

CAMBODIA ECONOMIC UPDATE

CAMBODIA CLIMBING UP THE MANUFACTURING VALUE CHAINS

October 2017

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Selected Issue:
CAMBODIA CALLING: Maximizing tourism potential



WORLD BANK GROUP

C A M B O D I A E C O N O M I C U P D A T E

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List of abbreviations

Abbreviations and acronyms	Meaning
ASEAN	Association of Southeast Asian Nations
CPI	Consumer Price Index
CR	Cambodian Riel
EU	European Union
FCD	Foreign Currency Deposit
FDI	Foreign Direct Investment
IDP	Industrial Development Policy
IMF	International Monetary Fund
GDP	Gross Domestic Product
LPCO	Liquidity-Providing Collateralized Operation
GIR	Gross International Reserves
MMA	Monthly Moving Average
NCD	Negotiable Certificate of Deposits
NPL	Non-Performing Loan
NSDP	National Strategic Development Plan
TVET	Technical and Vocational Education Training
PDR	People's Democratic Republic
RGC	Royal Government of Cambodia
SPPF	Social Protection Policy Framework
y/y or yoy	Year-on-Year
UN	United Nations
UNESCO	United Nations Educational, Scientific and Cultural Organization
US\$	United States Dollar
WB	World Bank
YTD	Year-To-Date





SECTION I: RECENT ECONOMIC DEVELOPMENTS AND OUTLOOK

EXECUTIVE SUMMARY

Growth remains robust, but is projected to ease slightly to 6.8 percent in 2017, compared with 7.0 percent in 2016. Exports of clothing and other textile products have moderated and the construction sector is showing signs of easing. Offsetting deceleration in the exports of clothing and other textile products, is the rising share of non-textile product exports, especially the exports of electrical machinery, equipment and auto parts, attracted by improved connectivity and access to a more reliable energy supply. Efforts to increase tourism potential seem to be paying off with a marked increase in the arrival of foreign tourists. Real growth is projected to remain strong, expanding at 6.9 percent in 2018. The medium-term outlook remains positive, boosted by export diversification and underpinned by healthy inflows of foreign direct investment (FDI) and an improving global outlook. A possible slowdown of the regional economy, especially China, and potential election-related uncertainties pose downside risks to the outlook.

RECENT DEVELOPMENTS

Growth remains robust, although signs of slight moderation are evident. In 2016, real growth was 7.0 percent. During the first six months of 2017, exports of clothing and other textile products continued to expand, reaching US\$3.3 billion¹. However, the value

of exports grew at 5.4 percent year-on-year (y/y), down from 8.4 percent in 2016 with declining unit prices caused by rising competitiveness from other textile exporters. Cambodia's external competitiveness is being constrained by rising real wages and high logistics costs. Partly offsetting this growth deceleration, exports of electrical

¹ Articles of apparel and clothing accessories, knitted or crocheted (Harmonized System, HS code 61) and Articles of apparel and clothing accessories, not knitted or crocheted (HS code 62).

machinery, equipment and auto parts, together with footwear exports, have picked-up. The share of the newly emerging exported products (excluding footwear) rose to 8.7 percent of total exports in 2016, up from less than 2 percent in 2010—indicating that Cambodia is at the cusp of climbing up to the next stage of manufacturing value chains. Authorities' efforts to attract foreign tourists seem to be paying off. Tourist arrivals accelerated to 12.8 percent growth (y/y) during the first six months of 2017, compared with 5 percent in 2016.

The financial sector, which has experienced exceptionally rapid growth in recent years, has shown healthy moderation. Credit growth has slowed, decelerating to 18.2 percent (y/y) in mid-2017, from 25.8 percent in 2016. Bank deposits, however, remained strong, growing at 20 percent (y/y) by mid-2017, reflecting healthy capital inflows and improved confidence in the banking system. Rising foreign currency deposits have contributed to the expansion of broad money, which grew by 19.7 percent (y/y) by mid-2017, compared with 17.9 percent in end-2016.

Cambodia's external position remains strong, underpinned by continued robust export growth and rising inflows of FDI. With solid exports and lackluster imports, the current account deficit is estimated to have narrowed to 10.2 percent of GDP in 2016, compared to 11.5 percent in 2015. Continued strong inflows of FDI supported the rapid accumulation of foreign reserves, which reached almost US\$7.8 billion (or six months of prospective imports) in mid-2017.

Inflationary pressures, built up during the latter-half of 2016, have now eased. Moderation in import growth during the first half of 2017 reflected softer domestic demand. There are signs that construction activity, which had fueled domestic demand until recently, is easing. Inflation moderated to 2.6 percent in August 2017, down from 3.9 percent at the end of 2016. The Cambodian riel (CR) has slightly depreciated against the US dollar, the Thai baht, and the Vietnamese dong. The riel/U.S. dollar exchange rate rose to CR 4,053 in September 2017, up from CR 4,037 in December 2016.

Cambodia's fiscal position remains stable and broadly supportive of growth. In 2016, strong revenue collection continued as domestic revenue is estimated to have increased by almost 1 percentage point of GDP. Rising current expenditure fueled by a growing wage bill was more than offset by a decline in capital spending. The fiscal deficit (excluding grants) is estimated to have narrowed to 3.0 percent of GDP in 2016, down from 3.5 percent in 2015. The grants component of the budget, however, continue to fall. Domestic revenue is likely to get a boost from oil revenue in the coming years following the signing of the Petroleum Agreement for Offshore Oil Field Development in Block A. Cambodia's debt distress rating, as per the latest World Bank/International Monetary Fund Debt Sustainability Analysis conducted in September 2017, is categorized as low. Cambodia has maintained a low debt distress rating since 2011, thanks to the authorities' prudent fiscal management and the overriding principle of borrowing only on concessional terms.

Poverty reduction continued, driven mainly by income diversification of rural households from remittances, non-agricultural wages and household businesses. The growth deceleration in the textile and construction sectors is expected to affect the income earnings of the poor in terms of less overtime working hours or days. The most recent preliminary quarterly survey of garment workers in Phnom Penh confirmed that daily income earnings of garment workers declined in May 2017, compared to February 2017. Consequently, remittances originating from these sectors could possibly decline. This will tighten household budgets and decrease expenditure in education, health, and investment in agricultural activities in the rural areas, if the current trend persists.

OUTLOOK

The growth outlook continues to be favorable. Real growth is projected to remain strong, at 6.8 percent in 2017. In 2018, growth is expected to pick up marginally, reaching 6.9 percent, largely due to rising election-related spending. In the absence of deeper structural reforms (see policy section below), trend growth is likely to slope downward in 2019 and beyond. Growth will continue to be propelled by export diversification and underpinned by healthy inflows of FDI. Rising government spending including public investment is also expected to drive growth. The recovery in global trade is expected to strengthen. There are promising signs of diversification in the manufacturing sector, with the entry of high-value-added manufacturers, especially for electrical appliances and components, and auto parts. Relatively high electricity and logistic costs, however, remain key bottlenecks.

The tourism sector is recovering, largely due to ongoing efforts to attract international tourists, especially from China with new regional direct flights and the “China Ready” initiative. The policy options suggested in the selected issue entitled “Cambodia calling—maximizing tourism potential” will enhance the tourism sector’s readiness to reap more benefits from the recent increase in tourist arrivals.

Downside risks to this outlook include a slowdown in the Chinese economy, gradual loss of external competitiveness, and potential election-related uncertainty. Given Cambodia’s increased dependency on Chinese FDI and tourist arrivals, a sharp slowdown in the Chinese economy could negatively impact growth prospects. Cambodia’s external competitiveness is currently being threatened by rising real wages, a strong dollar and emerging cheap labor competitors such as Myanmar. FDI inflows into the textile industry have declined. Facilitating structural reforms to accelerate Cambodia’s transition to higher-value-added manufacturing products is, therefore, critical. The general elections are scheduled to be held in mid-2018, which in the past have been associated with a period of heightened uncertainty, adversely affecting investor’ sentiment.

Poverty is expected to further decline over the next few years. This is underpinned by continued expansion of the services and manufacturing sectors, together with increases in remittances. However, there is a potential negative impact of the slowdown of the textile and construction sectors. The impact, if materialized, might reduce job and income opportunities available

for migrant workers, and consequently, diminish poverty reduction performance. With sluggish agriculture growth, the rural nonfarm (manufacturing, services and remittances) economy has so far been a significant contributor to poverty reduction and shared prosperity. An effort by the authorities has been made to stabilize agricultural prices (and to invest in rice storage and drying facilities), especially rice prices, with an introduction of a special fund for low-interest loans for rice purchases.

KEY MESSAGES AND POLICY OPTIONS

Cambodia appears to be on the verge of climbing up the manufacturing value chains—from garments to electronics and auto parts. It is crucial to nurture the newly emerging high-value-added manufacturing industries. Promoting export diversification beyond textile (and footwear) products is a priority. Supporting and further attracting on-going and future FDI in high-value-added products, especially electrical appliances and components, and auto parts is critical to this transformation. In this regard, addressing the high electricity and logistic costs together with skills constraints, which remain key bottlenecks, is the first important step. In this regard, reforming the electricity sector to provide competitive prices to industries is an imperative. Cambodia has made rapid strides in providing access to electricity, improving availability, and becoming nearly self-sufficient. However, the price of electricity remains relatively high compared to neighboring countries. It is due to lack of a competitive energy generation sector, and fragmented transmission and distribution systems. While restructuring the

sector will require time, in the near-term it is necessary to review electricity tariffs to bring them closer to their regional comparators.

It is also necessary to promote and improve the skills and quality of graduates coming out of the education and vocational programs. Identifying skills gaps to design courses that address such gaps, as targeted under the 2017-25 National Technical and Vocational Education and Training Policy, is also a priority.

Further efforts are needed to facilitate investment in the manufacturing sector. This is necessary, given the recent slowdown in FDI in the tradeable sectors, especially the textile sector. As real wages rapidly increase, Cambodia's external competitiveness, which primarily relies on cheap labor, is gradually diminishing. It is therefore imperative to further improve ease of doing business and the investment climate by eliminating regulatory impediments to bring down the costs of starting and operating businesses, as well as logistic costs. Relatively low costs will promote and facilitate investment, especially FDI in manufacturing as envisaged by the 2015-25 Industrial Development Policy. Cambodia's Doing Business ranking remains low. The country was ranked 131th out of 190 in 2017, compared with 82nd for Vietnam and 46th for Thailand. Starting a business ranked among the lowest (180th) with the time spent to register a business is four times longer than East Asia and Pacific region average. This calls for further improving regulatory environment. It is also important to reduce cost to export per container, which remained high. In 2014, it was US\$795 for Cambodia, significantly higher than that in Thailand (US\$595) and Vietnam (US\$610).

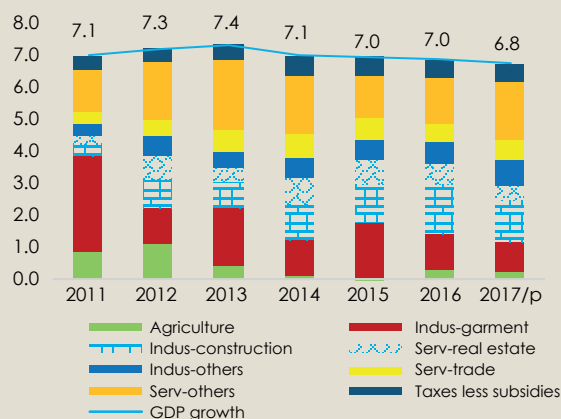
Mitigating measures are necessary to support rural households, which have been hard hit by continued low agricultural prices. The recent initiative to mobilize financial resources readily for rice purchases during the rice harvest seasons and improving access to markets by remote farmers will certainly help. In addition, the potential negative impacts of the slowdown of textile and construction sectors will need to be closely monitored. Both sectors, especially

the labor-intensive textile sector, have absorbed a large proportion of the rural labor force shed by the agriculture sector as structural transformation accelerates. Successfully implementing the two main pillars-social assistance and social security, envisaged by the 2016-25 national social protection policy framework will help prevent rural households from falling back into poverty.

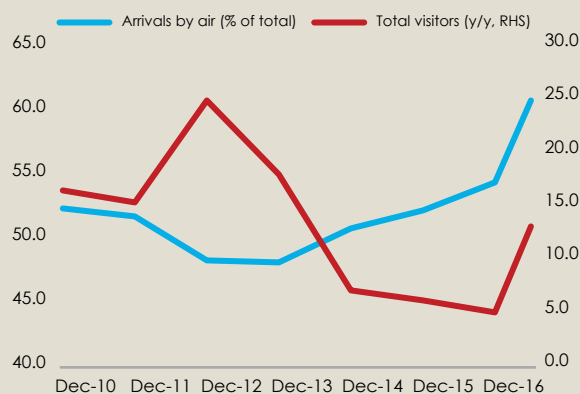


FIGURE ES.1: THE CAMBODIAN ECONOMY AT A GLANCE

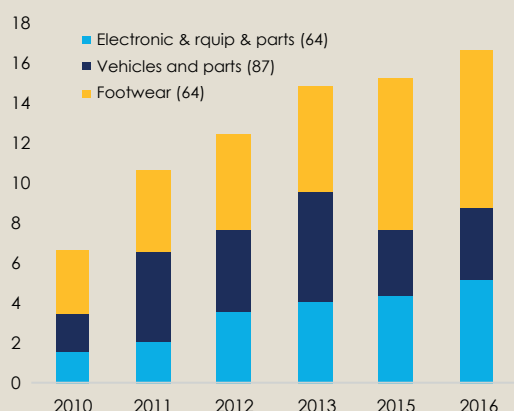
Strong growth continued in 2016...
(Contribution to growth, percent)



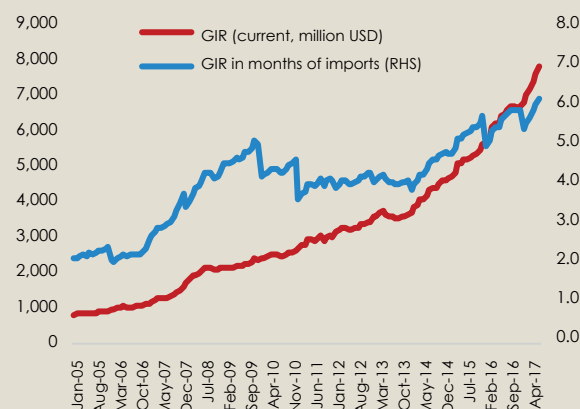
...dynamism in the tourism sector has returned...



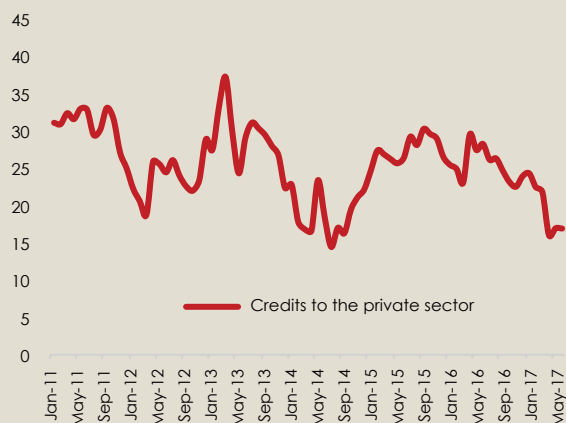
...and there are signs of export diversification (% total merchandise exports)



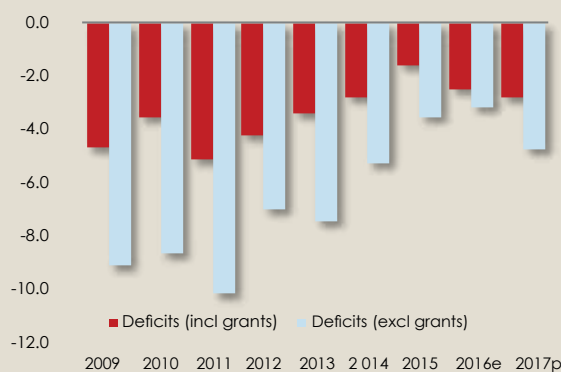
Gross foreign reserves rapidly accumulated on the back of healthy FDI inflows...



... while credit has eased, returning to a more sustainable growth path. (y/y, % change)



Strong revenue collection helped contain the fiscal deficit (General government fiscal deficits as a percent of GDP)



Sources: Cambodian authorities, UN Camtrade, and Bank staff estimates and projections.
Note: e = estimates; GIR = Gross International Reserves; p=projections; RHS = right-hand scale.





RECENT ECONOMIC DEVELOPMENTS

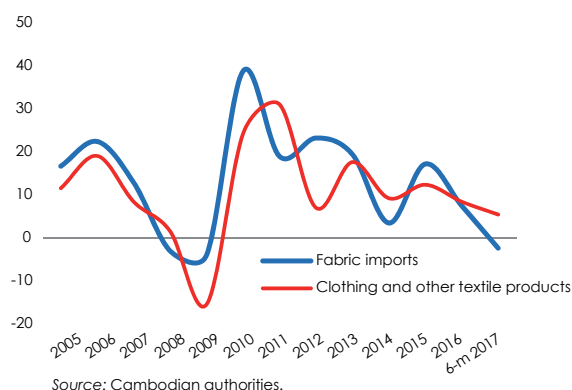
THE REAL SECTOR

The level of economic activity in the real sector remains strong, while there are signs of moderation in the exports of textile and apparel articles and in construction activity. Partly offsetting this moderation, exports of electrical machinery, equipment, and auto parts have picked up, and the authorities' efforts to attract international tourists seem to have paid off, with double-digit growth in international tourist arrivals.

a) Main drivers of growth

The manufacturing sector-the exports of textile and apparel articles. During the first six months of 2017, exports of clothing and other textile products reached US\$3.3 billion². Exports grew at 5.4 percent (y/y) during the first half of 2017, down from 8.4 percent in 2016 (figure 1). In volume terms, exports have also eased, increasing by 3.6 percent (y/y), compared with 12.3 percent during the same period last year.

Figure 1: Cambodia's exports of clothing and other textile products continue to moderate (y/y, % change)



Exports are facing increased competition. Real wages are rising, while productivity improvement remains modest. As a result, the prices of exported garment products have been declining. Currently, the minimum wage (excluding allowances) for the garment and footwear sector is US\$ 153 a month and is expected to increase to US\$ 170 a month in 2018³. Since 2013, the minimum wage has been rapidly

² Articles of apparel and clothing accessories, knitted or crocheted (Harmonized System, HS code 61) and Articles of apparel and clothing accessories, not knitted or crocheted (HS code 62).

³ Articles of apparel and clothing accessories, knitted or crocheted (Harmonized System, HS code 61), and

rising, increasing at an average of 17.6 percent per year during the period 2013-17, compared with only 7.4 percent during the period 2008-13. The textile sector is therefore under pressures to cut costs and gradually add value to its products by incorporating printing, embroidery and washing and vertically integrating to the extent possible. In addition, annual FDI inflows into the sector have slowed recently. Productivity of the textile (and footwear) sector grew at a modest average rate of 1 percent a year during the period after the 2008-09 global financial crisis. This followed a rapid expansion of the sector before the end of the Multi-Fiber Agreement in 2004. In 2016, Cambodia's real GDP per capita (at constant 2010 U.S. dollars) reached US\$1,078⁴. Evidence from garment-exporting countries suggests the "threshold" range to be between US\$1,150 and US\$2,000 real per capita GDP associated with decline in per-capita garment exports (see Box 1 for experience of Bangladesh and Vietnam).⁵

To prop up the textile industry and maintain its competitiveness, several initiatives and measures are being introduced. An important step is upgrading the skills of textile factory workers through on-the-job training with the establishment of Cambodian Garment Training Institute located in the Phnom Penh Social Economic Zone. Other initiatives recently introduced that are helping contain living costs of factory workers include access to lower utilities tariffs; and provision of free health insurance, pensions, and transportation.

Box 1: Export performance of Bangladesh and Vietnam in apparel and clothing

Bangladesh and Vietnam are two major exporters of articles of apparel and clothing accessories, accounting for 7.7 percent (US\$33.5 billion) and 5.7 percent (US\$24.6 billion) of the world market share, respectively. Both countries have been able to robustly maintain their export share, especially after the 2008-09 Global Financial Crisis, growing at an average rate of around 14.5 percent and 16.0 percent during the period 2010-16, respectively.

For Bangladesh, the share of the exports of articles of apparel and clothing accessories in the country's total exports continued to increase, rising to 86 percent in 2016, up from 75 percent in 2004. Bangladesh has retained its cost competitiveness by maintaining relatively stable and low minimum wage which is reviewed only every five years. Currently, Bangladeshi minimum wage is BDT5,300 (equivalent to US\$ 68) effective since 2013, compared to Cambodia's US\$153.

Success in export diversification has allowed Vietnam to reduce the share of the exports of articles of apparel and clothing accessories in the country's total exports. The share of exports dropped to 11.5 percent in 2016, down from 15.6 percent in 2004. Unlike Bangladesh and Cambodia, Vietnam is not a recipient of the "Everything But Arms" scheme which grants full duty free and quota free access to the EU Single Market for all products. Vietnam's GDP per capita (constant 2010US\$) reached US\$1,770 (2016), while its minimum wage remains relatively comparable to that of Cambodia.

Minimum wage (US\$)	2010	2015	2016	2017
Bangladesh	25	68	68	68
Vietnam	54-72	96-138	107-156	113-165
Cambodia	61	128	140	153

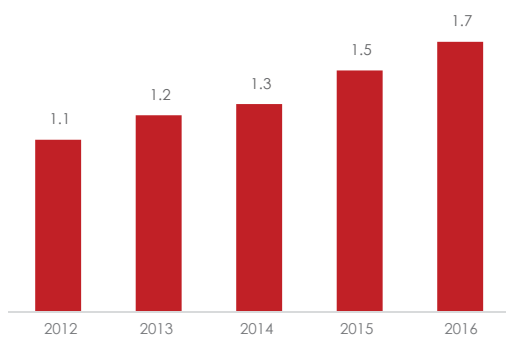
Sources: ILO, American Chamber of Commerce in Vietnam, and Factsheet Clean clothes campaign.

4 For more details, please see the selected issue entitled "the Garment Sector in Perspective", October 2016 Cambodia Economic Update.

5 News release, October 5, 2017, Ministry of Labor and Vocational Training.

The European Union (EU) continues to be the most important market for Cambodia's garment exports. The EU together with the UK absorbs about 45 percent of the total exports of clothing and other textile products. The US market is the second largest, accounting for a quarter of Cambodia's exports, while Japan accounts for 9 percent. Despite the challenges, Cambodia has been able to increase its share in the world's exports of textile and apparel articles, reaching 1.7 percent in 2016, up from 1.1 percent in 2011 (figure 2).

Figure 2: Cambodia's exports of apparel and clothing accessories (% of global trade in HS 61 and 62)



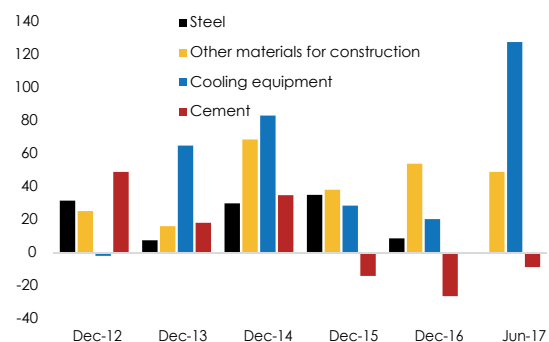
Source: UN comtrade.

Footwear exports continue to grow steadily. The exports of footwear products, largely destined for the EU market, are second after clothing and other textile articles. Total footwear export value reached almost US\$0.5 billion during the first six months of 2017 or 19.3 percent (y/y), up from 15.6 percent in 2016. Reflecting increased competition, average footwear export prices have been steadily declining since early 2016.

The construction sector—a key driver of growth and job creation—appears to be

slowing down. Many indicators point to moderation of the construction and real estate sector, although the number and value of approved construction projects during the first half of 2017 remains upbeat. Imports of basic construction materials which grew rapidly during the last four years fueled by the post 2008/09 global financial crisis construction boom, have recently decelerated. Notably, the growth of imports of steel and cement, which are basic construction materials, have either decelerated or turned negative during the first half of 2017 (figure 3).

Figure 3: Imports of basic construction materials (steel and cement) have moderated and declined (y/y % change)



Source: Cambodian authorities.

The majority of on-going construction activity in urban areas pertain largely to completion of modern high-rise commercial and residential building projects, which were begun several years ago. This is reflected in rising imports of fixtures and furnishings materials and equipment including cooling appliances, while the imports of the basic building materials have shrunk.

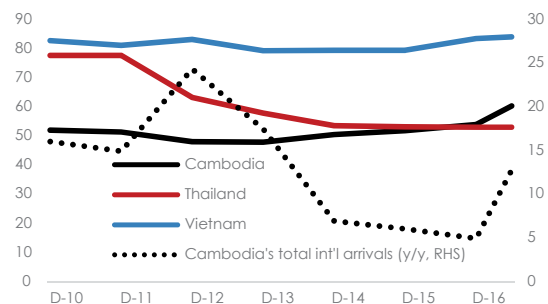
Growth of domestic credits going to the construction and real estate sector has also slowed. Domestic credits provided by the

banking sector to the construction and real estate sector declined to 28.6 percent (y/y) growth in mid-2017, down from an average of 36 percent (y/y) growth during the last four years. The share of construction and real estate in the total domestic credit, however, peaked, reaching 24 percent in mid-2017 (see the monetary section below for more details).

A new but relatively small segment of construction development projects--affordable housing projects -- seems to be emerging. This is happening following the boom in landed housing projects and high-rise residential and commercial construction projects located in prime locations within urban centers. Recently, there has been a shift toward investing more in affordable homes to serve the low-end market segment on the outskirts of Phnom Penh and newly developed areas. For this segment, a larger discount and lower (and even zero) down payments are being offered for new purchases (of "to be built" homes or "being built" homes) to prop up weak demand.

Efforts to attract international tourists, especially from China, by the authorities seem to be paying off, with a swift recovery of tourist arrival growth. During the first six months of 2017, total tourist arrivals reached 2.6 million, growing at 12.8 percent (y/y), up from a mere 5.0 percent increase in 2016 (figure 4). Importantly, tourist arrivals by air have increased significantly, rising by 23.1 percent (y/y), a record high since a decade ago.

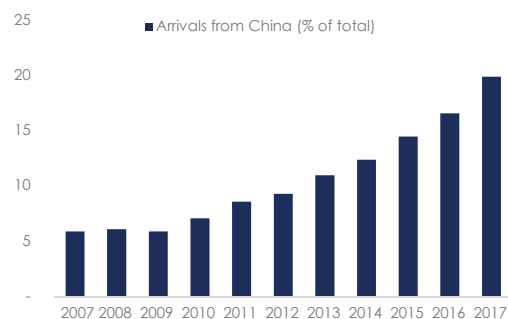
Figure 4: Cambodia's international arrivals by air has increased markedly
Arrivals by air (% of total)



Source: Tourism authorities (Cambodia, Thailand and Vietnam).

Tourist arrivals from China now outpace those from Vietnam, making them the number one group to visit Cambodia. Chinese tourists accounted for 20 percent of total international arrivals by mid-2017, up from 16.6 percent in 2016 (figure 5). Arrivals (mostly by air) from China skyrocketed, rising by 40 percent (y/y) or 0.52 million tourists by mid-2017, up from 12.4 percent during the same period last year. It is likely that Cambodia could receive as many as 1 million Chinese tourists by the end of 2017. If the rapid Chinese tourist arrival growth continues for the next few years, the authorities' target of reaching 2 million Chinese tourists by 2020 seems feasible.

Figure 5: Chinese tourists are rapidly increasing (% of total)

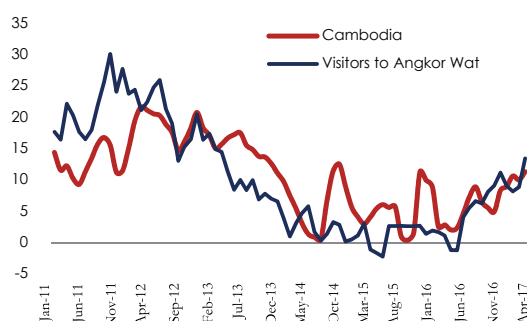


Source: Cambodian authorities.

During the first half of 2017, Vietnam, Lao PDR, the Republic of Korea, and Thailand were the main countries of origins for international tourists after China, accounting for 14.7 percent, 8.4 percent, and 6.3 percent of total arrivals, respectively. While Asia continues to be the major source of tourists, arrivals from Western Europe and North America have picked up, rising by 24.7 percent and 18.4 percent, respectively.

Despite of initial success in diversifying destinations, the Angkor temple complex remained the main attraction site in Cambodia (figure 6). Arrivals to Siem Reap province where the temple is located account for 60 percent of total international arrivals by air. Together with entrance fee increases, the recent jump in tourist arrivals has significantly boosted revenue collected from foreign tourists visiting the Angkor Wat temple complex. The revenue from Angkor Wat entrance fees has reached US\$ 60.3 million during first seven months of 2017, an increase of 68 percent over the corresponding months last year.

Figure 6: Angkor Wat remains the main attraction site, although initial success has been made in diversifying tourist destinations
(3mma, y/y)



Source: Cambodian authorities.

While there has been progress in diversifying destinations, especially to the coastal region, the potential for ecotourism remains untapped. Tourist destination diversification efforts have successfully boosted foreign visitors to coastal areas, receiving 15 percent of the total international arrivals, up from 10 percent a year ago. Ecotourism is incipient, with only a 2 percent share of total arrivals, although there is a large potential. There is a plan to promote eco-tourism mostly in the north and northeastern parts of the country with an introduction of wildlife adventure parks, trekking and more.

In addition, given the recent construction expansion, helping other emerging urban areas (beyond Phnom Penh and Siem Reap) to become more tourist-friendly destinations by improving tourism infrastructure, facilities, and accessibility, would help support diversification in tourism destinations. There are several new and rising attraction sites such as Sihanoukville, Battambang, and Kampot (see the selected issue entitled “Cambodia calling– maximizing tourism potential” for details).

Improved weather conditions have underpinned agriculture sector expansion, especially rice production. Rice production grew by 5.7 percent in 2016, reaching 9.8 million metric tons. Favorable weather conditions also extended during rainy season rice production in 2017. Contribution to growth by agriculture subsectors such as livestock and fisheries also improved last year. The agriculture sector remains an important sector for the economy although its share shrank to a quarter of GDP in 2016, down from 48 percent two decades ago. The sector provides 44 percent of

total employment or 53 percent of rural employment.⁶

However, most agricultural commodity prices continued to remain low. International prices of rice and rubber briefly picked up during the second quarter of 2016, but have declined since (figure 7). To stabilize local rice prices during the incoming harvesting season, the authorities recently introduced a number of initiatives, including the injection of relatively low-interest loans into the rice sector and investing in building rice storage and drying facilities.⁷ The authorities also plan to improve farmers' access to markets, while cutting transportation and storage (and export) costs. This likely will help reduce the large differences between low farm gate prices and high retail prices of agricultural products, and benefit local farmers more.

Figure 7: Agricultural commodities prices, in particular rice and rubber prices continued to be subdued



b) Newly emerging manufacturing industries

There are some promising signs of diversification in the manufacturing sector, beyond the garments and footwear industry. The entry of high value added (FDI targeted) manufacturers, especially for electrical appliances and components, and auto parts is encouraging. Sustained macroeconomic stability and continued liberal investment and trade policy, motivated by regional integration, are attracting new breeds of foreign direct investors. While Cambodia had in the past succeeded in attracting significant inflows of foreign investments, they were largely concentrated in footloose industries, mainly textile and clothing that require low skills and simple manufacturing processes such as cut, make, and trim (CMT).

During the last several years, however, long-term and high-quality investments have been growing. In addition to the energy sector, the construction, physical infrastructure and high-value-added/sophisticated manufacturing sectors have been receiving large and rising FDI inflows. Recently, the presence of non-textile industries which include manufacturers of electronic appliance parts, earphone, automobile parts, wire harnesses, electrical parts, optical parts, metal building materials, construction materials, and connectors are rising. These newly emerging high-value-added manufacturers are expanding, in terms of numbers and share of total manufacturers (Table 1).⁸ Accordingly, their export share has expanded (figure 8).

⁶ Cambodia Socio-Economic Surveys

⁷ In an effort by the authorities to stabilize agricultural prices, especially rice prices, a special fund with low-interest, amounting to US\$ 50 million has reportedly been established (and an additional US\$ 15 million will be invested in rice storage and drying facilities). The fund is mobilized to provide loans to rice millers so that they can purchase rice during the forth-coming rice harvesting season.

⁸ The Phnom Penh Special Economic Zone has witnessed a rapid expansion of non-textile manufacturing sectors. Of the 75 (ongoing and incoming) export manufacturers with total approved investment figure of more than half a billion US dollar during 2008 – 16 in the Phnom Penh Special Economic Zone (SEZ), only 7 are producing of apparel and clothing. From over a dozen countries, notable manufacturers include Minebea, Denso, Sumi Wiring Systems, Tanaka Foresight Inc., and Nikko Kinzoku. Companies located in other SEZs and other venues include Izumi Electronics (Cambodia) Co. in Sihanoukville Special Economic Zone, SC Wado Component (Cambodia) Co. (Cambodian-Thai border), Hyundai's car assembly plant in Koh Kong province, and a Ford vehicle assembly facility located in Sihanoukville Port.



Table 1: Rising number (and share) of nontextile and footwear manufacturers in Cambodia

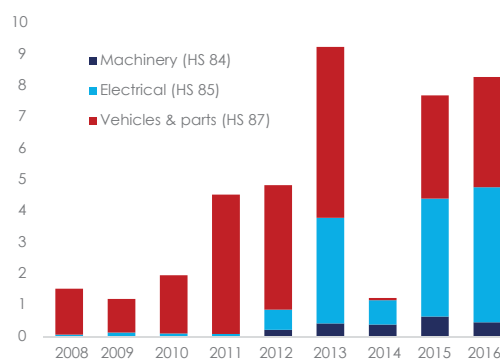
Industrial Classification (ISIC, Rev. 4)	2012		2017 (Aug)	
	Facto- ries	Share (%)	Facto- ries	Share (%)
Food, Beverages & Tobacco (10-11-12)	74	8.2	140	8.3
Textile, Wearing Apparel & Footwear (13-14-15)	673	74.2	1,110	65.5
Paper & Paper Products (17)	17	1.9	46	2.7
Chemical, Rubber and Plastics (20-22)	60	6.6	124	7.3
Other non-Metallic Manufacturing (23)	15	1.7	33	1.9
Metallic, Electronic, Electrical, Machinery, Motor Vehicle, other Transport Equip (24-25-26- 27-28-29-30)	46	5.1	121	7.1
Furniture (31)	12	1.3	82	4.8
Other Manufacturing (32)	10	1.1	39	2.3
	907	100.0	1,695	100.0

Source: Cambodian authorities.

Note: International Standard Industrial Classification (ISIC), Rev.4

The new industries, if successfully nurtured, will enable Cambodia to further integrate into regional value chains with horizontal division of labor. Supporting growing interconnectedness of the Cambodian economy and regional countries' economies, electrical and vehicle parts

Figure 8: Cambodia's export product diversification (beyond clothing) is expanding (percent of total exports)



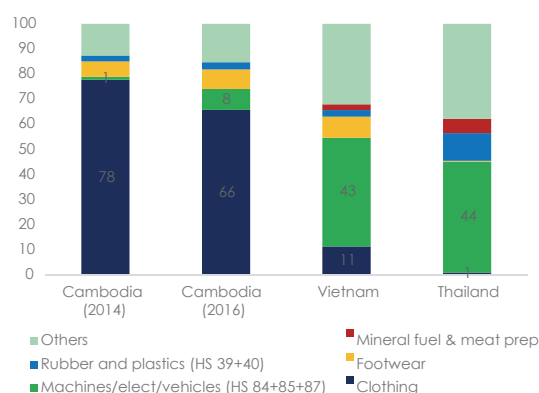
Source: UN Comtrade

and components produced in Cambodia as intermediate goods are exported to be further processed and/or assembled elsewhere. It will be further enhanced by progress under regional integration, the ASEAN Economic Community. As integration deepens, Cambodia may be able to move up from its production of nondurable consumer goods (clothing and footwear) to durable consumer goods (electrical machinery, machinery, and vehicle parts) and then to capital goods industries, according to the famous "Flying Geese" model of economic development.

Including footwear, exports of non-textile manufactured products already reached 16 percent of total exports in 2016, based

on international trade statistics database (figure 9).⁹ While quickly growing, Cambodia remains far behind Vietnam and Thailand in having diversified manufactured products, especially for exports machinery, electrical machinery, and vehicles and parts.

Figure 9: Export diversification - regional comparison (% share, 2016)

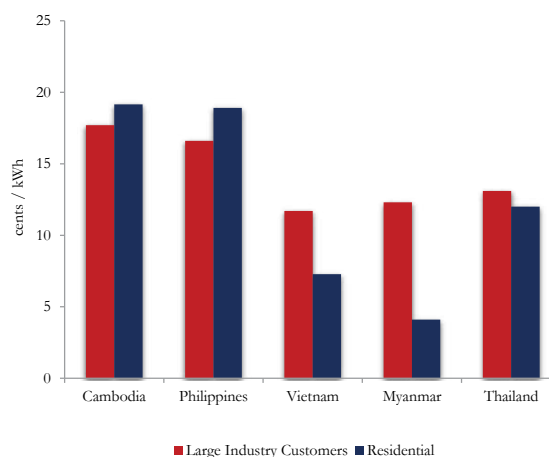


Source: UN Comtrade.

Key bottlenecks to attract and expand the newly emerging and energy-intensive industries include high electricity and logistic costs, and growing skills constraints. Access to electricity has substantially improved since 2014, when the Investment Climate Assessment found that electricity was the most severe constraint.¹⁰ Cambodia has made rapid strides in providing access to electricity, improving availability, and becoming nearly self-sufficient.

However, the costs of electricity remain among the highest in the region (figure 10) due to lack of competitive bidding in energy generation, and fragmentation in transmission and distribution, making addressing these costs an important next step. To address the high costs of electricity, the authorities have targeted electricity tariff reduction under

Figure 10: Electricity tariff, country comparisons



Sources: Electricity Authority of Cambodia, 2015; Philippines Energy Regulatory Commission, 2016; Vietnam Ministry of Industry and Trade, Decision No. 2256/QD-BCT, 2015; Myanmar Ministry of Electric Power, 2015; Thailand Energy Regulatory Commission, 2016; De Ferranti et al., 2016. Latest available data.

the 2015-25 Industrial Development Policy (IDP) (Table 2). It appears, however, that the targeted electricity tariffs remain relatively expensive, when compared regionally.

Table 2: Electricity tariff reduction schedule

Source of connection	2018	2019	2020
Sub-stations	0.126	0.126	0.126
P. Penh main network	0.165	0.163	0.162
Provincial main network	0.164	0.163	0.162

Source: 2015-25 Industrial Development Policy.

Promoting high-value-added manufacturing will require a skilled workforce. Due largely to insufficient skilled labor, high-value-added and sophisticated manufacturers must invest considerable time and resources to train their prospective workers (before they can be readily employed) to be successful. However, not many manufacturers are willing to substantially invest in training, given the possibility that their workers may be poached by others after being trained. Those not willing to make considerable

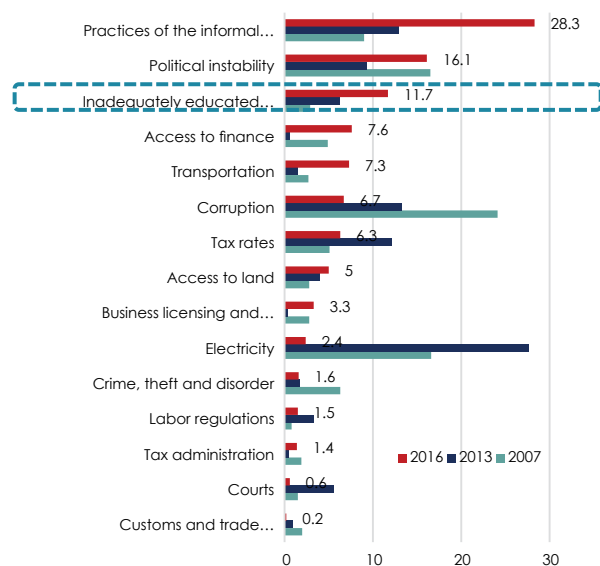
⁹ <http://www.intracen.org/>

¹⁰ <http://documents.worldbank.org/curated/en/251591468236679212/Cambodia-The-investment-climate-assessment-2014-creating-opportunities-for-firms-in-Cambodia>

investments in skills for their workforce have not been successful in improving worker productivity.

The World Bank Group Enterprise Survey in 2016 found that an inadequately educated workforce is the third most severe obstacle for firm operation. The perceived constraint of an inadequately educated workforce (12 percent of respondents) is behind only the constraint due to informal sector practices (28 percent of respondents) and political instability (16 percent) (figure 11). Access to transportation was the fifth most severe obstacle for firm operation. As discussed above, while electricity is no longer listed among the main concerns—most likely due to improvements in reliability of supply, costs remain high, especially for energy intensive manufacturers to compete.

Figure 11: Obstacles to firm operation
(Percent of firms)



Source: World Bank Group Enterprise Surveys.

c) Structural transformation

Economic activity of the real sector sustained robust expansion, resulting in acceleration of Cambodia's economic transformation. Thanks to sound economic policies, accommodative financial conditions, and healthy FDI inflows, Cambodia has recently experienced accelerated economic structural transformation. The contribution of agriculture to gross domestic product (GDP) has shrunk. Contribution by industry, a higher-productivity sector, has expanded.

Agricultural growth flattened, declining from an average rate of 4.1 percent during 2006-13 to 0.8 percent during 2014-16. In 2016, agriculture's share in GDP¹¹ declined to 26.3 percent, down from about one-third a decade ago. Its share is now below industry's share of 31.3 percent. The services sector's share in GDP remained relatively unchanged, accounting for the remaining 42.4 percent. This has contributed to the robust economic and productivity growth witnessed over the past two decades.

Accelerated structural transformation may have contributed to achieving two of the targets under the 2015-25 Industrial Development Policy.¹² These targets are (a) increasing the GDP share of the industrial sector to 30 percent by 2025, and (b) increasing exports of manufacturing products (nontextile products) to 15 percent of total exports by 2025. With the recent construction boom, the official national account statistics show the GDP share of the industrial sector has reached 29.5 percent at current prices or 32.1 percent at constant 2000 prices in 2016.

¹¹ GDP at current factor prices

¹² The 2015-25 Industrial Development Policy introduced in August 2015 strategically aims to (a) attract investment, (b) modernize small and medium-sized enterprises, (c) improve the regulatory framework, and (d) coordinate supporting policies. Key targets include (a) Increasing the GDP share of the industrial sector to 30 percent in 2025 from 24.1 percent in 2013 while increasing annual manufacturing sector growth to 20 percent in 2025 from 15.5 percent by 2013; (b) Increasing exports of manufacturing products (nontextile products) to 15 percent of total exports by 2025 (from 1 percent in 2013) and increasing exports of processed agricultural products to 12 percent by 2025 (from 7.9 percent in 2013); and (c) Officially registering 80 to 95 percent of the country's small and medium-sized enterprises by 2025, of which 50 to 70 percent will also have accurate accounts and balance sheets.

As discussed above, including footwear, exports of non-textile manufactured products already reached 16 percent of total exports in 2016.

However, the recent economic structural transformation seems biased toward construction. In the industrial sector, construction has quickly expanded to become one of main drivers of growth during the last decade. Within the industrial sector, the share of the construction sector increased partly at the expense of the manufacturing sector. The construction sector as a percentage of GDP doubled to about 12 percent in 2016, up from about 6 percent in 2006, while that of the manufacturing sector declined to 16 percent in 2016 from 18 percent in 2006.¹³

To support 2015-25 IDP implementation, the authorities introduced in June 2017, 2017-25 National Policy for Technical and Vocational Education and Training. The policy is aimed at mainly addressing skills gaps, supporting export diversification to move up the value chain (see Box 2 for more details).

POVERTY

Poverty reduction continued, driven mainly by income diversification of rural households—earnings from remittances, nonagricultural wages, and household businesses. Sustained economic growth has boosted household income and consumption. Household durable goods ownership, an important indicator of the overall welfare of the poor, has shown significant improvement.¹⁴ During the past two decades, household durable

Box 2: 2017-25 National Policy for Technical and Vocational Education and Training (TVET)

The TVET policy adopted in June 2017 serves as a roadmap, aimed at (a) strengthening the quality of TVET under national standards to meet market demands, (b) providing equal opportunity to obtain TVET for employment, (c) encouraging public-private partnerships, and (d) improving governance of TVET systems. The TVET policy also intends to create synergy of TVET programs and trainings provided the public sector, nongovernmental organizations, and the private sector.

To achieve the aims above, the National Policy for TVET is envisaged to set up a coordination mechanism to establish a national fund for skills developments, among others. New initiatives include introduction of TVET parks (and career centers) in main special economic zones, research centers to study new skills, and collaboration with employers to improve skills developments and avoid skills mismatch. In addition, establishing “single window” offices at TVET training centers including TVET awareness programs is also envisaged. TVET graduates are encouraged to become entrepreneurs and part of the skilled workforce for labor mobility. A supportive and regulatory legal framework, including TVET law, is to be established.

The NPTVET was developed under the leadership of and coordination by the Ministry of Labor and Vocational Training.

Source: The 2017–25 National Policy for Technical and Vocational Education and Training.

¹³ The share increases to 18 percent when the real estate sector (classified under services) is included.

¹⁴ As they become more prosperous, households and individuals tend to engage in purchasing of more durable goods and long-term assets than basic consumption commodities.

goods ownership in the rural areas of Cambodia has been catching up fast. Rising rural household ownership of cellphones, motorcycles, and personal computers has been impressive. In 2004, only 5.7 percent of rural households owned cellphones, and 22.3 percent owned motorcycles (table 3). By 2015, 75 percent owned cellphones and 67 percent owned motorcycles. Ownership of televisions (and personal computers) has also markedly improved. As of 2015, 61 percent of rural households own televisions compared with only 40 percent a decade ago.

Table 3: Selected items of durable goods owned by households by geographical classification (percent)

Items	2004		2015	
	Cambodia	Other rural	Cambodia	Other rural
Radio	36.1	34.9	32	32
TV	46.3	39.8	68	61
Satellite dish	0.5	0.4	3	3
Stereo	23.5	18.7	13	11
Cellphone	14.1	5.7	77	75
Bicycle	63.1	65.6	64	66
Motorcycle	29.1	22.3	71	67
Car	3	0.8	4	2
PC	2	0.2	8	5

Source: Cambodia Socio-Economic Surveys.

However, there is a potential impact on poverty reduction, if the textile and construction sectors experience a sharp decline. The deceleration of the textile and construction sectors could somewhat affect the income earnings of the poor in terms of less overtime hours or

days. The most recent preliminary quarterly survey of garment workers in Phnom Penh also confirmed that daily income earnings of garment workers declined in May 2017, compared to February 2017. Consequently, remittances originating from these sectors could decline, tightening household budgets and decreasing the expenditure on education and health, and on investment in agricultural activities in rural areas, if the trend continues.

Successfully implementing the two main pillars--social assistance and social security, envisaged by the 2016--25 National Social Protection Policy Framework (SPPF) can help prevent rural households from falling back into poverty (see box 3 for more details on SPPF). Given continued sluggish agricultural growth, the rural nonfarm (textiles, services, and remittances) economy has so far been a significant contributor to poverty reduction. A slowdown in the labor-intensive textile sector will therefore be a challenge for jobs, income and poverty reduction.

THE EXTERNAL SECTOR

Cambodia's external position strengthened further as the trade deficit narrowed. With solid exports and lackluster imports, the current account deficit is estimated to have narrowed, and continues to be financed by rising FDI inflows.

Merchandise exports remained solid during the first half of 2017 despite slight easing from last year. Merchandise exports are estimated to have expanded at 10 percent (y/y) in 2016, up from 8.4 percent in 2015. Although exports of clothing and other textile products have moderated, non-

BOX 3: The 2016-25 National Social Protection Policy Framework (SPPF)

The SPPF adopted in March 2017 envisages two main pillars: (a) social assistance (emergency, human capital development, vocational training, and welfare), and (b) social security (pension, health insurance, and workers' accidental and disability insurance). New social assistance programs envisaged to be introduced are cash transfers (child malnutrition disability and elderly), while the existing assistance programs, namely, the health equity fund, food reserve, nutrition, scholarships and vocational training programs are to be expanded. Social security schemes are aimed at moving toward universal coverage of health insurance, pension schemes and unemployment insurance. For poor and vulnerable people who cannot afford to contribute to the social security schemes, the Royal Government of Cambodia will consider all possibilities of contributing on their behalf.

To achieve the above objectives, the SPPF calls for a review of the institutional structure and clear division of labor including establishment of a National Social Protection Council, introduction of a social security regulator, and integration of all social security operators including the National Social Security Fund (NSSF), an NSSF for civil servants (NSSFC), the National Fund for Veterans (NFV), and a Persons with Disabilities Fund (PWDF).

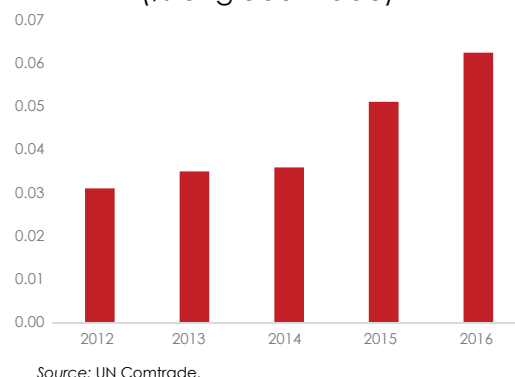
It is also envisaged that contribution to the Social Security System serves as a source of domestic financing which can be used to invest in government bonds. This enables the Royal Government of Cambodia to use this source of financing for public investment. This mechanism helps reduce the dependency on foreign financing and promote the development of the domestic securities market.

The SPPF was developed under the leadership and coordination of the Ministry of Economy and Finance and in consultation with other stakeholders including the Ministry of Social Affairs, Veterans and Youth Rehabilitation, and the Ministry of Labor and Vocational Training.

Source: The 2017-25 National Policy for Technical and Vocational Education and Training.

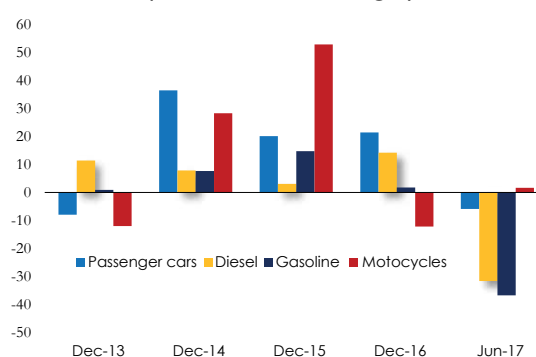
More importantly, Cambodia's share in global trade continued to rise (figure 12).

Figure 12: Cambodia's export share in percent of global trade rose
(% of global trade)



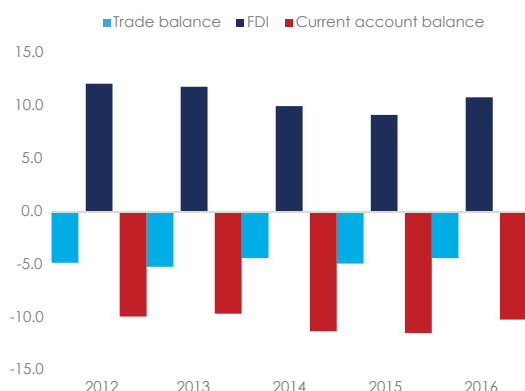
As the construction sector has shown signs of moderation, imports growth slowed. Steel and cement imports have declined. Moderated construction activity has also cooled domestic demand. As a result, imports of key durable consumer goods such as motor vehicles and nondurable goods such as petroleum product imports declined during the first half of 2017 (figure 13). In addition, imports are being curtailed by expansion of domestic industries. Those domestic industries have expanded their consumable goods production, especially for food and beverage products, partly substituting imported products.

Figure 13: Imports of durable goods and petroleum products have declined
(YTD, Y/Y % change)



Cambodia's external position has further improved. Continued solid merchandise exports and subdued imports have narrowed the trade deficit. The current account deficit is estimated to have declined to 10.2 percent of GDP in 2016 down from 11.5 percent of GDP in 2015 (Figure 14). The deficit was financed by rising FDI inflows, which are estimated to have reached 10.8 percent of GDP in 2016, compared with 9.1 percent in 2015.

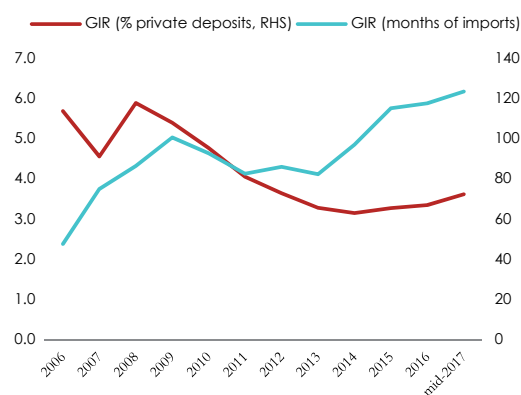
Figure 14: Cambodia's overall external position improved. Trade balance, FDI and current account deficit (% of GDP)



Source: Cambodian authorities.

Capital inflows and an improved current account position have contributed to rising international reserves, which reached US\$7.8 billion (equivalent to six months of prospective imports) by mid-2017 (figure 15). This occurred as accumulation of net foreign assets of the central bank accelerated, expanding at 30 percent (y/y) in mid-2017, up from 23.6 percent y/y in 2016. However, as a percent of private sector deposits (net of unrestricted foreign currency deposits), the level of foreign reserves remains below 100 percent.

Figure 15: Gross foreign reserves rose further



Source: Cambodian authorities.

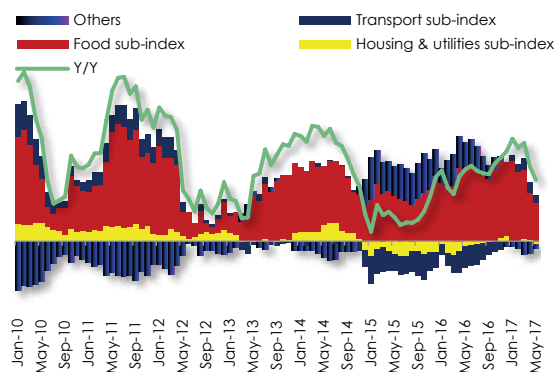
Note: GIR = GIR stands for; RHS = right-hand side.

INFLATION

Inflationary pressures which had built up in late 2016 eased by mid-2017 (figure 16). Moderation in import and credit growth reflected softer domestic demand as the construction boom is showing signs of slowing. Domestic credit growth has also decelerated. Inflation moderated to 2.6 percent (y/y) in August 2017, down from 3.9 percent at the end of 2016.

Figure 16: Inflation declined as food prices moderated with easing demand.

Contribution to 12-month inflation (percent)



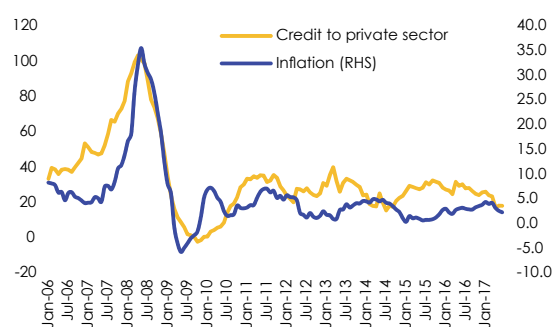
Source: Cambodian authorities.

The easing of food prices was primarily responsible for the recent decline in inflation.

The food sub-index, the main component having 43 percent of the total weight in Cambodia's inflation basket, has eased since the beginning of 2017. The sub-index decelerated to a 2.5 percent y/y increase by mid-2017, down from 6 percent during the same period in 2016. Pressures on the prices of fish, meat, poultry, vegetables, and fruits have subsided. The transportation component, however, has edged up with a slow recovery in international oil prices. Subdued food prices may have also held down restaurant, health care, furnishings, and clothing components, which are combined and classified under "others."

Inflation moderation during the first half of 2017 may be explained by softer domestic demand as the construction boom has shown signs of slowing and domestic credit growth has eased (figure 17). This has resulted in softer domestic demand, which subdued import growth during the first of six months of 2017. However, if the recovery in oil prices is gaining momentum, it is likely that imported inflation—with the "pass-through" from imported international oil prices to domestic inflation—may occur.

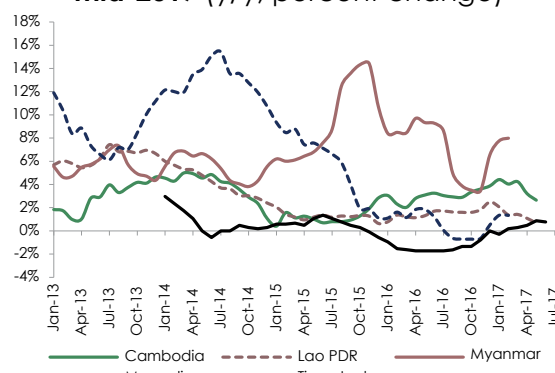
Figure 17: Inflation moderated, caused by weaker consumption as credit growth eased (Y/Y, % change)



Source: Cambodian authorities.

Regional inflation has also eased slightly. After experiencing an uptick in late 2016 and early 2017, inflation in several countries in the East Asia and Pacific region moderated slightly during the second quarter of 2017 (figure 18). Despite the recovery in commodity prices and the increase in producer price inflation, consumer price inflation is expected to remain low across most of the region, given generally well-anchored inflation expectations and relatively low pass-through.¹⁵

Figure 18: Inflation is benign in the region and declined in most countries toward mid-2017 (y/y, percent change)



Source: October 2017 East Asia and Pacific Economic Update.

THE MONETARY SECTOR

Broad money growth accelerated, driven primarily by rising foreign currency deposits and boosted by improved confidence in the banking system. Domestic credit has however, moderated, returning to a more sustainable growth path, as lending to the tradeable sectors eased (see banking sector section below). After several years of rapid financial deepening, it is the first time that the banking sector's credit growth has moderated to below 20 percent (y/y). As a result,

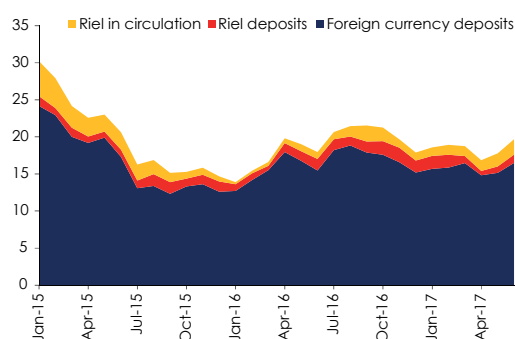
15 Regional Economic Outlook, Asia and Pacific, April 2017.

the (net) loan-to-deposit ratio declined to 95.7 percent by mid-2017, down from 100 percent at the end of 2016.

a) Monetary aggregates, interest rates and exchange rates

Broad money growth has accelerated, thanks to rising foreign currency deposits (FCDs). It grew at 19.7 percent (y/y) during the first half of 2017 (or 72.6 percent of GDP coverage), up from 17.9 percent (or 71.3 percent of GDP coverage) at the end of 2016. Boosted by improved confidence in the banking system, rising FCDs contributed the most, accounting for 16.5 percentage points by mid-2017 (figure 19). Rapidly rising FCDs also reflects healthy capital inflows, which allow the National Bank of Cambodia, Cambodia's central bank, to further accumulate gross foreign reserves.

Figure 19: Foreign currency deposit continued to drive broad money growth.
Contribution to broad money growth (Percentage point)

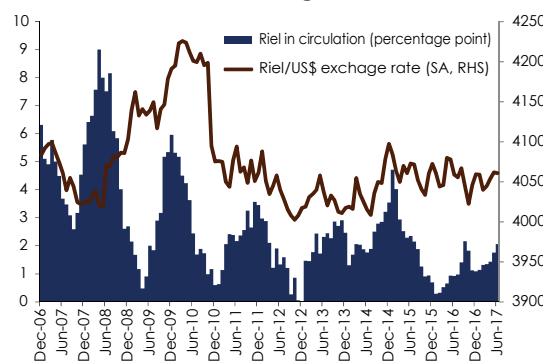


Source: Cambodian authorities.

The contribution to broad money growth from riel in circulation has also increased during the first half of 2017. The contribution rose to 2.1 percentage points, up from 1.1 percentage points in 2016. The policy of the central bank to promote the use of

local currency may have contributed to the increase. A newly established facility called the Liquidity-Providing Collateralized Operation (LPCO) aimed at establishing a benchmark rate of local currency borrowing for the market, is currently under implementation.¹⁶ This follows the introduction of Negotiable Certificates of Deposit (NCDs), a short-term interest-bearing debt issued by the central bank to promote interbank lending. Due to the highly-dollarized economy, any increases in riel in circulation often put the riel/U.S. dollar exchange rate under pressure (figure 20). Introduction of the LPCO helps “sterilize” excess liquidity when additional volumes of riels are injected. These measures may help Cambodia regaining some monetary policy independence, currently curtailed by the high degree of dollarization.

Figure 20: Contribution by riel in circulation to broad money (M2) growth and riel/US\$ exchange rate



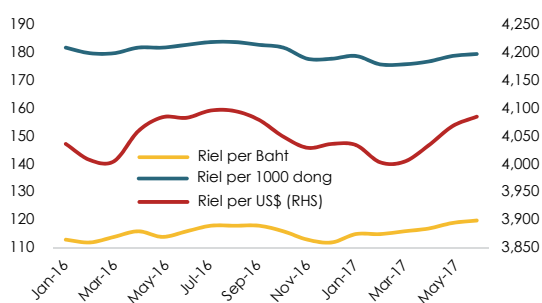
Source: Cambodian authorities and World Bank staff computation.
Note: SA = Seasonally Adjusted; RHS = Right-Hand Scale.

The riel/US dollar exchange rate has recently depreciated, reaching CR 4,053 in September 2017, compared with CR 4,037 in December 2016 (figure 21). The riel also depreciated against Thai baht and Vietnamese dong. However, the

¹⁶ According to the National Bank of Cambodia, the purpose of LPCO is to (a) establish a benchmark rate for the market so as to serve the conduct of the monetary policy based on the market mechanism; (b) promote Negotiable Certificates of Deposits, which then can be used as collateral in interbank market transactions; (c) promote the use of Riel; (d) support agricultural sector development; and (e) contribute to lowering the current high interest rate in riel. The LPCO interest rate is currently set at 3 percent per year. For more details, see https://www.nbc.org.kh/english/news_and_events/news_info.php?id=230.

depreciation of riel against US dollar and regional countries' currencies witnessed lately seems to be partly the result of seasonal factors. The depreciation does not seem to be caused by the expansion of local currency in circulation, which rose to an 18.3 percent y/y growth in June 2017, up from 8.9 percent in 2016 as a result of the central bank's initiative to promote the use of local currency.

Figure 21: Riel has depreciated slightly against the dollar, baht and dong



Source: Cambodian authorities.

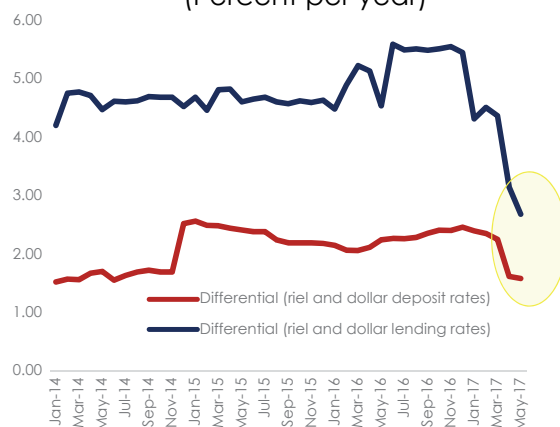
Both lending and deposit interest rates have declined. This may result from the recently introduced macro-prudential measures including the interest rate cap regulation. More importantly, short-term (12-month) riel deposit and lending rates have significantly dropped, declining to 5.99 percent per year and 14.42 percent per year in May 2017, down from 6.91 percent and 17.35 percent in December 2016, respectively. During the same period, short-term (12-month) US dollar deposit and lending rates experienced only a slight decline to 4.4 percent per year and 11.73 percent per year, down from 4.44 percent and 11.9 percent, respectively.

The sharp decline in riel deposit and lending rates may suggest that the recent measures targeting short-term interest rates by the

central bank may have yielded positive results, at least in the short-term. The policy measures are the interest rate cap (at 18 percent per year),¹⁷ and the introduction of LPCOs to supply riels at a lower interest rate, among others. NCDs are issued to mop up excess liquidity. On the demand side for riels, there is a requirement that banks and financial institutions increase their riel-denominated loans, reaching at least 10 percent of their total loan portfolio by the end of 2019.¹⁸

As the interest rates of riel-denominated loans were much higher before, the cap brought it down significantly. Thus, riel and U.S. dollar deposit (lending) rate differentials have narrowed significantly since early 2017 (figure 22). Underpinning the policy measures is the slowdown of overall domestic credit growth, thanks mainly to moderation of lending to the tradeable sectors. With these measures in place, the central bank may be able to promote loans denominated in riel, while maintaining the interest rate of riel-denominated loans only slightly higher

Figure 22: Riel and US dollar deposit (and lending) rates have started to converge
(Percent per year)



Source: Cambodian authorities.

¹⁷ Effective April 1, 2017, See Prakas B7017-109 PK dated March 13, 2017, National Bank of Cambodia

¹⁸ Prakas, B7-016-334-P-K dated December 1, 2016, National Bank of Cambodia. It takes effect from December 1, 2016 and to be fully implemented by December 31, 2019.

than (or even comparable to) that of U.S. dollar-denominated loans. This may also help underpin the central bank's policy to promote the use of local currency.

The central bank's ability to lower lending rates of loans denominated in riels, while maintaining a broadly stable riel/U.S. dollar exchange rate is crucial for conducting countercyclical monetary policy. Cambodia's monetary policy has currently been curtailed by high dollarization. So far, Cambodia has had only fiscal policy at its disposal for tempering business cycles.

b) The banking sector

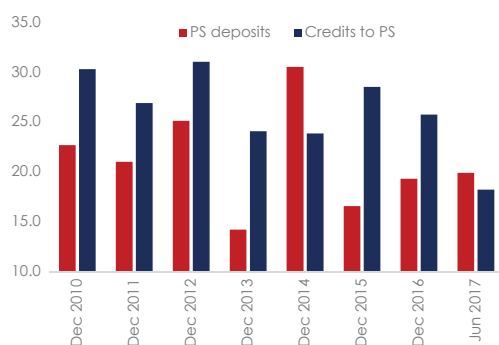
The banking sector's credit growth has moderated after several years of rapid credit growth. This is consistent with the signs of easing of the construction and real estate sectors and more importantly, moderation of lending to the tradeable sectors. The banking sector's credit growth decelerated to 18.2 percent (y/y) by mid-2017, down from 25.8 percent in 2015 (figure 23). As discussed above, the macro-prudential measures recently introduced by the central bank

may have partly helped to slow domestic credit growth. Outstanding credit provided to the private sector rose in absolute terms to US\$15.0 billion by mid-2017, up from US\$14.0 billion in 2016.

As a percent of GDP, outstanding credit declined to 68.1 percent of GDP, down from 70.0 percent of GDP during the same period. The non-performing loan (NPL) ratio for the banking sector remained at around 2.5 percent in mid-2017, similar to that of 2016. However, the reported NPL ratios may need to be interpreted carefully. There are inconsistencies in loan classifications and the continuous rolling over of loans that may disguise deeper problems.

Private sector deposits rose further on the back of rising FDI inflows owing to improved confidence in the banking system and the economy. Private sector deposits accelerated to 19.7 percent (y/y) in June 2017 (63 percent of GDP coverage), compared with 19.3 percent and 16.6 percent in 2016 and 2015, respectively. The loan-to-deposit ratio, however, remained high at 95 percent in June 2017.

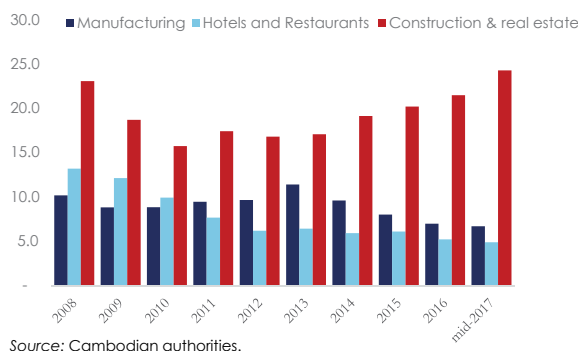
Figure 23: Credit growth has eased, while deposit growth has edged up
(year-to-date, y/y % change)



Source: Cambodian authorities.
Note: PS = Private Sector.

The shift in the allocation of domestic credit toward non-tradable sectors continued. The share of domestic credit going to the construction and real estate sector peaked at 24 percent of the total by mid-2017 (figure 24). It is now higher than 23 percent recorded in 2008, in the run up to the global financial crisis when a housing bubble eventually burst. Nevertheless, domestic credits provided by the banking sector to the construction and real estate sector declined to 28.6 percent (y/y) growth in mid-2017, down from an average of 36 percent

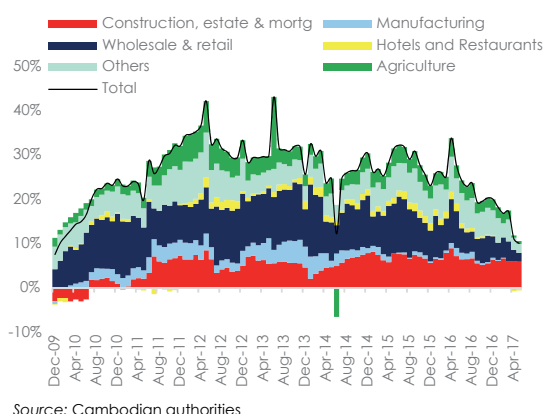
Figure 24: The share of domestic credits going to construction and real estate rose further to 24 percent (% of total credits)



(y/y) growth during the last four years.

The share of credit going to manufacturing and hotels and restaurants, however, has shrunk. This trend may reflect reduced competitiveness of the main tradeable sectors, namely garments and tourism. Investors and producers may be shifting investment toward nontradable sectors, especially the construction and real estate sector serving the demands in the country rather than for exports. This does not bode well for sustaining high levels of economic growth. Contribution to domestic credit growth from wholesale and retail have recently declined, reflecting the easing of domestic consumption (figure 25).

Figure 25: Lending to tradable sectors eased (Contribution to credit growth by business undertaking [percentage point])



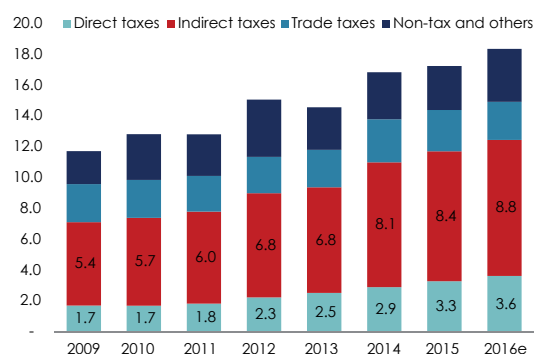
THE FISCAL SECTOR

Recent fiscal performance is characterized by continued strong revenue collection, thanks to successful implementation of the 2014–18 Revenue Mobilization Strategy. On the expenditure side, a rapidly rising public sector wage bill has been offset by the steady decline in capital spending. The overall fiscal deficit, therefore, continued to be contained.

a) Revenue mobilization

Revenue collection remained strong, estimated to have grown at 15 percent (y/y) in 2016. Domestic revenue is estimated to have increased to 15 trillion riel (US\$3.7 billion) or 18.4 percent of GDP, up from 17.6 percent in 2015 (figure 26). Of this, tax revenue contributed 15 percent of GDP in 2016, up from 14.4 percent in 2015. The largest component of tax revenue is indirect taxes which accounted for 60 percent of the total. Led by the value added tax (VAT), indirect taxes have expanded further, reaching 8.8 percent of GDP in 2016, up from 8.4 percent of GDP in 2015. Direct taxes also improved, rising to 3.6 percent of GDP in 2016, up from 3.3 percent in 2015.

Figure 26: General government revenue - main components (Percent of GDP)



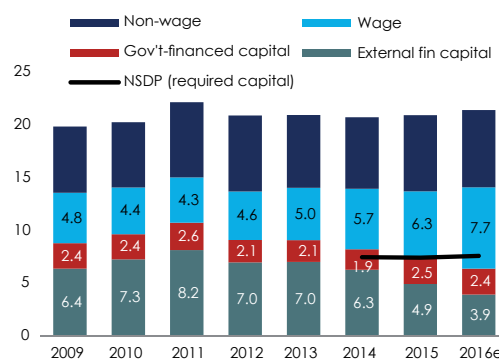
Source: Cambodian authorities and World Bank staff estimates.
Note: e = estimates

The good progress in revenue collection has been primarily supported by successful implementation of the 2014-18 Revenue Mobilization Strategy. The strategy appropriately emphasizes the importance of revenue administration, while keeping revenue policy largely unchanged. However, domestic revenue as a percent of GDP may have plateaued at around 18 percent, after rising rapidly during the last several years. The next revenue mobilization strategy, if introduced, will have to review the existing revenue policy including tax incentives, while further strengthening revenue administration.

b) Public expenditures

Driven largely by a rising wage bill, the authorities' fiscal position was budgeted to expand in 2016, after several years of fiscal consolidation. However, the latest estimates show that public outlay may have reached only 21.4 percent in 2016, compared to the budgeted outlays of 22.3 percent of GDP (figure 27). Despite the rapidly rising wage bill, public outlays remained largely contained due to the decline in capital spending. As illustrated in figure 27, the public sector wage bill has rapidly expanded since 2013. It is estimated to have risen to 7.7 percent of GDP in 2016 to achieve the minimum civil servants' wage target of at least 1 million riels (equivalent to about US\$250) a month by 2018. Meanwhile, total capital investment expenditure is on a downward trend, caused primarily by the gradual decline in the external-financed component (as a percentage of GDP).

Figure 27: Outlay was contained, as rising wage bill was offset by declining capital spending (percent of GDP)



Source: Cambodian authorities and World Bank staff estimates.
Note: e = estimates; NSDP = National Strategic Development Plan.

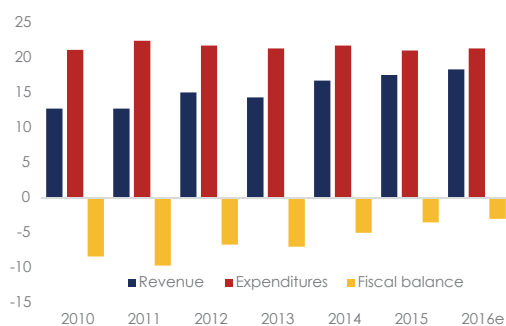
In 2016, capital spending was below the required level, recommended under the 2014-18 National Strategic Development Plan (NSDP). Scaling up government-financed capital spending to boost investments, especially in physical infrastructure, is therefore needed. To raise potential growth, expansion of public infrastructure investment is crucial. It will promote output growth by boosting aggregate demand in the short term, and expand the productive capacity of the economy with a higher infrastructure stock in the longer term.

c) Fiscal balance

The overall fiscal deficit is estimated to have remained contained. The rising public sector wage bill was largely offset by the decline in capital spending. With rising revenue collection, the impact of rising wage was muted and the overall fiscal deficit is estimated to have remained at around 3 percent of GDP in 2016, slightly below that of 2015 of 3.5 percent of GDP (figure 28).¹⁹

¹⁹ Fiscal data for 2016 general government operations are preliminary.

Figure 28: The fiscal deficit continued to gradually decline (Percent of GDP)



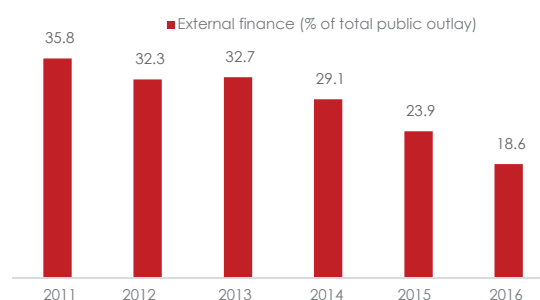
Source: Cambodian authorities and World Bank staff estimates.
Note: e = estimates.

Domestic revenue collection is likely to be boosted somewhat by a new source of revenue – oil revenue in the coming years, if a final investment decision on an offshore oil field development is made. The Petroleum Agreement for Offshore Oil Field Development in Block A was signed in August 2017.²⁰ After a final investment decision, putting in place necessary infrastructure for the oil field development under stage 1A will take 24 months before crude oil starts to flow. Production of crude oil amounting 8,000 barrels a day is expected. In addition to revenues from profit taxes, royalties and others, the government retains 5 percent share.

Cambodia's dependency on external funds to finance its annual budget has been reduced significantly during the last few years. This is largely due to the authorities' success in mobilizing domestic revenue which has been growing rapidly. In addition, budgeted development-partner-financed public investment relative to GDP has steadily declined. In 2011, development partners helped finance as much as one-third of the general government budget

(figure 29); this represented almost 80 percent of total public investment. By 2016, external financing in the annual budget of general government operations declined to less than one-fifth of the total budget (or 62 percent of total public investment).²¹ The dependency will continue to decline as the authorities continue to improve domestic collection. However, rapidly rising public sector wages could crowd out government funding for capital projects, exacerbating the dwindling of donor-financed infrastructure projects.

Figure 29: Cambodia's dependency on external financing mainly for public investment has significantly declined



Sources: Cambodian authorities and World Bank staff estimates.

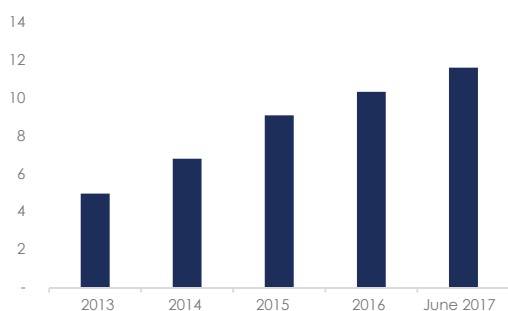
d) Government savings and public debts

Continued fiscal consolidation during the last several years has contributed to substantial accumulation of government savings. By June 2017, the total amount of government deposits at the banking system reached 11.6 percent of GDP or US\$2.5 billion (figure 30). During the 2008-09 global financial crisis, about 2 percent of GDP of the government deposits was used as a fiscal stimulus. In Cambodia, fiscal policy remains the only macroeconomic policy instrument as monetary policy has been constrained

²⁰ Press Release on the Official Signing Ceremony of the Petroleum Agreement for Offshore Oil Field Development in Block A, Cambodia Between Royal Government of Cambodia and KrisEnergy, August 23, 2017.

²¹ The amount of total external financing in the annual budget is smaller than that in the Cambodia Overseas Development Assistance (ODA) database published by Council for the Development of Cambodia. The ODA database includes assistance that is not part of the annual budget.

Figure 30: Government's deposit has increased (Percent of GDP)

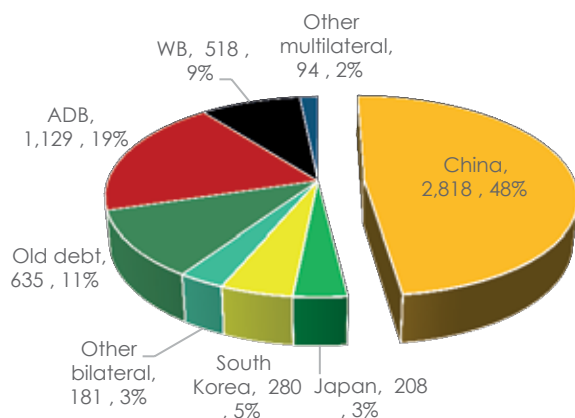


Source: Cambodian authorities.

by the high level of dollarization.

The “Cambodia Public Debt Statistical Bulletin” reveals that, at the end of 2016, the Royal Government of Cambodia had a total outstanding public debt of US\$5.8 billion, or 29.3 percent of GDP.²² China is by far the largest creditor (figure 31); almost half of Cambodia's outstanding debt is owed to China. The second- and third-largest creditors are multilateral, namely the Asian Development Bank and the World Bank, accounting for 19 percent and 9 percent of total outstanding debt, respectively. In 2016, public sector debt service payment

Figure 31: Outstanding debt by creditors (US\$ million, % of total)



Source: Cambodian authorities.

which covers principal, interest and other fee amounted to US\$186 million.

Cambodia's debt distress rating in the latest World Bank/International Monetary Fund Debt Sustainability Analysis conducted in 2017 remained low. Cambodia's debt distress rating has been consistently low since 2011, primarily underpinned by the authorities' prudent fiscal management. Cambodia continues to maintain its overriding principle of borrowing only on concessional terms.²³ Under annual budget law, only the Ministry of Economy and Finance is allowed, with the authorization by the head of the government's executive branch, to contract public debt. The annual budget law, which stipulates annual borrowing ceiling, is adopted by the parliament.

Cambodia has not started to tap into its domestic saving resources to finance its public investment needs. Currently, almost all outstanding debt is public external debt.²⁴ This means the majority (62 percent) public capital investment remains financed by external borrowing, although domestic savings resources are expanding as income grows. Household final consumption as a share of GDP has steadily declined during the last two decades, allowing domestic household savings to increase (figure 32).²⁵

Given the country's vast public investment needs, tapping into the growing pool of domestic savings to fund productive pro-poor and pro-growth investment projects may help. Cambodia continues to maintain

²² “Cambodia Public Debt Statistical Bulletin”, Volume 3, March 2017, Ministry of Economy and Finance.

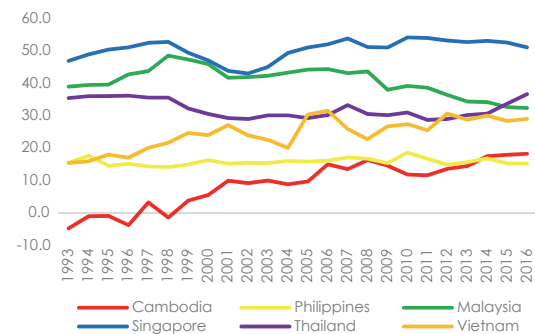
²³ The concessional terms borrowed are those with a grant element of 35 percent or above.

²⁴ Public domestic debt accounts for only 0.05 percent of the total outstanding public debt.

²⁵ Tradeable sectors, namely the textile and footwear sectors (and to some extent the tourism sector) remains to be largely funded by FDI. Domestic household investment seems to concentrate on the construction and real estate sector which may be less growth enhancing.

its liberal investment policy. Therefore, mobilizing domestic household savings to boost public capital investment is not likely to crowd out private investment. In contrast, it may serve as a catalyst, attracting additional private capital as Cambodia increasingly integrates into the regional and global value chain. This will further facilitate economic structural transformation which is currently taking place.

Figure 32: Cambodia's domestic saving is rising but remains relatively low.
Gross domestic saving (% of GDP)



Source: World Development Indicators, the World Bank.





The growth outlook remains favorable. While slightly easing, real growth is projected to remain strong, at 6.8 percent in 2017. In 2018, growth is expected to pick up marginally, reaching 6.9 percent, largely due to rising election-related spending before slowly trending downward in 2019 and beyond (see Cambodia: key indicators). Growth will continue to be boosted by export diversification and underpinned by healthy inflows of FDI. Growth will also be bolstered in part by rising government spending including public investment. Global trade is expected to progressively recover.

There are signs of diversification in the manufacturing sector with the entry of some high-value-added manufacturers, especially for electrical appliances and components, and auto parts. Relatively high electricity and logistic costs, however, remain key bottlenecks towards the formation of new manufacturing clusters. The tourism sector is recovering largely due to continued efforts to attract international

tourists, especially from China with new regional direct flights and the “China Ready” initiative. The policy options suggested in the selected issue entitled “Cambodia calling—maximizing tourism potential” will enhance the tourism sector's readiness to reap more benefits from the recent increase in tourist arrivals.

In the medium-term, growth is projected to remain favorable. Underpinned by healthy rise in FDI inflows, export diversification will accelerate, while the construction sector is expected to adjust. This will further improve Cambodia's external position. Adjustments in the construction sector after the post-global financial crisis boom will ease import growth in the short-term. Gradual progress in fostering domestic production will also help substitute the imports of basic and consumption goods in the medium term.

The expansionary fiscal policy is likely to continue in 2018 and beyond. A rising public sector wage bill (and election-related

expenditures) in the short term and a need to boost public investment in the medium term, are likely. As the adjustments of the construction and real estate sector resulting in softer demand for domestic consumption and imports take hold, the robust revenue gains that Cambodia experienced until recently may slowly diminish. To avoid a significant rise in the fiscal deficit, a new revenue mobilization strategy would need to be introduced to expand the domestic tax base, further strengthen revenue policy and enhance revenue administration in the short and medium term.

Downside risks to this outlook are a sharp regional slowdown, especially in China, erosion of competitiveness in traditional exports, and potential election-related uncertainty. Given Cambodia's increased dependency on Chinese FDI and tourist arrivals, a sharp slowdown in the Chinese economy could negatively impact growth prospects. Cambodia's external competitiveness is currently being curtailed by rising real wages and emerging cheap

labor competitors such as Myanmar. FDI in the textile industry has declined. Potential election-related uncertainty may also result in more cautious new investment (and business expansion) decisions during and shortly after the general elections, which are scheduled to be held in mid-2018.

Poverty reduction is expected to continue over the next few years. This is underpinned by continued expansion of the services and manufacturing sectors, together with increases in remittances. However, there is a potential negative impact of the slowdown of the textile and construction sectors. The impact, if materialized, may reduce job and income opportunities available for migrant workers; consequently, diminishing poverty reduction achievements. With sluggish agricultural growth, the rural non-farm (manufacturing, services and remittances) economy has so far been a significant contributor to poverty reduction and shared prosperity. An effort by the authorities has been made to stabilize agricultural prices (and to invest in rice storage and drying facilities), especially rice prices, with an introduction of a special fund for low-interest loans for rice purchases.





KEY MESSAGES AND POLICY OPTIONS

It is crucial to nurture the newly emerging high-value-added manufacturing industries. Promoting export diversification beyond textile (and footwear) products is a priority. Supporting and further attracting ongoing and future FDI in high-value-added products, especially electrical appliances and components, and auto parts is crucial. In this regard, addressing the high electricity and logistic costs together with skills constraints, which remain key bottlenecks, are the first important steps. Cambodia has made rapid strides in providing access to electricity, improving availability, and becoming nearly self-sufficient. However, the price of electricity remains relatively high compared to neighboring countries, and is due lack of competitive bidding in energy generation, and fragmentation in transmission and distribution. While restructuring the sector will require time, in the near-term it is necessary to review electricity tariffs to bring them closer to their regional comparators. It is also necessary to promote and improve the level

of skills and quality of graduates coming out of the education and vocational programs. Identifying skills gaps to design courses that address such gaps as targeted under the 2017-25 National Technical and Vocational Education and Training Policy will be critical.

Further efforts are needed to facilitate investment in the manufacturing sector. This is necessary, given the recent slowdown in FDI in the tradeable sectors, specially the textile sector. As real wages increase, Cambodia's external competitiveness which primarily relies on cheap labor, is gradually diminishing. It is therefore imperative to further improve ease of doing business and the overall investment climate. This is to bring down the costs of starting and operating businesses as well as logistic costs to facilitate firm establishment and growth, attract FDI in manufacturing, while promoting investment in high-value-added manufacturing industries as envisaged by the 2015-25 Industrial Development Policy.

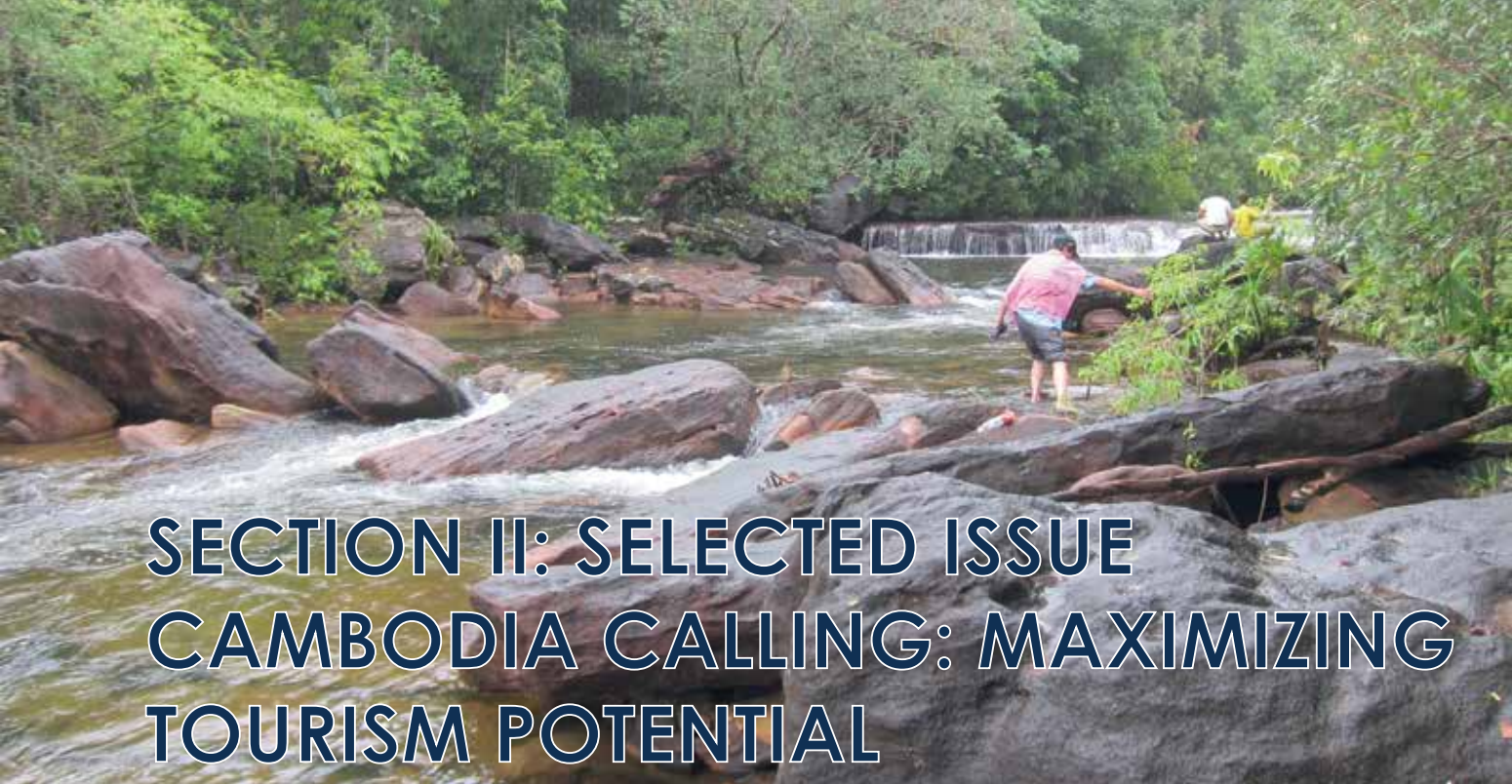
Cambodia's doing business ranking remains relatively low.²⁶ The country was ranked 131st out of 190 in 2017, compared with 82nd for Vietnam and 46th for Thailand. "Starting a business" ranked amongst the lowest (180th) with the time spent to register a business is four times longer than the East Asia and Pacific region average. This calls for further improving regulatory environment. It is important to also reduce cost to export per container which in 2014 was (US\$795), significantly higher than that in Thailand (US\$595) and Vietnam (US\$610).

Mitigating measures are necessary to support rural households that have been hard hit by continued low agricultural prices. The recent initiative to mobilize financial resources readily for rice purchases during the rice

harvest seasons and improving access to markets by farmers living in remote areas will certainly help. In addition, the potential negative impacts of the slowdown of textile and construction sectors will need to be closely monitored. Both sectors, especially the labor-intensive textile sector, have absorbed a large proportion of the rural labor force shed by the agriculture sector as structural transformation accelerates. It will be a challenge for employment creation, if expansion of the textile sector has slowed. Successfully implementing the two main pillars--social assistance and social security-- envisaged by the 2016-25 National Social Protection Policy Framework will help prevent rural households from falling back into poverty.

26 For more details, please see <http://www.doingbusiness.org/data/exploreeconomies/cambodia>





SECTION II: SELECTED ISSUE CAMBODIA CALLING: MAXIMIZING TOURISM POTENTIAL

INTRODUCTION

It is essential to enhance the tourism sector's readiness to reap more benefits, taking advantage of the recent surge in tourist arrivals discussed in Section I above. The tourism sector is one of the largest industries in the world and a vehicle for job creation and shared prosperity. As a source of foreign investment, tax revenue, job creation, and economic growth, tourism may offer an alternative to traditional export-led sources of growth and addresses poverty reduction directly. The sector generates jobs and opportunities along its value chain, including the primary sector, which occupy most of the region's poor. Moreover, tourism can be a tool to develop lagging regions where opportunities for industrial development are often limited.

Demographic, economic, and technological shifts are fueling growth and creating

opportunities for tourism. Millennials travel more than any other generation, including baby boomers, and they will likely travel more as their incomes and financial standings grow.²⁷ Moreover, the number of Chinese households able to afford international holiday/leisure travel is growing rapidly. The spread of internet access and mobile technology has empowered travel consumers and spawned a new sharing economy, while cheap computing power has allowed tourism suppliers to improve services and marketing by harnessing big data. Increased awareness of climate change and of tourism's potential environmental, social, and cultural impacts has made sustainability a central concern for many travelers and businesses. There are now segments of the travel market willing to pay more to visit destinations that demonstrate responsible practices.

To realize the developmental effects of

²⁷ Millennials are the generation aged 15 to 34.

those trends, countries need to improve the competitiveness of their tourism markets. The 2017 World Economic Forum's Tourism and Travel Competitiveness Index highlights some of the challenges faced by the sector in the region. The region hosts only one of the world's top 20 markets, with China ranked 15th, followed by Malaysia (26th) and Thailand (34th). But the region also suffers from poor performance on environmental sustainability, health and hygiene, tourism service infrastructure, transport infrastructure, and ICT readiness, among others.

Cambodia has globally significant resources for tourism that are diverse and well placed to be a pillar for socioeconomic development as identified by the government. Key attractions include the world heritage site of Angkor Wat, religious and cultural sites, wildlife, and pristine beaches and islands. But Cambodia was ranked low, at 101st, on the competitiveness list. Although tourist arrivals exhibit a stable pattern of travel through regional hubs in Thailand, Vietnam, and China, there are some worrying trends that could threaten the chances for developing tourism as a central pillar of an inclusive economy. Value captured per tourist has not changed much in the last decade—from US\$585 in 2005 to US\$655 in 2016—low-end businesses have mushroomed, stays are short with limited repeat visits, and there are signs of overcrowding and degradation of the key assets at the Angkor temples.

INDUSTRY PERFORMANCE

Cambodia experienced a rapid expansion of the tourism sector until recently, thanks mainly to its historical and cultural heritage. International arrivals grew at an average

rate of 12.2 percent per year during the period after the 2008–09 global financial crisis. Its “open sky” policy has attracted considerable investment in international travel and tourism. Siem Reap and Phnom Penh, centers of Cambodia's cultural and historical heritage are the most popular destinations, but tourism in the coastal zone is also growing, capturing about 15 percent of total arrivals. Leisure is the main purpose of visits, followed by business and visiting friends and relatives. The forecast remains positive, although certain challenges remain. The performance of the industry is best presented by analyzing where visitors come from, how long they stay, and how much they spend, as well as the industry's value to Cambodia's general economic performance.

a. Source market performance and international arrivals

After steadily decelerating during the last few years, international arrival growth has rapidly recovered since early 2017. Continued efforts by the authorities to attract international tourists, especially from China, with new regional direct flights and the “China Ready” initiative, seem to have paid off. International arrivals to Cambodia reached 5.01 million visitors in 2016. During the first six months of 2017, total tourist arrivals reached 2.6 million, growing at 12.8 percent (y/y), up from a 5.0 percent growth in 2016 and therefore well on its way to surpassing the 2016 total. As with many destinations across Asia, arrivals from China are now highest, outpacing arrivals from Vietnam and accounting for 20 percent of the total international arrivals by mid-2017, up from 16.6 percent in 2016. Vietnam, Lao PDR, the Republic of Korea, and Thailand

Table S1: Contribution to tourist arrivals growth by country of origin during the last six years (percent)

	2011	2012	2013	2014	2015	2016
Asia	80.1	84.1	83.7	84.6	84.2	62.0
Vietnam	26.7	23.1	20	19.6	20.9	-11.6
China	18.6	14.5	16.8	19.2	25.5	56.0
Lao PDR	9.7	15	18.9	18.4	13.8	-14.9
Thailand	-8.7	4.9	4.2	6.5	8.9	19.9
Europe	14.3	11.3	12.3	11.2	10.1	20.4
Americas	4.9	4.2	3.8	3.9	5.1	15.5
Africa	0.4	0.1	0.1	0.1	0.2	0.8
Middle East	0.3	0.3	0.2	0.2	0.3	1.2
Total	100	100	100	100	100	100

Source: Bank staff calculations using the data from Cambodian authorities.

are the main countries of origins after China, accounting for 14.7 percent, 8.4 percent, and 6.3 percent of the total arrivals, respectively.

Chinese tourists contributed to more than half (56 percent) of total international arrival growth in 2016 (table S1). Contribution by Vietnamese and Lao tourists, however, declined, dropping by 11.6 percent and 14.9 percent, respectively. Arrivals from Europe, especially from the United Kingdom, France, and Germany, picked up, contributing 20.4 percent of total international arrival growth in 2016.

Due to the authorities' policy to facilitate visits by Chinese tourists after the introduction of "China Ready" initiative, arrivals from China are now number one. Chinese tourists account for 20 percent of the total international arrivals by mid-2017. The initiative provides Chinese signage and documents for visa processing, encourages local use of the Chinese yuan currency, promotes the use of Chinese language,

and ensure that food and accommodation facilities are suited to Chinese tastes.

International tourists visiting Cambodia are multinational, but Asian tourists continue to be the largest group, accounting for about two-thirds. China and Vietnam are the top two countries of origin, together accounting for more than a third of total arrivals. Visitors from these countries are, like all Asian tourists, particularly interested in cultural heritage and historical sites. Western tourists also show strong demand for nature-based adventures and exploration. Asian tourists are increasingly demanding higher-end hospitality services as a standard throughout their travels, where Western visitors (still) enjoy local experiences and do not mind "roughing" it a few nights. Both the Vietnam and China market are characterized by weekend trips that keep visitors almost exclusively at their hotels, located close to the border.

Cambodia, as well as several regional

countries that are newly “open” to tourism and in transition to market economies, received only small fractions of total regional arrivals in 2015. Cambodia received only 2.4 percent of total visitor inflows to the region, while Vietnam received 4 percent. More established destinations, namely China, Thailand, and Malaysia, obtained 29 percent (56.9 million), 15.2 percent (29.9 million), and 13.1 percent (25.7 million), respectively.²⁸ Over 85 percent of tourists visiting emerging East Asia come from within the broader East Asia region.

b. Spending

While the country continues to attract a growing number of international tourists, average daily spending across all international overnight markets has declined. Tourism product and destination diversification has been lagging, with the Angkor temple complex (and Phnom Penh)

still the main destination (see also Annex 1 on the challenge of creating an inclusive tourism system and attracting investment in Lombok, Indonesia). In 2016, repeated visits accounted for only a quarter of total arrivals. Average daily spending declined to an average of US\$92.5 a day in 2016, down from US\$120.7 per day in 2013 (table S2).²⁹ The decline may relate to the fact that tourists visiting Cambodia as Free Independent Travelers (FIT) have been increasing with rising arrivals from Asia and by road. Limited success in tourism destination and product diversification may have contributed to declining spending by Group Inclusive Travelers (GIT). In addition, the share of international arrivals by air declined to around 50 percent during the period after the 2008–09 global financial crisis in 2016, down from over 60 percent before the crisis. In 2016, FIT travelers accounted for 82.6 percent of total international

Table S2: Average daily tourist spending has declined

	2013		2014		2015		2016	
Market share	FIT	GIT	FIT	GIT	FIT	GIT	FIT	GIT
(%)	41.5	58.5	41.5	58.5	23.2	76.8	82.6	15.1
Average expenditure per tourist (in US\$)								
Accommodation	148.57	N/A	127.5	N/A	129	N/A	125	N/A
Food & beverage	84.42	N/A	119.43	N/A	123.5	N/A	120	N/A
Local transport	80.04	N/A	65	N/A	64.5	N/A	73	N/A
Package tours		983.46	N/A	345	N/A	355	N/A	342.5
Shopping	94.35	180.11	90	120	88.7	118	85	115.4
Others	79.03	101.07	80	100	79.5	101	75.5	95.5
Total	486.4	1,264.6	481.9	565.0	485.2	574.0	478.5	553.4
Average daily spending	120.8		93.5		95.1		92.5	

Source: Annual Tourism Statistics Reports, 2013–16, Ministry of Tourism.

Note: FIT: Free Independent Travelers, GIT: Group Inclusive Travelers.

28 October 2017 East Asia and Pacific Economic Update, the World Bank, Washington, DC.

29 This is, however, in contrast with the (estimated) increase in tourism receipts reported in the 2016 Tourism Statistics Annual Report, Ministry of Tourism.

arrivals, compared with only 41.5 percent in 2013. During the same period, the share of GIT travelers declined to 15.1 percent, down from 58.5 percent (based on 2016 government statistics). In 2016, GIT travelers spent US\$553.40 per visit on average, or 15 percent more than FIT travelers.³⁰

c. Length of stay and seasonality

The average length of stay of foreign tourists visiting Cambodia has also gradually declined. The 2016 Annual Tourism Statistics Report indicates the average length of stay decreased to 6.3 days per visitor in 2016, down from 6.7 days in 2013. This is the case for both FIT and GIT travelers (table S3). For FIT visitors, length of stay declined to 5.8 days for Phnom Penh and 5.4 days for Siem Reap, down from 6.1 days and 6.0 days, respectively. Similarly, length of stay for GIT travelers declined to 4.1 days for Phnom Penh and Siem Reap, down from 4.9 days

and 4.7 days, respectively. The improved and expanded flight connections to these two hubs, Phnom Penh and Siem Reap, are seen as an influencing factor making it easier for visitors to arrive, visit, and leave within a short period of time. International airports in Phnom Penh, Siem Reap, and Preah Sihanoukville together receive 54 percent of total international visitor arrivals; 43 percent enter the country through overland borders and 3 percent enter by water.

While there have always been large differences in visitor arrivals between the peak months of December/January and the low season months of May/June, Cambodia exhibits much wider variation. Variation in Cambodia is as high as 47 percent compared to its peers, namely Vietnam (38 percent), Myanmar (41 percent), and Lao PDR (27 percent). This irregular demand causes cash flow problems for hotels, guesthouses, and tour operators, which often leads to seasonal layoffs that can make

Table S3: Average length of stay

	2013		2014		2015		2016	
Average length of stay per tourist (days)	Phnom Penh	Siem Reap	Phnom Penh	Siem Reap	Phnom Penh	Siem Reap	Phnom Penh	Siem Reap
FIT	6.1	6.0	5.8	5.5	6.2	5.9	5.8	5.4
GIT	4.9	4.7	4.2	4.1	4.5	4.3	4.1	4.1

Source: Annual Tourism Statistics Report, 2016, Ministry of Tourism.

Note: FIT = Free Independent Travelers; GIT = Group Inclusive Travelers.

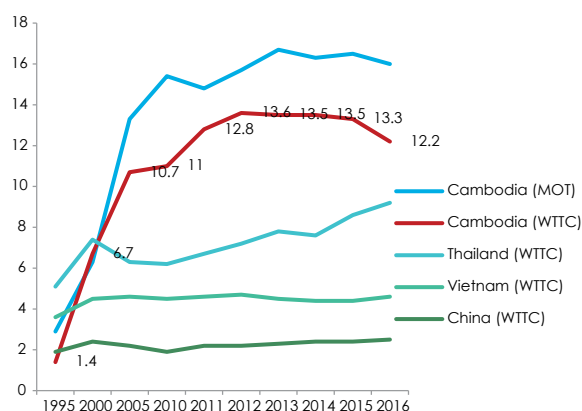
30 2016 Tourism Statistics Annual Report, Ministry of Tourism, Cambodia.

employment in the subsectors less attractive. The major constraints in Cambodia appear to be insufficient public and private funding, weak coordination among tourism industry stakeholders, and low capacity to design and implement effective destination marketing campaigns.³¹

d. Contribution to GDP

The direct and indirect contribution of tourism to Cambodia's GDP is reportedly substantial. The tourism sector's direct contribution as a percentage of GDP is 12.2 percent (Cambodia's own statistics show an even higher contribution of 16 percent of GDP) which is much higher than that of many other countries, including Thailand where a more developed tourism sector has existed for decades (figure S1). However,

Figure S1: International tourism receipts - direct contribution (% of GDP)



Source: Ministry of Tourism (MOT) 2016 & World Travel Tourism Council (WTTC) 2017.

the sector's contribution in percent of GDP has been declining since 2013. This seems to be consistent with the gradual deceleration of international arrival y/y growth, which declined from 24.4 percent in 2012 to 17.5

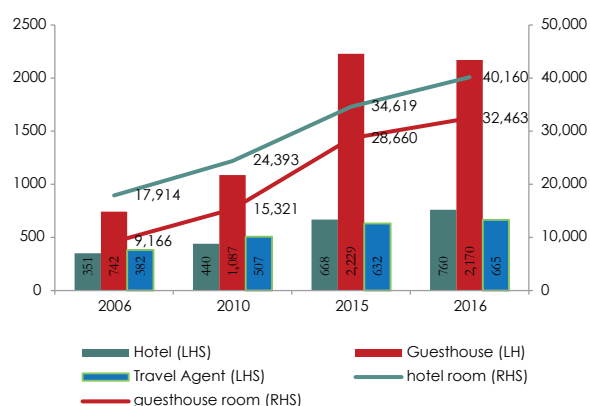
percent in 2013, 7.0 percent in 2014, 6.1 percent in 2015, and 5.0 percent in 2016.

TOURISM SECTOR ORGANIZATION

a. Enterprises and ownership

To accommodate rising international arrivals, the number of accommodations including hotels and guesthouses and travel agents has increased significantly during the last decade. The number of hotels and hotel accommodations doubled, reaching 760 hotels and 40,160 rooms, respectively in 2016 (figure S2). The number of guesthouses

Figure S2 : Number of hotels, guesthouses and travel agents



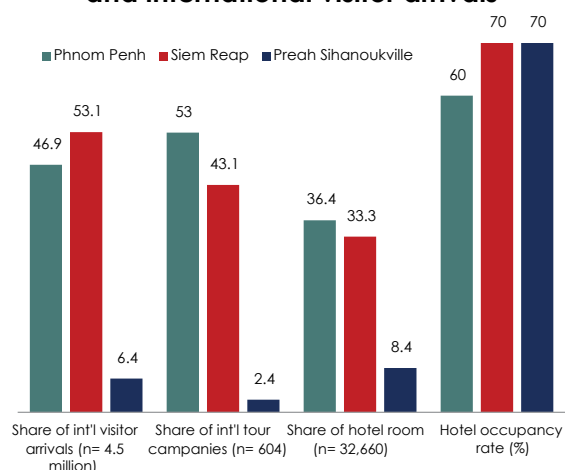
Source: Annual Report on Tourism Statistics 2016, Ministry of Tourism. Note: LHS = Left-Hand Scale; RHS = Right-Hand Scale.

and their capacity experienced even higher growth, tripling to 2,170 in 2016 from 742 in 2006, and the number of rooms to 32,463 from 9,166 during the same period. The number of registered travel agents serving the tourism sector almost doubled, with their main source of business still outbound travel and benefiting from increased income and interest of residents in traveling.

31 Experience Mekong: Greater Mekong Subregion Tourism Marketing Strategy and Action Plan 2015–2020, Mekong Tourism Coordinating Office, Bangkok, 2015.

Hotels are predominantly present in the four urban hubs of Phnom Penh, Siem Reap, Sihanoukville, and Battambang zone.³² As much as 83.4 percent of hotels and 86.1 percent of hotel rooms are concentrated in the hubs. Phnom Penh accounts for the largest shares of hotel numbers (38.3 percent) and hotel rooms (36.4 percent), followed by Siem Reap (27.8 percent of hotels and 33.3 percent of hotel rooms), and Sihanoukville (8.4 percent of hotels and 8.5 percent of hotel rooms) (figure S3). Battambang zone accounts for 8.9 percent of hotels and 7.9 percent of hotel rooms. Guesthouses are more disperse; the hubs capture only 57 percent of guesthouses and 65 percent of guesthouses' rooms.

Figure S3 :Tourism services intensity and international visitor arrivals



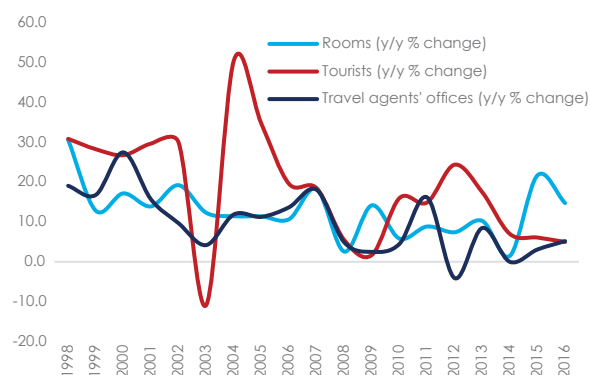
Sources: Annual Report on Tourism Statistics 2016, Ministry of Tourism & New Crossroads Asia, 2015.

Except for several international hotel chains, most hotels and guesthouses are owned by domestic investors. The rapidly rising number of guesthouses across the country reflects that the benefits of tourism development are spreading more widely, which is likely to be followed by hotel operation, if growth is sustained. Newly emerging urban centers

such as Kompong Cham, Svay Rieng, and Kandal are provincial towns benefiting from tourism growth. The construction and real estate boom that Cambodia is currently experiencing is also likely to boost the capacity of the hospitality industry in urban centers with serviced apartments appearing and shared-economy initiatives such as Airbnb hosts (375 in October 2017) establishing themselves further.

However, the growth of accommodations such as hotels and guesthouses and travel agencies has eased gradually in line with the overall tourism sector development downward trend (figure S4). This is also reflected in a slowdown in private investment in the sector.

Figure S4: Growth of tourist arrivals, accommodation and travel agents is decelerating



Source: Annual tourism statistical reports, Ministry of Tourism.

Although real data are missing, there is substantial anecdotal evidence that there is little formal integration by tourism enterprises along the vertical value chain. Destination management companies operating or owning accommodation and transport companies do not exist, and at most, tourism enterprises have two outlets (Phnom Penh and Siam Reap), often managed as a single entity. This reflects the way Cambodia is

³² The ministry of Tourism classifies "Battambang zone" as covering five four provinces, Battambang, Banteay Meanchey, Pailin, and Pursat. See 2016 Annual Tourist Statistics Report.

being offered to visitors, with limited overland travel and product development by operators around established destinations.

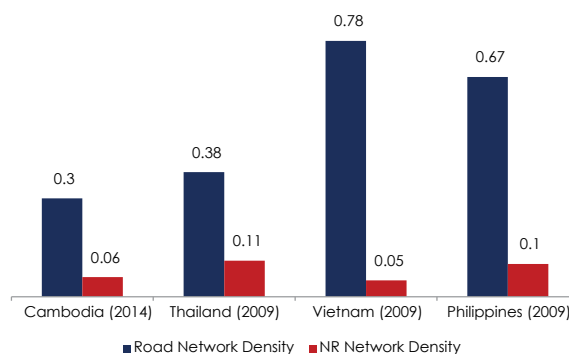
b. Connectivity and capacity

Cambodia's "open sky" policy has attracted considerable investment in international travel and tourism. To meet growing air traffic demand, the Phnom Penh and Siem Reap airports were expanded to double passenger capacity in 2016. The extension and renovation of Sihanoukville airport is supporting booming growth, with a 66 percent increase in air traffic in 2016. By 2018, the capacity of the airport's existing terminal will be expanded to accommodate 0.5 million passengers per year, tripling its current annual capacity. The three international airports witnessed a total passenger growth rate increase of 8.5 percent in 2016, with arrivals and departures totaling 7 million. In 2016, Phnom Penh, Siem Reap, and Sihanoukville airports handled 3.48 million, 3.47 million, and 0.15 million passengers, respectively.³³

In Cambodia, both demand and investment spending grew at a broadly comparable rate over the last decade, but the quality of infrastructure is still regarded as short of most ASEAN destinations.³⁴ Connectivity infrastructure, especially, one of the key enabling facilities supporting tourism development, is insufficient in Cambodia. While the road network has significantly expanded

during the last several years, the country exhibits insufficient connectivity to secondary destinations. Road density in Cambodia (proportionate to its land size), while improving, remains less than those of its neighbor countries (figure S5).³⁵ Quality infrastructure is essential for tourism and should include not only good connection and quality environmental infrastructure, but also services (waste and wastewater, piped clean water supply, and access to reliable electricity). In Cambodia, infrastructure improvements and service delivery in secondary destinations has not kept pace with demand, mainly due to funding and capacity constraints for construction and maintenance, low population density in rural areas, and limited decentralized planning. Thus, Cambodia lags behind Asia-Pacific benchmarks for infrastructure competitiveness and health and hygiene (Table S4).

Figure S5: Road density in selected ASEAN countries



Sources: "Overview of Transport Infrastructure Sector in the Kingdom of Cambodia," MPWT (2015); and "A Study on National Road Traffic Safety Master Plan in the Social Republic of Vietnam Until 2020," JICA (2009).
Note: NR = National Roads

33 For more details, please see <http://www.vinci-airports.com/en/supporting-long-term-growth-cambodia> and <http://www.cambodia-airports.aero/en/our-business/traffic-data>.

34 "Travel & Tourism Investment in ASEAN," World Travel & Tourism Council, October 2016.

35 Road density is the ratio of the total road network length of the country to 100 square kilometers of the country's land area.

Table S4: Competitiveness Rankings for Infrastructure, Health, and Hygiene

	<u>Air Transport</u>		<u>Ground and Ports</u>		<u>Tourist Services^a</u>		<u>Health and Hygiene^a</u>	
	Value ^b	Rank ^c	Value ^b	Rank ^c	Value ^b	Rank ^c	Value ^b	Rank ^c
Cambodia	2.1	103	2.6	116	2.9	108	3.9	112
Lao PDR	2.3	89	3.0	96	3.2	97	4.3	108
Myanmar	2.0	115	2.2	132	2.1	137	4.4	101
Vietnam	2.7	68	3.1	87	2.9	105	5.0	83
Asia-Pacific Average	3.58		3.83		3.68		5.14	

Source: The Travel and Tourism Competitiveness Report 2015, World Economic Forum, Geneva, 2015.

Note:

- a. Tourist services infrastructure includes hotels, resorts, and other facilities developed, especially to respond to visitor demand. Two of six indicators for health and hygiene are concerned with sanitation and clean water supply.
- b. Value range = 1–7, with a higher number indicating better performance.
- c. Rank = 1–141, with lower number indicating better performance.

Insufficient transport infrastructure and weak environmental services hold back sustainable and more inclusive tourism growth, as many secondary destinations are unable to attract private investment in quality tourist service infrastructure. This discourages visitors from venturing off the beaten track and keeps driving the imbalanced growth around Siem Reap and Phnom Penh. As discussed above, these sites account for about 70 percent of Cambodia's total accommodation stock and more than half of the country's international visitor arrivals. In comparison, the seaside town of Kep—with good tourism potential but lacking a piped water supply and adequate sanitation—has received only 1.1 percent of international visitors to date. Inadequate transportation and environmental services can also be quickly overwhelmed by a surge in visitor arrivals, leading to incomplete collection and treatment of solid waste and wastewater,

shortages of piped clean water, and traffic congestion.

c. Employment and skilled labor force

Tourism is a labor-intensive industry, and Cambodia has benefited substantially from the rapid expansion of the industry more than its regional peers. The tourism industry currently generates almost 1 million in direct employments. If direct, indirect and induced employments are combined, the industry provides up to 2.2 million jobs (table S5). It is projected that with continued rapid growth in tourists, nearly 700,000 additional new direct jobs will be created by 2027.³⁶ The new jobs are largely created by diverse small and medium-sized enterprises that provide goods and services consumed by visitors.³⁷ However, as discussed above, there are large variations in tourist arrivals between the peak months of December/January and the low season months of May/

36 2017 World Travel and Tourism Council. Across Cambodia, Lao PDR, Vietnam, and Myanmar, roughly US\$4,600 in tourism expenditure sustains one job.

37 See Travel and Tourism Economic Impact Reports for Cambodia, the Lao PDR, Myanmar, and Viet Nam, World Travel & Tourism Council, London, 2015.

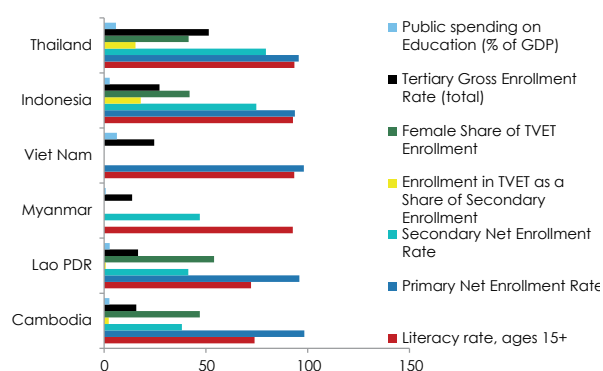
Table S5: Jobs generated by the tourism sector (2016)

Country	Direct contribution		Total contribution	
	Jobs	% share	Jobs	% share
Cambodia	988,000	11.4	2,252,500	25.9
Lao PDR	118,000	3.7	397,500	12.4
Vietnam	1,959,500	3.6	4,003,000	7.3
Thailand	2,100,000	5.5	5,739,000	15.1
China	23,680,500	3.1	69,527,500	9.0

Source: 2017 World Travel Tourism Council.

June, which has rendered irregular demand that causes cash flow problems for hotels, guesthouses, and tour operators. This often leads to seasonal layoffs that can make employment in the subsectors less attractive.

Industry stakeholders report that the need for quality human resources far outstrips supply, and the lack of well-trained workers is one of the main barriers to improving tourism service quality and competitiveness. Selected indicators for education, training, and literacy substantiate these concerns. Cambodia (as well as Lao PDR and Myanmar) shows substantial deficiencies in secondary and tertiary enrollment compared to other ASEAN countries (figure S6), as well as low enrollment in technical and vocational education and training (TVET). As Cambodia has more favorable processes for employing foreign staff, a disproportional increase of immigrant labor can occur (see also Box S1: Siem Reap paradox). This will lead to increased leakages in the tourism accounts and increasing the barriers to entry by nationals.³⁸

Figure S6: Education, training, and literacy in selected ASEAN (% most recent years available)

Sources: United Nations Educational, Scientific and Cultural Organization (UNESCO) Institute for Statistics; Table adapted from International Labour Organization; and ASEAN Community 2015: Managing integration for better jobs and shared prosperity, Asian Development Bank, Bangkok, 2014. Note: TVET = Technical and Vocational Education and Training.

Industry stakeholders report that the need for quality human resources far outstrips supply, and the lack of well-trained workers is one of the main barriers to improving tourism service quality and competitiveness. Selected indicators for education, training, and literacy substantiate these concerns. TVET = Technical and Vocational Education and Training.

38 Consultant's Report, TA-6179: "Greater Mekong Subregion Tourism Sector Strategy," Asian Development Bank, Manila 2005.

Box S1: Siem Reap paradox

Siem Reap Province is an illustration of the challenge of creating the links between an engine of growth, such as tourism, and the local economy. While the tourism revenues from the Angkor temple complex represent the lion's share of the total tourism revenues of Cambodia, Siem Reap is the eighth-poorest province in Cambodia out of 25. In 2014, 23.3 percent of Siem Reap Province's population of 1,042,286 was living below the national poverty line, a figure significantly higher than the latest estimated national average of 18.8 percent.

The economic benefits of tourism have limited impact on the socioeconomic development of the whole province, with communities living in the vicinity of Siem Reap temple sites among the main beneficiaries of job opportunities offered by tourism and subsectors such as construction. However, these same communities often do not have the required skills, education, or social networks to reap the full benefits of the growing tourism.

Although a number of universities operate in Siem Reap Province alone, their curriculums do not seem to match the needs of the growing private sector. Thus, migrant workers from neighboring countries with higher qualifications occupy more qualified positions. While some investment in training and customer services is being undertaken to increase the qualifications of Cambodians involved in the tourism industry, more needs to be done to improve access to job markets for people of Siem Reap, especially youth. Another challenge is to strengthen the links of the tourism sector to other sectors, particularly the agriculture sector, on which more than 80 percent of Siem Reap's population rely.

Existing studies recognize that although tourism has been significant for economic growth, its impacts on the local communities and poverty reduction have been limited. Those studies also found that benefits from tourism are concentrated in the communities living in the vicinity of the Angkor temple complex, and the best benefit for the poor is nothing more than low-paid employment. This is due to their limited capital, social networks, required skills, or education to access better-paid employment.

d. Supply chain

Even more important is the composition of influence of international tourism expenditure on Cambodia's economy. Where substantial parts of destination expenditure are spent on imports or where Cambodia's supply capacity of the destination economy is too limited to meet additional & dispersed demand, income multiplier effects will remain low and foreign exchange "leakage" high, resulting in suboptimal net income contributions to the country's economy.³⁹ Foreign exchange leakage factors were earlier estimated at 40 percent for Cambodia (equal to Lao PDR, and Myanmar), higher than Vietnam at 35 percent.⁴⁰ This is mainly due to the countries' relatively early-stage tourism development, less-diverse economies, and underdeveloped local value chains (see also box S2: Maldives – Low national participation increases leakages).

Enabling environment

Cambodia's preparedness for and competitiveness in tourism is modest, which implies unfulfilled potential. Based on Cambodia's Travel & Tourism Competitiveness Index, which measures the factors that make it attractive to develop business in the travel and tourism industry, the ranking for Cambodia remains low. While Cambodia rose by four places, in 2017, it was still ranked 101st out of 136 countries globally. During the last three years, the tourism sector has made some progress, especially on ITC readiness and national resources, but potential improvements in many aspects are yet to be tapped (figure S7).

Box S2: Maldives - Low national participation increases leakages

Tourism is the largest sector of the economy in the Maldives. However, it seems also to have the largest tourism leakage since eighty cents of every dollar spent on tourist inputs accrued to foreign companies.¹ Maldives' tourism does not generate a high overall multiplier effect instead, the high rate of imports, the large number of expatriates employed in tourism industry, and the prominent role that foreign investors play in the ownership, management and operation of tour companies. This is largely due to all major goods for developing and maintaining tourism services and facilities are imported, including building materials and equipment for the construction of tourist hotels and resorts. Acknowledging this issue, improving the linkage between tourism and domestic industries has received attention from the Maldives's government. Maldives Third Tourism Master Plan emphasis on increasing linkages between tourism and other supporting sectors, namely fisheries, agriculture and handicrafts, was a strategy to reduce these leakages of tourism revenue.²



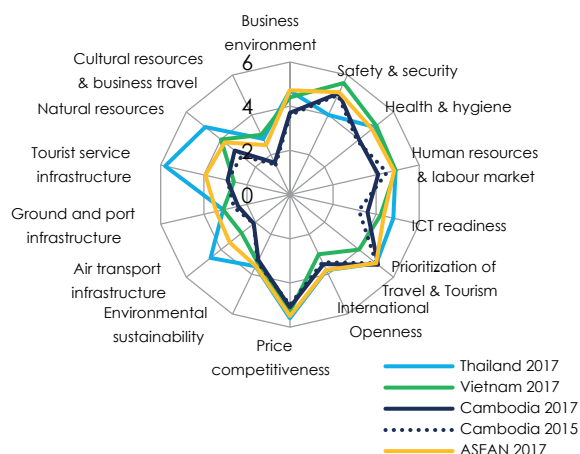
1 <http://shodhganga.inflibnet.ac.in/bitstream/10603/72940/8/chapter%204.pdf>

2 <http://www.tourism.gov.mv/downloads/ttmp.pdf>

39 For each dollar of direct visitor spending on tourism-linked activities (travel, accommodation, tour services), a portion goes toward imported goods and services. This portion is called "leakage," which means that its direct contribution to GDP is generally less than one-for-one.

40 The estimates were done in 2005. See "Tourism sector assessment, strategy, and roadmap for Cambodia, Lao PDR, Myanmar, and Vietnam (2016–2018)," Asian Development Bank, Manila; <https://www.adb.org/sites/default/files/institutional-document/227186/clmv-tourism-sector-assessment.pdf>.

Figure S7: Cambodia's successes and gaps ranked by Travel & Tourism competitiveness index in 2015 and 2017



Source: Travel & Tourism Competitiveness Index 2015 & 2017.
Note: Score varies from 0 (worst) – 7 (best).

Currently, the main drivers underpinning Cambodia's travel and tourism competitiveness are the authorities' overall policy and strategy. Those include its prioritization of travel and tourism (ranked 29th), price competitiveness (51st), international openness (58th), natural resources (62nd), and cultural resources (76th). Nevertheless, Cambodia's performance lags behind in environmental sustainability (130th), business environment (125th), human resources and labor market (110th), health and hygiene (109th), ground infrastructure (108th), and tourist service infrastructure (102nd).

A comparison of travel and tourism competitiveness across several regional countries indicates that Cambodia is behind its peers, although the country is endowed with natural and cultural assets. While in terms of natural and cultural resources Cambodia is only second to Vietnam, Cambodia's

overall tourism competitiveness ranking of 101st is behind Lao PDR, Vietnam, and Thailand, which are ranked 94th, 67th, and 34th, respectively.

The tools used to measure competitiveness within specific market segments show mixed results for Cambodia. The country is home to two UNESCO cultural heritage sites (one being the Angkor archaeological site within the destination of Siem Reap), but no natural heritage sites. Regarding adventure tourism, Cambodia ranked 96th among 163 countries in the Adventure Tourism Development Index (ATDI) in 2015.⁴¹ This, however, represents a notable improvement from its ranking of 107th in the first edition of the ADTI in 2008. As for the meetings market, Cambodia placed 87th in the 2015 International Congress and Convention Association (ICCA) rankings, having hosted nine major international meetings that year, below Vietnam (55th) and Thailand (27th). Finally, cruise tourism has increased dramatically in Cambodia over the last three years (by 118.8 percent). Yet the total number of port calls it received in 2016 (35) was still the lowest among the East Asia Pacific economies featured in the Cruise Lines International Association's Asia Cruise Trends study.

Policy and initiatives

Underpinning the importance of tourism development, regional and national strategic plans have been adopted. A 10-year ASEAN Tourism Strategic Plan was adopted in 2015,⁴² which lays out two

41 For more details, see <http://www.adventureindex.travel/downloads.htm>.

42 This plan envisions that "By 2025, ASEAN will be a quality tourism destination offering a unique, diverse ASEAN experience, and will be committed to responsible, sustainable, inclusive and balanced tourism development, so as to contribute significantly to the socioeconomic well-being of ASEAN people."

strategic directions. The first is to enhance the competitiveness of ASEAN as a single tourism destination by intensifying promotion, diversifying products, attracting investments, and raising human capital with the implementation of ASEAN tourism standards. The second is to ensure that ASEAN tourism is sustainable and inclusive by upgrading local communities and public-private sector participation, and ensuring the safety/security/protection of heritage sites and the environment. Cambodia is actively driving the rollout of ASEAN tourism standards as a national agenda and as lead member across the ASEAN community.

At the national level, Cambodia has formulated the Tourism Development Strategic Plan 2012–2020. Promoting the “Cambodia: Kingdom of Wonder” and “Clean City, Clean Resort, Good Service” campaigns is one of its objectives. Improving and developing tourism infrastructure to help drive the industry forward (roads, airports, water supply, electricity) is critically important. To take advantage of regional integration, the national strategy also is envisaged to endorse ASEAN tourism agreements, especially visa exemption agreements between Cambodia and ASEAN.

The China Ready initiative represents Cambodia's effort to capitalize on the rapid growth in Chinese inbound tourism. The five-year initiative targets 2 million Chinese tourists per year by 2020. With the recent surge in Chinese tourists, it is likely

that Cambodia will receive at least 1 million Chinese tourists by the end of 2017. Clearly, continued successful implementation of this initiative will enable the authorities to reach 2 million Chinese tourists, or nearly a third of the total projected 7.5 million visitors by 2020. The initiative discusses steps to facilitate visits by Chinese tourists, such as providing Chinese signage and documents for visa processing, encouraging local use of the Chinese yuan, and ensuring that food and accommodation facilities are suited to Chinese tastes.⁴³

The Clean City initiative aims at improving awareness of the importance of sanitation and hygiene in everyday life for urban residents. It was introduced to help change urban dwellers' behavior on generating, reusing, recycling, and disposing of waste to make homes, cities, and communities clean. The initiative also supports tourism by allowing visitors to explore more and stay longer. “Clean City, Clean Resort, Good Service and Best Hospitality” is the theme of Cambodia's Clean City Program.⁴⁴

Key messages

Based on recent and expected demographic, economic, and technological trends, tourism growth will only accelerate in the coming years. This should generate increased opportunities to develop tourism destinations and capture the economic benefits of tourism. At the same time, this growth, if not properly managed, will place greater pressures on the sector's economic,

⁴³ For more details, see <http://www.adventureindex.travel/downloads.htm>.

⁴⁴ This plan envisions that “By 2025, ASEAN will be a quality tourism destination offering a unique, diverse ASEAN experience, and will be committed to responsible, sustainable, inclusive and balanced tourism development, so as to contribute significantly to the socioeconomic well-being of ASEAN people.”

social, and environmental sustainability. Therefore, Cambodia must address key market and policy failures to properly manage and benefit from the expected growth.

There is room to maximize the potential contribution of Cambodia's tourism sector to the economy. Note also that the total GDP multiplier of tourism is found to be highest among service sectors.⁴⁵ Given Cambodia's relatively low average expenditure per visitor compared to its peers (table S6), increasing length of stays and average expenditure per day is feasible. However, doing this will require additional tourism products to entice more tourist daily expenditures, and diversification of tourism sites to prolong length of stays. Cambodia's total (public and private) investment in the tourism sector may also need to be boosted, while reducing leakages due to the fact that a large proportion of tourism products and services are imported.

There are several areas that require active intervention or close monitoring if Cambodia is to fully capture its socioeconomic development potential from tourism.

a. There are considerable opportunities for the development of new markets, products, and services. As stated above, other countries with similar portfolios for tourism have emerged from conflict and shown two- and three-fold increases in the value of their tourism industry in the 5 to 15 years following the end of conflict. This indicates the potential to expand the sector over a relatively short time frame, notably in the following segments and subsectors:

- **Protected area tourism:** There is considerable potential to develop nature tourism; despite the fact that a large percent of the land area is covered by national parks and reserves, the vast majority of visitors are currently focused on only a small number of these areas.
- **Domestic tourism:** Little attention is paid to domestic tourism in Cambodia but, given that its contributing value across ASEAN is estimated to be at least equal to international tourism, it also offers a potential source of growth. In 2016, Cambodia's domestic

Table S6: Tourism's contribution highlights (latest available years)

	Cambodia	Lao PDR	Thailand	Viet Nam
International visitor expenditure (\$ billion)	2.44	0.69	44.6	8.29
Direct contribution to GDP (%)	12.2	4.3	9.30	4.6
Tourism investment (\$ billion)	0.6	0.6	7.0	5.5
Average expenditure per visitor (\$)	655.5	191.7	1488.9	925.3
Average length of stays (days/nights)	6.3	4.8	9.8	11.3
Average expenditure per day (\$)	92.5	76.5	148.1	126.0

Sources: World Travel & Tourism Council, 2017 and World Tourism Organization.

⁴⁵ Combined indirect, direct, and induced impacts of international visitor spending (less leakage) on output, income, and employment are called the "multiplier effect." The WTTC estimates the total GDP multiplier of the tourism sector to average 3.2 globally, the highest among service sectors and second only to automotive and chemicals manufacturing, according to the World Bank's October 2017 East Asia Economic Update.

tourism statistics showed Cambodian and foreign visitors accounted for 10.6 million and 6.0 million visitors, respectively.

- **High-value products:** There is space for the development of high-value tourism products. For example, areas are suitable for development as wildlife viewing destinations, and high-value services can be established around existing products.
- **Business and events tourism** could be developed in several areas, building on the steady flows currently witnessed. All areas with good air access would be ideal destinations, if destination facilities could be improved.
- **The internet** is having a major impact as a source of information for tourism. Internet-based electronic commerce offers considerable opportunities for firms to expand their customer base and enter new product markets in more cost-effective ways.⁴⁶ The potential for e-commerce development is significant in Cambodia.⁴⁷ The number of citizens with regular internet access is projected to almost double to 9.5 million (60 percent of the population) by 2020.⁴⁸

b. It is important to improve destination-level management if these markets are to be tapped. Annex 2 presents a matrix on the importance of destination-level

management, national investment, and the environment for high-value services. If action is taken on these, the sector can guarantee growth and inclusion by better development and protection of key assets, and through improved use and redistribution of tourism revenues. By doing this, Cambodia creates a solid diversity of source markets. While the recent recovery of international arrivals, boosted largely by arrivals from China, is encouraging, it is crucial to maintain the momentum in other markets to reduce seasonality and reliance, and to attract higher-paying visitors.

c. Given Cambodia's very low score and ranking on ground infrastructure, addressing infrastructure and connectivity deficiency is a priority. Growing urbanization and tourism mean that the city needs to have better infrastructure and transportation in place to accommodate needs, curb potential traffic issues, and build resilience. Transforming emerging urban areas resulting from a construction boom to become more tourist-friendly destinations by improving tourism infrastructure, facilities, and accessibility will support destination diversification. Connecting those destinations with each other and with the main urban centers ("hubs") that act as gateways to other tourist destinations will enhance connectivity.⁴⁹ This can be developed by employing two possible approaches from a destination perspective:

46 "E-business for Tourism, Practical Guideline for Tourism Destination and Business," World Tourism Organization, Madrid, 2001.

47 "Cambodia: Rapid e-Trade Readiness Assessment," United Nations Conference on Trade and Development (UNCTAD), Geneva, 2017.

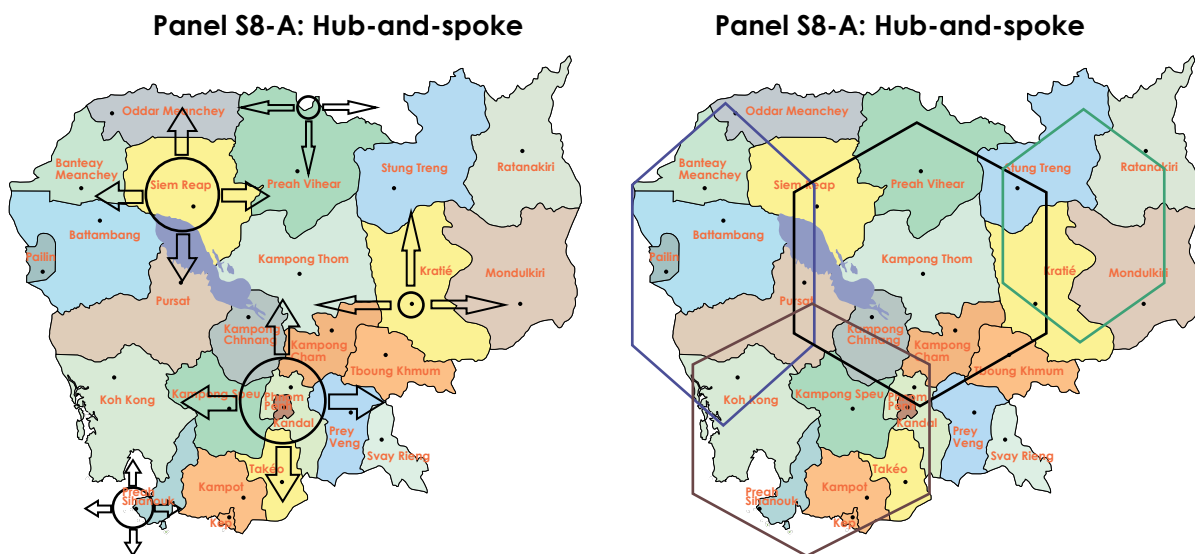
48 According to the Ministry of Posts and Telecommunications. Despite recent progress, however, Cambodia ranked only 115th out of 144 in the UNCTAD B2C E-commerce Index 2017.

49 Hub-and-spoke and circuit models have been used to promote the tourism industry in India. See Rahul Chakravarty and Pragya Singh, "Tourism Infrastructure: The Roles State Play," 2015 (<http://ficci.in/spdocument/20610/Report-Tourism-Infrastructure.pdf>).

➤ **Hub-and-spoke.** First, enhance access to and mobility in and around the urban centers, or hubs. Then develop the “spokes”—rural locations closely linked to the urban hubs that represent great tourism potential. This approach establishes new itineraries for tourists in a way that disperses tourism-related socioeconomic benefits to people in areas currently bypassed by tourism. For instance, Cambodia’s main tourism hubs may include Phnom Penh, Siem Reap, and Sihanoukville. Establishing spokes for each hub will allow tourists to explore more than one area surrounding the hub. In this regard, linking (packaging) attractive destinations in Preah Vihear, Battambang, Banteay Meanchey, and Pailin provinces to Siem Reap hub (panel A in figure S8) can be one of the several options to attract tourists to stay longer.

➤ **Circuits.** An alternative approach involves developing multidestination itineraries that integrate a variety of visitor experiences across a region or zone, based on a variety of themes and primary travel motivations. As with the hub-and-spoke model, any connectivity issues that might exist between destinations within a circuit are addressed. For instance, a circuit may include Siem Reap, a cultural and religious site of the Angkor Wat temple complex, which can be linked to nature-based and ecotourism sites in Tonlesap region (Kompong Thom and Kompong Chhnang provinces), Mekong region (Stung Treng and Kratie provinces), and historical sites (the capital city of Phnom Penh) (panel B in figure S8).

Figure S8: The “hub-and-spoke” approach aims at enhancing access to and mobility in and around the urban centers, while “circuits” targets multidestination itineraries that integrate visitors’ experiences



➤ More road networks, while improving the existing ones, are needed to improve the backward and forward links across economic sectors and provinces. The industry sector and the service industry, including the tourism sector, would further benefit from public investment in road infrastructure. Without proper destination management, this will put future tourism growth at risk and cause environmental degradation, economic losses, and inconvenience for residents.⁵⁰ As discussed, Cambodia has the highest dependency on tourism as part of its GDP (12.2 percent), so any fluctuation in tourism arrivals, length of stay, and expenditure will impact the country more severely than its neighbors.

d. Addressing tourism leakages can be initiated by assisting producers (and providers) of food, crafts, and other local goods (and services) to access tourism value chains, which could boost overall spending in destinations. For example, the souvenir market in Siem Reap, where imported items account for the majority of its inventory, generates about US\$50 million to US\$70 million per year. However, tourists report they would spend an additional US\$60 million per year if Cambodia-made products that match market demand were available for purchase. It is also important to adopt an eco-sustainable approach—organic and low-water-dependent crops (vegetables instead of rice),

Box S3: Thailand/Vietnam—the value of food as destination brand ambassador

In recent years, food tourism has grown considerably and has become one of the most dynamic and creative segments of tourism. Both destinations and tourism companies are aware of the importance of gastronomy to diversify tourism and stimulate local, regional, and national economic development. Food has a particularly important role in the development of tourism services and in alleviating poverty, because it often comprises 30 percent or more of tourist expenditure, and this money is regularly spent directly in local businesses.^a

Many countries in the region have been using food to promote tourism, both directly and indirectly. Thailand, for instance, has consistently attempted to promote Thai cuisine internationally. Thailand launched its first culinary diplomacy initiative in 2002 to increase the number of Thai restaurants worldwide by providing loans and training for entrepreneurs seeking to open Thai restaurants overseas, creating the “Thai Select” certification program that encouraged the use of ingredients imported from Thailand, and promoting integration among Thai investors, Thai Airways, and the Tourism Authority of Thailand with Thai restaurants overseas.^b

Similarly, Vietnam launched a “Vietnamese Kitchen” project to bring Vietnamese cuisine to the world by promoting the freshness and healthfulness of the food. In 2006, MSN’s travel website selected Hanoi as the third best city in the world for delicious dishes.^c

⁵⁰ Economic Impacts of Sanitation in Southeast Asia, World Bank, Jakarta, 2008; Economic Impacts of Sanitation in Lao PDR, Water and Sanitation Program, World Bank, 2009.

while protecting wildlife to increase the natural attractiveness of the tourist destinations. Establishing associations among farmers and food processors to supply domestically produced foods to hotels will be necessary (see also Box S3: Thailand/Vietnam—the value of food as destination brand ambassador). This will help Cambodia generate and retain more income from tourism, better balancing the distribution of benefits. By reducing large foreign exchange leakages⁵¹ (compared with Thailand, where this is only 5 percent!), there is excellent potential for an enhanced net income contribution of tourism by 2020 under two scenarios (table S7). The first assumes no further reductions in the foreign exchange leakage factor during 2015–20 (benchmarked at 24 percent). The second assumes leakage drops to 18 percent in 2020, resulting in US\$270 million more in net income for Cambodia.

In order to use food and tourism as an economic development strategy, it is important to encourage visitors to stop, spend, and stay longer. Short-, medium- and long-term strategies include a range of options and relationships (with local businesses and organizations as well as with other regional stakeholders), and develop intellectual capital to enhance the regional knowledge base and create engaging food experiences.^c

Note:

a. "Global Report on Food Tourism," World Tourism Organization, 2012.

b "Food Tourism in Thailand." Pipaboon Kururatchikul, 2014.

Table S7: Potential net income contributions from tourism in 2020

	Projected international visitor arrivals	Projected expenditure	Projected Income with 24% Foreign Exchange Leakage Factor (US\$ billion)	Projected Income with 18% Foreign Exchange Leakage Factor (US\$ billion)
Cambodia	7,000,000	4.50	3.42	3.69
Lao PDR	4,700,000	0.80	0.61	0.66
Myanmar	7,500,000	10.10	7.68	8.28
Vietnam		19.00	14.44	15.58

Sources: Tourism sector assessment, strategy, and roadmap for Cambodia, Lao PDR, Myanmar, and Vietnam (2016–2018), Asian Development Bank; <https://www.adb.org/sites/default/files/institutional-document/227186/clmv-tourism-sector-assessment.pdf>.

51 Domestic producers and service providers are expected to supply goods and services to international tourists. In the case of foreign exchange leakages, imported goods and foreign services are supplied.

e. Expanding and upgrading skilled workers, while strengthening public-private partnerships. A set of intervention measures could be introduced in main hubs such as Siem Reap and Sihanoukville. In this regard, the Ministry of Tourism has introduced training programs on hospitality including adoption of the ASEAN standards for tourism professionals in close partnership with the private sector, mainly tourism-related associations. Those include building human resources and skills developments such as tour guides, massage service providers, service experts at restaurants, hotel services, and travel services, aiming at improving service quality and proper hospitality in line with the campaign "Clean City, Clean Resort, Good Service and Best

Hospitality". In this regard, leveraging the 2017–25 National Policy for Technical and Vocational Education and Training (TVET) and public-private partnerships to provide and improve access to quality training for youth and women from poor communities to get the right skills and knowledge and maximize their potential for employability will help. Improved collaboration among (better-trained and well-organized) local workforces, farmers, small and medium-sized enterprises, and tourism-related associations such as the Cambodia Association of Travel Agents, Cambodia Hotel Association, and Cambodia Restaurant Association, will underpin resilient tourism and, in particular, reduce leakages.

ANNEX 1

The challenge of creating an inclusive tourism system; the case of attracting investment in Lombok, Indonesia



The Government of Indonesia is actively targeting an inclusive growth of its tourism sector by creating well-planned destinations as alternatives to Bali. These efforts are coordinated by the highest authority (the vice-president's office) and are aimed at the attraction of private sector investment. The challenges of enticing development away from the country's main attraction (Bali) are similar to what Cambodia experiences with Angkor Wat.

At present, the development of additional subnational destinations able to attract different (longer-staying/higher-spending) markets is further influenced by characteristics similar to Cambodia:

- Lombok is too close to Bali and Bali has more to offer visitors.
- The quality transportation links are seen as a positive point for Lombok, which is placed alongside Borobudur as a potential destination for investment in the future.
- The destination's lack of critical mass, which is deterring potential investors who have spent time researching Lombok and who have identified the beach demographic to suit their target market. They are waiting to see how the destination develops further before making the investment.
- The majority of possible investors canvassed had no interest investing in Lombok, seeing it as "hype and no substance," which indicates they think that Lombok lacks depth as a destination. Lombok, as stated above, has been discussed and debated since the 1990s, with very little investment or development. It is no wonder, therefore, that potential investors are concerned about the destination having no substance, as it has been given the spotlight but has not yet shined.
- Domestic investors have not pursued the destination due to issues of culture ("it is

tough to do business in Lombok, we are not sure it's worth the pain"), and the slowness in the general development of Lombok. They prefer to wait several years until Lombok has had more time to grow.

- Development in Lombok has stalled. It needs a kick-start, which can only be initiated by the government, which has been lacking to date.

Lombok therefore wants to establish itself as a distinctly different destination. Like Cambodia, different parts of Lombok are at different stages of the development cycle. There are mature, well-known destinations internationally and regionally that are currently enjoying relatively good levels of investment with new hotels opening, properties under renovation, and chain owners accumulating additional properties. Performance is relatively strong for tourism services and assets including hotels, restaurants, and travel agencies and guides. This constitutes the profile of Angkor Wat, although chain development is not found in Cambodia.

Other areas are at the development stage, including a long, new hotel pipeline along the south coast with the potential for large-scale hotels and restaurants, and supporting a tourism service infrastructure comparable to Cambodia's coast, as well as infancy destinations where restaurants, homestays, and smaller nonstar hotels have begun to open with small investment levels, some aimed at niche adventure visitors. The supporting infrastructure is currently only minimal, with a one-night length of stay.

The accelerated growth of development and infancy destinations across Cambodia

can learn from the situation in Lombok and the impact on the supply and demand for tourism infrastructure:

- Investment is occurring in Lombok, but predominantly in the more established/key tourism areas, as is the case in Cambodia with Siem Reap.
- Outside the tourism nodes, investments remain relatively small scale, with no investors willing to invest large sums in an anchor development that could help push Lombok into a new phase of investment/development.
- Small-scale investment and small-scale developments do not help increase air lift or road improvements, which is a limiting factor for the further development of Lombok.

The positioning of the destination is essential, and market value is found in (Lombok) being the unspoiled paradise. This fosters the development of sustainable and different key tourism areas offering various options to appeal to diverse market sources of tourism demand. It should not develop a single identity, such as halal or ecotourism (although they can be components). Destinations include:

- Senggigi and Gili Islands: largely luxury or high-end beach destinations that are expected to develop further organically. Target markets: Australia, Europe.
- Kota Mataram: business driven, mid-tier. Target markets: Domestic, Malaysia.
- Mount Rinjani and surroundings for nature-based, niche tourism. Small/low impact. Not a principal focus, but identified as a

secondary alternative. Target markets: Europe, China (niche).

- **Southwest Coast**, including Selong Balanak, low-density beach destination to cater to high-yielding visitors, surfers, and divers, particularly along the coast. Facilities should match this demand. Target markets: United States, Europe (France), Australia, Japan, Germany, Singapore.
- **Central South Coast**, including Mandalika, developed as a high-density mass market tourism area. Close to airport. Multiple hotels, all price points, greater variety of facilities. Target markets: China; Malaysia; Singapore; Australia; the Middle East; meetings, incentives, conferences, and events (MICE) countries.

The Lombok example confirms that Cambodia can benefit from:

- ✓ An active role of government driving tourism development
- ✓ Enabling anchor developments of appropriate scale
- ✓ Developments that target specific source markets
- ✓ Creating a distinct destination image outside the well-established attractions.

ANNEX 2

The importance of destination-level management



The importance of destination-level management, national investment, and the environment for high-value services, along with the associated drivers and constraints, need to be recognized, and recommendations are needed on the most promising entry points for action. If action is taken on these, the sector can guarantee growth and inclusion by better development and protection of key assets, and through improved use and redistribution of tourism revenues.

Key problems

Destination-level management

There is a lack of concerted action to manage and develop areas, including inadequate services, problems with installing small and medium infrastructure, and poor planning and zoning for tourism.

Related to this, there is also poor management of tourism attractions, with early signs of degrading and overutilization. These factors also hamper the ability to develop new products and compound the pressure on the existing attractions, especially at Angkor Wat.

National-level connectivity and investment

There is poor national-level management of, and public investment in, tourism destinations, with the most urgent aspect being poor connectivity. Problems with an inadequate last-mile road network are reported, and there are too few airports and limited air connectivity in support of diversified itineraries, reducing the ability to develop new areas for tourism and increasing pressure on existing destinations.

Barriers to high-value services

There are a series of problems hindering businesses from providing high-quality services or catering to high-value clients.

The investment climate allows for overcrowding in similar segments and spatial destinations. Tourism businesses also face additional challenges associated with missing skills among the local population for higher-end and specialized market segments. This reduces value captured in the tourism system for which no adequate (targeted) tax

The foundations for destination-level management are set by public sector interventions shaped by economic concessions in the forest sector. Private sector incentives relating to destination development are under discussion, but there are no regulated factors that push businesses toward making important contributions to the local area, and neither joint ventures nor tourism concessions in support of conservation of tourism resources.

The management of tourism is more frequently characterized by limited (at best informal) partnership among key players, with a fragmented appreciation of problems faced and a lack of platforms for building shared solutions. Some of the knowledge and experience required to facilitate action on local problems is available, but there is insufficient technical capacity, and challenges relating to politicization.

The distribution of public investment in general and transport infrastructure in particular reflects the political geography of Cambodia, with only sparse investment outside the real estate growth centers.

The tourism industry has not formed an effective lobby, owing to fragmentation and few corporate ventures. Interministerial coordination is reported as challenging, with tourism potential not usually a consideration, and there is a lack of (economic) information on areas of high potential. A strengthening economic lobby in government could represent an opportunity to promote tourism-related investments.

The potential value (revenue, investment, employment, and tax) of tourism is neither documented nor well understood, and is therefore unable to act as a convincing driver for investment in much-needed enabling infrastructure.

and/or revenue base exists. With growth stagnating, pressure is put on the room capacity that has been created, and (even more important), the capacity that is being planned and under construction, possibly impacting capital markets (loan defaulting).

The tourism sector is affected by the legacy of conflict, and by continued mistrust. Although there is a cadre of bright, innovative young entrepreneurs, overall a “copycat” mentality prevails as a way to ensure tourism is a solid additional livelihood strategy.

The history of poor relations between government and business hinders the ability of the government to catalyze and lead the sector, and perceptions of unethical business practices become a self-fulfilling prophecy.

The high level of Asian group travel keeps itineraries short and restricted, whereas the independent travelers fit the lower-spending segment challenging value growth.

The agreement on labor movement from neighboring Mekong states might create an inflow of semiskilled foreign labor in the hospitality sector, crowding out the unskilled local labor force.

Prospects for improving destination management vary, but there are genuine opportunities for expansion and for introducing new products and places. Central aims should be securing the involvement of tourism businesses in local destination establishment and growth, and strengthening local services with sectoral cross-benefits.

A direct approach to improving national-level public investment in tourism is unlikely to succeed in the short term, but there are other entry points. Efforts should be made to facilitate coherent private sector leadership of the sector, “crowding in” investment anchored to comprehensive long-term plans, catalyzed by public seed funding and encouraging FDI. This would help the tourism industry drive the development of larger-scale infrastructure (possibly planned as public-private partnership) projects. Improved economic data (collection) and analysis of the value of tourism destinations and products are also worthwhile national-level investments.

A considerable difference would be made by improved regulation that drives diversifying the quality scope of the product offering. Impact assessments and community monitoring for tourism-related levies could catalyze product upgrading, with the right support, and instruments should be explored that can help small businesses respond more constructively to opportunities in spatial development.

CAMBODIA: KEY INDICATORS

	2014	2015	2016	2017p	2018f	2019f
Output, Domestic Demand, and Prices						
Real GDP (% change, y/y)	7.1	7.0	7.0	6.8	6.9	6.7
GDP, expenditure shares (% , current prices)						
Private consumption	76.6	75.4	74.4	72.3	70.9	69.5
Government consumption	6.1	7.0	7.0	7.3	7.0	7.1
Gross fixed investment	20.9	21.4	21.7	22.4	23.3	23.6
Exports, GNFS ^a	62.3	61.7	61.3	61.4	61.7	62.6
Imports, GNFS	66.7	66.6	65.7	64.6	64.0	63.9
Domestic demand (% change, y/y)	10.1	8.5	9.5	8.5	9.4	9.6
Consumer price index (annual avg, % change y/y)	1.7	1.3	3.5	2.9	3.2	3.5
Public Sector (% of GDP)						
General government domestic revenues	16.8	17.6	18.4	18.4	18.5	18.8
General government expenditures	21.8	21.1	21.4	23.0	23.8	23.9
Overall fiscal balance excluding grants	-5.0	-3.5	-3.0	-4.5	-5.3	-5.1
Foreign Trade, Balance of Payments, and External Debt (US\$ million unless specified otherwise)						
Trade balance	-2,023.5	-2,261.9	-2,276.0	-2,273.8	-2,464.5	-2,602.8
Exports of goods	7,636.0	8,280.2	9,115.2	9,989.5	10,925.1	12,103.1
(% change y/y)	10.9	8.4	10.1	9.6	9.4	10.8
Key export (% change, y/y) ^b	8.8	10.9	13.6	5.5	4.0	3.5
Imports of goods	9,659.6	10,542.0	11,391.2	12,263.3	13,389.6	14,705.8
(% change y/y)	8.7	9.1	8.1	7.7	9.2	9.8
Current account balance ^c	-1,899.7	-2,093.9	-2,041.4	-2,106.4	-2,222.5	-2,382.4
(% GDP)	-11.3	-11.5	-10.2	-9.6	-9.2	-8.9
Foreign direct investment	1,679.9	1,668.8	2,164.4	2,418.8	2,662.3	2,853.7
External debt	5,351.2	5,732.7	6,522.4	7,427.6	8,551.3	9,535.9
(% GDP)	31.8	31.4	32.6	33.8	35.3	35.7
Debt service ratio (% exports of g&s)	1.2	1.5	1.6	1.9	2.1	2.2
Foreign exchange reserves, gross	4,657.9	5,672.1	6,730.8	8,175.4	9,594.3	9,144.7
(prospective months of imports of g&s)	4.6	5.2	5.7	6.3	6.8	5.8
Financial Markets						
Domestic credit (Net, % change y/y)	28.4	28.6	25.8	16.5	15.2	20.8
Short-term interest rate (% per year)	11.5	11.6	11.8	11.7	11.5	11.2
Exchange rate (riel/US\$, annual average)	4,030.0	4,025.0	4,058.0	4,062.0	4,067.0	4,075.0
Memo: Nominal GDP (millions US\$)	16,809	18,241.7	20,020.2	21,985.2	24,216.2	26,690.5

Sources: Cambodian authorities, IMF, and World Bank staff estimates and projections.

Note: a. Goods and Non-Factor Services (GNFS).

b. Garments.

c. Excluding transfers.

f = forecast; g&s = goods and services; p = projection.



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