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CAMBODIA DEVELOPMENT RESOURCE INSTITUTE

IN COLLABORATION WITH THE CAMBODIAN INSTITUTE FOR COOPERATION AND PEACE

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Foreword

Since August 1997, a network of Southeast Asian research institutes—the Development Analysis Network—has been undertaking collaborative work. With initial funding from the United Nations Development Programme, two meetings were held in Bangkok (August 1997) and Hanoi (December 1997), at which a programme of collaborative research was drawn up. The institutes participating in these meetings were the Cambodia Development Resource Institute, the Cambodian Institute for Cooperation and Peace, the National Economic Research Institute in Laos, the National Statistical Center also in Laos, the Central Institute for Economic Management in Vietnam, and the Thailand Development Research Institute. As problems arose with UNDP funding, the Development Analysis Network obtained support from the International Development Research Centre for research, a workshop and a conference (held from 19–22 January 1999 in Phnom Penh) on the *Impact of the Asian Financial Crisis on the Southeast Asian Transitional Economies (SEATEs)*. At the workshop, it was agreed to expand the network by adding a seventh member, the Institute of Economics from Vietnam.

This working paper consists of the Cambodia chapter and the introductory comparative analysis from the full volume of conference papers, which was published in August 1999 by the Development Analysis Network. In general, the main impression gained by conference participants was that, even though the impact of the Asian crisis began to be felt by the SEATEs in 1998, each was rather more affected by its own domestic crisis. In Cambodia, the July 1997 fighting in Phnom Penh had a major negative impact on the economy. Relaxed monetary and fiscal policies in the Lao PDR exacerbated inflation and the depreciation of the kip. Vietnam's transition to a market economy ran into trouble as inefficient state-owned enterprises and cumbersome domestic rules and regulations impeded the development of the private sector. As for lessons from the crisis, all three SEATEs recognised the need to develop robust financial systems. Thai experience in this respect provided useful insights for the SEATEs, where financial development is still at a relatively early stage.

It is hoped that the collaboration between these Southeast Asian research institutes initiated by this study will continue. The Development Analysis Network has plans for further research, and there are regional issues enough to keep it going for many years to come.

Martin Godfrey, Research Coordinator
Cambodia Development Resource Institute
September 1999

Glossary

Acronyms

ADB	Asian Development Bank
AFTA	ASEAN Free Trade Area
ASEAN	Association of Southeast Asian Nations
BIBF	Bangkok International Banking Facility
BIS	Bank of International Settlement
BOT	Bank of Thailand
CDC	Council for the Development of Cambodia
CDRI	Cambodia Development Resource Institute
CIB	Cambodia Investment Board
CICP	Cambodian Institute for Cooperation and Peace
CPI	consumer price index
CSF	capital support facility
DAN	Development Analysis Network
EU	European Union
FDI	foreign direct investment
GDP	gross domestic product
GSP	generalised system of preferences
IDRC	International Development Research Centre
IMF	International Monetary Fund
NBC	National Bank of Cambodia
NER	nominal exchange rate
NIS	National Institute of Statistics
RER	real exchange rate
SEATE	Southeast Asian transitional economy
SEC	Security Exchange Commission
SITC	Standard International Trade Classification
SOE	state-owned enterprise
USAID	United States Agency for International Development
VAT	value-added tax
WPI	wholesale price index
WTO	World Trade Organisation

Impact of the Asian Financial Crisis on the SEATEs: The Cambodian Perspective[1]

The financial crisis in Asia erupted in Thailand and spilled over to other Asian countries such as Malaysia, the Philippines, Indonesia and South Korea. Although the so-called contagion of the Asian crisis to the rest of the world seemed to have gone into remission by the end of 1998, it is by no means clear that the crisis and its contagion have really ceased. Some crisis countries, such as Thailand and South Korea, appear to have shown signs of economic recovery, whereas Indonesia continues to face not only an economic slump but also social tension and political uncertainty that were precipitated by the financial crisis.

Cambodia is surrounded by countries which have been adversely affected by the crisis. Cambodia's neighbours, particularly Thailand, Malaysia and Singapore, have also been its largest trading and investment partners in the past five years. The Asian crisis has thus dramatically changed the external economic environment surrounding Cambodia.

The economic boom in the countries around Cambodia from the late 1980s to mid-1997 was one of the major external factors fostering Cambodia's transition to a market economy, reconstruction and development. Thailand and Singapore have absorbed a large proportion of Cambodia's exports since the establishment of a coalition government in 1993. Foreign direct investment (FDI) from Malaysia, Singapore and other Asian countries also helped supplement the shortage of domestic savings, investment and human resources in Cambodia.

However, this favourable external environment changed after the Asian crisis erupted. Concerns have been expressed about whether and to what extent the crisis affected Cambodia's economy, and to what extent it had an adverse impact on the livelihood of the Cambodian people, 36 percent of whom live below the poverty line. Social development, particularly health and education, is recognised as a priority issue in Cambodia. How and to what extent has social development been affected by the crisis?

The crisis also raises interesting policy issues in terms of how the government should best respond to external shocks to the economy. What policies has the Cambodian government planned and implemented to contain the contagion of the crisis? What policy lessons can the government learn from the experience of other crisis-hit countries?

[1] The authors thank participants at the Regional Conference on the Impact of the Asian Financial Crisis on the Southeast Asian Transitional Economies (SEATEs) held in Phnom Penh from 21–22 January 1999, who provided useful comments. Above all, Martin Godfrey, Research Coordinator at CDRI, helped us to shape our ideas and gave useful suggestions in the process of our research. All the views expressed in this paper are those of the authors alone, and may not reflect the views of the Cambodia Development Resource Institute or the Cambodian Institute for Cooperation and Peace.

The current paper aims to answer these questions. It first analyses the impact of the Asian financial crisis on Cambodia's economy and society. Official data published by the government are used to analyse the impact at the macro level, while field surveys and interviews were conducted to assess the impact at the micro level. Second, the paper discusses various policies of the government to contain the adverse impact of the crisis. Official documents and records, as well as interviews with key government officials, were used to gather information. Finally, some key issues are discussed to draw lessons for policy-making. Special emphasis is given to examining the extent to which those issues are relevant in the context of Cambodia.

The structure of the paper is as follows: Section 1 provides our framework and methodology, within which we analyse the impact of the Asian financial crisis. Sections 2, 3 and 4 investigate the impact of the crisis on Cambodia in three areas—the financial sector of the economy, the real sector of the economy, and social development. Section 5 discusses the response of the government to contain the adverse impact of the crisis. Section 6 discusses policy lessons that Cambodia could learn from the experience of other crisis countries. The final section concludes the paper with a summary of findings.

1. Analytical Framework and Methodology

It is not always possible to isolate the impact of the Asian crisis from other incidents that have had a major impact on Cambodia's economy. The fighting of 5 and 6 July 1997 is the case in point. The fighting was precipitated by the conflict between the two major political parties, and changed the fundamental conditions of domestic economic activity in Cambodia. Confidence in political stability was lost, the security and safety of citizens and enterprises in Cambodia was threatened, and the future political environment became uncertain. The international community responded to the July fighting by either terminating or suspending foreign assistance to Cambodia. Soon after the fighting, ASEAN decided to postpone Cambodia's accession to the grouping, which had been scheduled for the end of July 1997.

The fighting in 1997 had an immediate adverse impact on Cambodia's economy. In addition to the destruction and the looting of many factories and shops around Phnom Penh, the foreign exchange rate of the riel started depreciating against the dollar, inflation soared, consumption and investment expenditures contracted, tourist arrivals plunged, and the inflow of foreign aid was disrupted. The government introduced austerity measures in public expenditures in August 1997 to respond to an expected shortage of public revenue due to the suspension of foreign aid and the loss of customs revenues. All of these contributed to the contraction of aggregate expenditures in the second half of 1997. Consequently, Cambodia's economy grew by only 1 percent in 1997, much lower than the average annual 6-percent growth of real GDP between 1993 and 1996 (Table 1.1). It should be noted that the fighting had a major adverse impact on Cambodia's economy even before the spill-over of the Asian financial crisis was felt in the second half of 1997.

Our analysis of impacts is not intended to isolate the impact of the Asian crisis from other major events. Rather, it tries to identify some impacts on Cambodia that could be attributed to the Asian financial crisis, and to observe and analyse the changes that have taken place since the crisis began. Three major impacts are identified and discussed in this paper: 1) the impact on the financial sector; 2) the impact on the real sector; and 3) the impact on social development.

First, the crisis started with financial turmoil in Thailand, and transmitted rapidly to the financial sector in other crisis countries. It is thus reasonable to begin our analysis by examining whether the contagion spilled over to the financial sector in Cambodia. The impact could take the form of the withdrawal of foreign capital, credit crunch, or the closure of commercial banks that are affiliated with or owned by foreign banks in the crisis countries.

Table 1.1. Macro-Economic Indicators, 1992–98

	1992	1993	1994	1995	1996	1997	1998[1]
Growth rate of real GDP (1989 constant prices)	7.1	4.1	4.0	7.6	7.0	1.0	0.0
Agriculture	1.9	-1.0	0.0	6.5	2.4	1.2	-
Industry	15.7	13.1	7.5	9.9	18.2	-2.9	-
Services	11.2	7.0	7.5	7.8	7.0	2.6	-
Gross domestic savings (percentage of GDP)	7.3	5.6	4.8	5.4	4.9	4.7	-
Gross domestic investment (percentage of GDP)	9.8	14.3	18.5	21.2	20.4	16.1	-
Growth rates of CPI (final quarter basis)	112.5	41.0	17.9	3.5	9.0	9.1	15.0
Growth rates of money supply (M2)	209.0	40.0	29.4	44.3	40.4	16.0	-
Exchange rates (riel/dollar)	1,253	2,470	2,543	2,462	2,624	2,989	3,700
Central government operations (percent of GDP)							
Expenditure	9.8	11.2	16.5	16.7	16.3	13.9	11.7
Revenue	6.2	5.4	9.6	8.9	9.1	9.7	8.1
Budget surplus/deficit	-3.6	-5.8	-6.9	-7.8	-7.2	-4.2	-3.6
Balance of payments							
Current account balance ($ million)	-50	-190	-329	-474	-485	-346	-329
Current account balance (percentage of GDP)	-2.5	-9.4	-13.7	-16.1	-15.5	-11.4	-11.6

1 = Estimates. Source: World Bank (1999)

Second, the experience of the crisis countries revealed that the turmoil in the financial sector caused a subsequent contraction of the real sector of their economies. Major deterioration of performance in the crisis countries could adversely affect Cambodia's real economy through two channels: 1) the realignment of foreign exchange rates; and 2) the slowdown of economic growth in the crisis countries. Drastic realignment of foreign exchange rates in the crisis countries could affect the competitive position of Cambodia's goods and services in domestic, regional and world markets. This could potentially affect domestic consumption, production and the flow of foreign trade and investment. In addition, the slowdown of economic growth in the crisis countries could reduce the demand for Cambodia's exports, and possibly the inflow of foreign private investment from the crisis countries. Furthermore, some domestic services, such as tourism, could be affected by the crisis.

Third, the economic crisis in the region and its contagion in Cambodia could put pressure on the livelihoods of the Cambodian people, and adversely affect social development, such as health and education. In particular, the poor and vulnerable groups in both urban and rural areas could be severely hit by the internal and external crises. For instance, the crises could reduce earnings and job opportunities of urban workers on the one hand, and increase the prices of the essential items such as food, medicine and education on the other. In rural areas, migrant workers who live near the Thai border may no longer find as high a demand and wages in Thailand as they used to. The loss of income-generating opportunities in Thailand could motivate them to migrate to towns and cities in Cambodia to seek alternative earning opportunities.

The next three sections analyse the impacts of the Asian crisis within the framework described above. In these sections official government data are used to assess the overall impact. In addition, CDRI has conducted a series of interviews and surveys to generate primary information. These small-scale surveys are intended to assess micro impacts of the crisis, particularly on consumers, enterprises and vulnerable workers in urban and rural areas. The surveys fill the gap between the lack of official data in these areas and the need for timely information for research and policy-making. Although the surveys are small in scale and geographically limited, our experience of monitoring Cambodia's economy reveals their value in current circumstances.

2. Impact on the Financial Sector of the Economy

The Asian crisis was triggered by massive and rapid outflows of private capital from the crisis countries. In Thailand, for instance, net private capital inflows recorded an annual average of 10 percent of GDP from 1989 to 1995, and remained around 9 percent of GDP in 1996 (Table 2.1). However, the inflow of private foreign capital reversed dramatically in 1997, such that net capital outflows accounted for 13 percent of GDP. A similar pattern before and after July 1997 was observed in the other crisis countries, such as Malaysia, the Philippines, and Indonesia, though the extent was much less than that in Thailand.

Table 2.1. Private Capital Flows (percentage of GDP)

	1983–88[1]	1989–95[1]	1996	1997[2]
Cambodia[3]	-	-	5.4	4.9
Countries most affected by the crisis				
Thailand	3.1	10.2	9.3	-10.9
Malaysia	3.1	8.8	9.6	4.7
Indonesia	1.5	4.2	6.3	1.6
Philippines	-2.0	2.7	9.8	0.5
South Korea	-1.1	2.1	4.9	2.8
Countries less affected by the crisis				
Singapore	5.0	3.8	-10.1	-5.5
Taiwan	0.2	-4.0	-3.2	-3.8
China	1.2	2.5	4.7	3.7

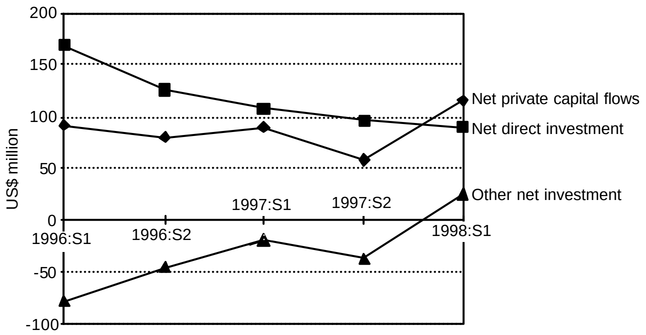
1 = Annual averages. 2 = IMF projections. 3 = Actual figures calculated from data from the National Bank of Cambodia. Source: IMF (1997)

The drastic outflows of private capital created a vicious circle in the crisis economies, as their currencies depreciated dramatically and equity prices plunged. A large number of commercial banks and financial institutions suffered from soaring short-term unhedged foreign debt, and mounting unperforming loans. Governments liquidated insolvent financial institutions to restore confidence in the economy. The collapse of the financial sector, coupled with tight monetary policies to curb inflation, pushed up market interest rates in the crisis countries. This had an adverse impact on the real sector in the economy. Many non-financial firms suffered from credit crunch and faced difficulty finding credit even for ordinary operations of production and export. Domestic consumption and investment consequently contracted, and unemployment soared.

Cambodia also experienced a decline in private capital inflows in 1997. However, the scale and the speed of the decline were modest relative to the experience of the crisis countries. For instance, net private capital inflows to Cambodia declined from $170 million in 1996 to around $150 million in 1997. In percentage terms relative to GDP, this was a decline from 5.4 percent in 1996 to 5.0 percent in 1997. The extent of the decline was much smaller than that in Thailand, Malaysia and other severely affected Asian countries.

The adverse impact of the Asian crisis instead appears to have been felt more strongly in 1998. First, even though total private capital inflows recovered in the first half of 1998, the proportion of short-term loans increased relative to long-term investment (Figure 2.1). According to the estimates by the National Bank of Cambodia (NBC), net private capital inflows increased by 30 percent from $89 million in the first semester of 1997 to $116 million in the first semester of 1998. However, the expansion came from an increase in other net investment, including short-term currency transactions, deposits, loans and trade credit. In

Figure 2.1. Net Private Capital Inflows into Cambodia, 1996–98



contrast, direct investment, which had been a major source of private capital inflows into Cambodia until 1996, continued to decline from $108 million in the first semester of 1997 to $90 million in the first semester of 1998. This indicates that the proportion of short-term private capital inflows relative to long-term inflows has been increasing from 1997 to 1998.

Second, the Asian crisis has gradually been putting pressure on the banking sector in Cambodia. One of the most notable developments was the decline of foreign currency deposits after mid-1997. Foreign currency deposits expanded rapidly after the operation of private and foreign banks was liberalised in 1991. Since then, foreign currency deposits have comprised the major part of bank deposits in Cambodia, accounting for 90 to 95 percent of total deposits in the past few years. However, this trend reversed after July 1997. The total value of foreign currency deposits peaked in February and March 1997, and then started to decline. The decline of foreign currency deposits continued from July 1997 to August 1998. It should be noted that the internal political crisis appears to have had a major impact on foreign currency deposits—major declines of foreign currency deposits were observed during or after political incidents, for instance, in April 1997 after the 30 March grenade attack on opposition demonstrators, in July 1997 following the July fighting, and in July 1998 before and during the national election.

The decline of foreign currency deposits has been putting adverse pressure on lending in the banking sector. However, the credit crunch to date appears to have been much less severe in Cambodia than in other crisis countries. The total value of outstanding credits increased until May–June 1997, and has since levelled off. The declining trend of credit growth became more apparent after March 1998, when the annual growth rates became negative for the first time. These figures indicate that the impact of credit crunch on the non-financial business sector in Cambodia has not been as serious as the experience in other crisis countries.

Finally, unlike Thailand and other crisis countries, Cambodia did not experience closure of commercial banks until mid-1998. Immediate contagion of the financial turmoil thus did not take place in Cambodia. However, in the second half of 1998, two Thai-owned commercial banks closed their offices in Cambodia, perhaps reflecting the restructuring of banking activities undertaken in Thailand.

To sum up, our analysis revealed that the Asian crisis did not immediately affect the financial sector in Cambodia. However, its adverse impacts came to be felt more strongly in 1998. Why then was Cambodia not immediately affected? First, even though Cambodia had received a large amount of private capital inflows since 1993, the majority of them took the form of FDI. As FDI involves the development of physical facilities and human resources, it tends to take longer for entry/exit decisions to be made than is the case with portfolio investment. Second, Cambodia's financial sector is still at an infant stage, where financial markets for bonds and securities have not yet been established. There is thus no portfolio investment in these markets by foreign and domestic investors. Third, while the banking sector comprises perhaps the only formal financial institution in Cambodia, its role as a financial intermediary to channel savings to investment has been limited. A majority of business enterprises in Cambodia, which are usually small-scale, secure little funding from commercial banks. The turmoil in the financial sector and credit crunch therefore had only a limited impact on the real sector, relative to the crisis countries. Fourth, speculative investment in real estate markets in Cambodia has never been as widespread as that in the crisis countries. Finally, wide circulation of dollars appears to have acted as a "buffer" to moderate the fluctuation in the foreign exchange rate of the riel.

3. Impact on the Real Sector of the Economy

This section analyses the impact of the Asian crisis on the real sector of Cambodia's economy. Before going into detail, however, the development of the real sector until 1996 is briefly reviewed as a background to the following analysis.

3.1. Real Sector Development before July 1997

The real sector of Cambodia's economy experienced steady growth until mid-1997. Real GDP increased by an average annual rate of 6 percent between 1991 and 1996 (Table 1.1 above). This reasonable performance was led primarily by the expansion of the industrial and the service sectors, even though the agricultural sector continues to play a dominant role in Cambodia's economy. Agriculture comprised 43 percent of real GDP and absorbed almost 80 percent of total employment in 1996.

Cambodia has taken several measures to liberalise international trade since the early 1990s. For instance, tariff lines have been streamlined, and various quantity restrictions have been abolished. Cambodia thus maintains a liberal trade regime.

Cambodia's foreign trade expanded rapidly between 1992 and 1995, stimulated by trade liberalisation and the steady growth of the domestic economy. High economic growth in neighbouring countries also contributed to the expansion of trade. This has, however, led Cambodia to run sizeable current account deficits since 1993, deficits which have accounted for around 12 to 16 percent of GDP between 1993 and 1996. A large proportion of the current account deficit was met by the comparably large amount of unilateral transfers, in the form of foreign aid and grants, during that period.

Cambodia's trade patterns have some notable characteristics and problems. The export structure has been highly concentrated in two products: 1) natural resource-based products (logs, timber and rubber); and 2) light manufacturing products (mainly garments). In 1996, exports of these products (classified as SITC-2 and SITC-8) accounted for 65 percent of total exports in Cambodia (Table 3.1). It should be noted that exports of agricultural products remained at less than 5 percent of the total in 1995 and 1996, despite agriculture's substantial role in domestic production and employment. Cambodia's largest import items in 1996 were machines and transport equipment (SITC-7, including motorcycles, automobiles, televisions and video cassettes), followed by basic manufactures (SITC-6, including construction materials, cement, fabric and steel) and mineral fuels (SITC-3, petrol, diesel oil and lubricants) (see Kato, Chan & Long 1998).

Recent trade performance broken down by country indicates that ASEAN countries are Cambodia's major trading partners, both for exports and imports. In 1996, Cambodia's exports to ASEAN accounted for 67 percent of total exports (Table 3.2 on page 8). It should be noted that exports to the European Union (EU) and the United States have increased with the expansion of garment exports following the granting of generalised system of preferences (GSP) status. Cambodia imported about three-quarters of its total imports from ASEAN countries in 1996.

Table 3.1. Cambodia's Trade Patterns, 1995–96

	1995	Share (%)	1996	Share (%)
Imports				
1. Food and live animals	77,108	7.2	70,062	7.0
2. Beverages and tobacco	41,767	3.9	46,553	4.7
3. Crude materials, excluding fuels	24,444	2.3	29,785	3.0
4. Mineral fuels	127,001	11.8	142,700	14.3
5. Animal and vegetable oil and fat	3,785	0.4	6,669	0.7
6. Chemicals and related products	57,811	5.4	75,227	7.5
7. Basic manufactures	161,946	15.1	197,005	19.7
8. Machines, transport equipment	249,750	23.2	341,466	34.1
9. Miscellaneous manufactured goods	45,915	4.3	51,151	5.1
0. Goods not classed by kind	285,898	26.6	39,984	4.0
Total	1,075,425	100.0	1,000,602	100.0
Exports				
1. Food and live animals	7,027	4.5	5,644	3.5
2. Beverages and tobacco	3,415	2.2	6,521	4.0
3. Crude materials, excluding fuels	97,326	62.2	75,236	46.1
4. Mineral fuels	-	0.0	60	0.0
5. Animal and vegetable oil and fat	-	0.0	5	0.0
6. Chemicals and related products	591	0.4	194	0.1
7. Basic manufactures	12,676	8.1	18,222	11.2
8. Machines, transport equipment	6,068	3.9	6,286	3.9
9. Miscellaneous manufactured goods	29,460	18.8	29,115	17.8
0. Goods not classed by kind	1	0.0	21,911	13.4
Total	156,564	100.0	163,194	100.0
Re-exports				
1. Food and live animals	7	0.0	20	0.0
2. Beverages and tobacco	205,135	81.6	205,405	89.2
3. Crude materials, excluding fuels	17	0.0	-	0.0
4. Mineral fuels	-	0.0	-	0.0
5. Animal and vegetable oil and fat	-	0.0	-	0.0
6. Chemicals and related products	10	0.0	114	0.0
7. Basic manufactures	-	0.0	-	0.0
8. Machines, transport equipment	46,083	18.3	24,772	10.8
9. Miscellaneous manufactured goods	3	0.0	-	0.0
0. Goods not classed by kind	-	0.0	-	0.0
Total	251,255	100.0	230,311	100.0

Source: Robertson & Pohoresky (1998)

3.2. Macro Impacts: Competitiveness, Foreign Trade and Investment

3.2.1. Competitiveness

Macro impacts of the Asian crisis have been transmitted to the real sector of Cambodia's economy through the drastic realignment of foreign exchange rates of the crisis countries since July 1997.

The nominal exchange rate of the baht against the dollar depreciated sharply after the Thai government adopted a floating foreign exchange rate system in July 1997. In the half-year until January 1998, the value of the baht halved against the dollar. During the same period, the riel also depreciated against the dollar, though this is most likely to have been caused by the fighting of 5 and 6 July 1997. This contrasts with the case of the crisis countries, where rapid and large-scale outflows of short-term foreign capital triggered the depreciation of their currencies. The extent of the depreciation of the riel against the dollar was much less than that of the baht against the dollar. Consequently, the riel appreciated against the baht by around 30 percent between July 1997 and February 1998.

Table 1.4. Cambodia's Trading Partners, 1995–96 (thousands of US dollars)

	Imports				Exports			
	1995	Share	1996	Share	1995	Share	1996	Share
ASEAN	798,799	74.3	743,728	74.3	300,814	80.3	254,351	66.5
Singapore	529,727	49.3	457,689	45.7	173,475	46.3	116,832	30.5
Thailand	133,728	12.4	137,009	13.7	107,265	28.6	109,167	28.5
Vietnam	109,086	10.1	119,630	12.0	13,674	3.7	24,425	6.4
Malaysia	15,462	1.4	19,714	2.0	2,163	0.6	3,127	0.8
Indonesia	9,091	0.8	9,313	0.9	2,757	0.7	532	0.1
Philippines	1,705	0.2	316	0.0	764	0.2	130	0.0
Laos	1	0.0	47	0.0	-	-	84	0.0
Myanmar	-	0.0	12	0.0	717	0.2	55	0.0
Other Asia and Pacific	191,131	17.8	148,626	14.9	42,572	11.4	32,371	8.5
Taiwan	9,186	0.9	42,925	4.3	21,197	5.7	11,508	3.0
Japan	64,112	6.0	32,619	3.3	7,854	2.1	7,601	2.0
China	28,401	2.6	28,409	2.8	3,548	0.9	5,534	1.4
Hong Kong	58,179	5.4	23,833	2.4	5,288	1.4	5,037	1.3
United States	17,406	1.6	15,495	1.5	4,379	1.2	2,066	0.5
Australia	13,598	1.3	5,210	0.5	308	0.1	617	0.2
New Zealand	249	0.0	136	0.0	-	-	9	0.0
European Union	44,772	4.2	42,660	4.3	24,566	6.6	92,224	24.1
Other	2,603	0.2	1,524	0.2	499	0.1	924	0.2
Subtotal	1,037,304	96.5	936,539	93.6	368,452	98.4	379,870	99.2
Statistical discrepancy	38,122	3.5	64,063	6.4	6,061	1.6	2,896	0.8
Total	1,075,426	100.0	1,000,602	100.0	374,513	100.0	382,766	100.0

Source: Robertson & Pohoresky (1998)

The appreciation of the riel and dollars *vis-à-vis* the currencies of the crisis countries raises concerns about whether and to what extent the competitiveness of Cambodia's goods and services has been affected. Observing nominal exchange rates does not fully answer this question, because the relative movement of prices of goods and services in Cambodia and its trading partners also affects competitiveness. A widely used indicator of competitiveness is real exchange rates (RER), which take into account the relative movement of prices.[2]

The RER of the riel against the baht and the Singapore dollar are shown in Table 3.3. Thailand and Singapore were selected because they were the two largest trading partners of Cambodia in 1995 and 1996. The RER of the riel against the baht fell by 16 percent from July 1997 to January 1998, indicating the decline of Cambodia's competitiveness against Thailand.[3] By contrast, the RER of Cambodia against Singapore remained at more or less the same level in 1997. While Cambodia's nominal exchange rates depreciated against the Singapore dollar in the second half of 1997, the prices of its goods and services increased more than those in Singapore. Domestic inflation in Cambodia thus offset the gain of competitiveness due to the depreciation of nominal exchange rates during that period.

After January 1998, however, the nominal exchange rate of the riel against the baht started recovering. The RER of Cambodia against Thailand (riel/baht) increased from 65 points in January to 91 points in June 1998. This indicates that the competitiveness of Cam-

Table 1.5. RER of Cambodia against Thailand and Singapore (index)

2 RER is defined as E x P^f/P^d, where E is the nominal exchange rate (domestic currency units per foreign currency unit), P^f is the price of a foreign basket of goods, and P^d is the price of a domestic basket.

3 It should be noted that the appreciation of the riel and US dollar against the baht reduced the domestic prices of imported intermediate inputs in Cambodia, and reduced the cost of Cambodia's products to some extent. This partly offset Cambodia's loss of competitiveness against Thailand.

	WPI[1] Thailand	WPI[1] Singa-pore	CPI[2] Cambodia	NER[3] Riel/baht	Riel/S$	RER[4] Riel/baht	Riel/S$
1997 – January	105	101	106	105	109	104	103
February	105	99	107	106	108	104	100
March	105	99	106	105	106	104	99
April	105	97	108	105	106	102	96
May	105	98	109	106	108	103	96
June	104	97	110	107	108	101	96
July	105	96	117	90	110	81	91
August	111	98	116	87	110	83	93
September	113	99	120	87	117	82	97
October	114	100	121	86	120	80	99
November	116	101	121	85	120	81	100
December	118	101	120	73	115	71	97
1998 – January	123	101	122	65	115	65	95
February	126	101	123	83	123	84	101
March	126	101	124	92	125	94	102
April	124	101	125	94	129	94	105
May	126	101	128	100	134	98	106
June	126	101	131	94	131	91	101

1 = WPI is wholesale price index. 2 = CPI is consumer price index. 3 = NER is nominal exchange rate. 4 = RER is real exchange rate. Source: IMF *International Financial Statistics* (various issues)

bodia against Thailand recovered considerably from February to June 1998. The RER of Cambodia against Singapore remained near pre-crisis levels through this period.

3.2.2. Foreign trade

Despite the loss of competitiveness of Cambodia's goods and services in the second semester of 1997, the Asian crisis did not affect immediately the export performance of Cambodia. In fact, Cambodia's domestic exports rose by 49 percent and 35 percent in the third and fourth quarters of 1997 relative to 1996. This was mainly due to the expansion of garment exports during that period, when Cambodia was granted GSP status for garments from the EU and the United States. This, together with generous investment incentives and relatively low labour costs, provided strong incentives for foreign investors to locate their garment factories in Cambodia. In addition, the European and the US economies, which are the main destination of garment exports, have not yet been affected severely by the crisis.

The adverse impact of the crisis, however, appears to have become more apparent in 1998. Domestic exports declined in the first and second quarters of 1998 relative to the previous year. This may reflect the fact that some major Cambodian export items, other than garments, experienced a major decline during this period. As is reported below, the volume of exports of wood-related products declined sharply in the first semester of 1998. Interviews with managers of wood-related companies revealed that their exports had faced tough price competition with products from the crisis countries, which had become much cheaper.

With regard to imports, the loss of competitiveness up to January 1998 was expected to increase Cambodia's imports, as the appreciation of the RER against Thailand indicates. On the other hand, the decline of domestic expenditures and income since July 1997 due to the domestic political crisis would be likely to decrease demand for imports. The impact on total imports would thus depend on the extent to which the former dominated, or was dominated by, the latter.

Cambodia's import performance does not appear to have shown a notable change in the second semester of 1997. This is presumably a reflection of the mixed impacts of the two factors discussed above. In addition, Cambodia's imports from the crisis countries did not surge, partly because the severe credit crunch had disturbed normal export activities in the crisis countries, which made it difficult to take advantage of the gain in competitiveness. Cambodia's retained imports, however, declined in the first half of 1998.[4] The recent decline may reflect the depreciation of the riel and the US dollar against regional currencies in the first half of 1998, as the regional currencies bounced back after February 1998. In addition, a sharp decline of economic growth in 1997 and 1998 contributed to the decline of import demand in the first half of 1998. Furthermore, a decline of foreign aid after the fighting of 5 and 6 July 1997 reduced imports related to foreign aid. Finally, the wait-and-see atmosphere that appeared to spread among the Cambodian business community in the approach to the national election in July 1998 may have also contributed to the decline of imports in the second half of 1998.

3.2.3. Foreign direct investment

The inflow of FDI to Cambodia was affected by changes in its competitive position and the slowdown of growth in the crisis countries. The depreciation of currencies in the crisis countries reduced their unit labour costs in dollar terms, even taking into account high inflation in some countries. Foreign investors looking for an export base considered Cambodia to be less attractive than before. In addition, the slowdown of economic growth in the crisis countries made their investors more cautious about investing in overseas, as they faced problems of credit crunch at home. These factors exacerbated the decline of FDI that had been caused by the political uncertainty prevailing since the fighting of July 1997.

Official data confirm the adverse impact of the crisis on foreign investment discussed above. According to the NBC, the net inflow of FDI plunged to $200 million in 1997, down from $290 million in 1996. On a quarterly basis, the inflow of FDI revealed a downward trend from July 1997 to the second quarter 1998. In fact, the declining trend of FDI had already began in 1996, well before the Asian crisis, perhaps reflecting foreign investors' perceptions about the deterioration of Cambodia's investment climate since 1996.

Another source of information regarding foreign investment indicates changing patterns of investment by country and region. According to data from the Cambodia Investment Board (CIB), foreign investment in Cambodia has been dominated by ASEAN countries, China, Hong Kong, Taiwan and South Korea since 1995 (Table 3.4).[5] This pattern has not been greatly affected by the Asian crisis. The extent of the decline in investment from ASEAN countries (Indonesia, Malaysia, Singapore, Thailand and Vietnam) was smaller than that of total foreign investment. Instead, a larger slowdown was observed in total investment from other Asian and Pacific Rim countries, such as Hong Kong, Taiwan and South Korea.

3.3. Micro Impacts: Enterprises and Consumers

This section reports the results of the field studies undertaken by CDRI to investigate the impact of the Asian crisis on Cambodia's enterprises and consumers (Chan, Tia & So 1998; Chan *et al.* 1999). The field studies include a series of interviews with enterprises conducted in February, May, August, November and December 1998, and seven market surveys from July 1997 to November 1998.

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[4] A considerable proportion of Cambodia's total imports were re-exported to Vietnam, and thus did not enter Cambodia's markets. Retained imports, defined as total imports minus re-exports, is thus a better indicator than total imports to assess the impact of the crisis.

[5] The investment data from the CIB should be read with caution, because it compiles only projects approved by the CIB rather than projects that are actually implemented. The discrepancy between approved and actual investments can be quite large, as is the case in other countries. The data presented here can best be seen as an indication of the willingness of foreigners to invest in Cambodia.

Table 3.4. Foreign Investment Project Approvals, 1996–98

	Number of investment projects			Registered capital ($ million)			Fixed assets ($ million)		
	Jul 95 – Jun 96	Jul 96 – Jun 97	Jul 97 – Jun 98	Jul 95 – Jun 96	Jul 96 – Jun 97	Jul 97 – Jun 98	Jul 95 – Jun 96	Jul 96 – Jun 97	Jul 97 – Jun 98
ASEAN	56	48	46	75	101	83	217	255	259
Indonesia	3	4	5	2	1	3	13	1	3
Malaysia	24	18	16	38	54	61	126	187	181
Singapore	16	18	19	20	36	17	47	38	55
Thailand	12	8	5	15	10	2	30	29	21
Vietnam	1	-	1	-	-	-	0		0
Other Asia-Pacific	97	129	117	111	223	155	145	416	240
China	27	31	34	23	21	72	33	22	100
Hong Kong	23	27	25	10	15	17	25	71	58
Taiwan	28	50	29	67	83	32	74	115	27
South Korea	7	10	7	5	66	9	4	172	20
Others	12	11	22	5	38	26	9	37	35
Europe	22	17	18	53	48	15	204	39	25
North America	7	12	8	4	26	2	4	15	87
Middle East	0	0	1	0	0	1	0	0	0
Total	182	206	190	243	398	255	570	725	611
Change from previous year (%)		13.2	-7.8	-	63.7	-35.8	-	27.3	-15.8

Source: CDRI calculation based on data from the CIB.

3.3.1. Impact on export-oriented enterprises

Interviews were conducted with enterprises and retailers to investigate micro impacts of the crises. The interviews covered the following industries: garment, wood and wood-processing, rubber, cement, beverages, milk and plastics. The first three are major export-oriented industries, while the other four are import-competing. The interviews were concerned with changes in output, input prices, wage payments, transactions and the difficulties that the companies were facing.

The wood-related industry in Cambodia appeared to have been one of the most severely affected by the crisis. The export performance of wood-related products deteriorated on a large scale. According to official data from the Ministry of Commerce, Cambodia's exports of wood-related products plunged from 65,000 m^3 in the first semester of 1997 to 38,000 m^3 in the second, and then to 11,000 m^3 in the first semester of 1998.

Interviews with wood-related enterprises revealed the nature and severity of the difficulties that some were facing since the crisis began. Two enterprises producing and exporting sawn timber and one producer of veneer for export reported that they had been severely affected. The first adverse impact was from a decline of timber prices, the second was the decline in demand for Cambodian sawn timber, which partly reflected the liquidity problems of importers in the crisis countries. The decline in regional demand forced all three companies to scale down their activities. One company laid off two-thirds of its workers in May 1998. Another exporting sawn timber to Thailand and employing about 100 workers reported in May 1998 that it would soon go bankrupt because of the decline in demand.

Interviews with four major rubber enterprises that together account for 70 percent of domestic production revealed that Cambodia's rubber industry has also been severely affected by the crisis. Export prices declined by an average of 23 percent, from $660 per ton in the third quarter of 1997 to $510 per ton in the third quarter of 1998. The export volume was not affected immediately after the crisis, but its decline became apparent in 1998, as the volume of rubber exports plunged by 36 and 17 percent in the second and third quarters of 1998 respectively.

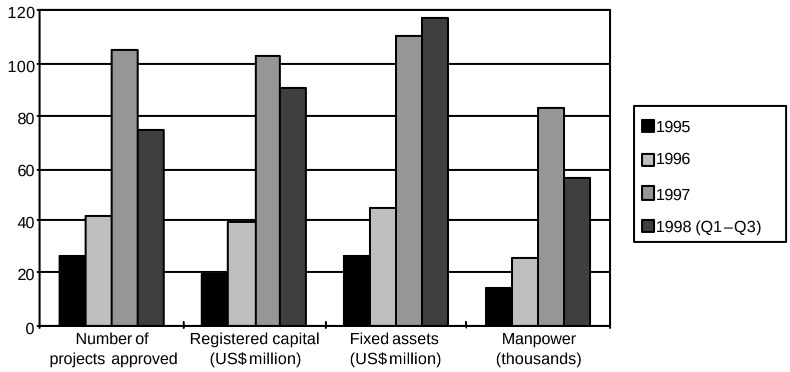
Interviewees pointed to two main reasons for the decline in prices. First, the price of rubber started to decline in the major destinations of Cambodia's rubber exports, such as Malaysia and Singapore, one year *before* the Asian crisis. The price of rubber in Malaysia denominated in ringgit, for instance, declined by about 15 percent in 1997 and 20 percent in 1998 compared to the price in mid-December 1996. Second, the drastic depreciation of foreign exchange rates in the crisis countries after July 1997 reduced the dollar price of their rubber. The decline in the volume of Cambodia's rubber exports was also attributed to the overall decline in demand for rubber as the economies of the crisis countries slowed down.

The decline of both the price and the volume of rubber exports since July 1997 cut the profits of the rubber enterprises, which reported that they had recorded net losses in both 1997 and 1998. The employees of the four enterprises surveyed (over 10,000 workers) have been suffering from a decline in their real wages, because some of the enterprises paid lower nominal wages in 1998 compared to before July 1997 and because the cost of living increased due to inflation of basic food items.

Among major export industries in Cambodia, the garment sector has been much less severely affected by the Asian crisis than timber and rubber. Total garment exports increased even after July 1997—from $86 million in the first semester of 1997 to $140 million in the second semester of 1997. The high level of garment exports continued in the first semester of 1998. Investment projects in the garment industry increased significantly during the second semester of 1997, even though some factories were destroyed and looted during the July 1997 fighting (Figure 3.1). A major reason for this was the granting of GSP status to garments by the EU and the United States.

Interviews with several garment factories confirmed that the Asian crisis had had little impact on their production and exports. Some managers expressed concerns, however, that the currency depreciation in the countries affected by the crisis had reduced those countries dollar-denominated labour costs. This made Cambodia's labour costs relatively high and reduced its competitiveness in the region.[6]

Figure 3.1. Investment in the Garment Sector, 1995–98



3.3.2. Impact on import-competing industries

One Cambodian cement company surveyed reported severe price competition from cheap imported cement, from Thailand in particular. Due to the depreciation of the baht, the price of Thai cement fell to around $72 per ton in February 1998 from $105 per ton the previous year. The company had to reduce the price of its domestic cement from $90 to $65 per ton during the same period. When the baht bounced back against the dollar after January 1998, the price

6 In most of the garment factories surveyed, workers' wages were paid in dollars.

of Thai cement started to increase again, reaching $75 per ton in May 1998, and allowing an increase in the price of domestic cement to $70.

One cement company adopted a coping strategy to reduce production costs by cutting out an intermediate production process of extracting domestic limestone to make cement. Instead, it imported clinker (a semi-finished product) from Thailand. Although this strategy helped the company to survive, it was likely to have an adverse impact on employment in the medium term.

Domestic breweries had also been affected by price competition from imported beer, again particularly from Thailand. One brewery in response launched a new product which was 30 percent cheaper than its original brand. According to retailers in Phnom Penh, the new brand had been gradually increasing its market share.

The crisis appeared to have led to increased smuggling across the Thai border. Thai beer was smuggled into Cambodia and sold at around $11 per case in early 1998, compared with $17 per case the previous year. One Cambodian brewery reported that it had been completely eliminated from the market in two of the provinces bordering Thailand. Its total sales had declined by 50 percent (from the previous year) in the second half of 1997.

The Asian crisis affected soft drink producers in Cambodia, as imported brands became relatively cheap due to the weakening of regional currencies. Almost all respondents who were retailing soft drinks said that there had been a large demand for Thai soft drinks during the Chinese New Year (February 1998), when the Thai baht was at its weakest against the dollar. Since February 1998, however, locally produced soft drinks had gradually increased their market share again because the baht bounced back and inflation picked up in Thailand.

It was also found that the Asian crisis had adversely affected one major condensed milk producer in Cambodia. The factory reported that the price of white sugar (an essential raw material) imported from Thailand had increased by 60 to 80 percent in US dollar terms in February 1998, because of emergency policy measures by the Thai government to restrict the export of white sugar, considered to be an essential food item. In addition, the company had to cut its wholesale prices to maintain market share. Despite these efforts to compete with imported products, the sales of the domestic brand are reported to have slumped since July 1997. To cope with the situation, the local producer had sold 80 percent of its share holdings in December 1997 to a Swiss dairy company.

A Cambodian plastic producer established in 1994 closed down in late February 1998 due to loss of competitiveness against imported plastic products since the Asian crisis, according to interviews with a board member. Although the factory survived for a few months after the crisis started, it was eventually forced to cease operating as a result of competition with imported plastic products.

3.3.3. Impact on tourism

The tourism sector in Cambodia grew rapidly until mid-1997, at an annual average rate of 20 percent between 1993 and 1996, far exceeding the annual average rate of overall economic growth of 6 percent during the same period. The tourism sector also contributed to an increase in export earnings, with a total value of $81 million in 1996—about the same as the sum of rubber and log exports in that year (Godfrey 1997). The development of the tourism sector also had a significant economic impact on other sectors in Cambodia. For instance, tourism boosted domestic demand for construction, transportation, the wholesale and retail trade, and even agricultural products.

The tourism sector, however, experienced a dramatic decline in the second semester of 1997. This was primarily caused by the fighting in July 1997. The total number of tourist

Table 3.5. Passenger Arrivals at Pochentong International Airport, 1995–96

	1995	1996	1997	1998[1]
Number of arrivals				
Tourists	154,686	221,341	185,334	122,797
Business	42,567	63,213	55,597	34,836
Officials	15,526	12,665	14,193	12,406
Total	212,779	297,219	255,124	170,039
Percentage change from previous year				
Tourists		43.1	-16.3	-33.7
Business		48.5	-12.0	-37.3
Officials		-18.4	12.1	-12.6
Total		39.7	-14.2	-33.4

1 = Data are only available for January to October 1998. Source: Ministry of Economy and Finance

arrivals at Pochentong International Airport plunged by 50 percent in the second semester of 1997 relative to the same semester in 1996 (Table 3.5). Overall, tourist arrivals declined by 16 percent in 1997 relative to 1996, despite the strong growth in the first semester of 1997. As a result, the growth rate of real GDP of hotels and restaurant declined sharply to -2.5 percent in 1997, down from 22 percent in 1996 (World Bank 1999).

Although it is difficult to distinguish the impact of the Asian crisis from other impacts, the stagnation of the tourism sector in Cambodia since July 1997 may be partly attributed to falling incomes in the crisis countries. For instance, tourist arrivals from ASEAN countries declined by 43 percent in the third quarter of 1997 compared to the same quarter in 1996. The number of tourists from ASEAN declined even in the third quarter of 1998, during which period tourist arrivals from other areas increased strongly relative to the previous year.

3.3.4. Impact on consumer spending

Despite the importance of consumption spending as an indicator of general economic activity, Cambodia's national account statistics are reported only once per year. CDRI undertook seven market surveys from July 1997 to November 1998 to supplement the lack of information on consumer expenditures. Vendors in five major markets in Phnom Penh were asked about prices and sales of various consumer goods and services.[7] The surveys also asked vendors how fluctuations in the foreign exchange rates of regional currencies had affected Phnom Penh markets.

Market surveys in December 1997 and February 1998 found that the rapid depreciation of the regional currencies, particularly the baht, resulted in a substantial decrease in the dollar- and riel-denominated prices of products imported from the rest of the region, thus raising the competitiveness of foreign, and especially Thai, products. Since most non-food products sold in Phnom Penh markets were imported, consumers enjoyed "benefits" from the Asian crisis in the form of cheaper imported products.

The surveys also found that consumers had not fully benefited from the appreciation of the dollar and the riel against the baht. This is because the baht prices of some Thai products increased after July 1997. All the retailers interviewed reported in February 1998 that their wholesalers had charged higher baht prices for some products. They also reported that they had had to pay higher baht prices to Thai distributors. The extent of the increase in baht prices, however, varied considerably depending on the product. For instance, the price of construction

[7] About 130 vendors were asked about their views on issues such as the impact of the Asian crisis on their business. The small sample size and limited geographical coverage mean that the results cannot be generalised to the national level. However, these surveys provide a primary source of information that is not available from official data sources.

materials, fishing nets, bedding and suitcases increased about 5 percent, while the price of shoes, clothes, groceries, kitchenware and stationery increased between 10 and 30 percent.

The depreciation of the baht from July 1997 to January 1998 made Thai products more competitive than products imported from other countries. Interviews were conducted in February 1998 with two motorcycle companies: one selling the Suzuki brand imported from Thailand, and another selling the Yamaha brand imported from Japan. The depreciation of the baht enabled Suzuki to lower the price of its top range motorcycle from $1,700 to $1,200, and it trebled the number sold. Sales of Yamaha motorcycles fell by 60 percent, because the dollar-denominated prices remained at their pre-July 1997 level due to the relative stability of the yen against the dollar.

The market survey undertaken in May 1998 found some evidence that consumer benefits from the exchange rate realignment were short-lived. Due to the relative strengthening of the baht after February 1998, the riel-denominated prices of most imported products had risen to more or less their pre-July 1997 levels. Some Thai products were more expensive even than their pre-July level once the riel-baht exchange rate had returned to its pre-July level.

Market surveys also found that baht prices for some Thai products, such as sarongs, increased in February 1998, and remained at similar levels in May 1998. In addition, the riel weakened against the baht from February to May 1998, as the baht bounced back against the dollar. The increase in baht prices and the depreciation of the riel against the dollar suppressed the recovery of sales and fuelled inflation in Cambodia from February to May 1998.

The dollar-denominated prices of some imported products from Vietnam, China, Singapore and Western countries were found to be slightly lower in May 1998 than their pre-July 1997 level. However, riel-denominated prices of these imported products increased during the same period, because the depreciation of those countries' currencies against the dollar was far less than that of the riel.

The market surveys also found indications of a low level of consumer spending since July 1997. In the July 1997 survey, vendors were asked about the percentage change of their current sales relative to those before July 1997. Vendors reported that the level of average sales dropped on average by about 60 percent immediately after the fighting of July 1997. The same questions were asked in the subsequent six surveys, which found that sales continued to stay at 50 percent of the pre-July 1997 level throughout 1998 (Table 3.6 overleaf).

Examining the reasons for this given by market vendors, it seems that the crisis partly suppressed the recovery of sales in Cambodia. First, vendors reported that they had seen fewer tourists in the markets, reflecting the substantial reduction in the number of tourists from the crisis countries. Second, market vendors received far fewer workers, consistent with reports of the temporary closure of enterprises hit by weak demand for imports from the crisis countries. Finally, the reduction in investment projects from the crisis countries contributed to the weak demand for consumption and investment seen by market vendors.

3.4. Impact on the Real Sector—Summary

The Asian crisis has been adversely affecting Cambodia's economy slowly but steadily. The spill-over effects of the crisis have come through two channels—the realignment of foreign exchange rates and the slowdown of economic growth in the crisis countries. Export growth, which had been virtually unaffected until the end of 1997, appeared to slow in the first semester of 1998. Interviews with some enterprises revealed severe competition in the regional market and a sharp decline of exports. Although imports at the macro level have not shown an obvious increase, interviews with enterprises revealed a severe impact on some import-competing enterprises such as cement beverage and plastic manufacturers. Some domestic

Table 3.6. Sales and Earnings in Five Markets in Phnom Penh, 1997–98

	1997		1998			
	September	December	February	May	August	November
Percentage of vendors who reported selling less[1]						
All items	95	90	87	98	93	92
Non-food items	100	95	92	99	92	92
Durable items	100	96	95	100	93	90
Luxury Items[a]	100	100	100	100	100	100
Household and utility items[b]	100	94	82	100	91	83
Clothing, shoes, bags	100	95	100	100	93	94
Non-durable items/services	87	91	91	93	88	95
Food items	92	81	80	98	94	93
Average amount of sales as a percentage of those before 5–6 July 1997[2]						
All items	40	47	54	48	52	51
Non-food items	34	40	48	45	47	50
Durable items	33	38	46	43	46	44
Luxury Items[a]	24	30	36	45	40	38
Household and utility items[b]	40	43	54	44	53	50
Clothing, shoes, bags	32	40	46	42	45	44
Non-durable items/services	36	46	56	54	48	56
Food items	44	59	61	54	59	52
Percentage of vendors who reported earning enough to cover their daily expenses[3]						
All items	23	52	68	58	57	58
Non-food items	16	44	60	49	47	57
Durable items	6	43	53	45	44	45
Luxury Items[a]	0	30	29	47	38	33
Household and utility items[b]	21	53	75	60	54	50
Clothing, shoes, bags	0	43	57	37	44	56
Non-durable items/services	44	36	81	67	59	77
Food items	33	67	80	76	73	60

1 = Is the amount of your sales [more than, the same as, less than] that before 5–6 July 1997? 2 = If less, what percentage are current sales relative to those before 5–6 July 1997? 3 = Are you earning enough money to cover your daily expenses? a = Luxury items include precious stones, gems, gold, jewellery, televisions, cassette players, watches, video-tapes, gifts, etc. b = Household and utility items include kitchenware, plastic containers, blankets, mosquito nets, construction materials, electrical appliances, motorcycle spare parts, etc. Source: CDRI market surveys from September 1997 to November 1998.

sectors, such as the tourism industry, have been suffering from stagnation in arrivals, notably from ASEAN and East Asian countries, since July 1997. Consumers, by contrast, enjoyed a decline of dollar- or riel-denominated prices of Thai products in Phnom Penh markets until January 1998. The benefits from cheaper imported products, however, turned out to be short-lived because of the recovery of the baht after February 1998 and inflation affecting Thai products in baht terms.

4. Impact on Social Development

A growing number of studies have reported that the Asian financial crisis placed enormous pressure on people's livelihoods in the crisis countries (ADB 1998; World Bank 1998). The pressure has been both on household income and expenditures. Falling incomes and the loss of jobs have been reducing total income per household, whereas inflation of essential items has been pushing up the cost of living. It has also been reported that pressures on livelihoods have forced poor households to withdraw their children from school to support their families. The fight against poverty now a huge challenge, despite the enormous success that the crisis countries had achieved until 1996. Pressures on livelihoods have contributed to popular frustration and an increase in social and political tensions in some crisis countries.

This section assesses the impact of the Asian crisis on peoples' livelihood and social development in Cambodia. Here again, it is not always possible to isolate the impact of the Asian crisis from other impacts such as that of the July 1997 fighting and the decline of agricultural production caused by natural droughts and flooding. The following analysis should therefore be seen as an analysis of the intertwined impacts of the financial crisis in Asia, the internal political crisis after fighting in July 1997, and other shocks to the economy.

4.1. Peoples' Livelihood

4.1.1. Wages and waged employment in Phnom Penh

Labour market indicators suggest that the slowdown of economic growth put pressure on the livelihood of waged employees in Phnom Penh after July 1997. According to the quarterly labour market surveys undertaken by the National Institute of Statistics (NIS), average monthly real wages peaked in the second quarter of 1997, then declined sharply in the third and fourth quarters (Table 4.1).[8] The decline was notable in all sectors—in the private sector, government services, and in international agencies and organisations. Waged employment showed a similar pattern during the same period. The economic slowdown precipitated by the July 1997 fighting adversely affected the livelihood of waged employees in Phnom Penh.

Table 4.1. Real Wages and Waged Employment in Phnom Penh, 1997

	1997:Q2	1997:Q3	1997:Q4
Monthly wages at current prices (base: 1997:Q2 = 100)			
Private sector	100	104	93
Government service	100	102	100
International agencies	100	64	69
Total	100	101	97
Monthly wages at constant prices (base: 1997:Q2 = 100; constant prices at July–September 1994)			
Private sector	100	94	82
Government service	100	92	88
International agencies	100	58	60
Total	100	91	85
Waged employment			
Private sector	71,203	57,429	60,062
Government service	65,265	71,074	73,070
International agencies	2,523	3,045	1,781
Total	138,991	131,548	134,913
Percentage of total employment			
Private sector	51	44	45
Government service	47	54	54
International agencies	2	2	1
Total	100	100	100
Wage employment (base: 1997: Q2 =100)			
Private sector	100	103	107
Government service	100	105	108
International agencies	100	64	38
Total	100	102	105

Source: NIS

4.1.2. Livelihood of vulnerable workers

The poor and the vulnerable are usually the most severely affected by an economic downturn. Surveys of vulnerable workers undertaken by CDRI in Phnom Penh in May, August and

8 The geographical coverage of the quarterly labour market surveys is limited to Phnom Penh, and the surveys were terminated at the end of 1997 due to the loss of funding. There are no other periodical surveys regarding labour markets at present.

November 1998 monitored the change in livelihoods of four occupational groups deemed most vulnerable in the capital (Chan *et al*. 1998; Chan *et al*. 1999)—cyclo drivers, porters, small vegetable traders and scavengers. Thirty workers in each group were sampled and asked about their net daily earnings, working hours/days, and the problems encountered in their day-to-day activities. In the May 1998 survey, a question was also asked about earnings before July 1997, to assess the impact of the twin crises.

The surveys revealed a large fall in the net daily earnings of vulnerable workers in May and August 1998 relative to before July 1997. There were also some indications that recovery had been slow and weak even after the formation of a new coalition government in early November 1998 (Table 4.2). According to the data, net daily earnings fell sharply after July 1997 for all groups. The extent of the decline since May 1998 appeared to have slowed, though the decline continued until November 1998 for all groups except small vegetable traders. The sustained decline in earnings has forced vulnerable workers (except small vegetable traders) to work harder than they were before July 1997. It should also be borne in mind that these are nominal earnings—most vulnerable workers also reduced their consumption as a result of the increase in prices, especially rice.

The surveys also revealed that the number of rural residents moving to Phnom Penh in search of work increased in 1998. In the November 1998 survey, vulnerable workers were asked whether they thought that the number of rural residents coming to Phnom Penh to look for work had increased relative to the previous year. Among 120 interviewees, 65 percent reported that the number had increased. In addition, only 3 percent of cyclo drivers described themselves as permanent residents of Phnom Penh, compared to 10 percent in August 1998 and 15 percent in May 1998. Similarly, only 3 percent of porters reported themselves to be permanent residents of Phnom Penh in November 1998, compared to 23 percent in August

Table 4.2. Net Daily Earnings of Vulnerable Workers, 1997–98

	Net daily earnings (riels)					Percentage change[1]			
	Before	1998				1998			
	Jul 1997	Jan	May	Aug	Nov	Jan	May	Aug	Nov
Nominal earnings (riels)									
Cyclo drivers	12,250	9,100	6,975	6,167	6,100	-2	-2	-1	-
Porters	9,675	6,905	5,415	4,720	4,543	-2	-2	-1	-
Small vegetable traders	7,050	5,150	3,400	4,767	5,913	-2	-3	4	2
Scavengers	4,155	3,415	3,040	2,610	2,567	-1	-1	-1	-
Nominal earnings (base: pre-July 1997 = 100)									
Cyclo drivers	100	74	57	50	50	-26	-23	-12	-1
Porters	100	71	56	49	47	-29	-22	-13	-4
Small vegetable traders	100	73	48	68	84	-27	-34	40	24
Scavengers	100	82	73	63	62	-18	-11	-14	-2
Composite index[2]	100	75	59	57	61	-25	-22	-2	6
Real earnings (base: pre-July 1997 = 100)									
Cyclo drivers	100	67	49	42	40	-33	-27	-15	-3
Porters	100	64	48	40	38	-36	-25	-16	-6
Small vegetable traders	100	66	41	56	68	-34	-37	35	21
Scavengers	100	74	63	52	50	-26	-15	-17	-4
Composite index[2]	100	68	50	48	49	-32	-26	-6	3
Consumer price index[3]	100	111	116	121	123	11	5	4	2

1 = Percentage change from the previous period. 2 = Composite index is the average of indexes of the four groups with equal weight. 3 = Official CPI published by the NIS; CPI in June 1997 was used as a proxy for pre-July 1997 CPI.

and 25 percent in May. The cyclo drivers and porters explained that most rural residents who had come to Phnom Penh earlier had remained working in the capital until the next harvest.

Scavengers, who are mostly Phnom Penh residents, earn the lowest average earnings among the four groups, and also appear to have been the most severely hit by the economic downturn. They reported that the amount of saleable rubbish had fallen sharply because of the decline in overall consumption in the capital. The survey also revealed that the price of saleable rubbish had dropped by 40 to 50 percent in November 1998 compared to earlier in the year.

Traders who buy rubbish from scavengers offered two reasons for the decline in prices. First, some local plastic and glass producers that used recyclable rubbish as inputs closed down because their products could not compete with imported plastic and glass from Thailand and Vietnam after July 1997. The domestic demand for recyclable rubbish therefore went down in 1998. Second, transport costs to export recyclable rubbish to Vietnam significantly increased from the beginning of 1998, due to the increase in the number of checkpoints along the roads to Vietnam where informal fees have to be paid. Since market prices of rubbish were fixed in Vietnam, the informal fees were charged to scavengers' receipts.

4.1.3. Migrant workers to Thailand

A recent study of Cambodian migrant workers to Thailand revealed a significant adverse impact on their livelihoods from the Thai economic downturn (Chan & So 1999). The study was conducted in three districts of Battambang province, in 14 villages with a total of around 3,800 households. It was found that 517 households had had members migrating to seek labour-intensive work, mostly in construction, deep inside Thailand. Another 669 households had members working for Thai farmers along the Thai-Cambodian border. The study found that the former group of migrants had been negatively affected by the crisis in the Thai economy. Adverse impacts on those working along the border were not as severe (Table 4.3).

Questions were asked about working trips to Thailand during two consecutive periods—before July 1997 and between July 1997 and November 1998. Jobs were found easily in only 40 percent of the working trips after July 1997, compared with 88 percent before. The migrant workers interviewed mentioned that in 1998 they had seen many buildings under construction left unfinished in Thailand, and few new buildings started. Early 1998 also saw tougher implementation of a policy to return illegal labour migrants by the Thai authorities.

Moreover, in 58 percent of the migrants' journeys since the crisis they encountered low levels of wage disbursement by their Thai employers, compared with 21 percent of journeys before the crisis. Instead of receiving full payment of their daily wages of 100 to 200 baht, more than half of the migrant workers interviewed were provided only 30 baht per day, barely enough for subsistence. The incidence of this is reported to have increased drastically since late 1997, with reasons cited that: 1) some Thai banks released cash slowly to construction companies, or did not have enough money to disburse to the companies; 2) construction companies had gone bankrupt; and 3) the supervisors stole the wages of the illegal migrant workers.

Table 4.3. Labour Migration from Battambang to Thailand, 1997–98

	Before July 1997	July 1997 to November 1998	Total
Number of journeys in which	33	48	81
jobs were easily found	29	19	48
jobs were not easily found	4	29	33
more than half of due payments were not provided	7	28	35
Percentage of journeys in which	100	100	100
jobs were easily found	88	40	59
jobs were not easily found	12	60	41
more than half of due payments were not provided	21	58	43

Source: Chan & So (1999)

Facing a decline in the number of jobs available, the increase in the incidence of under-payment, and a tougher policy stance against foreign migrant labourers, the Cambodian villagers interviewed appear to have been discouraged from venturing back to Thailand, at least for the time being. Based on interviews with village chiefs, village development committees and NGO workers in the 14 villages, the largest numbers of villagers were migrating to Thailand in late 1996 and 1997. The total number of long-range migrants in the 14 villages dropped from 605 in 1997 to 169 in 1998. Almost all the migrant workers in these villages returned home between March and July 1998. Some went back to Thailand after participating in the July 1998 elections. However, most of them found no jobs, or were reportedly 'cheated' by their Thai employers who failed to pay them the full wages.

The survey also found that each migrant villager had to pay 3,000 baht to the guides or smugglers who took them to work sites deep inside Thailand. Borrowing money to pay this "smuggling fee" appeared to be common among poor migrant workers. Of a total 81 journeys, 77 percent were financed by local moneylenders, who had charged villagers interest rates ranging from 10 to 30 percent per month. In addition, the moneylenders usually demanded collateral in the form of fixed assets, mostly land. If villagers failed to earn enough money, or were caught by the authorities, they returned home empty-handed and often in poor health, which left them in severe debt and often forcing them to sell assets such as land, houses and livestock. Of the 37 households covered by the survey, nine had sold their land or cows, and 17 were in serious debt due to the failure to earn enough money.

4.2. Social Development—Health and Education

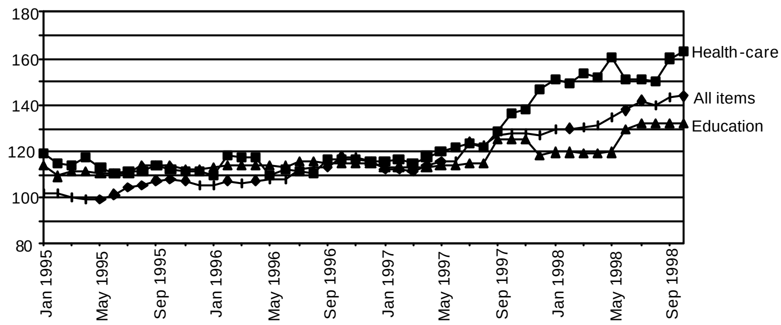
Social development, in particular health and education, is without doubt the top priority for long-term development in Cambodia. The economic downturn precipitated by the twin crises, however, could slow the progress of social development in Cambodia. This section makes an initial assessment of the extent of their impact with available data. As the data currently available are limited, however, further studies are needed to fully assess the impact on social development.

4.2.1. Cost of health-care

One of the channels through which the crises could affect social development is the rise in health-care costs caused by the depreciation of foreign exchange rates. As Cambodia imports almost all its modern medical supplies, including pharmaceutical products, the depreciation of the riel against the dollar pushed up the cost of health-care, and put pressure on people's livelihoods. The poor, who generate their earnings in riels, were most severely affected by the rise in health-care costs. According to the NIS, the CPI of health-care showed much higher inflation rates than the CPI of all items after July 1997 (Figure 1.3).[9] Inflation in health-care (final quarter basis) surged from 4 percent in 1996 to 21 percent in 1997. The increase in inflation of health-care contrasts sharply with the CPI of all items, which remained at around 9 percent in 1996 and 1997. The cost of health-care continued to increase at even higher rates in 1998. As of October 1998, the cost of health-care had increased by 32 percent compared to the pre-crisis level in June 1997.

[9] Health-care CPI includes medical services (doctor's fees, dental fees, etc.), hospital admission fees, medical supplies, pharmaceutical products and other medical supplies.

Figure 1.3. CPI of Health-Care and Education in Phnom Penh, 1995–98 (index)



4.2.2. School enrolment

The recent studies on the Asian financial crisis revealed that increasing numbers of children had dropped out of school in the crisis countries. The fall of incomes and the increase in the cost of living in the crisis countries have put enormous pressures on the livelihood of poor households, and forced their children into work rather than allowing them to continue with their education.

Despite the importance of assessing the impact of the Asian crisis on Cambodia's schooling, few studies have been undertaken to date. However, data on school enrolment allow an initial assessment to be made. According to the Ministry of Education, Youth and Sports, the total number of children enrolled from pre-school to upper secondary school increased by 3 percent, from 2.3 million to 1996/97 to 2.4 million in 1997/98 (Table 4.4). However, the total level of school enrolment varied between urban, rural and remote areas. Rural areas experienced an increase of 6 percent, whereas urban and remote areas both experienced a decline, of 1 percent and 8 percent respectively.

Table 4.4. School Enrolment, 1996/97–1997/98 (thousands of students)

	Pre-school		Primary		Lower secondary		Upper secondary		Total	
	Total	Girls	Total	Girls	Total	Girls	Total	Girls	Total	Girls
Total (1996/97)	44.8	22.3	1,919.0	860.7	265.9	98.5	61.7	21.6	2,291.4	1,003.1
Urban areas	17.0	8.4	487,2	222.0	152.7	59.7	53.6	19.1	710.5	309.3
Rural areas	27.4	13.7	1,289.8	575.8	111.1	38.1	8.1	2.5	1,436.5	630.1
Remote areas	0.4	0.2	142.0	62.9	2.1	0.6	0.0	0.0	144.5	63.7
Total (1997/98)	43.4	21.6	2,011.8	906.8	229.1	79.8	73.8	25.6	2,358.1	1,033.8
Urban areas	15.1	7.6	514.4	234.8	115.9	43.8	57.2	21.0	702.6	307.1
Rural areas	27.8	13.8	1,366.2	613.8	112.4	35.8	16.6	4.6	1,523.0	668.0
Remote areas	0.4	0.2	131.2	58.2	0.8	0.2	0.0	0.0	132.4	58.7
Percent change	-3.3	-3.4	4.8	5.4	-13.8	-18.9	19.7	18.5	2.9	3.1
Urban areas	-10.9	-9.7	5.6	5.8	-24.1	-26.7	6.7	9.5	-1.1	-0.7
Rural areas	1.4	0.7	5.9	6.6	1.1	-6.0	106.3	88.6	6.0	6.0
Remote areas	-2.9	-11.4	-7.6	-7.3	-60.9	-65.1	0.0	0.0	-8.3	-7.9

Source: Ministry of Education, Youth and Sports

Among the four levels of education, lower secondary schools experienced the largest decline. The total number of students enrolled in lower secondary school decreased by 14 percent, from 266,000 in 1996/97 to 230,000 students in 1997/98. The number of enrolled lower secondary students in urban areas dropped sharply by 24 percent, from 153,000 in 1996/97 to 116,000 in 1997/98. The extent of the decline in the number of enrolled students was much higher for girls than for boys in lower secondary schools in all areas.

It is still inconclusive, however, whether the sharp decline in lower secondary enrolment was caused by the crises or by other factors, such as demographic change, damage to agricultural production caused by natural disasters, the movement of refugees to Thailand following the July 1997 fighting, and so on. One hypothesis could be that children of lower secondary school age are seen as being of working age, and are therefore forced to leave school in order to work.

4.2.3. Public expenditure

The tightened fiscal discipline in some crisis countries led to a reduction in public expenditure, including health and education. This undermined the effectiveness of the social safety net that the government provided for the poor and vulnerable.

In the case of Cambodia, fiscal discipline was imposed as an urgent response to the July 1997 fighting. This was primarily related to fears of the withdrawal of foreign assistance, on which the government depended, and the decline of customs revenue from imports. Another concern at that time was the risk of inflation if the government used monetary financing to pay for the loss of national revenues.

The budgetary pressures after July 1997 made it impossible for the government to implement the 1997 Budget Law, which had planned to increase the proportion of expenditures on health and education within total expenditure. The total current expenditure actually spent in 1997 was kept at about 94 percent of the level determined by the 1997 Budget Law (Table 4.5). Expenditures on education, health, and agricultural and rural development were most severely affected by the austerity measures, experiencing 10 to 25 percent cuts from 1997 Budget Law levels. Current expenditures on these sectors in 1997 consequently remained at similar levels, or even declined, compared to 1996. By contrast, actual expenditures on defence and security over-ran the 1997 Budget Law levels by 4 percent.

Table 4.5. Current Expenditures, 1995–98 (billions of riels)

	1995 actual	1996 actual	1997 budget	1997 actual	1998 budget	1998 project.	Actual as percent of total expenditure 1995	1996	1997	1998
Defence and security	386	435	425	440	384	486	58	53	54	52
Education	74	81	91	80	94	110	11	10	10	12
Health	26	44	61	46	62	54	4	5	6	6
Agriculture and rural dev.	15	19	24	18	24	20	2	2	2	2
Other ministries	165	248	270	231	445	260	25	30	28	28
Total current expenditure	667	827	870	816	1009	931	100	100	100	100

Source: Ministry of Economy and Finance

5. Policy Responses of the Government

This section discusses policy responses of the Cambodian government to contain the adverse impact of the Asian financial crisis on the economy. The government responded to the Asian crisis and the aftermath of the July 1997 fighting with several policy measures, primarily in the following broad areas: 1) fiscal policy; 2) monetary policy; and 3) structural policy.

5.1. Fiscal Policy—Imposing Strict Budgetary Discipline

5.1.1. Curtailing public spending

The slump in tourism, the decline of customs revenues, and the suspension and termination of foreign aid after July 1997 cut into government revenues. According to the Ministry of Economy and Finance, government revenues from taxes on tourism alone dropped by 25 percent in 1997, down from $100 million in 1996.

The government responded to the decline in revenue by introducing stringent budgetary discipline. Efforts were made on both expenditure and revenue sides of public finance. With regard to expenditures, the government in October 1997 cut spending on civil administration and expenditures on operation and maintenance by 20 percent to balance the national budget. The Council of Ministers also imposed a ban on the free use of mobile telephones by government officials (other than ministers) in an attempt to economise government resources.

5.1.2. Implementing the law on taxation

Budgetary discipline was also pursued by fiscal reforms intended to increase national revenues. The 1998 budget included fiscal reform measures aimed at broadening the tax base and improving the capacity of tax collection. It also implemented the Law on Taxation, which contained several revenue-enhancing measures.

The introduction of value-added tax (VAT) was a notable development among those policy measures. VAT came into force on 1 January 1999, with the rate set at 10 percent, replacing turnover taxes that had previously been levied. VAT is applied to about 2,000 large firms with variable taxable income, except for food and staple products. Some types of business, such as commercial banks, medical clinics, postal services, non-profit activities and insurance services, are exempt from VAT.

5.1.3. Improving the law on investment

It has been widely recognised that the Law on Investment has contributed to the erosion of the tax base, as it includes too broad a scope for *ad hoc* tax exemptions (Kun 1998). In December 1997, the Council of Ministers adopted a sub-decree on the Implementation of the Regulations for the Law on Investment, which was designed to eliminate some *ad hoc* tax exemptions. Under the new regulations, tax concessions were to be granted only if investment projects met strict conditions in terms of the location of the project (to encourage investment in remote areas), the size of the project, the number of jobs to be created, the export potential, value-added, use of local resources, training of local workers, and the employment of women and disabled people.

In addition, tax exemptions were to be applicable only to taxes on profits and customs duties. Customs duty exemptions were to be granted only for the following types of projects: 1) export-oriented projects with at least of 80 percent of production designed for export; 2) projects located in a special promotion zone; 3) tourism industry projects; 4) projects in labour-intensive, processing and agri-business industries; and 5) physical infrastructure and energy projects. Products eligible for customs duty exemptions were restricted to construction materials, machinery, raw materials, intermediate goods and packaging equipment directly used in the production process.

5.1.4. Fiscal reforms under the 1999 Budget Law

Fiscal reform measures were also encompassed in the 1999 Budget Law. The reforms further broaden the tax base and improve tax collection. The Council of Ministers approved a proposal to levy taxes on senior government officials' salaries, from minister to under-secretary of state levels. Under the proposal, ministers' salaries are subject to a tax of 10 percent, secretaries of state to 5 percent, and under-secretaries of state to 2 percent.

Efforts have also been deployed to improve the collection of stamp duties and revenues from visas. The authority to use revenues from stamp duties will be transferred from provincial governments to the central government. The Council of Ministers also decided to levy tax on petrol, diesel and lubricants, and transfer the revenues to the Ministry of Public Works and Transport for road maintenance.

5.1.5. Seeking aid resumption

Finally, the government made efforts to seek the resumption of foreign assistance at previous levels. Foreign assistance is critical to maintain fiscal discipline, as almost all development expenditure has been financed by external assistance. After the July 1997 fighting, all US-supported projects were affected by USAID's decision to cut off aid flows ($35 million). In September 1997, the International Monetary Fund (IMF) decided to withdraw concessional loans because of the government's unsatisfactory implementation of policies to enable it to collect revenue from all logging activities.

5.2. Monetary Policy—Restoring Macro-Economic Stability

The depreciation of the riel against the dollar began in July 1997, and continued for about one year until the national election in July 1998. The NBC intervened occasionally in the foreign exchange market to stabilise the fluctuation of the riel through the use of auctions of dollars. This instrument was used to defend the riel against speculative attacks. A notable intervention was undertaken in June 1998, prior to the July national election, when the exchange rate passed 4,000 riels to the dollar. To maintain the value of the riel, the NBC bought $400,000 worth of riels in dollar auctions. This intervention was fairly successful in restoring stability in the foreign exchange market, as the riel bounced back to 3,900 riels to the dollar and has remained stable at 3,800 since then.

The decline in foreign currency deposits was discussed above in Section 2. The NBC issued two regulations in 1998 to stem the outflow of dollars and increase confidence in the banking sector. The first regulation, passed in August 1998, stated that the transfer of foreign currency overseas must be performed by the NBC. The second regulation, also issued in August 1998, stipulated that commercial banks and financial institutions had to keep foreign currency deposits received from clients and inter-bank deposits for use within Cambodia.

5.3. Structural Policies

5.3.1. Foreign trade policy—protecting import-competing industries

In February 1998, the government issued a sub-decree to increase import tariffs for 14 types of products, ranging from foodstuffs (noodles, salt) to construction materials (cement, bricks, tiles, metal), and some plastic and rubber products. This measure was taken to protect domestic producers which had lost competitiveness due to the depreciation of the regional currencies, particularly the baht. The import tariffs on most of these products were raised from 0–7 to 15 percent, and for some from 15 to 35 percent.

Concerns have been raised, however, about the desirability and effectiveness of this response. First, even though the measure was said to be temporary, its duration was not clearly defined. As our analysis in Section 3 revealed, Cambodia's competitiveness against Thailand recovered from February to June 1998. The reason for protecting those industries had thus already passed. In addition, raising tariffs goes against the spirit of the ASEAN Free Trade Area (AFTA) and the World Trade Organisation (WTO), and could create scepticism among members of the Association of Southeast Asian Nations (ASEAN) and the WTO regarding the government's commitment to liberalise its trade regime. Furthermore, raising import tariffs is likely to exacerbate smuggling activities with little protection for domestic producers. For example, some cement retailers in Phnom Penh reported that the price of Thai cement had remained cheap even after the rise in import tariffs from 7 to 15 percent, due in part to smuggling through former Khmer Rouge zones in the northwest of the country.

5.3.2. Foreign investment policy—improving the investment climate

Cambodia has experienced a decline of FDI since 1996, as recorded in Section 3. In response to the downward trend of investment inflows, the government passed a sub-decree on the Implementation of the Law on Investment in December 1997.

The objective of the sub-decree was to attract high quality investment and to speed up the implementation of projects. New regulations require investors to maintain a 1.5–2.0 percent deposit in the NBC for projects valued at $1–40 million. The deposits are returned to investors upon the completion of 30 percent of the project. Privileges and incentives granted may be revoked if projects are not implemented in accordance with the agreed schedule, or within six months of the issue of licences. The regulations also ban investors from changing their investment activities and/or transferring ownership without prior approval by the Council for the Development of Cambodia (CDC). To prevent debt problems, the sub-decree prohibits recourse to loans that exceed threefold the company's capital, except for priority projects.

5.3.3. Tourism policy—recovering from the slump

In response to the drastic fall in tourist arrivals and the slump in the tourism industry, the government took specific measures to promote foreign investment in the aviation industry. In late 1997, the government introduced an "open sky" policy that ended the monopoly of the national carrier Royal Air Cambodge on domestic flights. Thai-owned Kampuchea Airlines was permitted to resume its services in Cambodia, and two other airlines, President Airlines and Angkor Air, submitted applications to the government for approval.

It was also recognised that the realignment of regional currencies reduced the cost of living in some of the crisis countries in dollar terms, and diverted visitors to these countries from Cambodia. In response, the government rescinded its decision to impose an additional 10-percent tax on the hotel industry. To attract more visitors to Cambodia, the government also granted a licence to Bangkok Airways to establish direct flights from Bangkok to Siem Reap, where some of Cambodia's most popular tourist destinations are located.

6. Lessons for Future Policy-Making[10]

The Asian countries hit by the regional economic crisis from mid-1997 were often praised as the "East Asian miracle" for their remarkable growth and development. The crisis made it clear that the tremendous success of these countries had masked weaknesses and mismanagement. It also showed that differing government responses to the crisis influenced the effectiveness of counter-measures and the speed of recovery. The Asian crisis thus provided Cambodia an opportunity to reflect on the relevance and effectiveness of its own systems and policies, and to elaborate its strategies for long-term development.

Since the Asian crisis and its contagion effect have not come to a finish, it is perhaps somewhat premature to draw conclusions about the effectiveness of the policy measures undertaken by the governments in the crisis countries. However, some key lessons seem to have emerged already. This section examines three key lessons that are relevant in the context of Cambodia: 1) developing a robust financial system; 2) mitigating the volatility of foreign capital flows; and 3) establishing the rule of law and democracy.

[10] This section draws liberally on Kato (1998)

6.1. Developing a Robust Financial System

The Asian crisis disclosed the weaknesses of the financial systems in the crisis countries, particularly their vulnerability to large outflows of foreign private capital. It should be noted, however, that the financial sectors in the crisis countries had been extremely successful throughout the 1980s. Indeed, these countries managed to mobilise domestic savings more than any other developing countries, efficiently allocated these funds to domestic investment, and achieved some of the highest economic growth rates in the world. Government policies and institutional reforms to establish sound financial systems, however, failed to keep pace with the liberalisation of foreign capital flows in the 1980s and 1990s. This is seen as one of major causes of the crisis in these countries.

Cambodia's financial sector is still in its infancy relative to those in the crisis countries. It was only in 1991 that the banking system was opened up to private and foreign commercial banks. A new Bank Law was adopted in 1996 to set out the framework for modern monetary and banking systems. Given the short history of the modern banking system in Cambodia, it is not surprising that the banking sector has played a minimal role in mobilising domestic savings and allocating investment. The operation of commercial banks is generally confined to Phnom Penh, though a few have established branches in some provinces.

Other financial markets, such as bond and security markets, have not yet been established. Although the National Assembly approved a plan to issue treasury bills in 1997, it will be a major challenge to set the yield of the bills at a level that can attract investors, because confidence in the riel and in the government has not yet been well established.

This under-development is not altogether disadvantageous. Cambodia is in a position learn from the successes and failures of the crisis countries to establish a robust financial system. In doing so, it could achieve the same success as its neighbours while minimising the vulnerability of the economy to large capital outflows.

To this end, at least three issues need to be addressed: 1) establishing a legal framework for sound supervision and regulation; 2) developing a framework for corporate governance; and 3) de-dollarisation.

6.1.1. Establishing a legal framework for the supervision of commercial banks

It is imperative that legislation governing private financial institutions in Cambodia be passed. The Commercial Bank Law setting out the framework for banking regulation, in particular, should be adopted. Although the adoption of this law has already been delayed for more than one year, this could be seen as an opportunity to consider the experience of the crisis countries in the legislation. The adoption and enforcement of a sound banking law will lay the foundation for the development of a robust financial system in Cambodia.

One of the key issues arising from the Asian crisis is non-performing loans accumulated by commercial banks and finance companies. Cambodia should consider adopting regulations that require financial institutions to classify and report their assets in accordance with Bank of International Settlement (BIS) standards.[11] This would strengthen the NBC's supervisory function, because information regarding the holding of non-performing loans in bank assets will help the NBC identify the actual financial condition of commercial banks.

[11] The BIS standards provide the following classification of assets: 1) *worthless or irrecoverable assets*, are those that have to written off; 2) *doubtful assets likely to be lost* are receivable assets in arrears for more than 12 months; 3) *doubtful assets* are receivable assets in arrears for more than six months; and 4) *sub-standard assets* are receivable assets in arrears for more than three months. According to the BIS classification, non-performing loans are assets that are worthless, irrecoverable or doubtful.

6.1.2. Developing a framework for corporate governance

It is of paramount importance that a legal framework to govern private business corporations be developed. This involves legislating various modern commercial laws and the reform of existing laws, such as those governing business organisations, contracts and arbitration, trademarks, product liability, and bankruptcy. These laws will define the rules that business has to follow in Cambodia's market economy. The adoption of internationally accepted accounting standards is also a necessary prerequisite, not only for accounting purposes *per se*, but also for commercial banks to be able to monitor the performance of their borrowers.

In the context of the Asian crisis, bankruptcy laws deserve special attention. During the crisis, the number of companies going bankrupt soared, leading to a large contraction of production, investment, credit flows, and consequently aggregate output and employment. It has since been recognised that the costs associated with resolving bankruptcies were enormous (Stiglitz 1998a; 1998b).

At the moment, no bankruptcy law exists in Cambodia, and legislation covering this would thus be highly recommended. It would help contain the adverse impact of bankruptcies on various sectors of the economy, and minimise the resulting social costs. A proper bankruptcy law can offer a legal framework for bankrupt and indebted companies to find new funding sources and to repay lenders under an agreed schedule, instead of simply being forced to shut down and hurting workers, shareholders and lenders. Creditors would still have the legal right to get their share of remaining assets from liquidation. A bankruptcy law is also likely to encourage foreign investors to enter Cambodia, because it provides them with a legal framework to recover their business assets in case of bankruptcy.

6.1.3. De-dollarisation

Dollarisation is without doubt one of the major issues in Cambodia's monetary economy because it is so widespread. A large proportion of financial transactions in Cambodia are undertaken in foreign currencies, especially in US dollars. In the provinces along the Thai border, the baht takes the place of the dollar as a widely accepted currency. Foreign currency deposits with commercial banks account for more than 90 percent of total bank deposits. Dollars are believed to account for at least 80 percent of the total currency in circulation. The use of the riel is limited to small transactions and wage payments by the government.

Under the current circumstances, dollarisation obviously impairs the effective conduct of monetary policy and the adjustment mechanism of foreign exchange rates in Cambodia. It is also recognised, however, that dollarisation brings some benefits, such as price stability and a large stock of foreign exchange readily available in the domestic economy (Menon 1998). Whether, and to what extent, a robust financial system can be developed in Cambodia with extensive dollarisation intact is still an open question. One could argue that de-dollarisation would take place as Cambodia's financial system is further developed. However, some preparations for eventual de-dollarisation would not be harmful. For instance, changing such conventions as paying wages in the private sector in dollars is one option.

6.2. Mitigating the Volatility of Foreign Capital Flows

The Asian crisis brought to light the fact that foreign capital is a double-edged sword for developing countries.

It is true that foreign capital has great potential to bring a wide range of benefits to such countries. It can augment a shortage of domestic capital, transfer new and appropriate technology, improve the quality of human resources, and earn foreign currency. It is thus important to establish a favourable investment climate conducive to private sector development. The Cambodian government has highlighted three key policies to encourage this: 1) simple and transparent regulatory systems; 2) effective legal and judicial systems that protect property rights, enforce contracts, and help create an atmosphere of law, order and personal security; and 3) tax systems that are simple and broad-based, with limited exemptions and reasonable and uniform rates (Keat 1998; Hang 1995).

However, the regional crisis has made clear that foreign capital tends to magnify, rather than smooth, fluctuations in developing economies because of its volatile and pro-cyclical characteristics. Stiglitz (1998a) points out these features, noting that "developing countries seem to get the most private capital when they are growing strongly and need it least, and have a relatively harder time accessing capital in hard times when they need it most."

In addition, inflows of foreign capital are inherently volatile because they are influenced by economic conditions and business cycles in the home countries of foreign investors. For instance, Japan's foreign investment in ASEAN increased dramatically after 1985. This was prompted first by the drastic appreciation of the yen against the dollar following the Plaza Accord of the G7 countries. The realignment of foreign exchange rates weakened the competitiveness of Japanese products, and was a strong incentive for Japanese firms to relocate their production overseas where they could enjoy lower production costs. The increase in real wages in Taiwan and South Korea in the 1980s directed Japanese foreign investment away from these countries and towards lower-wage countries in Southeast Asia. In addition, the wave of Japanese foreign investment to Asia was pushed by the Japanese economic boom in the second half of the 1980s. All of these factors are beyond the control of small developing countries such as Cambodia.

Cambodia has received large inflows of foreign private capital relative to the size of its economy since 1994. For instance, the net inflows of private capital accounted for 4.9 percent of GDP in 1997. The incentives offered to foreign investors have been among the most generous in the region. The majority of foreign capital inflows to Cambodia have comprised FDI, which tends to be long-term and stable. Given the composition of private capital inflows in Cambodia, a massive outflow of foreign capital is unlikely to happen in a short period of time, as was the case in the crisis countries. This is one of the reasons Cambodia was immediately affected by the crisis. Indeed, other less affected developing Asian countries, such as China, have a similar pattern of foreign capital inflows to Cambodia, and tend to have higher ratios of FDI to total private capital.

There are four considerations for Cambodia to reduce the potentially undesirable characteristics of foreign capital.

The first is to mobilise domestic private savings to finance investment. This would reduce Cambodia's heavy dependence on foreign capital by creating an alternative domestic source for funds. This could be achieved by the development of a robust financial system, particularly the banking sector, as discussed above.

The second consideration is to prioritise investment projects according to the duration of projects. A high priority should be given to projects which make a long-term commitment and are consistent with the long-term development strategies and objectives of the government. The selection or screening of foreign investment projects may reduce total foreign capital inflows to Cambodia, but it would reduce the risk of excess volatility and help channel foreign capital to productive investment.

The third is to consider carefully the risk of opening up Cambodia's financial markets, such as bonds and securities, to the rest of the world when these markets are established in the future. Careful analysis will be required before liberalisation of capital movement to ensure that the domestic regulatory framework is prudent, effective and robust enough to minimise the large risks involved in liberalisation.

Chile's experience of capital restrictions since 1991 is often cited as a successful case in which the inflow of short-term speculative capital (so-called "hot money") has been discouraged, whereas long-term investment in the form of FDI has been promoted (Rajan 1998). First, to discourage short-term speculative capital, portfolio inflows (including foreign loans and bond issues) above $10,000 are subject to a 10-percent reserve requirement, interest-free, to be deposited at the central bank for one year. This is an implicit tax if the capital were to remain in the country for a brief period. Second, Chilean firms and banks can tap international capital markets only if two bond-rating agencies rate their paper as high as Chile's own government bonds. Third, any foreign money coming into Chile must remain in the country for at least one year, a requirement that has discouraged many hedge funds and pension funds from investing in Chile. Whether or not this model is suitable for Cambodia's yet-to-be-developed financial markets needs further study.

Finally, careful consideration for foreign borrowing is needed not only in the private sector but also in the government, because the proportion of soft loans and bilateral grants for the government is likely to decline in the future. In this regard, the government needs to conduct proper debt and risk management to avoid macro-economic instability caused by the mismanagement of the national debt.

6.3. Establishing the Rule of Law and Democracy

The Asian crisis highlighted the fact that economic crises can erupt in any market economy, regardless of its stage of development. Many unforeseeable forces seem to affect the fluctuation of market economies, and even foreseeable forces may be extremely difficult to control. Foreign investors' decisions are the case in point.

Under these circumstances, good governance is a key characteristic for a country to be able to reform and adjust to changing situations. The Asian crisis seems to teach us that capacity for reform can substantially affect the effectiveness of containing and recovering from a crisis. Thailand and South Korea elected new governments soon after the crisis erupted. The transition process was based on the rule of law and was democratic, reflecting the opinion of the majority of the people, who had not been satisfied with the reforms offered by previous governments. By contrast, Indonesia had no mechanism for a democratic transition that reflected people's opinions. The authoritarian regime of former president Suharto blocked swift and effective implementation of appropriate reforms to contain the crisis. In doing so, it undermined the prospect for future economic growth.

The advantages of democratic regimes in carrying out economic reforms are at least threefold (Maravall 1995). First, the legitimacy accorded to leaders elected under democratic regimes means that they obtain the cooperation of their citizens much more easily than the leaders of other regimes. This sense of cooperation allows democratic leaders to implement difficult economic reforms which may in the process impose hardships on their citizens. Second, democratic regimes are more likely to provide a better check and balance mechanism to correct mistakes in reforms, since political oppositions serve as a warning function. Third, democratic regimes open windows of opportunity for further transition when newly-elected governments cannot, for whatever reason, implement necessary reforms.

This suggests that the rule of law and democracy are necessary prerequisites for good governance, *i.e.* that the government is able to respond to various external shocks to the economy in a timely, effective and efficient manner. Among other lessons, the regional crisis clearly demonstrates the advantages of democratic regimes over authoritarian regimes in carrying out economic reforms in the dynamic and changing world economy.

In this regard, Cambodia's national election in July 1998 and the following political developments appear to show some positive signs. A new coalition government emerged out of negotiations between the two political parties with a majority of seats. A third party remains as a political opposition. Despite allegations of fraud in the election from a number of observers, the transition to a new government has generated hope for the emergence of democracy in Cambodia.

All parties are now expected to play their relevant roles in the political arena—*i.e.* that the coalition government takes full responsibility for implementing various reforms, whereas the opposition party plays a check-and-balance function in the process of policy-making. Whether or not Cambodia is able to develop the capacity to reform depends critically on the participation of all, not just some, Cambodians in this endeavour.

7. Conclusion

This paper aimed to study the implications of the Asian financial crisis for Cambodia, one of the Southeast Asian transitional economies (SEATEs). The impact of the crisis on Cambodia's economy and society were analysed using available official data and a range of surveys. The paper also discussed the response of the Cambodian government to contain adverse impacts of the Asian crisis, and lessons that Cambodia could learn for future policy-making.

Our analysis revealed that the Asian crisis had not had immediate an adverse impact on the financial sector in Cambodia. The decline of private capital inflows was modest in the second half of 1997. This contrasts with the experience of crisis countries that suffered from contagion immediately after the crisis erupted in Thailand. It was argued that Cambodia's under-developed financial markets provided some sort of "cushion" against the crisis and delayed the contagion effects, at least for the first six months of the crisis.

The adverse impact on the real sector was also modest in the second half of 1997. The trade balance did not deteriorate, despite the loss of competitiveness arising from the appreciation of the riel and the dollar *vis-à-vis* the crisis currencies. This was primarily due to the rapid expansion of garment exports to the EU and the United States, which have not yet been greatly affected by the Asian crisis. FDI declined, but the speed of the decline was slow in the second half of 1997. Consumers actually enjoyed cheaper products from Thailand, as the riel and the dollar appreciated drastically against the baht until January 1998.

Our study found, however, that the adverse impact of the Asian crisis came to be felt more strongly in 1998. The decline of foreign currency deposits in commercial banks, which had started in April 1997, continued in 1998 with no significant sign of recovery. Two Thai-owned commercial banks closed down their offices in Cambodia in the second semester of 1998. Despite the recovery of competitiveness of Cambodia's products after February 1998, some domestic producers faced severe price competition with imported products. Some export-oriented enterprises, particularly wood products and rubber, faced a sharp fall in the volume and prices of their exports. This was primarily due to the slowdown of growth and the gain of competitiveness in the crisis economies. The tourism sector continued to suffer stagnant tourist arrivals, in particular from the crisis countries in ASEAN.

The livelihood of the people has been severely affected by the continued stagnation of Cambodia's economy that was precipitated by the internal political crisis in July 1997. The Asian crisis made it more difficult than it may otherwise have been for Cambodia's economy to recover from the stagnation. Vulnerable workers in the capital continued to earn only about half of the net earnings they had earned before July 1997. Migrant workers to Thailand suffered from a sharp reduction of demand for migrant labour and in the level of wages paid, in particular for those who worked in construction in large cities such as Bangkok.

Our study also found indications that social development, the top priority in Cambodia, has been adversely affected by the Asian crisis. The cost of health-care increased considerably as the foreign exchange rate of the riel against the dollar depreciated. A sharp decline of enrolment in lower secondary school in 1997/98 raises concerns about an increase of child labour, especially in poor households.

The government's policy responses to the Asian crisis were formulated within the context of policies and strategies for sustainable growth and development in Cambodia. Fiscal discipline was strengthened after the fighting in July 1997 to maintain sound macro-economic fundamentals. Several fiscal reform measures were undertaken or are planned to broaden the tax base and improve tax collection. The NBC has taken steps to strengthen the supervision of commercial banks to develop a sound banking system. Some measures were introduced to curb the outflow of foreign currency from Cambodia. The NBC's occasional interventions in the foreign exchange market helped to stabilise the value of the riel, particularly during the period before the national election in July 1998. Recognising the declining trend of FDI, the government took several measures to improve the investment climate in Cambodia. However, the responses of the government to the social impact of the crisis, particularly to protect the livelihood of the poor and the vulnerable, have not been notable.

The lessons of the Asian crisis for policy-making in Cambodia warrant further discussion and research. Although it may be somewhat premature, there are a few lessons that Cambodia's authorities may consider. First, it is imperative to pass legislation such as the Commercial Bank Law to lay the foundation for the development of a robust financial system. This should help enhance the supervision of the regulatory authorities, and increase transparency in commercial bank operations. The introduction of internationally accepted standards of loan classification, such as the BIS standards, accounting practices and disclosure rules, is also recommended. Second, the government may consider mitigating the negative impact on the economy of the volatility of foreign capital flows. Finally, the establishment of the rule of law and democracy are prerequisites for the government to be able to respond to various external shocks to the economy in a timely, effective and efficient manner.

Appendix One

The Asian Crisis and the SEATEs: Impact, Policy Responses and Lessons[1]

Toshiyasu Kato

A recent report by the Asian Development Bank (ADB) declared that the economies hit by the Asian crisis have finally bottomed out and begun to move towards recovery (ADB 1999). It predicts that, after a 7-percent contraction in 1998, the Southeast Asian economies will grow by 0.8 percent in 1999, and more strongly by 2.8 percent in 2000 (Table A1). The extent of the recovery will vary among the economies, however. South Korea and the Philippines will grow faster than Thailand, Malaysia and Indonesia, according to the ADB projection. The Southeast Asian economies experienced inflation of 21 percent in 1998, yet are expected to curb this to 8.3 and 6.4 percent in 1999 and 2000 respectively.

Although a large number of studies have examined these crisis-hit economies, relatively little attention has been paid to the impact of the crisis on the Southeast Asian transitional

Table A1. Economic Prospects of the East and Southeast Asian Economies

	Growth rate of GDP (annual percentage change)					Change in consumer prices (annual percentage change)				
	1996	1997	1998	1999[1]	2000[1]	1996	1997	1998	1999[1]	2000[1]
Southeast Asia	7.1	4.0	-6.9	0.8	2.8	6.6	5.6	21.0	8.3	6.4
Cambodia	7.0	2.0	0.0	4.0	6.0	9.0	9.1	12.0	10.0	6.0
Laos	6.9	6.9	4.0	–	–	13.0	19.3	90.1	37.0	–
Vietnam	9.3	8.2	4.0	3.7	4.5	4.5	3.6	9.2	8.0	7.0
Thailand	5.5	-0.4	-8.0	0.0	2.5	5.9	5.6	8.1	3.0	5.0
Indonesia	7.8	4.9	-13.7	0.0	2.0	7.9	6.6	58.2	17.0	9.5
Malaysia	8.6	7.7	-6.2	0.7	2.7	3.5	4.0	5.2	4.2	3.8
Myanmar	6.4	4.6	4.0	3.0	4.0	16.3	39.7	50.0	–	–
Philippines	5.8	5.2	-0.5	2.4	4.0	9.1	6.0	9.7	8.5	7.0
Newly industrialised economies	6.3	6.0	-1.4	2.3	4.3	4.3	3.5	3.8	1.1	2.3
Hong Kong	4.5	5.3	-5.1	-0.5	2.0	6.3	5.9	2.8	-1.5	1.0
South Korea	7.1	5.5	-5.5	2.0	4.0	5.0	4.5	7.5	2.0	3.0
Singapore	6.9	7.8	1.5	1.0	4.0	1.4	2.0	-1.5	0.5	2.0
Taiwan	5.7	6.8	4.8	4.9	6.3	3.1	0.9	1.7	1.9	2.6
Other										
China	9.6	8.8	7.8	7.0	6.5	8.3	2.8	-0.8	2.0	3.0
Mongolia	2.4	4.0	3.5	3.5	4.0	58.7	17.5	6.0	9.5	5.0

1 = ADB projections. Source: ADB (1999)

[1] This appendix is the introductory comparative chapter from the full volume of conference papers, *Impact of the Asian Financial Crisis on the Southeast Asian Transitional Economies*, which was published by the Development Analysis Network in August 1999.

economies (SEATEs)—Cambodia, Laos and Vietnam. The SEATEs are small relative to other developing Asian economies, yet their role as newly emerging market economies has been growing in recent years. They are expected to play a much larger role in the region in the next decade than ever, since all three SEATEs are likely to accelerate their transition to market economies and integrate themselves with the region through the ASEAN Free Trade Area (AFTA).

Recognising the urgent need to understand the implications of the Asian crisis for the SEATEs, six research institutes in Cambodia, Laos, Vietnam and Thailand—the Development Analysis Network (DAN)—undertook a collaborative research project in late 1998 which aimed to answer the following questions:

1) *What impact has the Asian crisis had on the SEATEs?* The impact of the Asian crisis on the SEATEs could be both economic and social. The economic impact affects both the real and monetary sectors of the economy, and consumers as well as enterprises. The social impact affects individuals, communities and society as a whole, through loss of jobs, pressures on the livelihoods of the poor and of vulnerable workers, and the deterioration of the social fabric, such as increased crime, child labour and prostitution. The economic and the social impacts are inter-related and equally important.
2) *What policy measures have the governments of the SEATEs taken to respond to the crisis?* The governments of the SEATEs have already implemented, or plan to implement, policies to contain the adverse impact of the Asian crisis on their economy and society. The relevance and adequacy of these policy responses needs to be examined.
3) *What lessons could be drawn from the Asian crisis for future policy-making?* The crisis-hit countries were often praised as the "East Asian miracle" for their remarkable growth and development. The recent crisis has made clear, however, that their tremendous success masked weaknesses and mismanagement in their economies and policies. The Asian crisis thus provides the SEATEs an opportunity to learn from those mistakes, reflect on their own systems, and elaborate strategies for long-term development.

DAN undertook independent studies to seek answers to these questions. The studies of Cambodia, Laos and Vietnam concentrated on analysis of the actual and potential impact of the crisis on their economies and societies, using both statistical analysis, special surveys and appropriate case study material. The Thai country paper focused on aspects of the crisis in Thailand which have an actual or potential impact on the SEATEs, in addition to an analysis of the causes of the Thai crisis and its impact on Thailand's economy. Effects on SEATEs may include, *inter alia*, effects on Thai imports of labour, on Thai investment in neighbouring countries, on Thai imports and exports of goods and services, on Thai tourists visiting neighbouring countries, and the diversion of third-country tourists to Thailand.

This appendix provides a overview of the findings in the four country studies. It also aims to draw a picture of what has happened in the SEATEs as a whole. To do so, economic and social impacts, policy responses of the governments, and lessons for future policy-making are discussed from a comparative perspective. Thailand is used as a yardstick for comparison with the SEATEs.

The structure of this appendix is as follows. Section 1 provides an overview of the origins or causes of the crisis in Thailand. This helps us understand the mechanism of the crisis, and also draw lessons to prevent a recurrence. Sections 2 and 3 discuss the economic and social impact of the crisis on the SEATEs, relative to those in Thailand. Section 4 summarises policy responses of the governments in the SEATEs and Thailand, while Section 5 tries to draw lessons from the experiences of the four countries.

1. Causes of the Crisis: The Case of Thailand

The Thailand country paper reviewed the causes of the crisis in Thailand. It argued that the crisis was the result of at least four critical factors that were compounded in the economic "boom" that continued until 1995.

The first is foreign exchange liberalisation under the fixed exchange rate system. The Thai government liberalised international foreign exchange transactions with the establishment of Bangkok International Banking Facility (BIBF) in 1993. This measure, aiming to establish Thailand as a financial centre in the region, simplified foreign exchange transactions and facilitated international lending and borrowing. It particularly stimulated out-in activities, *i.e.* lending in domestic markets through borrowing abroad. The Security Exchange Commission Act of 1992 also permitted companies to issue debt instruments overseas without permission from the Security Exchange Commission (SEC). This provided companies, particularly large companies, with access to low-interest foreign funds.

These liberalisation measures caused an influx of foreign capital. This was attributable primarily to the fixed exchange rate system, which eliminated foreign exchange risks, and high interest rates in Thailand relative to those in developed countries. The sharp increase in public expenditure, while maintaining a balanced budget, also put pressure on the Bank of Thailand (BOT) to maintain high interest rates to control inflation. Consequently, outstanding foreign debt surged from $44 billion in 1992 to $91 billion at the end of 1996.

The second factor is weak management of financial institutions. The foreign borrowings would not have been too problematic if financial institutions had properly managed the risks of their borrowing and lending activities. The reality was over-borrowing of unhedged foreign funds and over-investment in many unprofitable sectors such as property development and speculation. Mounting foreign debts and non-performing loans followed. The BOT, the central bank and the sole authority in charge of financial institutions, turned out to be ineffective in supervising and regulating the activities of financial institutions in Thailand.

The third factor is weak governance of the non-bank corporate sector. The phenomenon of over-borrowing and over-investment in the private sector was partly due to weak accounting and supervisory capacity in corporations, including a shortage of experienced auditors. Common practices in companies, such as the mingling of funds among listed and closely held companies of the same family, the use of multiple sets of accounting books, and highly paid rubber-stamp directors, were also noted as an indication of the lack of corporate control and a cause of the crisis.

The fourth factor is the appreciation of the baht and an export slowdown. The real exchange rate of the baht continued to appreciate during the economic boom from 1985. The real appreciation of the baht was due primarily to the continuous and steady increase in price levels in Thailand at higher rates than those in its trading partners. As a result, Thai exports lost competitiveness in international markets, and export growth slowed significantly. Indeed, export growth plunged from 23 percent in 1995 to only 0.5 percent in 1996. Stagnant export growth resulted in the high and persistent current account deficit of between 5 and 8 percent of GDP during the period 1992–96.

All those factors made the Thai economy vulnerable to external and internal shocks. The baht was under speculative attack from international hedge funds for two years after 1996. Despite several BOT efforts to defend the baht from these attacks, massive outflows of foreign capital continued and foreign reserves fell sharply. After severe speculative attacks in February and May 1997, financial institutions ran into trouble as non-performing loans rose, and deposit runs caused a liquidity crunch. The outflow of foreign capital increased further, to the point where foreign exchange reserves were almost depleted. The BOT had no option but to abandon the fixed exchange rate system. Thailand shifted to the floating exchange rate system on 2 July 1997.

2. Economic Impacts of the Crisis

2.1. Foreign Exchange Rates and Prices

The economic crisis in Thailand was triggered by massive outflows of short-term foreign capital after 1996. A drastic depreciation of the baht took place after the Thai government shifted to a floating exchange rate system in July 1997. The so-called “contagion” phenomenon then spread rapidly to currencies in Malaysia, Indonesia, South Korea and other Asian countries. It is thus interesting to ask how and to what extent the foreign exchange rates of the currencies in SEATEs were affected by the contagion (Table A2).

Our study found that the impact of the crisis on foreign exchange rates varied considerably among the SEATEs. Laos experienced the largest fluctuations, with the kip losing its value against the dollar to an even greater extent than the baht in 1997 and 1998. The foreign

Table A2. Economic Impact of the Crisis on Thailand and the SEATEs

	Thailand	Laos	Vietnam	Cambodia
1. Monetary sector				
Foreign exchange rates				
- against the dollar	Large depreciation	Large depreciation	Small devaluation	Moderate depreciation
- against the baht	–	Large depreciation	Large appreciation	Moderate appreciation
Inflation (1997 / 1998)	Moderate (6.0% / 8.0%)	Extremely high (19.0% / 90.0%)	Moderate (3.6% / 9.2%)	Moderate (9.0% / 15%)
Foreign private capital inflows	Large-scale outflows	Declining inflows	Declining inflows	Declining inflows
Interest rates	Increased; recently lowered	Increased	–	Increased
Financial services	Closure of 56 financial institutions; widespread credit crunch	Kip deposits declined sharply	Overdue bank loans increased	Foreign exchange deposits declined
2. Real sector				
Real GDP growth (1997 / 1998)	Slowed; negative (-0.4% / -7.0~8.0%)	Slowed; positive (7.2% / 6.7%)	Slowed; positive (8.8% / 5.8%)	Slowed; positive (1.0% / 0.0%)
Export growth	Increased in 1997; slowed in 1998	Slowed; negative in 1997 and 1998	Slowed; 21.0% in 1997, 1.0% in 1998	Increased in 1997; slowed in 1998
Import growth	Slowed; negative in 1997 and 1998	Slowed; negative in 1997 and 1998	Slowed, 7.0% in 1997, -3.0% in 1998	Slowed; positive in 1997 and negative in 1998
FDI	Drastic fall	Drastic fall	Moderate fall	Moderate fall
Enterprises	Widespread credit crunch; slow recovery of export sector	Slump of wood-related exports	Deterioration in performance of state-owned enterprises	Limited credit crunch; slump of wood and rubber exports
Tourism	Expanding	Less affected	Affected	Severely affected
3. Fiscal sector				
Public revenue	Declined	Increased	Less affected	Declined
Public expenditure	Curtailed	Increased, but government counterpart funds	–	Curtailed

curtailed

exchange rate of the kip depreciated dramatically from 1,131 kip to the dollar in June 1997 to 3,224 kip to the dollar in June 1998 (using parallel exchange rates). Unlike the baht, which bottomed out in February 1998, the kip continued to weaken in the second half of 1998, reaching around 4,700 kip to the dollar in October 1998.

Compared with Laos, Cambodia was affected only moderately. The exchange rate of the riel depreciated against the dollar by around 30 percent in the second half of 1997. The riel became stable in the second half of 1998, however, after a period of depreciation before the national election in July 1998. The total depreciation of the riel against the dollar was around 40 percent from its pre-July 1997 level to December 1998. The impact on the Vietnamese dong was even smaller, reflecting the fixed exchange rate system in Vietnam. The exchange rate of the dong against the dollar was kept at the pre-crisis level throughout 1997, though it was devalued twice in 1998 by a total of 16 percent.

The drastic depreciation of the kip pushed up the domestic prices of imported products, and fuelled inflation in Laos. The consumer price index (CPI) started increasing rapidly, particularly from early 1998, surging by 102 percent in June 1998 from its pre-crisis level in June 1997. The impact on CPI was substantial because around 50 percent of total imports in Laos came from Thailand in 1997. In addition, lax monetary and fiscal policies in 1997 exacerbated inflation. The growth rate for broad money in 1997 was 64 percent, far exceeding 16 and 27 percent recorded in 1995 and 1996 (IMF 1998). The expansion of direct credit from the Bank of Laos to finance the building of irrigation systems contributed to the decline of foreign exchange reserves and the expansion of cash circulating in the economy in the second half of 1997 and 1998 (IMF 1998). Policy measures to crack down on parallel exchange markets in May 1997 spurred capital flight, and aggravated the depreciation of the kip.

By contrast, Cambodia and Vietnam managed to contain the upward pressures on inflation relatively well. Reflecting the lower rate of depreciation of its foreign exchange rate, Cambodia experienced much lower rates of inflation compared to Laos, recording 9 percent in 1997 and 15 percent in 1998. The two-digit inflation in 1998 was partly attributable to poor harvests due to bad weather conditions. Inflation in Vietnam was kept even lower, at 3.6 and 9.2 percent in 1997 and 1998 respectively.

2.2. Financial Sector

In Thailand, the drastic depreciation of the baht against the dollar put enormous pressure on commercial banks and finance companies. The problem of insolvent banks and finance companies became acute, as their unhedged foreign borrowing increased dramatically while non-performing loans mounted. Consequently, a large number of financial institutions were closed down in the second half of 1997.

The SEATEs also experienced pressure on the financial sector, though the extent of the impact appears to have been much less than that in Thailand. In Laos, the massive depreciation of the kip eroded people's confidence and caused a decline of commercial bank deposits in kip. The emergence of capital flight was also noted. Despite these difficulties, however, none of the banks in Laos had gone bankrupt as of February 1999. Cambodia also experienced a decline in foreign currency deposits after July 1997, yet only two out of 29 commercial banks in Cambodia, both Thai-owned, closed their offices in Phnom Penh in the second half of 1998 (one of these banks recently re-opened). In Vietnam, the amount of overdue debt in the banking system increased more rapidly than in the period before the crisis, and eroded confidence among depositors in Vietnam. The problems in the banking sector were partly associated with difficulties recovering loans from state-owned enterprises (SOEs).

The performance of the financial sector in the SEATEs needs be interpreted with caution, however. This is because all three SEATEs are still in the early stages of developing the supervisory and regulatory framework that enhances transparency and accountability in the financial sector. At the moment, only limited information is available to assess the activities of banks. In addition, heavy-handed state intervention, particularly in Vietnam and Laos, make it difficult to assess the "true" performance of the banks. For instance, the banks in Vietnam receive *de facto* subsidies from the national budget because state funds have been poured into unprofitable SOEs, to which the banks are lending funds.

2.3. Real Sector

The crisis in the financial sector had devastating effects on output growth in Thailand. The closure of many finance companies caused a serious problem of credit crunch, as banks became reluctant to extend loans to companies with deteriorating balance sheets. In addition, increased interest rates aimed at restoring confidence and stability in the financial sector raised the cost of borrowing and discouraged private investment. Credit crunch in the financial sector also hindered a swift recovery of exports, as trade credits became scarce. All of those factors contributed to a large contraction of the Thai economy in both 1997 and 1998.

All three SEATEs experienced a slowdown of economic growth in 1997 and 1998, with the declining trend becoming more apparent in 1998. The adverse impact was, however, relatively moderate compared with that in Thailand.

Despite the major fluctuations of foreign exchange rates and prices, real GDP in Laos grew by 7.2 and 6.7 percent in 1997 and 1998 respectively. The slowdown of the economy was more apparent in Vietnam, where real GDP growth dropped from 8.8 percent in 1997 to 5.8 percent in 1998.[2] In Cambodia, the adverse impact of the Asian crisis was compounded by the domestic political crisis precipitated by the fighting of 5-6 July 1997. The impact of the external and domestic crises forced Cambodia's real GDP to grow only by 1 and 0 percent in 1997 and 1998 respectively.

2.4. External Sector

The slowdown of economic growth in the SEATEs was partly attributable to the slowdown of exports and inward foreign direct investment (FDI). Laos experienced a fall of exports in 1997 and 1998, and a drastic fall of FDI, reflecting the crisis in Thailand, its largest trade and investment partner. Vietnam managed to maintain positive export growth even after the crisis, but growth rates plunged from 21 percent in 1997 to only 1 percent in 1998. The decline of FDI in Vietnam appears to have been smaller than that in Laos, however. Cambodia was in a more fortunate situation, as the recent development of the garment sector mitigated the adverse impact of the crisis. Cambodia's exports expanded in 1997 and slowed only slightly in 1998, due primarily to garment exports to the European Union (EU) and the United States, which granted the generalised system of preferences (GSP) status to Cambodia. As regards imports, all three SEATEs experienced declines in 1998.

2.5. Fiscal Sector

Impacts on the fiscal sector varied considerably among the SEATEs. Although Vietnam's public finance does not appear to have been greatly affected, there were fiscal implications for Cambodia and Laos. In Cambodia, tariff revenues from imports and foreign aid declined after July 1997, due to the domestic and external crises. As a response, the government introduced austerity measures to curtail public expenditures. In Laos, the increase in the fiscal deficit was caused by both increased public expenditures and the loss of revenues due to the Asian crisis.

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2 According to more recent estimates by the ADB, summarised in Table A1 above, real GDP in Laos and Vietnam grew by only 4 percent in 1998. The ADB figures are much lower than those reported in the country papers prepared by the DAN researchers.

3. Social Impacts of the Crisis

In Thailand the financial crisis turned into a social crisis. Unemployment increased sharply, the number of waged employees plunged, and many Thai migrant workers in other regional economies returned home. In the manufacturing sector, a large number of factories had to curtail working hours as an alternative to laying off workers. Many who lost jobs in urban areas returned to the countryside, reversing the flow of migration from rural-urban to urban-rural. Public hospitals have been overwhelmed by people who can no longer afford private medical services. The number of children dropping out from school has increased as their parents can no longer afford to send them to school.

So far the social impact on the SEATEs has not been as severe as in Thailand. However, our studies revealed some evidence that the crisis had been increasingly putting pressures on people's livelihood and undermining social development in all three SEATEs (Table A3).

In Laos, unemployment rates have not shown any significant change. However, the social impact came to be felt in urban areas more so than in rural areas. A larger number of household members, particularly spouses and children, have been participating in income-generating activities in the capital Vientiane. People in urban areas have increased working hours in secondary jobs to compensate for the loss of earnings from their primary jobs. Responding to a sharp decline in real wages and earnings due to high inflation, people cut back

Table A3. Social Impact of the Crisis on Thailand and the SEATEs

	Thailand	Laos	Vietnam	Cambodia
1. Livelihood				
Unemployment	Increased sharply; migrant labour overseas returned to Thailand	No significant change; more household members began work	Increased in urban areas; idle workers in SOEs increased	Waged employment declined
Working hours	Declined in manufacturing	Increased for secondary jobs	Fell for waged employees	Increased for vulnerable workers
Wages and earnings	–	Real wages declined sharply	–	Declined for waged employees and vulnerable workers
Consumption	–	Declined; more vegetables and less meat, fish eaten	–	Declined, especially for vulnerable workers
2. Migration				
Domestic migration	Urban-rural migration increased	–	–	Rural-urban migration increased
Cross-border migration	Migrant workers in Taiwan and Brunei returned home	–	–	Migrant workers in Thailand returned home
3. Social development				
Health	Public hospitals overwhelmed	Price of medicine increased	Unaffected	Health-care costs increased
Education	School drop-outs increased	Schooling costs increased	–	School enrolment declined

their overall consumption by eating more vegetables and less meat and fish. The price of medicine and the costs of schooling also increased as a result of high inflation and the depreciation of the kip. The situation in Vietnam appears to be similar to that in Laos. Unemployment rates increased, primarily in urban areas, with a slight increase at the national level. Adjustment of labour markets has been also taking place inside firms, *i.e.* the increasing number of idle workers within SOEs. The working hours of waged employees in urban areas reportedly declined as well.

In Cambodia, both the domestic political crisis and the Asian crisis have apparently had an adverse impact on the livelihood of the people. The number of waged employees has declined considerably in Phnom Penh, and real wages have dropped. Those who were most severely hit were self-employed vulnerable workers. The earnings of vulnerable workers in Phnom Penh (scavengers, cyclo drivers, vegetable traders and porters) plunged substantially in real terms. These groups responded to the loss of earnings by increasing their daily working hours. A large number of Cambodian migrant workers to Thailand lost their earning opportunities and returned home. Cambodian migrants who worked as construction workers in Thailand were most severely hit, as the construction sector there has been in deep trouble. Although inflation in Cambodia was much lower than that in Laos, medical costs (including imported medicine) increased disproportionately due to the depreciation of the riel against the dollar. Enrolment in lower secondary school has also dropped sharply.

4. Policy Responses

The responses of the governments to contain the crisis varied between Thailand and the SEATEs, reflecting the variation of the extent and nature of the problems each was facing (Table A4).

Thailand, the origin of the crisis and the country hardest hit, has taken the most comprehensive measures among the countries studied. With regard to macro-economic policy, the Thai government tightened monetary policy to restore confidence in the financial sector. It also cut back public spending, following the conditions imposed by the International Monetary Fund (IMF). These tight fiscal and monetary policies were subsequently relaxed, as the urgent need for public spending on social services was recognised. Several measures to reform the financial system have been undertaken as well, most notable of which are the closure of insolvent finance companies and the establishment of capital support facilities (CSFs) for solvent finance institutions. Some state-owned enterprises were privatised, and the laws and procedures for foreclosure and bankruptcy were strengthened.

The overall impact of the crisis on Laos has perhaps not been as severe as that in Thailand, since output growth rates were still positive. However, accelerating inflation and the continued depreciation of the kip raise serious concerns. The Lao government recently made efforts to tighten fiscal and monetary policies to meet this challenge. For instance, the Bank of Laos limited issuance of the kip and sold central bank bonds to reduce the kip supply in the non-bank sector. The interest rates of kip savings accounts in commercial banks were also raised to encourage people to save their money in kip. The government curtailed public expenditure on overheads, and introduced some measures to enhance tax revenue, such as raising import tariffs on luxury goods. Despite these efforts, however, these measures did not appear to have borne fruit as of January 1999. This clearly indicates the urgent need for new measures to fight inflation and the slide of the kip.

The Cambodian government responded to the twin crises with both macro and structural policy measures. Dollar auctions were undertaken by the National Bank of Cambodia (NBC) to curb the fluctuation of foreign exchange rates following the crises. This turned out to be fairly successful compared to Laos, as the exchange rate of the riel became stable after a year of gradual depreciation. Foreseeing a shortage of national revenue due to the decline of trade tax revenue and foreign aid after July 1997, the government imposed fiscal discipline by reducing public expenditure. Simultaneously, it introduced fiscal reforms to enhance the capacity of revenue collection. Both measures contributed to reducing the use of monetary financing of the fiscal deficit. The Law on Investment was reviewed to improve the investment

Table A4. Policy Responses of Thailand and the SEATEs to Contain the Crisis

	Thailand	Laos	Vietnam	Cambodia
1. Macro-economic policies				
Foreign exchange policy	Shifted to managed float system	–	Dong devalued twice; foreign exchange controls tightened	Conducted dollar auctions
Monetary policy	Tightened; recently relaxed	Tightened; interest rates raised for kip savings accounts	–	Tightened
Fiscal policy	Tightened; recently relaxed; more spending on social services	Recently tightened	–	Fiscal reforms; broadened tax base; curtailed public spending
2. Structural policies				
Financial sector reform	Closure of insolvent finance companies; intervention in troubled companies; introduction of CSFs for solvent companies	Merger of commercial banks planned	–	Improved monitoring system for commercial banks
Enterprise reform	State enterprises privatised; corporate debt restructuring; reform of bankruptcy legislation	–	Reform of state-owned enterprises	–
Foreign trade policy	–	Raised import tariffs on luxury goods	Relaxed restrictions on exports; increased restrictions in imports	Raised import tariffs
Foreign investment policy	Liberalised foreign shareholding limit in financial institutions	–	Measures to promote FDI	Measures to promote FDI; introduced "open skies" policy
3. Social policies				–
Labour market policy	Several measures implemented (not reported in the Thai paper)	–	–	–
Health and education policies	–	–	–	–
Poverty alleviation	–	–	Measures to protect the poor proposed	Requested emergency food assistance
Social safety net	–	–	–	–

climate in Cambodia. Import tariffs on some products were raised to protect domestic enterprises, but questions have been raised about whether this would benefit Cambodia.

Vietnam's policy responses were centred around reviving high economic growth. Recognising that the high growth in the past was led by the expansion of exports and FDI, the government introduced several reform measures to improve the investment and business environment. The deteriorating performance of state-owned enterprises (SOEs) after the crisis prompted an urgent call to accelerate their "equitisation" (*i.e.* privatisation in Western terminology). The Vietnam paper also pointed to the growing risks of policy failure if the government continues to pour state funds into inefficient and unprofitable SOEs simply to rescue their workers.

5. Lessons from the Asian Crisis

Although further studies are no doubt necessary to draw concrete and detailed lessons for policy-making, some important points have already emerged from the experiences of the four countries studied.

The Thailand country paper pointed out that Thailand chose a wrong sequence in its financial liberalisation. It argued that some important policy measures should have been taken *before* the financial sector was opened up to foreign capital, such as the removal of inadequate state intervention in domestic financial markets, the establishment of strict bank regulation and supervision, the adoption of a floating foreign exchange system, and the disclosure of reliable information about bank performance to lenders. It stressed that financial liberalisation under the pegged foreign exchange system is dangerous because it tends to cause over-borrowing in foreign currencies when foreign interest rates are lower than domestic ones.

The Thai paper also pointed to the importance of establishing good governance in both the public and private sectors. Rampant corruption in the public sector not only increased the transaction costs of business, but also led to mismanagement of policy measures. Several irregularities in business practice and unreliable information disclosed by corporations contributed to the loss of investor confidence. Governance in the public and private sectors should therefore be improved to recover from the current crisis.

The Cambodia country paper also points to the importance of the development of a robust financial system and good corporate governance. It stresses that the early stage of development of the financial and private sectors in Cambodia should be advantageous, because both the successes and failures of the crisis countries provide useful lessons. For instance, several commercial laws which have yet to be passed in Cambodia could incorporate the experience of Thailand to prevent a similar crisis from occurring in Cambodia. The experience of Thailand also gives insights to the best sequence for financial liberalisation in Cambodia when such markets are established in the future.

It was also argued in the Cambodia paper that, while foreign capital can bring a wide range of benefits to Cambodia, some policy measures should be considered to mitigate the volatile and pro-cyclical characteristics of short-term foreign private capital. To do so, efforts to reduce heavy dependence on foreign capital may be considered, such as mobilising domestic savings is an option to finance domestic investment. It may also be worth considering the prioritisation of investment projects according to their duration. High priority should be given to long-term investment projects that are consistent with Cambodia's development strategies and objectives. Careful consideration of foreign borrowing is needed, not only in the private sector, but also in the public sector. The problems of sovereign debt and risk management will increase as the proportion of grants in total foreign aid declines in the future. Finally, establishing the rule of law and a democratic political regime not only nurtures the emergence of democracy in Cambodia, but is also a critical prerequisite for carrying out economic reforms to respond to external shocks.

The Vietnam and Laos papers also referred to the urgent need for reform in the banking sector. Reform measures may include improving the effectiveness of regulation and supervision, enhancing transparency and the disclosure of information, and upgrading accounting systems and risk management. In Vietnam, the reform of SOEs is deemed essential to revive economic growth. The Vietnam paper argued that the equitisation of unprofitable and inefficient SOEs should be accelerated and preferential treatment of SOEs should be reduced to create a level playing field for private enterprises, particularly small and medium-size enterprises. In Laos it was recognised that the impact of the crisis was partly attributable to the country's heavy dependence on Thailand in foreign trade and investment. Diversifying trade partners is thus seen as a way to minimise the adverse impact of the problems in Thailand. Good corporate governance was also mentioned as a matter of consideration for reforms to develop an efficient market economy in the Laos.

6. Conclusion

The Asian crisis has had an adverse impact on the SEATEs, but the overall extent of this was much less severe than that in Thailand. Cambodia and Vietnam appear to have been insulated to some extent from the so-called "contagion" phenomenon, whereas the Lao currency, the kip, was severely affected.

The adverse impact of the crisis on the SEATEs came to be felt more strongly in 1998. Export growth and foreign investment declined sharply in Vietnam and Laos. Increasing joblessness and falling incomes were found in all three SEATEs. High inflation in Laos put pressure on people's livelihoods, particularly the urban population. A large number of Cambodian migrant workers, particularly construction workers, lost their jobs in Thailand and returned home.

The adverse impact of the crisis was compounded by domestic problems in the SEATEs. In Cambodia, the political crisis following the fighting of 5–6 July 1997 had a major negative impact on the economy. Relaxed monetary and fiscal policies in Laos exacerbated inflation and the depreciation of the kip. Vietnam's transition to a market economy has run into trouble as inefficient SOEs and cumbersome domestic regulations impeded the development of the private sector.

The governments in all the SEATEs took measures to promote a recovery of exports and FDI. Monetary and fiscal policies were tightened in Cambodia, and more recently in Laos. Some foreign exchange controls and import protection measures were introduced in Vietnam and Cambodia. Few policy measures to mitigate the social impact have been addressed in the SEATEs, however.

All three SEATEs recognise the development of robust financial systems as a major lesson from the Asian financial crisis. Thailand's successes and failures in developing and reforming its financial sector give useful insights to the SEATEs, whose financial development is still at a comparatively early stage. Each SEATE has to face up to its own domestic issues as well. In Cambodia, establishing the rule of law and concept of democratic political transition are needed to restore confidence in the economy. Vietnam urgently needs to reform the state sector and provide a level playing field for the private sector. Laos needs to reduce its heavy dependence on Thailand in foreign trade and investment.

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Impact of the Asian Financial Crisis on the SEATEs: The Cambodian Perspective

Cambodia is surrounded by countries which have been ad-versely affected by the Asian financial crisis. Cambodia's neighbours, particularly Thailand, Ma-laysia and Singapore, have also been its largest trading and investment partners in the past five years. The crisis thus dramatically changed the external eco-nomic environment surrounding Cambodia, raising concerns about the extent to which its economy has been affected, and the extent to which the crisis has had an adverse impact on the livelihood of the Cambodian people.

This working paper comprises the Cambodia chapter plus the comparative introduction from a volume of conference papers published by the Development Analysis Network in August 1999 under the title the Impact of the Asian Financial Crisis on the Southeast Asian Transitional Economies.

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