr>
<tr>
<td>III. Subtotal (I+II)</td>
<td>6,270.5</td>
<td>6,924.7</td>
<td>7,660.1</td>
</tr>
<tr>
<td>IIIa. Private capital expenditure (71.5%)</td>
<td>3,053.8</td>
<td>3,389.3</td>
<td>3,760.9</td>
</tr>
<tr>
<td>IIIb. Public capital expenditure (28.5%)</td>
<td>1,217.3</td>
<td>1,351.0</td>
<td>1,499.1</td>
</tr>
<tr>
<td>IV. Total of non-budgeted public expenditure</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>V. Total required public capital expenditure (IIIb+IV)</td>
<td>1,953.3</td>
<td>2,087.0</td>
<td>2,235.1</td>
</tr>
<tr>
<td>VI. Total estimated expenditure needs (III + IV)</td>
<td>7,006.5</td>
<td>7,660.7</td>
<td>8,396.1</td>
</tr>
<tr>
<td>VII. Available public sector capital expenditures</td>
<td>-390.0</td>
<td>-390.0</td>
<td>-390.0</td>
</tr>
<tr>
<td>Public capital expenditure gap (V+VII)</td>
<td>1,563.3</td>
<td>1,697.0</td>
<td>1,845.1</td>
</tr>
</tbody>
</table>

Targeted support for the development and diversification of rural economies to alleviate poverty in rural and remote areas

Expansion of social services sectors to achieve CMDG targets

Support to strengthen the capacity of RGC institutions to deliver their programmes and services efficiently

IV. Total of non-budgeted public expenditure

736.0

736.0

736.0

736.0

736.0

809.6

890.6

979.6

1,077.6

1,185.3

1,303.9

1,434.3

To be used to leverage financing from traditional and non-traditional development partners and the private sector

10% annual growth

10% annual growth

10% annual growth

10% annual growth

10% annual growth

10% annual growth

10% annual growth