CAMBODIA ECONOMIC UPDATE

RECENT ECONOMIC DEVELOPMENTS AND OUTLOOK

April 2018

SELECTED ISSUE:
SUMMARY FINDINGS OF FUTURE JOBS IN CAMBODIA

WORLD BANK GROUP

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CONTENTS

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To be included in the email distribution list of the CEU and related publications, please contact Linna Ky (lky@worldbank.org). For questions on the content of this publication, please contact Saroeun Bou (sbou@worldbank.org).

LIST OF ABBREVIATIONS

ASEAN	Association of Southeast Asian Nations
CPI	Consumer Price Index
CR	Cambodian riel
EU	European Union
FCD	Foreign Currency Deposit
FDI	Foreign direct investment
GDP	gross domestic product
GIR	gross international reserves
GNI	gross national income
IDP	Industrial Development Policy
IMF	International Monetary Fund
LPCO	Liquidity-Providing Collateralized Operation
MA	moving average
MoEYS	Ministry of Education, Youth and Sport
NCDs	negotiable certificate of deposits
NFHE	nonfarm household enterprises
NPL	non-performing loan
NSDP	National Strategic Development Plan
PDR	People's Democratic Republic
PFM	public financial management
RGC	Royal Government of Cambodia
RMS	Revenue Mobilization Strategy
SDR	Special Drawing Rights
SMEs	small- and medium-sized enterprises
SPPF	Social Protection Policy Framework
TVET	Technical and Vocational Education and Training
US$	United States dollar
VAT	Value-added tax
WBG	World Bank Group
YTD	Year-To-Date
y/y	year-over-year

EXECUTIVE SUMMARY

While the economy continues to expand rapidly in Cambodia, real GDP growth eased to 6.8 percent in 2017 from 7 percent in 2016. Cambodia therefore bucked the regional trend, as most developing countries in East Asia experienced a growth acceleration in 2017. Following some moderation during the first half of 2017, textile and apparel exports rebounded. The tourism and agriculture sectors experienced initial recovery in the last few years after facing gradual moderation. Growth is projected to remain robust, expanding at 6.9 percent in 2018. Downside risks to the outlook include erosion of export competitiveness due to rapidly rising real wages, a buildup of vulnerabilities from a prolonged real estate and construction boom, potential election-related uncertainty, and periodic jolts to the international trade order in the form of protectionism and escalating trade disputes.

Recent developments

Growth remains robust, underpinned by upbeat external demand. Growth is estimated to have eased to 6.8 percent in 2017, according to preliminary estimates by Cambodian authorities. Textile and apparel exports to the European Union (including the United Kingdom) accelerated at a healthy rate of 7.4 percent (year-over-year [y/y]) by December 2017, compared with -1.0 percent in May 2017. Similarly, textile and apparel exports to the United States quickly recovered, expanding at 3.7 percent, compared with -3.5 percent during the same period. Despite rapidly rising real wages, textile and apparel exports growth held up well, rising at 7.7 percent in 2017, a slight deceleration from 8.4 percent in 2016. Tourist arrivals accelerated to the 11.8 percent in 2017, compared with 5 percent in 2016, thanks to the authorities' efforts to establish more regional flights, including the introduction of "China-Ready" initiative.

The agriculture sector also recovered with expansion of rice and rubber plantation, owing to favorable weather conditions and the gradual recovery of agricultural commodity prices.

Cambodia, however, could not take as much advantage of the strengthened global economic recovery as some of its regional neighbors. The economies of China, Indonesia, Thailand, and Vietnam witnessed a growth acceleration in 2017. Similarly, the ASEAN countries as a group grew at 5.4 percent in 2017 relative to 4.9 percent in 2016. Much of their growth acceleration was due to improved export performance. In case of Cambodia, exports did perform well too, but not at the same level as its regional peers—suggesting deeper structural problems facing the Cambodian economy.

Private consumption eased, subduing inflation, as credit expansion decelerated. Inflation declined to 2.2 percent at the end of 2017, compared with 3.9 percent in 2016. While growth of overall bank credit remained subdued at 19.6 percent in 2017, well below 25.8 percent in 2016, domestic credit financing the construction and real estate sector accelerated again, growing at 37.1 percent in November 2017, up from 28.4 percent in May 2017, as an appetite for construction and real estate investment revived.

Cambodia's liberal trade and investment policy continues to attract large inflows of foreign direct investment (FDI). Owing to slower imports caused by easing domestic demand, the current account deficit narrowed to 9.8 percent of GDP, financed by strong FDI inflows. Bank deposits (largely in U.S. dollars due to high dollarization) rose, growing at 23.3 percent in December 2017. Gross foreign reserves further accumulated, reaching US$ 8.7 billion or 6.8 months of prospective imports coverage. The Cambodian riel (CR), which is pegged to the U.S. dollar, remained stable at CR 4,000 per U.S. dollar in March 2018.

Better-than-expected revenue collection helped contain the general government deficit which has been under pressure as the wage bill increases. The fiscal deficit (excluding grants) is estimated to have narrowed to 2.7 percent of GDP in 2017, compared to 3.6 percent in 2016. While the 2018 annual budget continues to reflect a rising wage bill, which now reaches 8.4 percent of GDP, it is the first time that budgeted public investment received a large boost, amounting to 7.8 percent of GDP. Cambodia's debt distress level remained low as per the 2017 World Bank/International Monetary Fund Debt Sustainability Analysis.

Outlook

Cambodia's high growth trajectory is expected to continue. Growth is projected to accelerate to 6.9 percent in 2018, underpinned by rising government spending and favorable global conditions, including robust demand in advanced economies. Cambodia's growth rate is, however, expected to gradually decelerate, if structural problems (for example, loss of competitiveness) are left unaddressed. It is expected that the announcement of the new Rectangular Strategy after the elections will revive the reform momentum.

Therefore, in the medium term, large FDI inflows and rising public investment in infrastructure are expected to help expand the productive capacity of the economy. This, together with several structural reforms designed primarily to boost Cambodia's external competitiveness, could help speed up growth momentum in the longer term.

Risks to the outlook remain tilted towards the downside. Domestically, risks are associated with a prolonged real estate and construction boom, potential uncertainty related to the July 2018 general elections, and declining external competitiveness. Externally, risks are associated with uncertain global trade as protectionism rises. In addition, employment growth prospects look less certain. As real wages rapidly increase, Cambodia's external competitiveness, which primarily relies on cheap labor, is being eroded. As a result, the pace of poverty reduction could slow in the future.

Key messages and policy options

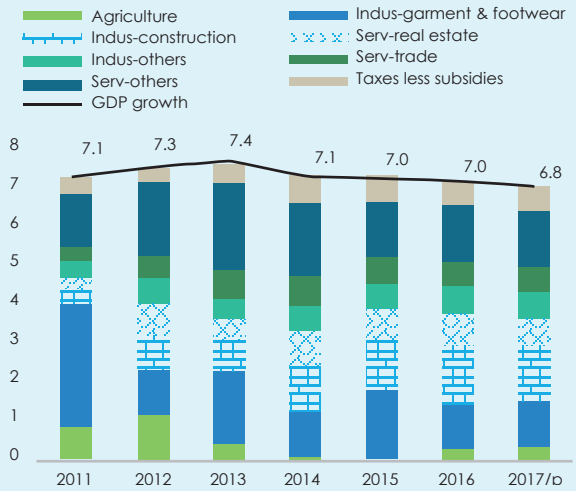
Invest to develop human capital. A skilled labor force helps boost productivity growth and compensate for rapidly rising real wages, while underpinning ongoing structural transformation. To this end, the success of any policy intervention will likely depend on the effectiveness of incentives and processes to facilitate the enterprise sector's role in providing, guiding, and advocating for a skills development system that responds to the demands of industry (see the selected issue section on future jobs in Cambodia). Addressing skills constraints, as envisioned in the 2017—25 National Technical and Vocational Education and Training Policy is, therefore, a priority. Greater coordination among public and private entities will be essential to the successful implementation of this framework.

Addressing the constraints facing small businesses and enterprises can support diversification, while promoting job growth. It is important to reduce the costs of firm formalization, operation, and financing, while providing incentives and access to support programs. The introduction of policy supports to promote small and medium-sized enterprises and nonfarm household enterprises will help boost job creation. Potential policy supports may then include skills development for firm owners, and development of and access to digital and internet technologies. Fostering domestic investment, including in agroprocessing, could also help strengthen links to foreign-owned businesses and exporters.

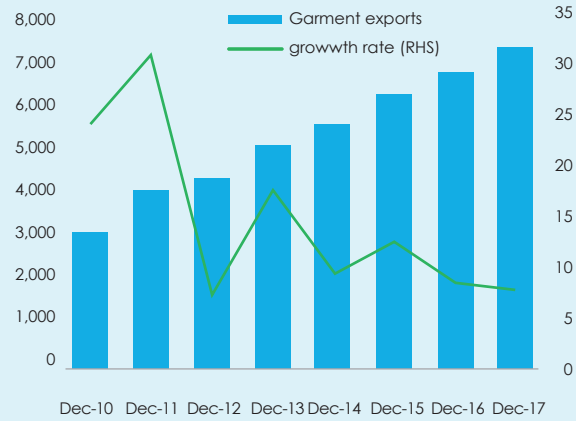
The ongoing construction and real estate boom needs close monitoring. Credit growth directed to the construction and real estate sector has been accelerating in recent years. It is therefore necessary to develop macro-prudential policies to reduce the scope for speculative activities. In the banking and microfinance sectors, it is crucial to adopt lending guidelines and ensure adequate monitoring, while revisiting the non-performing loan classifications.

FIGURE ES.1: THE CAMBODIAN ECONOMY AT A GLANCE

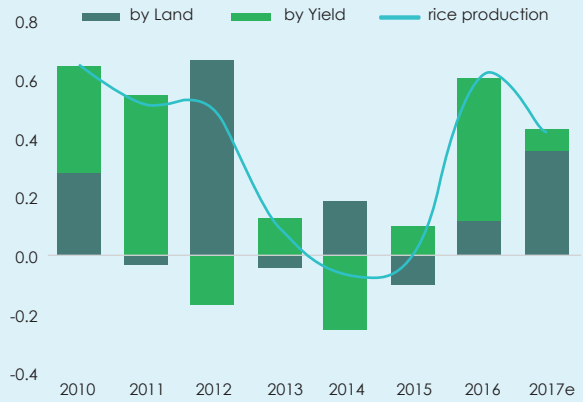
Growth eased slightly in 2017
Contribution to growth (percent)



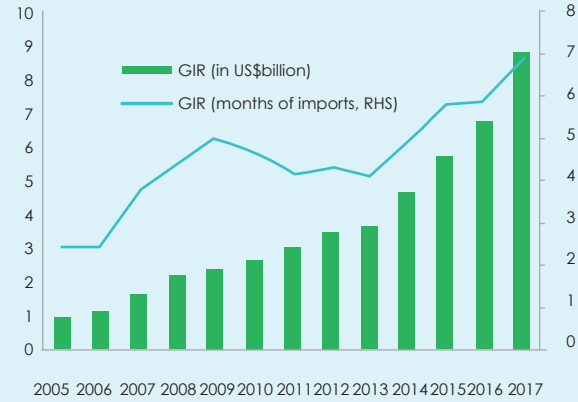
Garment exports continued to hold up despite real wage increases (US$ million)



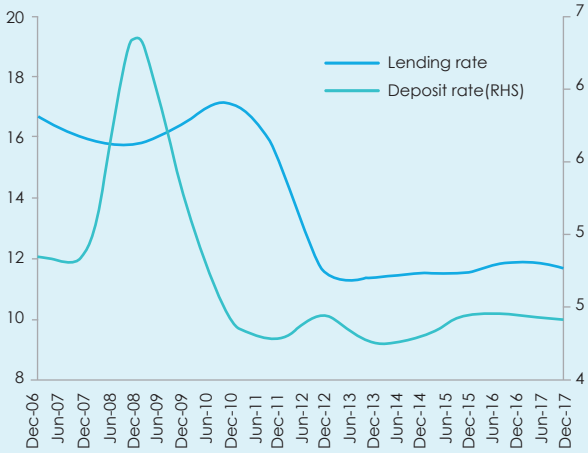
Agricultural production, especially rice expanded
Contribution to production increase (million metric tons)



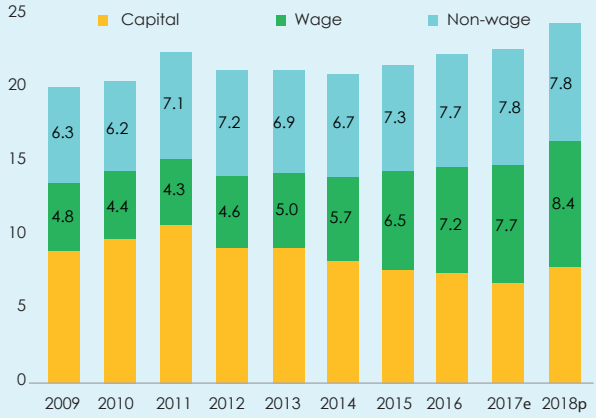
Rising FDI inflows strenthened the external sector, boosting foreign reserves



Short-term interest rates moderated, facilitating private investment



Public spending boosted, giving rise to public investment (percent of GDP)



Sources: Cambodian authorities and World Bank staff estimates and projections.
Note: e = estimates; GIR = Gross International Reserves; p =projections; RHS = right-hand side.

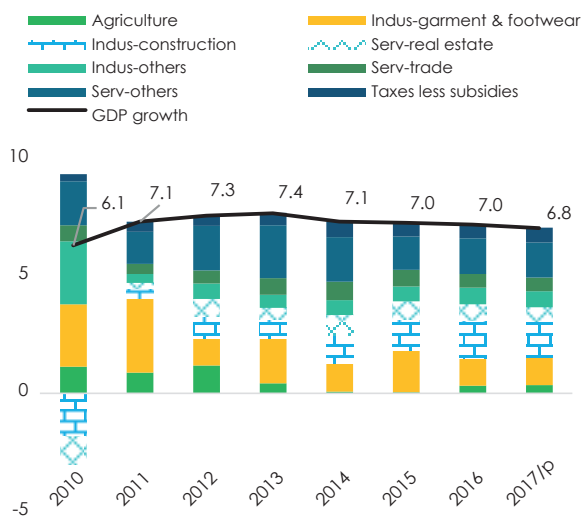
SECTION 1: RECENT ECONOMIC DEVELOPMENTS AND OUTLOOK

1. RECENT ECONOMIC DEVELOPMENTS

a) The real sector

Growth remains robust, underpinned by upbeat external demand. Growth is estimated to have slightly eased to 6.8 percent in 2017, according to preliminary estimates by the authorities, slightly below 7.0 percent in 2016 (figure 1). Following a gradual moderation in early 2017, textile and apparel exports rebounded in the second half of the year as a broad-based cyclical global recovery got underway (see box 1 on Global and Regional Outlook and Risks), aided by a rebound in foreign investment.[1] The tourism and agriculture sectors continued their recovery, while appetite for construction and real estate investment remained upbeat.

Figure 1: Contribution to real growth (percent)



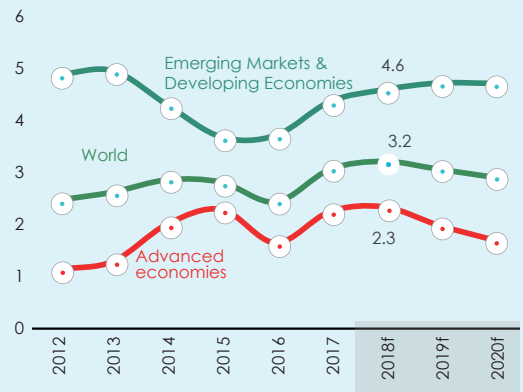
Source: National Institute of Statistics.
Note: P = preliminary.

1 2018 January Global Economic Prospects, the World Bank.

Box 1: Global and Regional Outlook and Risks[1]

Global growth is projected to reach a peak of 3.2 percent in 2018, as the cyclical momentum continues. It will then slightly moderate to an average of 3 percent in 2019–20, reflecting a gradual slowdown in advanced economies (figure B1.1). Following a broad-based recovery in 2017, growth in advanced economies is projected to firm slightly to 2.4 percent in 2018, and moderate thereafter toward an average of 1.8 percent in 2019–20, as labor market slack diminishes and monetary policy accommodation is gradually unwound.

Figure B1.1. Real GDP growth (percent)

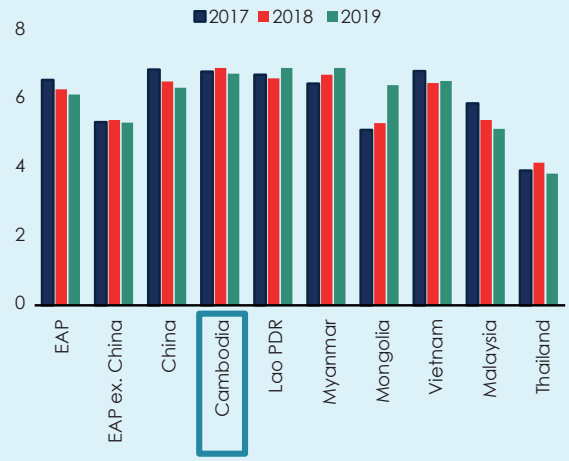


Source: Global Development Finance, June 2018 (Forthcoming).
Note: f = forecast.

Growth in emerging market and developing economies (EMDEs) is expected to reach a five-year high 4.5 percent in 2018, and stabilize at an average of 4.7 percent in 2019–20. This mainly reflects a further cyclical pickup of growth in commodity exporters as the effects of the earlier commodity price collapse dissipate. A gradual slowdown in China is expected to be offset by a modest pickup in the rest of the group reflecting the diminishing role of idiosyncratic factors weighing on activity in some large economies in 2017.

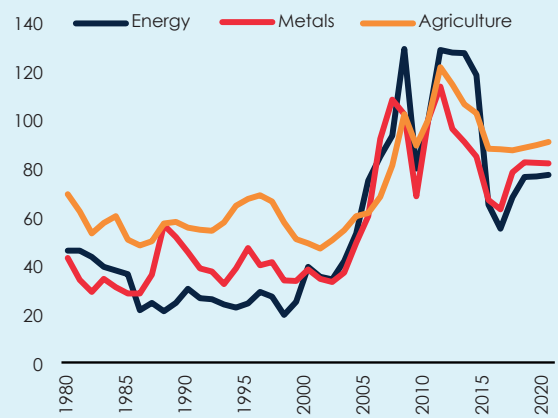
Growth in the East Asia and Pacific region is expected to gradually moderate from 6.3 percent in 2018 to 6.1 percent on average in 2019-2020 (figure B1.2). The modest slowdown in regional growth is largely due to the gradual and planned structural slowdown in China. Activity in the rest of the region is expected to peak at 5.4 percent in 2018 and remain steady, around its potential rate in 2019. The outlook is predicated on broadly stable commodity prices, strong but gradually moderating global demand, and a gradual tightening of global financing conditions. Despite the projected robust activity in the region in the near term, underlying potential growth—which has fallen considerably over the past decade—appears to have declined over the long term, reflecting increasingly adverse demographic patterns and projected slowing pace of capital accumulation, which is needed to rein in credit growth.

Figure B1.2. Real GDP growth (percent)



Source: Global Development Finance, June 2018 (Forthcoming).

Figure B1.3. World commodity prices forecast (nominal U.S. dollars, 2010 = 100)



Source: Global Development Finance, June 2018 (Forthcoming).

Global trends are expected to become less supportive over the forecast period. Global trade, which accelerated sharply in 2017, benefiting from a cyclical upturn in global manufacturing,

Box 1: Global and Regional Outlook and Risks (continued)

is expected to remain strong in 2018, but to moderate thereafter, as global investment growth eases. Overall, growth in global trade of goods and services is expected to moderate from 4.8 percent in 2017 to 4.3 percent in 2018.

Global financing conditions, which remained benign throughout 2017, are likely to tighten in 2018, as monetary policy gradually normalizes in major advanced economies. Inflation expectations and prospects of a faster normalization of U.S. monetary policy have increased. Global interest rates are expected to continue rising, as inflation gradually picks up and monetary policy normalizes across advanced economies. A continued drawdown of net asset purchases by major central banks will contribute to upward pressure on long-term yields. Capital inflows are still expected to be sustained in 2018, assuming continued recovery in EMDE growth. As global interest rates continue to increase, EMDE external financing conditions could become increasingly challenging in 2018 and 2019.

Energy prices, and to some extent agricultural prices, are expected to moderately firm during the forecast period (figure B1.3). Oil prices are expected to average US$60 per barrel in 2018, and US$60.8 per barrel in 2019. Metals prices have been stable in the first quarter of 2018 and are expected to change little over the forecast horizon, as Chinese demand gradually slows. Agricultural prices have increased slightly in the first quarter of 2018, following three years of stability. Stocks-to-use ratios for grains—a measure of global supply availability relative to demand—remain high for most grains, which will continue to put downward pressure on prices.

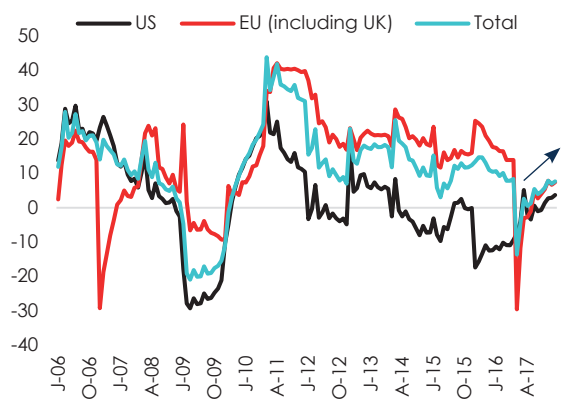
Although risks to the global outlook is more balanced than before, important downside risks remain. Disorderly financial market movements, such as an abrupt tightening of global financing conditions or a sudden rise in financial market volatility, could trigger financial turbulence and potentially derail the expansion. The adverse effects of rising borrowing costs could be particularly acute for those EMDEs with large external financing needs, fragile corporate balance sheets, and significant fiscal sustainability gaps. In addition, escalating trade protectionism or rising geopolitical risk could also negatively affect confidence, trade, and overall economic activity. While the aggregate impact of tariff increase announced by the United States and China so far appears limited, the risk of further escalation exists. Over the longer term, a more pronounced slowdown in potential output growth in both advanced economies and EMDEs would make the global economy more vulnerable to shocks and worsen prospects for continued improvements in living standards.

1. Prepared by Ekaterine T. Vashakmadze, Senior Country Economist, World Bank Group.

Main drivers of growth

The textile sector. **Following a gradual deceleration, textile and apparel exports rebounded during the second half of 2017, supported by recovering global demand.** In 2017, the exports to the European Union (EU) market surged, rising from -1.0 percent (y/y) in May, to 7.4 percent in December (figure 2). During the same period, exports to the United States bounced back, moving up from -3.5 percent to 3.7 percent. The share of exports destined to these two major markets remained at 70 percent in 2017.

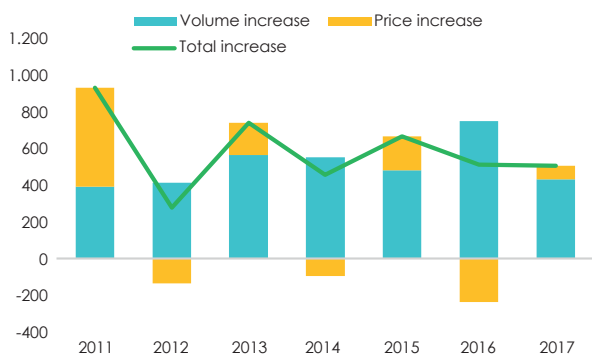
Figure 2: Clothing and other textile products export growth (YTD, y/y percent change)



Source: Cambodian authorities.

In 2017, exports of clothing and other textile products reached US$7.2 billion, registering 7.7 percent growth, slightly below 8.4 percent in 2016.[2] The textile and apparel sector has adjusted to cope with rising competition by adding value to its products by incorporating printing, embroidery, and washing and vertically integrating to the extent possible. While the effort to climb to higher product prices continued in 2017, the growth in the exports of clothing and other textile products is reliant largely on volume increase, reflecting intense competition (figure 3). In volume terms, exports of textile and apparel articles grew by 6.6 percent, compared with 12.3 percent in 2016.

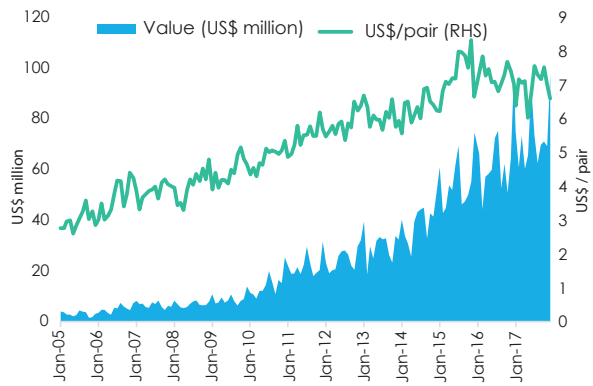
Figure 3: Contribution to the gains in clothing and other textile exports (in US$ million)



Source: Cambodian authorities.

The footwear sector. **Footwear exports continued to expand, but average prices eased.** Attracted by "Everything but Arms" preferential treatment provided by the EU, footwear products have expanded and become the second-largest manufacturing export after clothing and other textile articles. Total footwear export value reached almost US$0.9 billion in 2017 or 14.4 percent, slightly higher than 13.9 percent in 2016. Unlike the case of textile and apparel articles, average footwear export prices have been steadily declining during the last few years due to rising competition, dropping to US$6.6 a pair in 2017, down from US$7.0 a pair in 2016 (figure 4).

Figure 4: Footwear exports continued to expand, but average prices are easing



Source: Cambodian authorities.
Note: RHS = Right-hand side.

Other non-textile and apparel manufacturing sectors. **Exports of bicycles are third largest after textile articles and footwear exports.** Bicycle exports reached US$355 million in 2017. In addition, there have been newly emerging high value-added (mostly FDI) manufacturers, especially for electrical appliances and components, and auto parts. Electrical and vehicle parts exports combined accounted for US$430 million in 2017. Reinforced by growing interconnectedness between the Cambodian economy and regional value chains, electrical and vehicle parts and components produced in Cambodia as intermediate goods are being exported

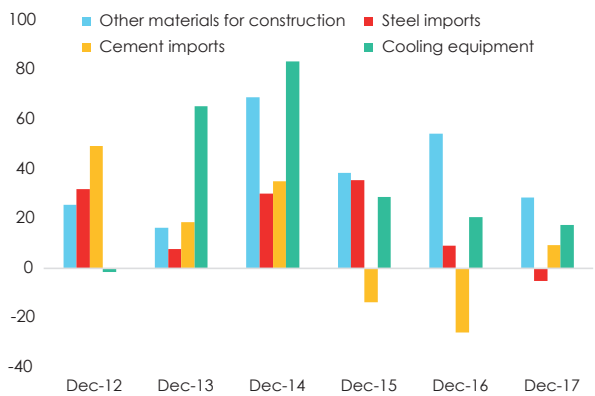
2 Articles of apparel and clothing accessories, knitted or crocheted (Harmonized System, HS code 61), and Articles of apparel and clothing accessories, not knitted or crocheted (HS code 62).

to be further processed and/or assembled elsewhere. As integration deepens, Cambodia could be able to move up the value chain. Factories are being set-up to take advantage of the newly introduced tariff-free market access to the United States for travel goods.[3]

Growth in the construction sector **— an important driver of growth and a contributor of job creation — moderated.** As depicted in figure 1, the preliminary estimates by Cambodian authorities indicated that in 2017, the contribution of the construction and real estate sector to GDP growth shrank. Reflecting a disconnect between an upbeat investment appetite and the easing of construction activity, the value (and number) of approved construction projects rose further, expanding at 22 percent in 2017. Many indicators, however, point to moderation in the construction and real estate sector. Notably, the growth of imports of steel and other basic construction materials, have either decelerated or turned negative in 2017 (figure 5).

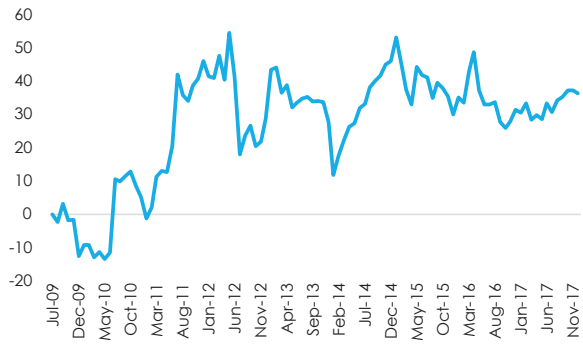
Growth of domestic credit going to the construction and real estate sector, which decelerated since late 2016 until mid-2017, has picked up again (figure 6). The stock of domestic credits provided by the banking sector to the construction and real estate sector rose to 36.3 percent at the end of 2017, up from 28.4 percent in May 2017. The growth rate at the end of 2017 is now back to the average of 36 percent growth during the previous four years. This may partly reflect rising demand fueled by a new but relatively small segment of development projects — low-price housing projects.[4] This follows the boom in landed housing projects and high-rise residential and commercial construction projects located in prime locations within urban centers. In addition, there has been a new wave of land buying fueled by rising FDI in infrastructure sectors.

Figure 5: Construction materials and steel imports (y/y, percent change)



Source: Cambodian authorities.

Figure 6: Stock of domestic credit going to construction, real estate & mortgage sector (y/y, percent change)



Source: Cambodian authorities.

3 On June 30, 2017, the Office of the U.S. Trade Representative announced a major expansion of trade preferences that stands to bring significant benefits to Cambodia. Under the new changes to the U.S. Generalized System of Preferences, Cambodia and other Least Developed Beneficiary Developing Countries as well as African Growth and Opportunity Act countries producing travel goods such as luggage, backpacks, handbags, and wallets will be able to export those products to the United States duty free. Source: https://kh.usembassy.gov/duty-free-access-travel-goods-made-cambodia/.

4 See https://www.realestate.com.kh/news/Demand-for-Affordable-Residential-Housing-Expected-to-Continue-Throughout-2-0-1-8/.

The disconnect between the easing of construction activity and the upbeat investment appetite with rising domestic credit going to the construction, real estate and mortgage sectors is a cause for concern. A buildup of vulnerabilities from speculative activity may accur. In addition, FDI inflows into the sector eased in 2017.[5]

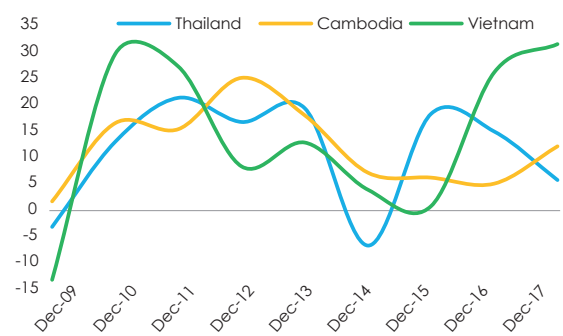
Domestic construction activities are spreading beyond the traditional major urban centers such as the capital city of Phnom Penh, Kandal and Siem Reap provinces. Construction activities are occurring in key coastal provinces such as Sihanoukville and Koh Kong, as well as in the provinces bordering Thailand and Vietnam such as Bantey Meanchey and Svay Rieng.

The share of construction and real estate in total domestic credit increased to 26 percent in 2017, up from 22 percent in 2016 (see the monetary section below for more details). The current share is well above the peak of 23 percent in 2009, when the global financial crisis caused the construction bubble to burst.

Purchases of low-price houses and small land plots have been made affordable by real estate developers for low-income families. The shift toward investing more in affordable homes and small land plots is to serve the low-end market segment on the outskirts of Phnom Penh and newly developed areas. This segment of the market until recently was not the focus of many developers. But as large scale, high-end projects have gradually saturated the market, competition has intensified at the low-price end, with larger discounts and lower down payments being offered for new purchases to shore up demand.

The tourism sector — **The recovery of the tourism sector, which started early last year continued unabated.** Underpinned largely by arrivals from China, growth in total tourist arrivals for 2017 reached 5.6 million or 11.8 percent, up from 5.0 percent in 2016 (figure 7). Importantly, tourist arrivals by air have increased significantly, rising by 22.5 percent, the highest in a decade, thanks to the efforts by the authorities to expand and deepen regional connection flights, especially between Cambodia and China. In-land connectivity together with clean and green campaigns to further attract and diversify tourist destinations beyond the Angkor temple complex is underway.

Figure 7: Tourist arrivals to Cambodia improved, but lagged behind its neighbor, Vietnam (y/y, percent change)



Source: Cambodian, Thai and Vietnamese authorities.

Accommodated in part by the introduction of the "China Ready" initiative, tourist arrivals from China now outpace those from Vietnam, making them the number one

5 Approved FDI projects (in fixed asset) investing the construction and real estate sector declined to US$150 million in 2017, down from US$700 million in 2016.

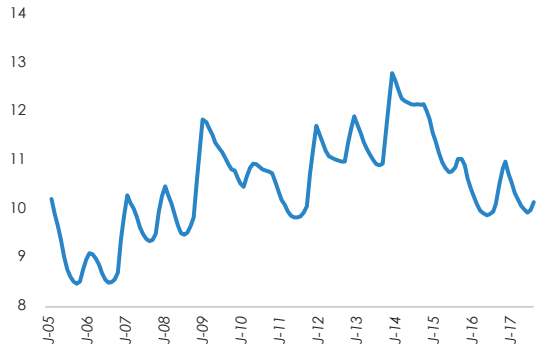
group to visit Cambodia.[6] Chinese tourists accounted for over 1.2 million visitors or 21.6 percent of total international arrivals in 2017 or a whopping 46 percent increase. If the rapid growth in Chinese tourist arrivals continues for the next few years, the authorities' target of reaching 2 million Chinese tourists by 2020 is feasible. Vietnam, Lao PDR, Thailand and the Republic of Korea continued to be the main countries of origin for international tourists after China, accounting for 14.9 percent, 9.0 percent, 7.0 percent and 6.2 percent of total arrivals, respectively. Three-quarters of foreign tourists visiting Cambodia are from the Asia and Pacific region, while only 15 percent are from Europe.

Arrivals to Siem Reap province, where the Angkor temple complex is located, account for almost 60 percent of total international arrivals by air. Together with entrance fee increases, the recent jump in tourist arrivals has significantly boosted revenue collected from foreign tourists visiting the temple complex. The revenue from Angkor temple complex entrance fees reached over US$ 100 million in 2017, an increase of about 70 percent over 2016. However, tourism potential remains untapped. Diversifying tourist destinations, focusing on ecotourism mostly in the north and northeastern parts of the country, with an introduction of wildlife adventure parks and trekking activities, remains to be realized (see October 2017 Cambodia Economic Update for a detailed analysis of Cambodia's tourism sector).

Cambodia's share of the combined tourist arrivals to three countries (Cambodia, Thailand and Vietnam) **has declined, and potential is untapped.** Cambodia's neighbors, Thailand and Vietnam combined attracted almost 50 million tourists in 2017 or an 11.3 percent increase from 2016, while Cambodia's total international arrivals were only 5.6 million visitors. Compared to the combined market of 54 million tourists visiting the three countries (Cambodia, Thailand and Vietnam), international arrivals to Cambodia accounted for a mere 10 percent, and Cambodia's share is trending downward (figure 8). In 2017, Cambodia's neighbor, Vietnam, experienced a record-breaking year for tourism as foreign visitors to the country surged 29 percent over the previous year, reaching an all-time high of 12.9 million (see box 2 on Vietnam Tourism – Untapped Potential). One of the policies to make inroads into this growing market may involve looking at the demand segments beyond what are being offered in Thailand and Vietnam. Cambodia could then develop a strategy to meet those segments. Potential market segments may include eco-tourism, in particular, wildlife adventure parks and trekking, given Cambodia's relatively large share of the land area which is covered by national parks and reserves with high biodiversity.

6 White Paper on China Ready for Cambodia Tourism (2015), Ministry of Tourism. The China Ready initiative represents Cambodia's effort to capitalize on the rapid growth in Chinese inbound tourism. The initiative provides Chinese signage, facilitates documents for visa processing, encourages local use of the Chinese yuan, promotes use of the Chinese language, and ensures that food and accommodation facilities are suited to Chinese tastes. The five-year initiative targets 2 million Chinese tourists per year by 2020.

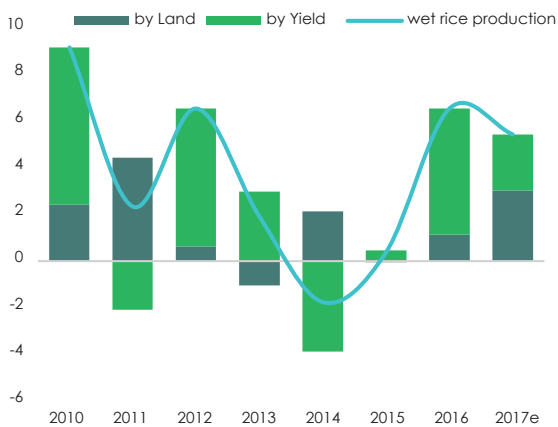
Figure 8: Cambodia's share in combined tourist arrivals to Cambodia, Thailand and Vietnam (percent, 3mma)



Source: Cambodian, Thai and Vietnamese authorities.
Note: 3mma = 3 month moving average.

The agriculture sector — **The agriculture sector continues to remain an important source of growth and jobs for the economy.** Its contribution to GDP growth has partly recovered, thanks to improved weather conditions during the last two years. The agriculture sector experienced continued expansion, especially in rice production. Wet season rice production grew by 5.4 percent in 2017 (figure 9), slightly below 6.5 percent in 2016, reaching 8.05 million metric tons.[7] Total rice production is estimated to have reached 10.4 million metric tons or a 4.4 percent increase in 2017.

Figure 9: Contribution to annual wet season rice production increase (percentage points)



Source: Cambodian authorities.

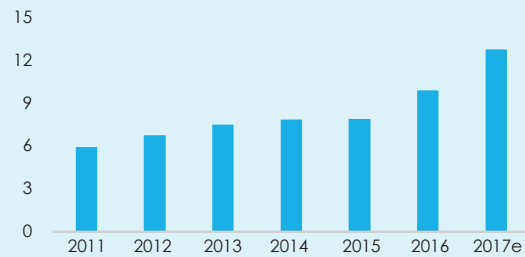
7 January 2018 monthly report on agriculture, forestry and fisheries, Ministry of Agriculture, Forestry and Fisheries, dated February 16, 2018.

Box 2: Vietnam Tourism – Untapped Potential[1]

Vietnam has recently made a significant effort to upgrade tourist infrastructure, improve the quality of tourism services, bolster the sector's human resources and simplify visa procedures for foreign visitors. The country has set a target of receiving 19 million foreign tourists in 2020.

During 2006-16, foreign arrivals to Vietnam increased at an average of 11 percent annually. 2017 was another record-breaking year for tourism as foreign visitors to Vietnam surged 29 percent over the previous year, reaching an all-time high of 12.9 million (figure B2.1). The country consistently makes it into the "world's top tourism destination" according to reputable travel sites and newspapers.

Figure B2.1: Foreign arrivals (million of people)



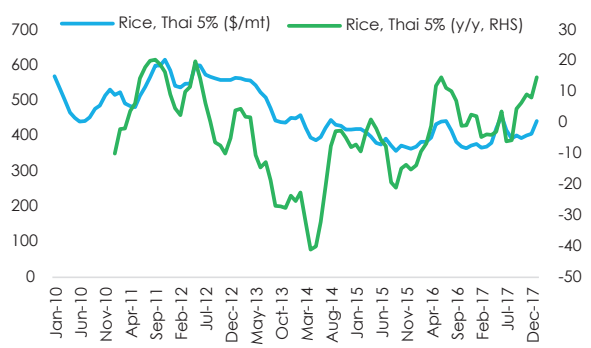
Source: Vietnam's General Statistics Office.

The success has been achieved after the Government of Vietnam issued an Action Program on developing tourism into forefront economic sector. The Action Program is a far reaching reform. It looks toward developing and finalizing documents guiding the implementation of the 2017 Tourism Law; issuing preferential policies encouraging investment in tourism; prioritizing capital for developing tourism human resources and enhancing tourism promotion work; and reviewing, amending, and supplementing the law on entry, exit, transit, and residence of foreigners in Vietnam, as well as the Investment Law 2014 and other relevant legal regulations.

The Action Program has set specific goals of renovating the methods and content and ensuring the consistent, professional, and effective implementation of tourism promotion activities, both at home and abroad; applying technological advances in the tourism promotion work; and developing

Rice prices have recovered gradually (figure 10). The authorities recently introduced several initiatives to help improve competitiveness of the rice sector and reduce the large differences between low farm gate prices and high retail prices of agricultural products. To benefit local farmers more, there are plans to improve farmers' access to markets, while cutting transportation and storage (and export) costs. The rice sector's access to relatively low-interest loans including investments in building rice storage and drying facilities are being improved and expanded.[8]

Figure 10: Rice prices have gradually recovered



Source: World Bank.
Note: RHS = Right-hand side.

Rubber production also expanded as prices slightly recovered in 2017 (figure 11). While cultivated areas of rubber expanded by a mere 1.2 percent, rubber production reached 193,000 metric tons or a 33 percent increase in 2017. Reflecting its resilience, rubber production has rapidly expanded during the last several years, although rubber prices significantly declined from their peak in 2011.

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

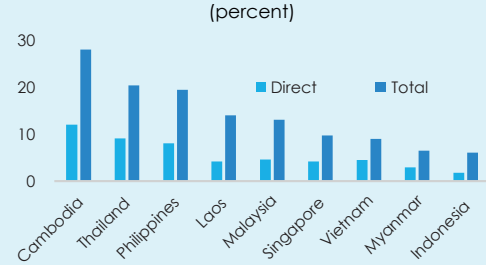
Box 2: Vietnam Tourism – Untapped Potential (continued)

and positioning the national tourism brand attached with the unique images, which are imbued with national cultural identities.

The Action Program also aims to providing a favorable environment for businesses and the community to develop tourism, via creating a healthy, transparent, and favorable business climate for enterprises, in addition to ensuring security and safety for tourism activities. The Action Program moves toward supporting tourism startups; encouraging travel agencies to diversify the tourism types, products, and services; associating tourism with cultural and arts products and handicraft villages; enabling the people to directly participate in tourism development and benefit from tourism; building a civilized and friendly tourism community in interacting with tourists; and promoting the role of social and occupational organizations in developing tourism.

The direct contribution of travel and tourism to GDP was an estimated US$10.2 billion (4.6 percent of GDP) in 2017, according to World Travel and Tourism Council. By the same estimate, the total contribution (direct + indirect) was about US$20 billion – equivalent to roughly 9 percent of GDP. The travel and tourism sector has also generated about 3.5 million direct and indirect jobs.

Figure B2.2 Contribution of travel and tourism to GDP
(percent)

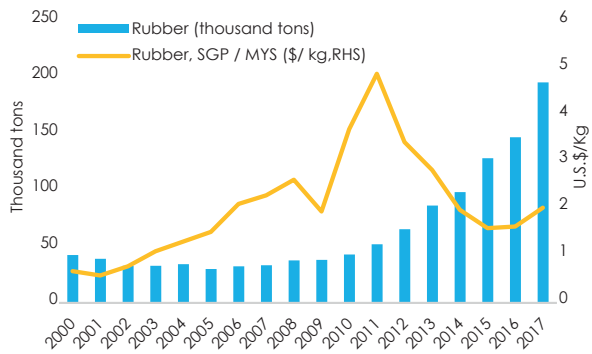


Source: World Travel & Tourism Council.

However, the performance of the Vietnam's travel and tourism sector is still far below its potential. Vietnam was ranked quite low in term of the contribution (direct and total) of travel and tourism to the economic growth among neighboring countries in the region (figure B2.2).

1. Prepared by Viet Tuan Dinh, Senior Economist, Vietnam Country Office, World Bank Group

Figure 11: Rubber production and price improved

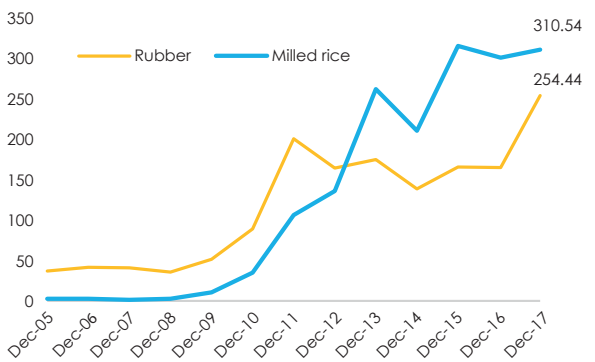


Source: Cambodian authorities and World Bank.
Note: RHS = Righ hand side; SGP = Singapore; MYS = Malaysia.

b) The external sector

Solid merchandise exports persisted, expanding at 9.7 percent in 2017, slightly eased from 11 percent in 2016. Boosted by better-than-expected export performance of clothing and other textile products during the second half, total exports held up well in 2017, thanks to an uptick in growth in advanced economies. The exports of main agricultural commodities such as rice, rubber, and sugar also rose (figure 12).

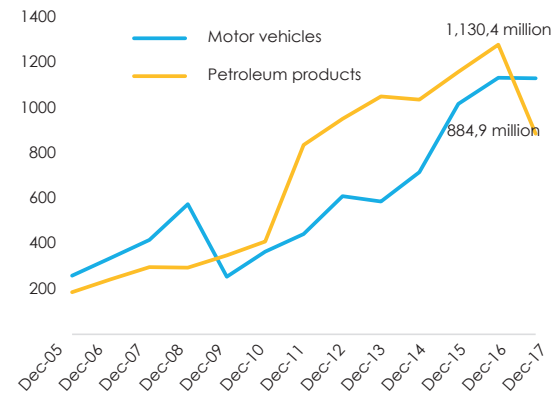
Figure 12: Agricultural commodity exports - milled rice and rubber are increasing (YTD, in US$ million)



Source: Cambodian authorities.
Note: YTD = Year-to-date.

Domestic demand weakened as domestic credit growth slowed, containing imports. As in the case of the easing of construction material imports, imports of key durable consumer goods such as motor vehicles and nondurable goods such as petroleum products decelerated in 2017 (figure 13). To promote domestic production and jobs, while reducing consumption goods imports, the expansion of food and beverage industries serving Cambodia's growing tourism sector continued.

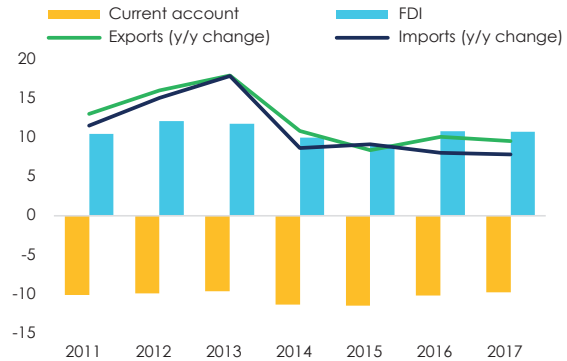
Figure 13: Durable and consumption goods imports such as motor vehicles and petroluem eased (YTD, in US$ million)



Source: Cambodian authorities.

Thanks to solid merchandise exports and subdued imports, the trade deficit narrowed. The trade deficit is estimated to have declined to 10.4 percent of GDP in 2017, down from 11.4 percent in 2016. Similarly, the current account deficit is estimated to have shrunk to 9.8 percent of GDP, down from 10.2 percent in 2016 (figure 14). The deficit was financed by rising FDI inflows, which are estimated to have remained at 10.8 percent of GDP in 2017, the same as the level registered in 2016.

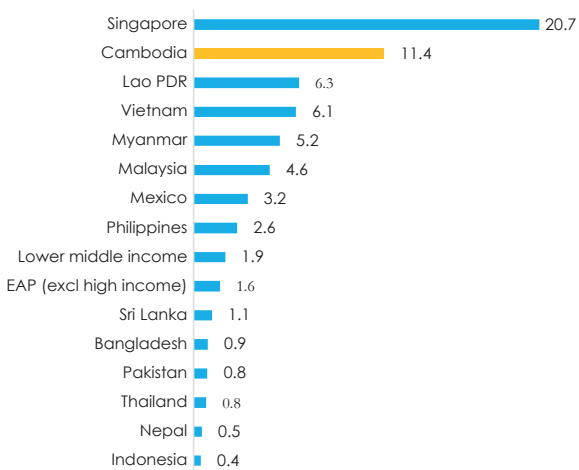
Figure 14: Declining current account deficit financed by adequate FDI inflows (percent of GDP)



Source: Cambodian authorities and World Bank staff estimates.

FDI inflows have targeted a broad range of key economic sectors, but the real estate, construction, and accommodation sectors combined received almost a third of total inflows. In 2016, FDI invested in real estate, construction and accommodation activities combined accounted for 30 percent of the total FDI inflows. The financial (banking) sector was next, receiving 28 percent of total inflows, followed by manufacturing (16.6 percent) and agriculture (10.3 percent). Cambodia's liberal trade and investment policy continues to attract large inflows of FDI which has been a key factor behind the country's strong export sector and more recently the real estate and construction boom. Net inflows of FDI remain substantially larger than those of regional countries (figure 15).

Figure 15: Foreign direct investment, net inflows (percent of GDP, 2016)

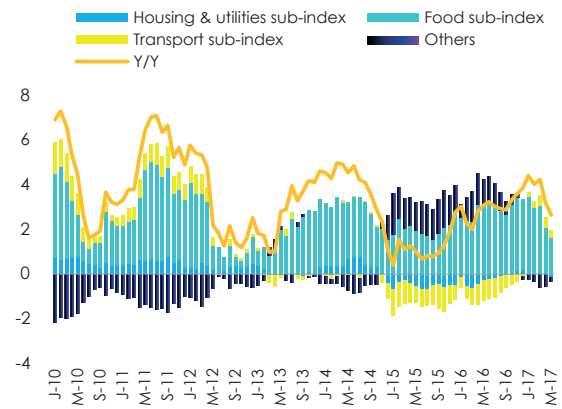


Source: World Develoment Indicators.

Inflation

Private consumption has eased, subduing inflation. Moderation of domestic credit growth, which started last year, following the introduction of an 18 percent interest rate cap, continues to contain private consumption. As a result, inflation declined to 2.2 percent at the end of 2017, compared to 3.9 percent in 2016 (figure 16).

Figure 16: Inflation subdued further as food prices eased. Contribution to 12-month inflation (percent)



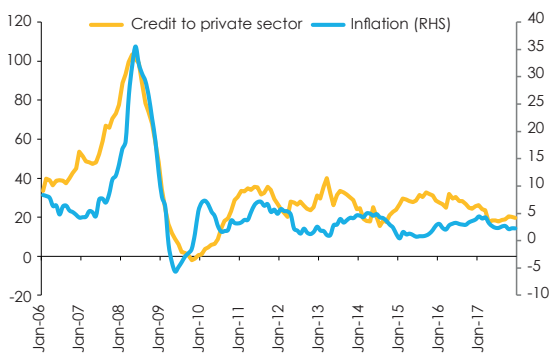
Source: Cambodian authorities.

The easing of food prices further contributed to lower inflation. This is because the weight of food items accounts for almost half of the total weight of Cambodia's Consumer Price Index (CPI) basket. Declining pressure on the prices of rice, fish, pork, and vegetables was primarily responsible for the moderation of the food sub-index (43 percent of the total

inflation basket weight), which plunged to 1.8 percent at the end of 2017 from 6.1 percent in 2016. The transportation component, however, edged up, with a slow recovery in international oil prices, which effectively is passed through to domestic retail gas prices. Other sub-indexes representing restaurant, health care, furnishings, and clothing components, which are combined and classified under "others", remained subdued.

While inflation moderation in 2017 is partly explained by supply-side improvements, given better agricultural production, it remained largely a demand-driven phenomenon. The construction boom has shown signs of slowing and overall domestic credit growth has eased; both subdued inflation (figure 17). However, rising inflationary pressures are likely to come from the recovery in oil prices. Imported inflation—with the "pass-through" from imported international oil prices to domestic inflation occurs, given Cambodia is an oil importer.

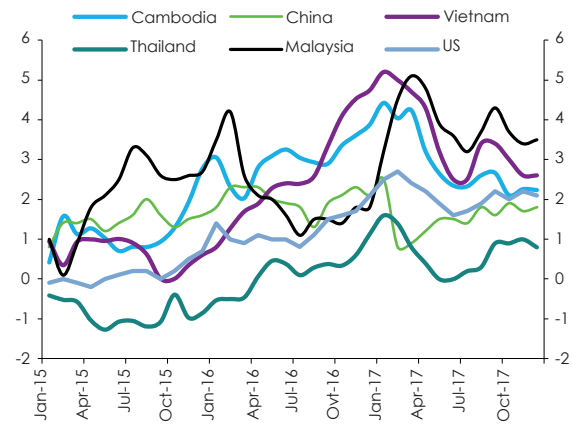
Figure 17: Inflation moderated, caused by weaker consumption as credit growth eased. (Y/Y, percent change)



Source: Cambodian authorities.
Note: RHS = Right-hand side.

Headline inflation in developing East Asia and the Pacific remains subdued in most countries, although it is getting closer to targets (figure 18). Overall, inflation has increased slowly since mid-2017, despite rising oil prices, strengthening growth, and fast credit growth in some countries. Stable international food prices and appreciating regional currencies have helped. Among major regional economies, inflation has picked up in the Philippines, China, and Vietnam, while remaining stable at low levels in Thailand. Despite the recovery in commodity prices, consumer price inflation is expected to remain low, given generally well-anchored inflation expectations.

Figure 18: Inflation remained benign in the region and declining in most countries toward end-2017 (y/y, percent change)



Source: Cambodian authorities and the economist.

c) Poverty

Structural transformation has been driving poverty reduction in Cambodia. In the rural areas, diversification of income sources underpinned by economic and structural transformation has contributed to rising wage and salary income at the expense of self-employed income (see box 3 on Structural transformation — policies, strategies and reforms). In 2015, as much as half of rural household income was from salary and wage, compared to only 30 percent a decade ago (figure 19).

Box 3: Structural transformation — policies, strategies, and reforms

To facilitate economic structural transformation, several policies, strategies, and reforms have been initiated. However, links among and coherence of those policies, strategies, and reforms are to be further strengthened for successful implementation.

The 2015-25 Industrial Development Policy (IDP). The most important policy underpinning economic structural transformation is the 2015-25 Industrial Development Policy introduced in March 2015. The Policy serves as a "new growth strategy" that responds to the ongoing structural transformation, taking advantage of Cambodia's strategic location by linking the economy and its industry to the region. The aim of the IDP is to pursue economic (and export) diversification by leveraging the industrial sector, in particular non-garment (and footwear) manufacturing industries (table B3.1). Performance against the targets envisioned by the IDP, however, is mixed. In 2017, the share of garment and footwear product exports in total merchandise exports stood at 72 percent, compared with the target of below 60 percent, making achievements toward diversification beyond the garment and footwear sector less certain.

Table B3.1: Main targets under the 2015-25 Industrial Development Policy

Distribution of GDP by sector (at current prices)			
Sector[1]/	2015	2020	2025
Industry	26.2%	28%	30%
-o/w Manufacturing	16%	18%	20%
Services	39.4%	40%	40%
Share of export products in total exports			
Sector[2]/	2015	2020	2025
Processed agriculture products	8%	10%	12%
Manufacturing Of which			
- Garment & footwear	60%	55%	50%
-Non-garment & foot-wear	5%	10%	15%

Source: Cambodian authorities
1/ The agriculture sector captures the remaining share
2/ Covers only targeted export products

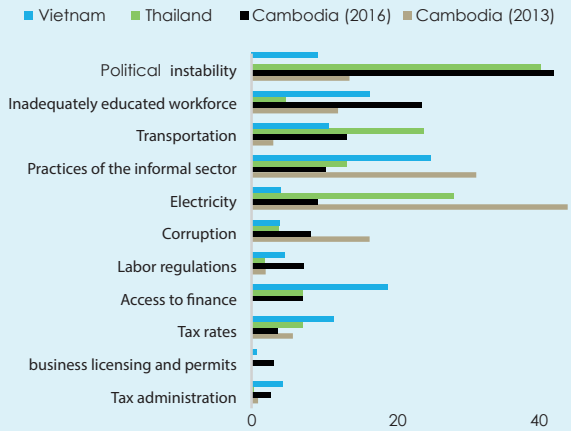
Looking forward, for the IDP to be successful, the industrial sector must not only help maintain high growth trajectory but also absorb excess of labor force shed by the agriculture sector. This will require more efforts to promote newly emerging manufacturing industries (with higher value added) to compensate for rapidly rising wages. At the same time, it is also necessary to spur job creation elsewhere, given the manufacturing industries are less labor intensive, compared with the garment sector.

2017--25 National Policy for TVET. It aims at supporting the implementation of 2015-25 IDP. The TVET policy is envisaged to mainly address skills gaps, one of the prerequisites discussed above for moving up the value chains, underpinning economic and export diversification as envisaged by the IDP.

Due largely to an inadequately skilled workforce, high-value-added and sophisticated manufacturers must invest considerable time and resources to train their prospective workers (before they can be readily employed) to be successful in Cambodia. It is because of market failures (i.e., private cost exceeds private benefit) that firms don't invest enough in training their workers when turnover is high (see the selected issue on future jobs in Cambodia for a more detailed discussion). The constraints caused by Cambodia's inadequately educated workforce have been found to be the second-most-severe obstacle for the operation of manufacturing enterprises, according to the 2016 World Bank Group Enterprise Survey (figure B3.1). Political instability (top constraint), transportation (third constraint) and electricity (fifth constraint) are also listed among the main concerns.

Box 3: Structural transformation — policies, strategies and reforms (continued)

Figure B3.1: Manufacturing sector's top 10 constraints



Source: World Bank Group Enterprise Surveys.

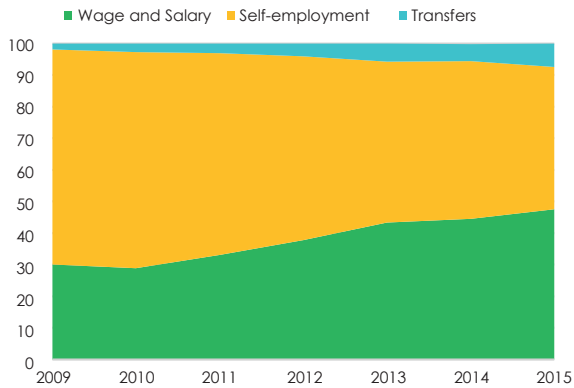
High transportation and logistics costs need to be addressed, given the fact that Cambodian firms are projected to move 4.1 times more goods by 2030. If current trends continue, exports, measured in 2016 prices, will grow from US$ 10.1 billion in 2016 to US$ 41.5 billion in 2030. To facilitate trade expansion, connectivity such as transportation and logistics upgrade is being identified with the preparation of the National Logistics Masterplan and the introduction of the National Logistics Council. In terms of logistics capabilities, Cambodia is ranked 73rd in a group of 159 countries, according to the 2016 Logistic Performance Index (LPI). On average, successful exporters of electronics, such as Thailand and Malaysia are positioned between 21 to 26 ranks ahead.

On the monetary policy, high dollarization constrains the central bank's ability to conduct routine monetary policy. Access to finance is also found to be the fourth- most-severe obstacle for firm operation in Cambodia, according to the World Bank Group 2016 Enterprise Survey. Cambodia recently experienced rapid financial deepening, facilitating improved access to finance. However, though declining, interest rates remain relatively high, resulting in the high cost of financing (see the monetary sector section for more details) which led to the introduction of an 18 percent interest rate cap in April 2017 by the central bank. This, together with other constraints challenges expansion of small businesses, especially small- and medium-sized enterprises (SMEs). SMEs in Cambodia remain under performed. The vital role of the SME sector is not unique to Cambodia. SMEs have been found to represent more than 95 percent of registered firms worldwide, account for more than 50 percent of jobs, and contribute more than 35 percent of GDP in many emerging markets. Small businesses generate most of the new jobs, and help diversify a country's economic base. This high financing cost also makes productive investments less viable, while partly fueling speculative activities including those in the real estate market.

The 2016-25 SPPF. To support the increasingly large labor force working in the industrial sector, the National Social Protection Policy Framework (SPPF) was adopted in March 2017. Ongoing assistance programs, especially the health equity fund, scholarships and vocational training programs, are being expanded to support structural transformation. There have been several initiatives to support welfare and reduce cost of living, offered mainly to factory workers. These include access to free healthcare, increased pay during maternity leave, financial support for deliveries, reduction in utilities tariffs, and free public transportation. In the longer term, implementing social assistance programs (emergency, human capital development, vocational training, and welfare) will boost mobility and upgrade the skills set of the industrial workforce. Implementing social security programs (pension, health insurance, and workers' accidental and disability insurance) helps ensure welfare, especially once workers are out of the labor force. A pension system for the private sector is slated to be established in 2019.

Effective monitoring and evaluation is key to ensure the success of these policies. In this regard, close interagency collaboration will ensure sequencing, links, and coherence of those policies, strategies, and reforms.

Figure 19: Rising salary and wage income of rural households (percent)



Source: Socio-Economic Survey.

In line with the positive macroeconomic developments in the second half of 2017, poverty is expected to have declined. Continued expansion of textile and apparel exports, and the recovery of the tourism and agricultural sectors, especially with a gradual uptick in agricultural commodity prices, have had the positive effect on income of poor households. In addition, the minimum wage of the garment and footwear sector was officially raised to US$170 per month in 2018 – an increase of 11 percent from 2017. Wages in the public sector are also increasing. This together with several initiatives recently introduced by the authorities to reduce the cost of living of factory workers, will continue to contribute to poverty reduction in the coming years. As income rises, purchasing power increases, leading to more consumption and spending in the rural areas. Successfully implementing social assistance and social security programs, envisaged by the 2016—25 Social Protection Policy Framework, can help prevent rural households from falling back into poverty. The rural nonfarm (textiles, services, and remittances) economic activities have now become a significant contributor to poverty reduction.

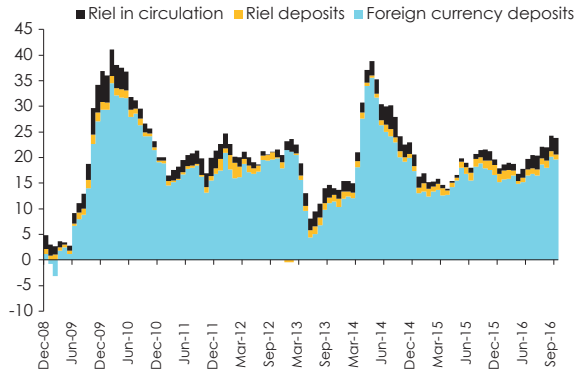
d) The monetary sector

Accommodating economic growth, money supply expanded further, but inflation remained low. Expansion of broad money is expected to have underpinned economic activity in the real sector. In the context of Cambodia's highly dollarized economy, the expansion continued to be driven primarily by rising foreign currency deposits, boosted by improved confidence. In addition, local currency in circulation has also increased, reflecting the central bank's initial success promoting the use of local currency. Domestic credit growth has eased but remained elevated, growing faster than nominal growth in 2017 (see also banking sector section below). As a result, the (net) loan-to-deposit ratio declined to 98 percent in 2017, down from 100 percent in 2016.

a. Monetary aggregates, interest rates and exchange rates

Broad money growth has quickly accelerated, hitting a two-and-a-half year high, owing to rising foreign currency deposits. Broad money grew rapidly, accelerating at 23.8 percent (y/y) in December 2017; it was the fastest rate of growth since May 2015. This was boosted by fast-growing foreign currency deposits (FCDs) (19.6 percentage points) and an accelerated expansion of local currency in circulation (3.2 percentage points) and riels deposits (1.0 percentage point) (figure 20). In 2016, broad money growth was only 17.9 percent, contributed by FCDs (15.2 percentage points), riels in circulation (1.1 percentage points), and riels deposits (1.6 percentage points).

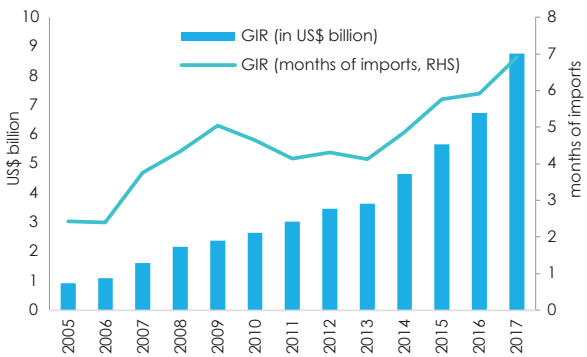
Figure 20: Foreign currency deposits continued to drive broad money growth Contribution to M2 growth (pecentage points)



Source: Cambodian authorities.

Acceleration of FCD growth indicates improved confidence in the banking system and healthy capital inflows. This has allowed the National Bank of Cambodia to further accumulate gross foreign reserves, which reached US$8.7 billion or 6.8 months of prospective imports coverage in 2017 (figure 21). The initial success in promoting the local currency has allowed for the expansion of riels in circulation without depreciation pressures. As a result, dollar purchases by the central bank increased further in 2017. Total purchases reached US$914.6 million in 2017, or 11.4 percent growth.[9] The demand for local currency by commercial banks has increased substantially, absorbing over half of the total local currency amount injected by the central bank in 2017.

Figure 21: Gross international reserves (GIRs) accumulated further (in US$ billion and months of imports)



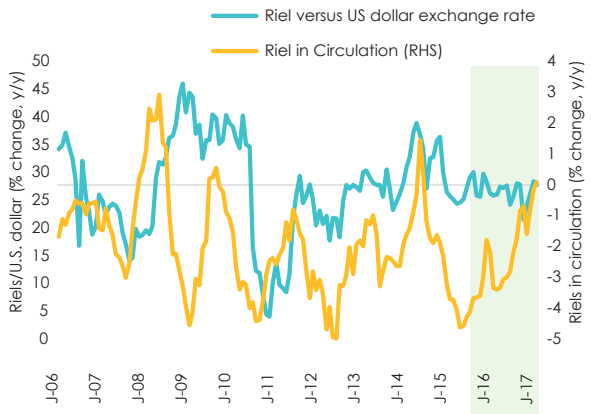
Source: Cambodian authorities.
Note: RHS = Right-hand side.

The Liquidity-Providing Collateralized Operation (LPCO) introduced last year to establish a benchmark rate of local currency borrowing for the market, is currently promoting the use of local currency.[10] This follows the introduction of Negotiable Certificates of Deposit (NCDs), a short-term interest-bearing debt issued by the central bank to promote interbank lending. The LPCO "sterilizes" excess liquidity when additional volumes of riels demanded by the market are injected by the central bank. The LPCO allowed the central bank to increase the contribution of riels in circulation in broad money growth to 3.2 percentage points in 2017, up from 1.1 percentage points in 2016, while maintaining a relatively stable riel/U.S. dollar exchange rate (figure 22). These measures therefore may help Cambodia regain some monetary policy independence, including short-term interest targeting and expansion of the use of local currency, currently curtailed by the high degree of dollarization.

9 2017 Annual Report, National Bank of Cambodia.

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

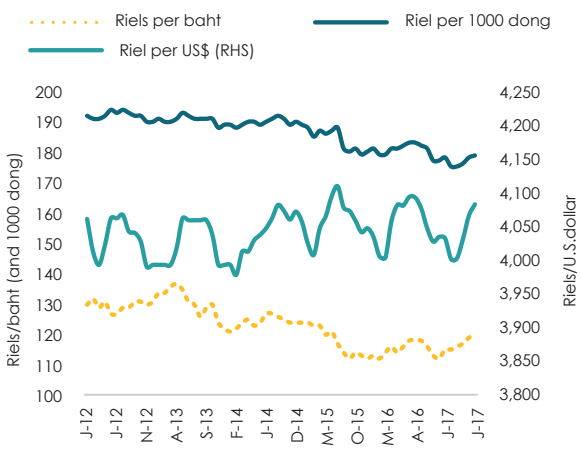
Figure 22: Riels in circulation recently expanded without pressuring riel/U.S. dollar exchange rate to depreciate (percent change, y/y)



Source: Cambodian authorities.
Note: RHS = Right-hand side.

The riel/U.S. dollar exchange rate has slightly appreciated, reaching CR 4,000 at the end of March 2018, compared with CR 4,037 in December 2016 (figure 23). The riel also appreciated against the Vietnamese dong, but depreciated against the Thai baht. Against the currencies of its main export markets (besides the United States), the riel recently depreciated against the euro, the Canadian dollar, and the British Pound.

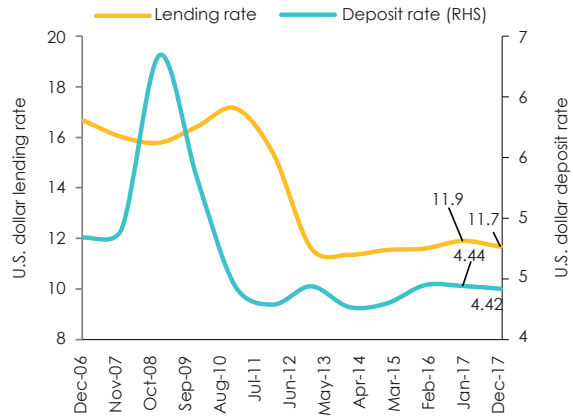
Figure 23: Riel has depreciated slightly against Thai baht



Source: The authorites, Bank of Thailand, and Vietnam statistics office.

Both short-term (12-month) US dollar lending and deposit interest rates have slightly eased (figure 24), declining to 11.7 percent and 4.42 percent in 2017, down from 11.9 percent and 4.44 percent in 2016, respectively. This may have resulted from the recently introduced macro-prudential measures, including the interest rate cap regulation.

Figure 24: Weighted average short-term (12-month) U.S. dollar interest rates (percent per year)

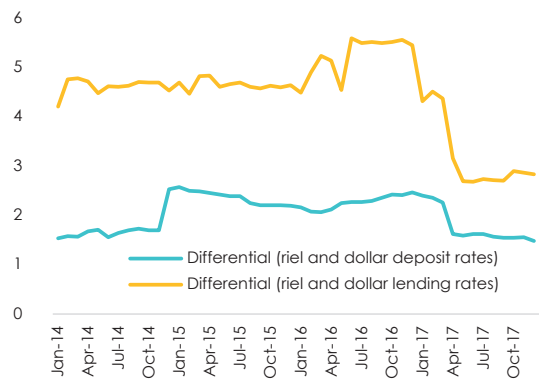


Source: Cambodian authorities.
Note: RHS = Right-hand side.

The decline of short-term (12-month) riel deposit and lending rates that the financial sector experienced after the introduction of an interest rate cap in April 2017 have ceased. As a result, the convergence between riel and U.S. dollar deposit (and lending) rates has diminished (figure 25). The differential between riel and U.S. dollar lending (deposit) rates may now reflect the higher cost of borrowing in local currency vis-à-vis the U.S. dollar under the LPCO facility, which requires collateral (NCDs) to obtain the local currency demanded. The requirement that banks and financial institutions increase their riel-denominated

loans, reaching at least 10 percent of their total loan portfolio by the end of 2019, has recently boosted the demand for riels. This helps stabilize riel/U.S. dollar exchange rate when riels in circulation rose.[11]

Figure 25: Convergence of riel and US dollar deposit (and lending) rates have now ceased. (percent per year)



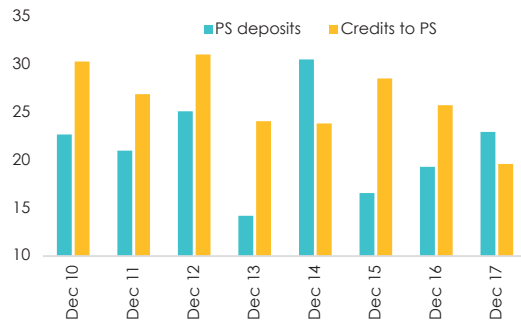
Source: Cambodian authorities.

Lowering lending rates of loans denominated in riels, while maintaining a broadly stable riel/U.S. dollar exchange rate may help the central bank to partly regain its monetary policy independence. Cambodia's monetary policy has traditionally been curtailed by high dollarization. Recently, NCDs have increasingly become an important instrument for liquidity management as they promote interbank markets. In 2017, as demand for NCDs (by commercial banks) rose, the (outstanding) amount of U.S. dollar- denominated NCDs issued surged, reaching US$20.8 billion or 93 percent increase.[12] Similarly, the amount of riel-denominated NCDs also climbed, reaching CR 15.5 trillion (equivalent to US$3.87 billion) or 29 percent increase.

b. The banking sector

Recent developments in the banking sector are characterized by rising deposits and moderate credit expansion (figure 26). Overall, the banking sector's credit has substantially moderated, albeit still at elevated levels, thanks to the introduction of an interest rate cap in April 2017. The banking sector's credit growth decelerated to 19.6 percent (y/y) in December 2017, down from 25.8 percent in 2016.

Figue 26: Credit growth has eased, while deposit growth remained strong. (YTD, y/y percent change)



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

Improved confidence in the banking system expanded private sector deposits further. Private sector deposits grew at 23.0 percent in 2017, up from 19.3 percent in 2016 (and 16.6 percent in 2015), suggesting increased attractiveness, thanks to Cambodia's liberal economic policy. The loan-to-deposit ratio, however, remained high at 95 percent in 2017.

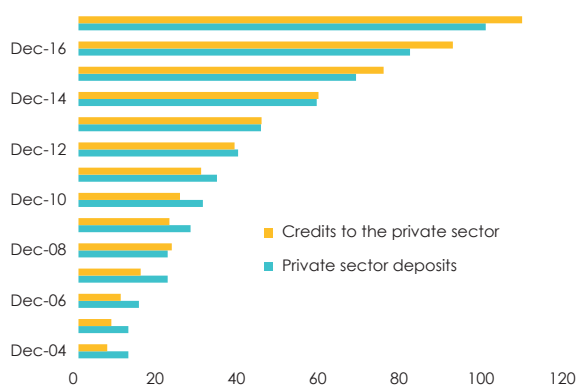
Rapid credit expansion during the last few years has propelled outstanding credit provided by the banking sector to

11 Prakas, B7-016-334-P-K dated December 1, 2016, National Bank of Cambodia. It took effect December 1, 2016, and will be fully implemented by December 31, 2019.

12 2017 Annual Report, the National Bank of Cambodia.

reach over 100 percent of GDP (figure 27). Similarly, private sector deposits reached 100 percent of GDP in 2017. This means the financial sector has played an increasingly larger role in supporting growth. In other words, financial and banking sector policies have now become an important tool for macroeconomic management. Despite rapid financial deepening, the reported non-performing loan (NPL) ratio for the banking sector remained at 2.4 percent in 2017, compared with 2.5 percent in 2016. However, the reported NPL ratios may need to be interpreted carefully. There are inconsistencies in loan classifications and the continuous rolling over and refinancing of loans that may disguise deeper problems.

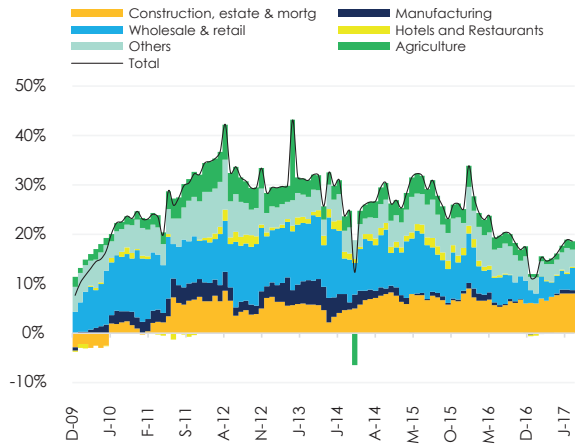
Figure 27: Rapid expansion of the banking sector's credit and deposit (percent of GDP)



Source: Cambodian authorities.

In contrast to the recent moderation in financial sector expansion, credit to the construction and real estate sector accelerated further during the second half of 2017 (figure 28). Domestic credit directed to the sector grew at 36.1 percent y/y in December 2017, up from 28.4 percent in May 2017, as the appetite for construction and real estate investment revived. The contribution of the sector to total credit growth surged, accounting for 8.1 percentage points (of total 18.6 percent) in 2017, up from 6.4 percentage points (of a total 20.1 percent) in 2016. As a share of total credit, it accounted for 26 percent in 2017, up from 22 percent in 2016. In absolute terms, total outstanding credit to construction and real estate and mortgage reached US$4.1 billion in 2017, up from US$3.0 billion in 2016.

Figure 28: Contribution to domestic credit growth (percentage point)

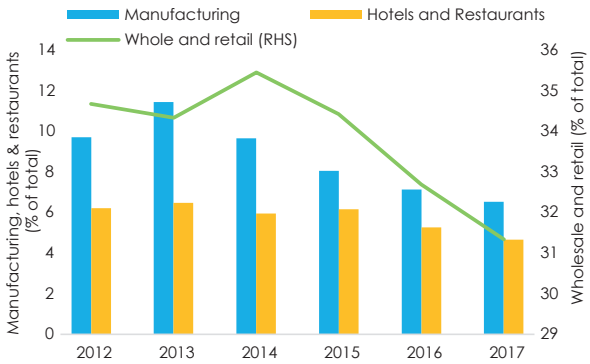


Source: Cambodian authorities.

Indicating the continued erosion of competitiveness of the manufacturing and tradeable sectors, the share of domestic credit going to trade (wholesale and retail), manufacturing, and hotels (and restaurants) has shrunk. Erosion of competitiveness may have made manufacturing and trade activities less attractive for investors and producers. FDI inflows into the manufacturing sector have slowed during the last few years (figure 29). This may be the result of quickly rising wages and Cambodia's relatively low rankings in doing business.[13] This does not bode well for sustaining high levels of economic growth.

13 Cambodia's Doing Business ranking remains low. The country was ranked 131th out of 190 in 2017, compared with 82nd for Vietnam and 46th for Thailand. Starting a business ranked among the lowest (180th) with the time spent to register a business is four times longer than East Asia and Pacific region average.

Figure 29: Domestic credits financing trade, manufacturing, and hotels (percent of total)



Source: Cambodian authorities. *Note:* RHS = Right-hand side.

e) The fiscal sector

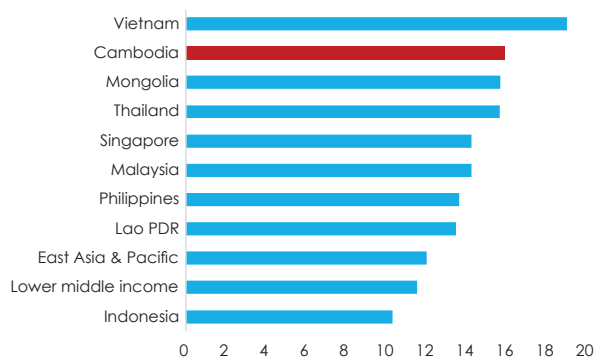
Recent fiscal performance reflects the authorities' expansionary fiscal policy. The authorities' decision to boost civil servant wages increased spending, but its effect on the fiscal deficit was neutralized by strong revenue collection. Exceptionally strong revenue collection in 2017, stemming largely from increased tax compliance, helped narrow the deficit.

a. Revenue mobilization

Continued strong revenue performance was above expectations. General government domestic revenue estimated to have grown faster than expected, given its prolonged robust performance. In 2017, domestic revenue growth accelerated to 18 percent, up from 16 percent in 2016. Domestic revenue is estimated to have increased to CR 17.6 trillion (US$4.4 billion) or 19.7 percent of GDP. This amounted to CR 17.5 trillion or US$662 million higher than 2016 collection. Domestic revenue grew rapidly, averaging at 15 percent a year during the period 2013-17, resulting in a spectacular gain of 5 percentage points of GDP when the revenue-to-GDP ratio reached 19.7 percent in 2017, up from 14.6 percent of GDP in 2013.

Of this, tax revenue experienced a remarkable increase, propelling Cambodia to be among the best performers in the region in terms of tax revenue collection as a percent of GDP (figure 30). During 2013-17, tax revenue rose by more than 4 percentage points of GDP, reaching 16 percent of GDP in 2017. Regional comparison shows that Cambodia's tax revenue as a percent of GDP in 2017 stood among the best performers.

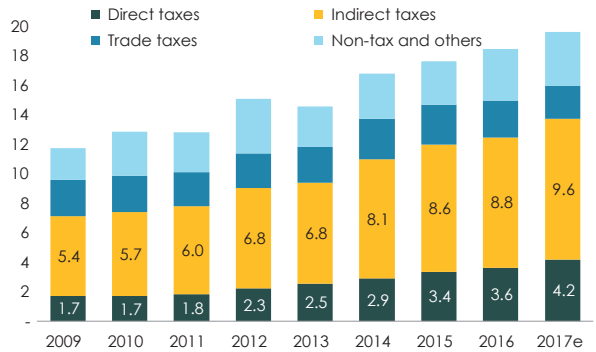
Figure 30: Tax revenue regional comparison (percent of GDP)



Source: World Development Indicators and Cambodian authorities. Latest available years.

The largest component of tax revenue remains indirect taxes, which account for 60 percent of the total. Led by the value-added tax (VAT) with a rising share of domestic VAT as consumption expenditure grows, indirect taxes have expanded significantly, reaching 9.6 percent of GDP in 2017, up from 8.8 percent in 2016 (figure 31). Indirect tax collection is estimated to have grown rapidly, rising to 19 percent in 2017, up from 14 percent in 2016.

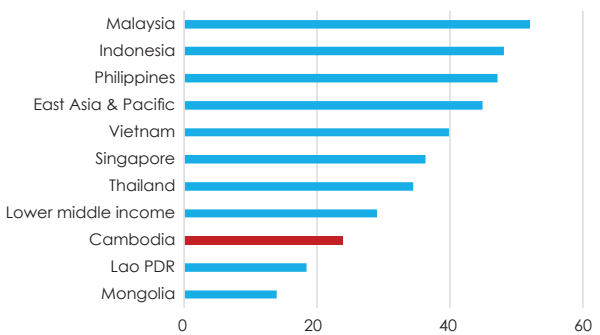
Figure 31: General government revenue — main components (percent of GDP)



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

Direct taxes also improved, rising to 4.2 percent of GDP in 2017, compared with only 3.6 percent of GDP in 2016.[14] During 2013-17, direct taxes grew fastest at 65 percent, though from a low base effect. Indirect taxes were next, rising by 40 percent. However, as a share of tax revenue, direct tax increased slowly, accounting for 26 percent in 2017, compared with 22 percent in 2013. Due to Cambodia's commitments under ASEAN free trade agreement, trade taxes declined to 14 percent, down from 21 percent. Therefore, Cambodia's tax system remains reliant on indirect taxes, and regional comparisons show that Cambodia's direct tax revenue collection in total domestic revenue remains relatively small (figure 32).

Figure 32: Direct tax collection — regional comparison (percent of revenue)

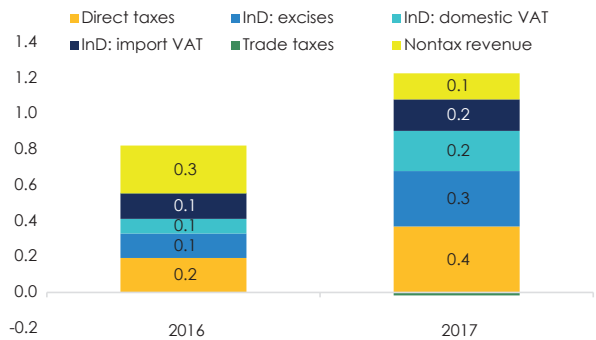


Source: World Development Indicators and Cambodian authorities. Latest available years.

14 Direct taxes include taxes on income, profits and capital gains.

Main revenue components (except non-taxes) showed an across-the-board increase, which led to an exceptional improvement in domestic revenue performance in 2017 (figure 33). This demonstrates to the important role of revenue administration—a core pillar of the 2014-18 Revenue Mobilization Strategy—which has been behind the success of Cambodia's revenue performance in recent years. Although there may still be room for further strengthening of revenue administration, it is likely that the next revenue mobilization strategy, if introduced, will also have to target improvements in direct taxes, which are currently being constrained by tax incentives including relatively long tax holidays.

Figure 33: Contribution to the gain in domestic revenue collection (percent of GDP)



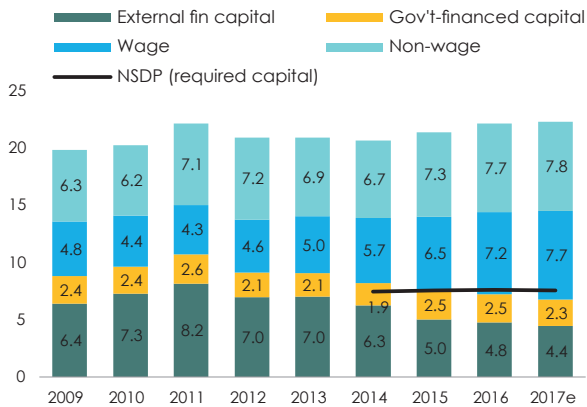
Source: Cambodian authorities and World Bank staff estimates.
Note: InD = Indirect taxes.

b. Public expenditures

The authorities' decision to boost civil servant wages increased spending. The public sector wage bill has rapidly expanded since 2013. It is estimated to have risen to 7.7 percent of GDP in 2017. This is to meet the minimum civil servants' wage target of at least 1 million riels (equivalent to about US$250) a month by

2018. The minimum wages of civil servants in 2018 were almost triple the wages in 2013.[15] Consequently, public outlay has been rising, reaching 22.3 percent of GDP in 2017, up from 21.1 percent in 2015 (figure 34).

Figure 34: Boosted by rising public wages, outlays have been rising since 2015
(percent of GDP)



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

Total capital investment expenditure as a percent of GDP is on a downward trend, caused primarily by the gradual decline in the external-financed component. Capital spending in 2017 is estimated to have remained below the required level, recommended by the 2014-18 National Strategic Development Plan. While the current level of public capital investment may have been relatively comparable to that of regional peers, Cambodia's quality of infrastructure remains behind, highlighting relatively low public investment efficiency (table 1). Scaling up government-financed capital spending to boost productive investments, while gradually improving value for money is therefore needed.

15 Press release by the Ministry of Economy and Finance on the adoption of the draft of 2018 budget by the Council of Ministers, October 27, 2017.

Table 1: Infrastructure quality (2014)

	Access to electricity	Cost to export	Port infrastructure quality
Malaysia	100.0	525.0	5.6
Singapore	100.0	460.0	6.7
Thailand	100.0	595.0	4.5
Vietnam	99.2	610.0	3.7
Indonesia	97.0	571.8	4.0
EAP	96.2	923.5	3.5
Philippines	89.1	755.0	3.5
Mongolia	85.6	2745.0	1.7
LMIC	79.5	1712.2	3.3
Lao PDR	78.1	1950.0	2.6
Cambodia	56.1	795.0	3.6
Myanmar	52.0	620.0	2.6

Source: World Development Indicators. Latest available years.
Note: EAP = East Asia & Pacific (excluding high income); LMIC = lower middle-income country.

Access to electricity (% of population)

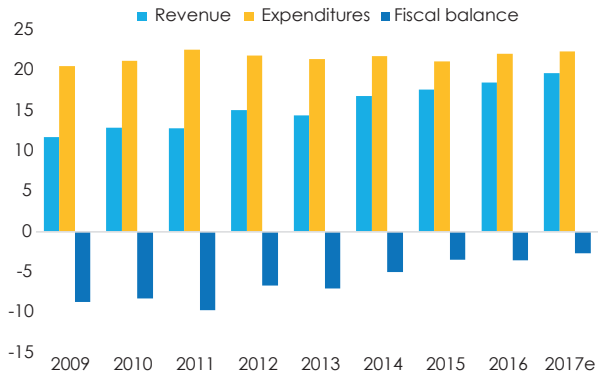
Cost to export (US$ per container)

Quality of port infrastructure, World Economic Forum (1=extremely underdeveloped to 7=well developed)

c. Fiscal balance

The overall fiscal deficit is estimated to have remained contained, thanks to exceptionally strong revenue collection. While the authorities' decision to boost civil servant wages increased spending, its effect on the fiscal deficit was neutralized by continued strong revenue collection. The fiscal deficit (excluding grants) is estimated to have narrowed to 2.7 percent of GDP in 2017, compared to 3.6 percent in 2016 (figure 35). However, rapidly rising public sector wages could potentially crowd out government funding for capital projects, exacerbating the dwindling of donor-financed infrastructure projects.

Figure 35: General goverment fiscal deficit continued to remain contained. (percent of GDP)



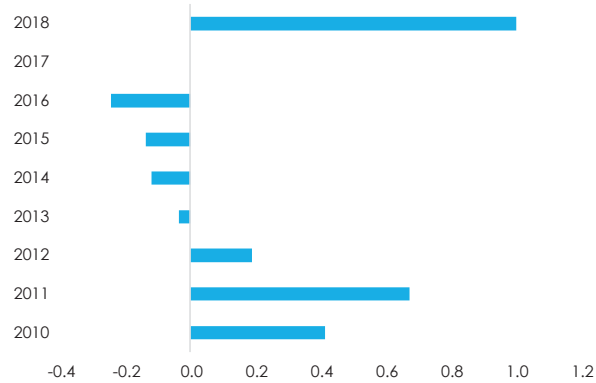
Sources: Cambodian authorities and World Bank staff estimates.
Note: e = estimates.

At the end of 2017, the total amount of government deposits in the banking system grew by 34.6 percent, reaching US$2.8 billion or 12.7 percent of GDP, thanks to fiscal consolidation during the last several years. Part of the deposits (about 2 percent of GDP) was used by the authorities as a fiscal stimulus to mitigate the negative effects of the 2008-09 global financial crisis. In Cambodia, fiscal policy remains the only macroeconomic policy instrument, as monetary policy has been constrained by the high level of dollarization.

d. The 2018 budget

For the first time in many years, there is a relatively large fiscal expansion, scaling up both current spending and capital investment in the 2018 budget. The total public outlay budgeted in 2018 amounts to 24.0 percent of GDP, up from the estimated public spending of 22.3 percent in 2017. The expansion is for the most part financed by a drawdown of government deposits. The 2018 budget targets the largest drawdown (figure 36) since the 2-percent-of-GDP fiscal stimulus introduced in 2009 to mitigate negative impacts of 2008-09 global financial crisis. The expansion scales up both public investment and public sector wages.

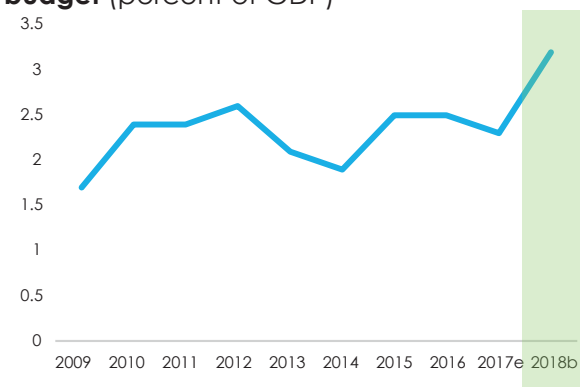
Figure 36: Budgeted drawdown of government deposits for central government (percent of GDP)



Source: Cambodian authorities.

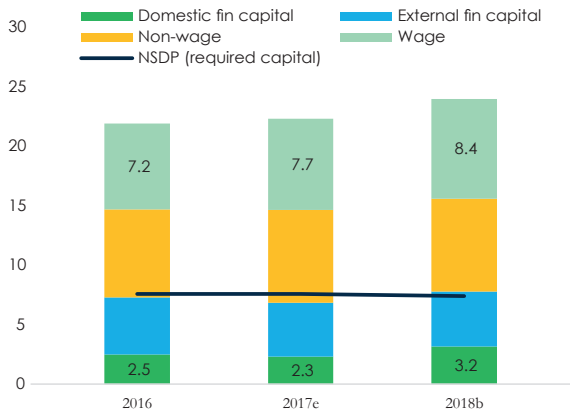
For the first time in several years, a significant boost is provided to domestically financed capital investment in the 2018 budget (figure 37). The relatively large fiscal expansion lifts domestically financed capital spending to 3.2 percent of GDP, up from 2.3 percent in 2017. As a result, total (domestically and externally financed) capital spending has reached the level recommended in the 2014-18 National Strategic Development Plan (figure 38). The public sector wage bill has also risen, reaching 8.4 percent of GDP, up from 7.7 percent in 2017.

Figure 37: There has been a large boost in domestically financed capital in 2018 budget (percent of GDP)



Source: Cambodian authorities.
Note: b = budget; e = estimates

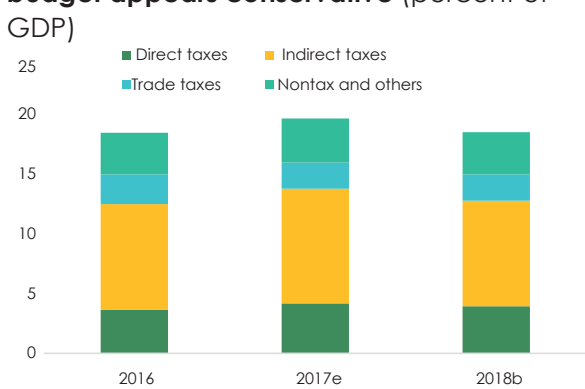
Figure 38: Relatively large fiscal expansion boosts budgeted capital spending in 2018



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

The domestic revenue budgeted in 2018 appears conservative compared with exceptional revenue performance in 2017. The revenue is budgeted to reach only 18.5 percent of GDP in 2018, well below the 19.7 percent estimated collection in 2017 (figure 39). As discussed above, revenue collection which experienced rapid growth during the last five years, may be moderating. In this regard, there is a plan to introduce a new revenue mobilization strategy for the next five years.

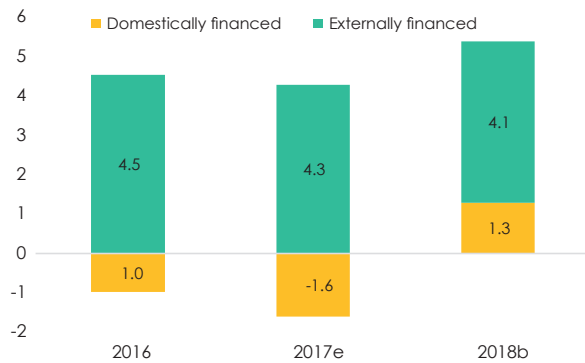
Figure 39: Given exceptional performance in 2017, the domestic revenue in the 2018 budget appears conservative (percent of GDP)



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

The overall fiscal deficit is targeted to increase to 5.4 percent of GDP in the 2018 budget, up from 2.7 percent in 2017 (figure 40). External finance is budgeted to cover 4.1 percent of GDP of the 5.4 percent of GDP fiscal deficit, while the remaining 1.3 percent of GDP is budgeted to be financed by domestic funds—mostly from the drawdown of government deposits at the central bank. As mentioned earlier, total government deposits at the central bank stood at 12.7 percent of GDP at the end of 2017.

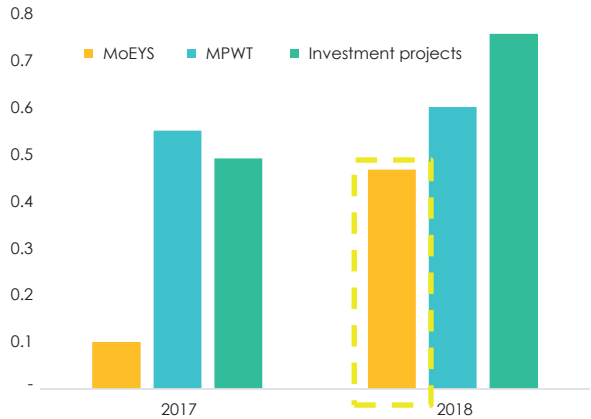
Figure 40: The drawdown in government deposits is to finance a relatively large deficit (percent of GDP)



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

The Ministry of Education, Youth and Sport (MoEYS) benefits the most from the increase in capital spending. The MoEYS receives the largest boost to its 2018 capital investment budget (figure 41) to meet the demand for building additional provincial schools. MoEYS' capital investment budget reaches CR 420 trillion (or 0.5 percent of GDP) in 2018, up from CR 90 trillion in 2017. Project investment funds (not classified under any ministries) and the capital budget for the Ministry of Public Works and Transport also receive large boosts.

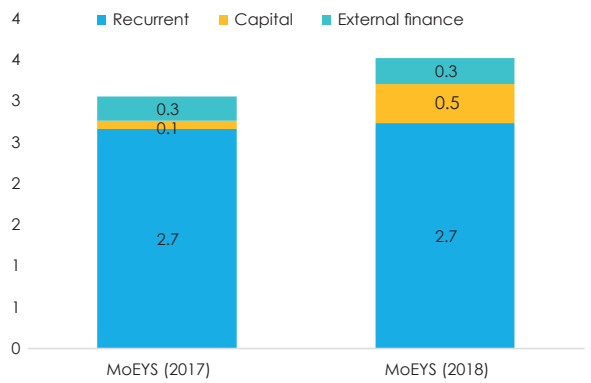
Figure 41: Education receives the largest boost in capital investment in the 2018 budget (percent of GDP)



Source: Cambodian authorities.
Note: MoEYS = Ministry of Education, Youth and Sport; MPWT = Ministry of Public Works and Transport.

MoEYS' total budget, which covers both domestically financed (current and capital budget) and externally financed components climbed to 3.52 percent of GDP up from 3.05 percent in 2017 (figure 42). In absolute terms, the total budget surged, reaching CR 3.43 trillion (equivalent to US$860 million), representing a 25.5 percent increase.

Figure 42: MoEYS' total budget in 2018 has been boosted (percent of GDP)



Source: Cambodian authorities.

In addition, to meet a rising demand for public investment, the 2018 budget increases the (concessional) borrowing ceiling to 1 billion SDR, up from 0.7 billion SDR in 2017. Other important highlights of the 2018 budget include an amendment to the law on taxation to include a fiscal provision on petroleum and mining operations. This is to clarify the authorities' fiscal provisions for conducting oil and gas and mining operations.

2. OUTLOOK AND RISKS

Cambodia's high growth trajectory is expected to continue. Growth in 2018 is projected to accelerate slightly to 6.9 percent in 2018 (table 2), underpinned by rising government spending and favorable global conditions, including robust demand in advanced economies. Cambodia's growth rate is, however, expected to gradually decelerate, if structural problems (for example, loss of competitiveness) are left unaddressed. It is expected that the announcement of the new Rectangular Strategy after the elections will revive the reform momentum.

In the medium term, large FDI flows and rising public investment in infrastructure are expected to help expand the productive capacity of the economy. Cambodia's exports are expected to continue to benefit from the most favorable regime available under the EU's Generalized Scheme of Preferences, namely the Everything But Arms scheme, for years to come.[16]

This, together with several structural reforms

16 The EBA scheme gives the 47 Least Developed Countries – including Cambodia – duty free access to the EU for exports of all products, except arms and ammunition. See http://ec.europa.eu/trade/policy/countries-and-regions/countries/cambodia/

Table 2: A favorable macro outlook remains, although growth is easing slightly

	2018	2019
GDP growth	6.9	6.7
Domestic demand (% change y/y)	8.1	9.7
Inflation (% change, average)	3.2	3.4
Overall fiscal balance (% of GDP)	-5.9	-5.4
Government debt (% of GDP)	35.3	36.1
Export growth	10.6	11.8
Import growth	9.2	10.0
Current account (% of GDP)	-9.4	-9.2
FDI (% of GDP)	10.9	10.6
Gross foreign reserves (months of prospective imports)	6.9	6.9

Source: World Bank staff estimates and projections.

designed primarily to boost Cambodia's external competitiveness could help speed up growth momentum in the longer term. Recent reforms to improve quality and access to basic education may also result in improved learning outcome and better labor force quality. Poverty reduction is expected to continue with expansion of the services and manufacturing sectors.

Cambodia's fiscal performance is expected to remain sustainable. Overall fiscal deficit and public debt, while rising as the authorities implement the fiscal expansionary policy, will continue to be contained.

Risks to the outlook remain tilted toward the downside. Domestically, risks are associated with a prolonged construction boom, potential uncertainty related to the July 2018 general elections, and declining external competitiveness resulting largely from rising real wages. Externally, risks are associated with uncertain global trade as protectionism rises. In addition, employment growth prospects look less certain. As real wages rapidly increase, Cambodia's external competitiveness, which primarily relies on cheap labor, is being eroded. As a result, potential negative impacts of the slowdown of the textile and construction sectors on poverty reduction may occur.

3. KEY MESSAGES

Investment in developing human capital is needed for both traditional and "new" skills. To this end, the success of any policy intervention will likely depend on the effectiveness of incentives and processes to facilitate the enterprise sector's role in providing, guiding, and advocating for a skills development system that responds to the demands of industry (see the selected issue section on future jobs in Cambodia). A skilled labor force boosting productivity growth would help compensate for rapidly rising real wages and underpin ongoing structural transformation. Addressing skills constraints, as envisioned in the 2017-25 National Technical and Vocational Education and Training Policy, is a priority. Greater coordination among public and private entities will be essential to the successful implementation of this framework.

Lifting the constraints to small and medium-sized enterprises and nonfarm household enterprises can support diversification, while promoting job growth. It is important to reduce the costs of firm formalization, operation, and financing, while providing access to incentives and support programs. Introduction of policy supports to promote small and medium-sized enterprises and nonfarm household enterprises will help

boost job creation. Potential policy supports may then include skills development for firm owners, and development of and access to digital and internet technologies. Fostering domestic investment, including in agroprocessing, could also help strengthen links to foreign-owned businesses and exporters.

The ongoing construction and real estate boom needs close monitoring. Credit growth directed to the construction and real estate sector has accelerated further. It is therefore necessary to reduce the scope for speculative activities. In the banking and microfinance sectors, it is crucial to adopt lending guidelines and ensure adequate monitoring, while revisiting the nonperforming loan classifications including the newly emerging trend of refinancing and rollover of loans. This will also help avoid overindebtedness after years of rapid loan expansion and accelerated rates of penetration of loans in households.

SECTION 2: SELECTED ISSUE FUTURE JOBS IN CAMBODIA[17]

1. INTRODUCTION

Cambodia has been able to sustain high economic growth, but the country has experienced slowing job growth, especially since 2012. The economy grew by an average annual per capita rate of 5.3 percent during 2005–15, ranking among the top 14 economies in the world, propelling to country to attain the lower-middle income status in 2015. With its current population of 16.1 million, Cambodia's GNI per capita is estimated to have reached US$ 1,300 in 2017. Cambodia continues to pursue its high growth policy, underpinned by its liberal investment and trade policy, targeting a real growth rate of around 7 percent a year. As economic structural transformation accelerates and the economy shifts from agriculture to industry and services, mostly low-value added jobs are being added. Two-thirds of new jobs are in construction, hospitality, and other services. So while current policy is creating jobs, it is not creating the good jobs that underpin greater productivity and prosperity.

Shifting trade patterns, a growing Asian middle class, demographic change, technology and rapid urbanization are changing the composition and nature of jobs. The current global geo-political environment is shaping the prospects of future jobs in Cambodia. The process of global economic is rebalancing toward Asia, both in terms of production and consumption. Regional integration efforts such as those under ASEAN Economic Community (AEC) and Regional Comprehensive Economic Partnership (RCEP) are creating momentum in the liberalization of trade in goods and services that will attract huge investment into the region. Technology is opening new industries and not (yet) threatening Cambodia's export industries. The emerging middle class, especially in China, will increase the demand for processed goods and more services. These developments will offer Cambodia opportunities to attract investments, expand its export markets through industrial and trade linkages as well as its physical and institutional connectivity with the regional and intra-

17 The Selected Issue on Future Jobs in Cambodia is a summary of preliminary findings of Cambodia Future Jobs Study led by Drs. Wendy Cunningham and Claire Honore Hollweg. Contributors to the study include Sodeth Ly, Miguel Sanchez, Une Lee, Johanne Buba, Mahesh Shrestha, Marong Chea, Dilaka Lathapipat, Lan Van Nguyen and Anne Lopez.

regional production networks and supply chains. These mega-trends could generate good jobs if Cambodia puts "jobs" as a key national priority.

Identifying policies and opportunities for Cambodia's job success to align with its economic success is therefore crucial. Both demand- and supply-side policies play a mutually reinforcing role. The demand-side policies promote job growth by boosting economic activity in those sectors that are particularly conducive to good jobs. The supply-side policies seek to improve the job readiness of people entering the labor force and to support them in finding the right jobs for their skills level (allocative efficiency). Macro-policies underpin these policies by creating the conditions for firms and workers to invest and engage in markets and with each other.

To support policymakers, the World Bank is conducting a jobs diagnostic that is intended to identify policies and opportunities to improve job quality and inclusiveness in a context of emerging mega-trends. The study is intended to identify the factors that drive the creation of good jobs and identify a small set of policies that, when taken together, will lead to better jobs. For the purposes of this analysis, a job is defined as a legal activity that generates (in-cash or in-kind) income while a good job is productive, high value-added, pays well, and provides worker benefits and good work conditions (within reach of a significant share of the population in a reasonable timeframe).[18] The below summarizes the emerging messages.

One of the findings discussed in the job diagnostic suggests that it is necessary to promoting entry and growth of SMEs which account for about 90 percent of firms. In other words, this pertains to narrowing the gaps in worker productivity, while improving spillover effects and technology transfers including managerial and entrepreneurship skills from the modern to traditional sector.

Investing to develop human capital is a priority. To this end, the success of any policy intervention will likely depend on the effectiveness of incentives and processes to facilitate the enterprise sector's role in providing, guiding, and advocating for a skills development system that responds to the demands of industry. Development of and access to agile and rapid skills-development modules will therefore be necessary.

2. CURRENT STATE OF JOBS

a) Structural transformation

Unlike many aging countries in East Asia, Cambodia is benefiting from a demographic dividend. Cambodia's working age population (age 15-64) is growing faster than its population—2.4 percent compared to 1.9 percent during the period 2007-2015—freeing up resources for investment and family income growth.

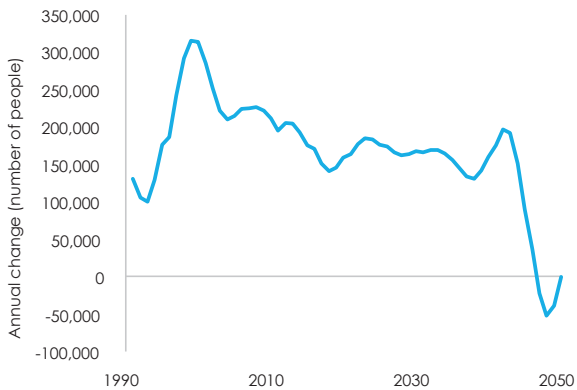
Given the existing population dynamics, the country has a window of opportunity for rapid economic growth during the next 30 years, until its working age population starts to decline (figure S1).[19] Cambodia's working

18 This working definition of a "good" job in Cambodia is used for analytical purposes of this report. The definition of a "good" job necessarily differs between workers and firms and likely even by industry, occupation, region, and a myriad of other variables.

19 After the post- Khmer Rouge recovery and "Baby Boom" fertility has started to decline in Cambodia from the early 1990s. See Fertility Trend in Cambodia, Dasvarm and Neupert (2002).

age population reached 10.1 million in 2015, up from 8.3 million in 2007 a larger increase than the net labor force—defined as those who worked or looked for a job[20]—that increased by 1.3 million persons over the same period. On average, Cambodia adds 164,000 persons to its labor force annually.

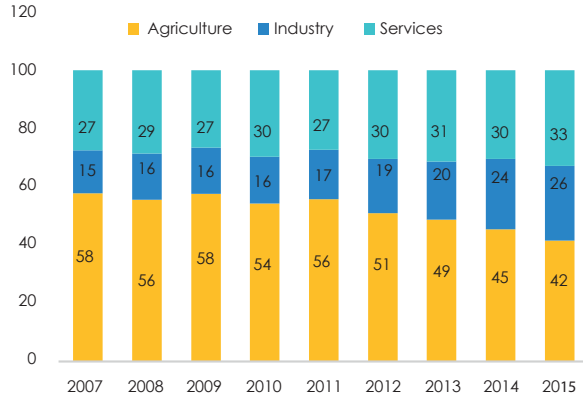
Figure S1: Projected annual change in the working age (15-64 years) population



Source: United Nations World Population Prospects: 2015 Revision.

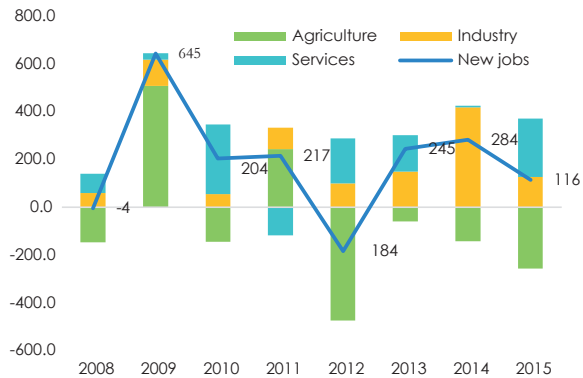
As structural transformation accelerates, Cambodia has experienced a sharp decline in the share of the employed population working in agriculture (figure S2). The steepest decline occurred in 2012 (figure S3). Employment creation supplied by the agriculture sector initially grew at 2.8 percent during 2007-11, driven by agricultural development boosted by rising agriculture commodity prices and cultivated land expansion. In 2009, the agriculture sector managed to absorb a large number of laid off factory workers caused by the collapse of the industry sector[21] as the garment and footwear sector faltered during the 2008/09 Global Financial Crisis. During 2011-15, employment creation by the agriculture

Figure S2: Employment by sector (percent)



Source: Cambodia socio-economic surveys.

Figure S3: Contribution to job creation ('000 jobs)



Source: Cambodia socio-economic surveys.

sector, however, shrank by 5.8 percent a year caused by drought and depressed agricultural commodity prices. While the agriculture sector contributes about a quarter to annual GDP, it is the source 41.6 percent of all jobs.

Instead, the economy has become increasingly dependent on the industry and services sectors, both for economic growth and to provide the jobs to absorb new entrants into Cambodia's labor force.

20 The definition is based on the Cambodia socio-economic survey where "working" is defined as a person (age 15 and older) who worked for pay (or in-kind) for at least an hour in the week prior to the survey and a person older than age 15 who searched for a job for at least one hour in the previous week (but was not on temporary leave) is defined as "looking for a job."

21 In 2009, growth of the industry sector's value added went negative in constant and market prices.

As depicted in figure S3, non-agricultural sectors have been the main source of job growth since 2012. This has been driven by an expansion in manufacturing, tourism, and (more recently) construction.

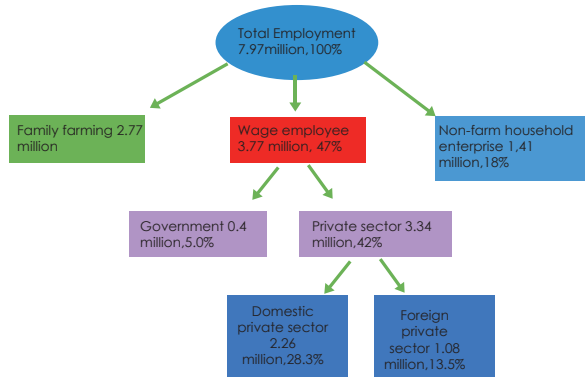
Since 2011, labor has played a declining role in GDP growth. While capital continues to be the driving factor for economic growth, employment played a significant role (since 1993) until 2011. In contrast, labor quality and total factor productivity increased relative to the period 2007-2011. This can be attributed to the shift out of agriculture, which is labor-intensive and into more skills- and productivity-intensive manufacturing and services.

Looking forward, the factors behind Cambodia's impressive job creation over the past decade are likely not the factors that will drive future growth of quality jobs. New mega-trends — global economic rebalancing toward Asia including regional integration and growing wealth, a shift toward smart production and value chains, and newly emerging firms and workers with new products and skills will reshape Cambodia's jobs picture.

b) Jobs picture

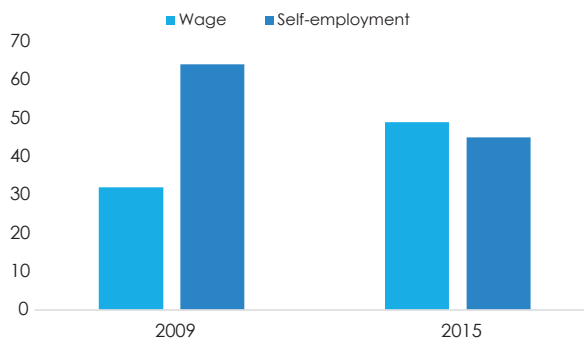
Cambodia's jobs picture is heterogeneous. Half of jobs are in the traditional sector while another half in the modern sector (figure S4). The traditional sector accounts for at least 4.2 million jobs in family farming (one third of all jobs) and nonfarm household enterprises (18 percent). Another 3.3 million people are engaged in wage-employment. One third of them (one million) work in foreign firms, which tend to abide by labor laws and have higher levels of productivity than domestic firms and so could be classified as "good" jobs. But there is no information about the quality of the remaining 2.26 million wage jobs. Some will be working in registered firms and receiving mandated wages and benefits while others will be wage earners on farms, household enterprises, or without contracts. In 2015, as much as half of Cambodian households' income (including rural households' income) is from salary and wage, compared to only 30 percent a decade ago (figure S5).

Figure S4: Cambodia's heterogeneous jobs picture



Source: Authors' calculations.

Figure S5: Rising share of wage and salary employment (percent of total)



Source: Cambodia socio-economic survey.

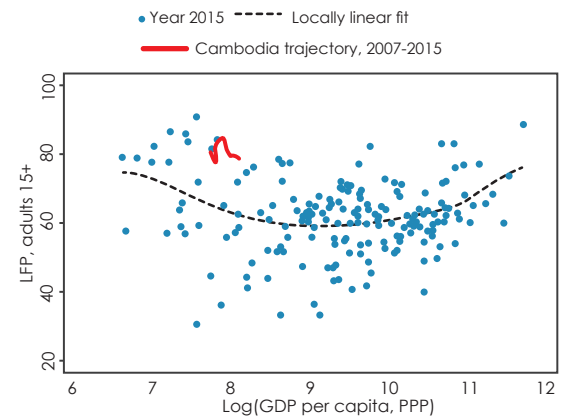
The foreign (FDI) private sector such as garment and footwear sector has been largely driving Cambodia's export led growth. In 2015, the garment and footwear sectors provided 10.6 percent of GDP and 7.3 percent of total employment. This is in contrast to the fastest growing domestically-owned industries, such as the construction sector, which captures 9.8 percent of GDP but contributes only 6.5 percent of total employment.

To align jobs policies with growth policies, it is necessary to pay close attention to both domestic and foreign private sectors. Boosting jobs growth provided by the private sector, especially the domestic private sector including small and medium-sized enterprises (SMEs) will help to draw workers out of the traditional sector, mainly family farming (skilled agricultural, forestry and fishery workers). It is equally important to promote nonfarm household enterprises which continue to absorb a large share of employment but are performing below potential.

c) Labor force participation

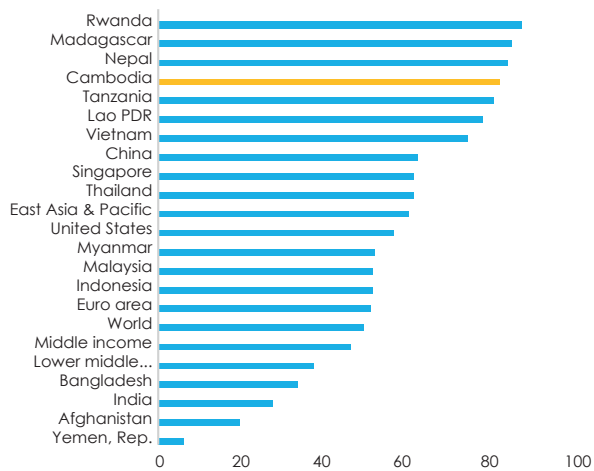
Cambodia's labor force participation rate is high by global standards. Given Cambodia's level of development, labor force participation rates are expected to be on the trend line in Figure S6; instead, it is far above the trend line and has been for several years. This reflects high female labor force participation in both modern and traditional sectors, especially the garment and footwear, and nonfarm household enterprises. Cambodia's female labor force participation rate is among the highest in region and in the world (figure S7). This is perhaps not surprising given the important of traditionally "female" industries in Cambodia's economy: garments and tourism.

Figure S6: Cambodia has a relatively higher participation rate than many of its peers



Source: Authors' estimates using CSES 2007-15 and WDI.

Figure S7: Labor force participation rate, female (percent of female population ages 15+)



Source: World Development Indicators.

Table S1: Employment by main occupation (percent)

Main occupation	2004	2015
Armed forces occupations	0.9	0.8
Manager	1.3	0.9
Professionals	3.8	3.2
Technicians and associate professionals	0.6	1.3
Clerical support workers	0.2	3.6
Service and sales workers	13.6	16.1
Skilled agricultural, forestry and fishery workers	58.7	33.7
Craft and related worker	6.1	23.5
Plant and machine operators and assemblers	6.1	3.9
Elementary occupations	8.4	12.9
	100	100

Source: Cambodia socio-economic surveys.

The job market has significantly evolved over the past ten years, largely driven by structural transformation (table S1). While 58.7 percent of workers were in agriculture, forestry, and fishery in 2004, the share had declined to 33.7 by 2015. Although this is still the most prevalent occupation, it is on the decline. At the same time, a shift toward more productive sectors has led to a rising shares of services, sale and clerical supports workers. Moving toward industrialization generates demands for more technicians and associate professionals. Occupation-specific data show that the top 3 fastest growing occupations are garment and related trades, building frame and related trades, and general office clerks (table S2) while eight of the ten fastest shrinking occupations are in agriculture, forestry, or fisheries.

Table S2: 10 fastest growing occupations

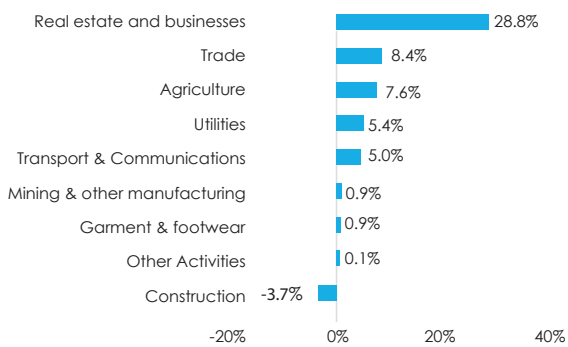
	Share 2009	Share 2014	Average growth
Garment and related trades workers	4.4	10.2	1.1
Building frame and related trades workers	0.5	2.8	0.7
General office clerks	0.8	2.6	0.3
Agricultural, forestry and fishery laborers	6.3	6.9	0.2
Shop salespersons	5.0	6.0	0.1
Waiters and bartenders	0.3	0.80	0.1
Building finishers and related trades workers	0.2	0.8	0.1
Tellers, money collectors and related clerks	0.2	0.7	0.1
Hotel and office cleaners and helpers; Building caretaker	0.1	0.3	0.1
Moto-taxi & Tuktuk drivers	1.2	1.5	0.1

Source: Authors' estimates using CSES 2009-15
Note: Occupations at the 3-digit ISCO that have an employment share of at least 0.1%

But quality of work performed by workers needs further improvements. Productivity growth of the fastest growing occupations such as garment and related trades is among the lowest (Figure S8). Productivity is found to be the highest in the real estate and business occupations due largely to the real estate boom, followed by trade and agriculture (due to shedding labor). From the worker perspective, although mean wages have increased, particularly for the poor, other shortcomings remain. For example, the gender gap in hourly wages remains large (figure S9). While further studies may be needed to explain the large gap in hourly wages between men and women,

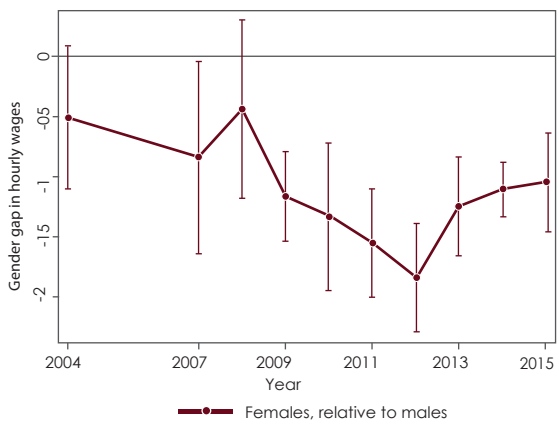
education attainment may be one of the underlying factors.

Figure S8: Annual productivity growth (2007-14) for key sectors remain low



Source: Authors' estimates using data from Cambodian authorities.

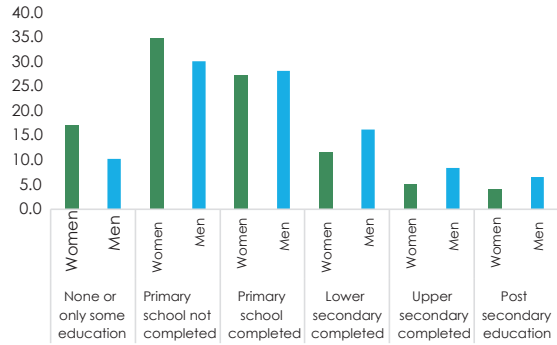
Figure S9: Gender gap in hourly wages



Source: Authors' estimates using CSES.

The results from Cambodia socio-economic surveys reveal that a much higher proportion of female labor force (15-64 years) has "none or only some education", compared to that of their male counterpart (figure S10). In 2015, 17% of the female labor force had "none or only some education" and 34.9 percent had "primary school not completed", while it was only 10.3 percent and 30.2 for their male counterparts. The opposite is true when education attainment reached "primary completion" and "lower secondary education". The proportions of

Figure S10: Labor force participation rate (15-64 years) by age group, level of education and sex (percent, 2015)



Source: Cambodia socio-economic survey, 2015.

male labor force with "primary completion" and "lower secondary education" accounted for 28.2 percent and 16.3 percent, respectively, compared with 27.3 percent and 11.6 percent for their female counterparts. This mirrors lower proportions of female students who complete primary school education and above, compared to those of their male counterparts.

3. JOBS OF THE FUTURE

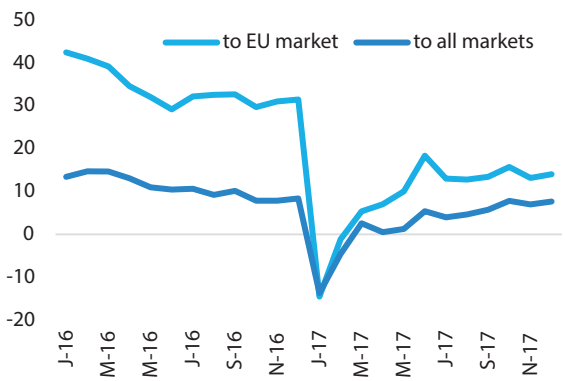
a) Opportunities and Bottlenecks

As discussed above, the demand for occupations such as skilled agricultural, forestry and fishery workers which accounted for majority of the jobs in the past decade and were behind Cambodia's impressive jobs growth, especially during agriculture commodity price boom are not likely the occupations that will drive future jobs growth. Macroeconomic environment, especially the ongoing structural transformation has implications on the nature of jobs in Cambodia. The upper middle-income status that Cambodia is pursuing during the next twelve to fifteen years may further reduce

the share of agricultural employment to around 20 percent, down from the current share of around 40 percent.[22] Therefore, the challenge is to identify the sources of new jobs.

Garment and related trades occupation, one of the largest occupations, are expected to continue thriving in global and (increasingly) regional value chains. Although minimum wage is rapidly rising – and unit labor costs are higher than in competitor countries in the same industry –, the occupation is likely to continue to strive for years to come, given Cambodia's preferential access to the European Union market under "Everything But Arms" (figure S11). In addition, as wages in China rise, relocations of factories from China to lower wage countries will present an opportunity for Cambodia to attract new industries and expand/upgrade the existing ones. This gives rise to demand for skilled labor such as technicians and machine operators and assemblers.

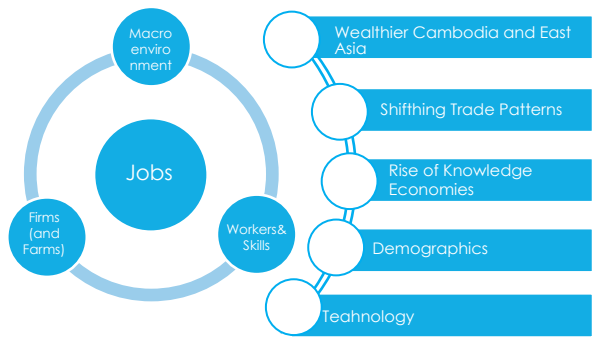
Figure S11: Exports of clothing and other textile producst (y/y, percent change)



Source: Cambodian authorities.

Other factors such as wealthier Cambodia and East Asia countries and shift of trade patterns give rise to other occupations (figure S12). As depicted in tables S1 and S2, services-related jobs including inter-personal skilled occupations, namely shop salespersons, office clerks, hotel/ office keepers and more are expanding. As income increases, consumers seek a widening range of personal and recreational services or consume more services-intensive and processed products, while producers search for more specialized and sophisticated inputs and professional advice.[23] The regional economy has shown rising contribution by the services sector, accounting for about half of its combined GDP and 60 percent of its total foreign direct investment inflows in recent years.

Figure S12: Factors driving new jobs growth



Source: Authors' assessments.

Shifting in trade patterns whereby China will increasingly become one of the major consumer markets in the world, entails demand for both merchandize and services imports. Cambodia together with regional countries is competing to attract Chinese tourists. Rising demand from retirees in Asia and Europe for customized tours and other

22 The Changing Nature of Work (2019), World Development Report

23 ASEAN Services Integration Report (2015), A Joint Report by the ASEAN Secretariat and the World Bank

related activities is another opportunity. Similarly, awareness of climate change and environment degradation will increase demand for eco-tourism, an untapped tourism potential in Cambodia. To serve many aging countries in the region such as Korea, Singapore, and Australia, aged care is expected to become an important occupation which Cambodia can grasp, given its a comparative advantage in English language skills. However, there are emerging trends that may have potential negative impacts on jobs. These include slowing growth in global trade and rising protectionist sentiments in the United States and elsewhere.

The rise of knowledge economies and development of digital technologies including internet penetration will command new occupations and change the nature of jobs in others. Based on current technological trends, certain sectors will continue to rely on labor as the primary factor of production. In those sectors, sectoral growth will lead to job growth.[24] But many of these jobs, in fact, most of the jobs in Cambodia, will increasingly incorporate technology into their work. Thus, tasks that may have been done manually instead will be relegated to machines, freeing up time for workers to carry out higher value-added tasks that cannot be mechanized. This is seen daily through ATM machines that free time for bankers to work with clients, computers that allow accountants to work more precisely and effectively, or the use of PassApp to call taxis rather than taxis driving around in search of passengers (see Box S1: PassApp Taxi provides a win-win solution for both taxi drivers and their customers). Jobs that create technology – such as careers in mobile app development – will also grow, but these will likely be a minority in the context of the larger job market. Technology is also unlocking current bottlenecks to job creation. For example, the expansion of mobile money systems that Cambodia has experienced during past several years not only helps create jobs but also facilitates transfers of remittances, improves access to credit and increases productivity and entrepreneurship.

While it is not an immediate threat for Cambodia, some jobs will disappear due to automation. Others will not be created due

Box S1: PassApp Taxi provides a win-win solution for both taxi drivers and their customers

PassApp taxi is gaining its popularity very quickly in the capital city of Phnom Penh. With one click on PassApp app on your smart phone, a taxi will be at your doorstep. Fare is much cheaper, especially for three-wheeler taxi rides. This is because: (i) for three-wheelers, it is LPG (and gasoline) powered; (ii) drivers can just wait for a message sent by a passenger using a cell phone (instead of driving around looking for his or her customers); (iii) fare is transparent which is based on travel distant shown by GPS multiplied by a fixed unit cost per kilometer and shown on cell phones of both driver and passenger.

The wining factor is the transparent ride fare offered by PassApp and shown on phones of both taxi driver and its customer. Traditional four-wheelers (motorbike towed carts) do not have this feature. While taxi meter system seems to provide similar transparent fare computation, customers may not have complete confidence in the accuracy of their meter system.

24 The Changing Nature of Work (2019), World Development Report

to reshoring of manufacturing in advanced economies and China due to the rise of more sophisticated technologies such as advanced robotics, Internet of Things, 3-D printing and more. For instance, the use of on line services for mobile banking, bookings and other travel arrangements as well as for obtaining public services facilitated by e-government negatively impacts medium-skilled, routine-based occupations such as tellers and clerical jobs. Wage increases will speed up the pace of automation, Cambodian workers' skills will need to be trained or retrained to align with the factors that driving new jobs growth.

At the same time, technological progress will create many new jobs that don't exist in Cambodia today. New opportunities for entrepreneurship and self-employment are growing rapidly in the digital economy. China's State Information Center estimates that the recent boom in the country's e-commerce sector has created 10 million jobs in online stores and related services, about 1.3 percent of the country's employment. In Kenya, the M-Pesa digital payment system has created additional income for more than 80,000 agents. Samasource and Rural Shores link clients in the United States and the United Kingdom with workers in Ghana, Haiti, India, Kenya, and Uganda. Of global online workers on the Elance freelancing platform, part of Upwork, 44 percent are women, and many wish to balance work and family life. Moreover, ICT jobs, tend to pay well, and each high-tech job generates 4.9 additional jobs in other sectors in the United States.[25]

The country will, however, need to prepare for the future of works. Cambodia's education system will need to be updated to build the rights skills for the next generation. And today's current workers will need to upgrade skills while working, either through on-the-job training or short training courses to learn the skills that will be needed in a technologically-enhanced work place. If Cambodia is aiming to diversity into higher-value service exports including high value tourism and back-office processing services, it has to prepare their work force to have more foreign language skills in addition to English and Chinese. It appears however that the current pace of regional integration remains slow as ASEAN countries have, on average, more restrictive services policies than any other region in the world, except the Gulf States. The share of services in GDP, accounts for less than half of the GDP, compared to more than 60 percent in Latin America, Eastern Europe, and the Middle East.[26]

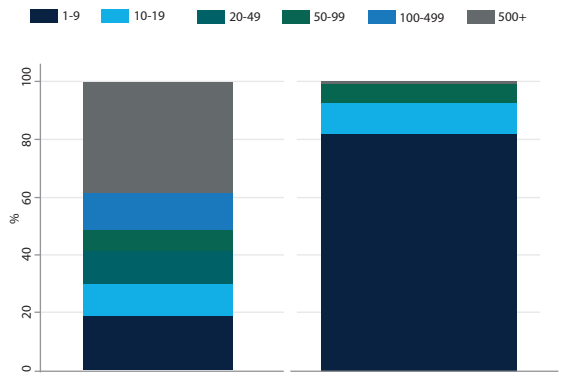
b) Firms: Missing middle

The existing composition of Cambodia's firms is characterized by a missing middle, which significantly challenges job growth. More than 80 percent of firms are considered (micro and) small, employing less ten employees, while less than a fifth are large firms, employing more 100 employees each, provide as much as half of total employment in the private sector (figure S13). The missing middle challenges job creation and indicates large gaps in worker productivity caused by low spillover effects

25 World Development report (2016): Digital Dividends.

26 ASEAN services integration report (2015): a joint report by the ASEAN Secretariat and the World Bank.

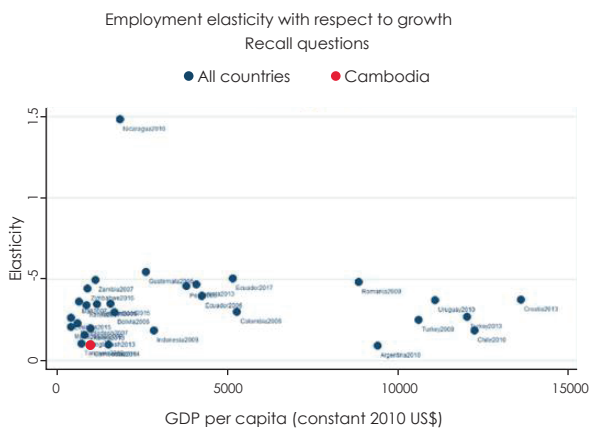
Figure S13: Distribution of employment (left) and firms (right)



Source: Authors' calculations based on Census and ICES.
Note: Minimum size1 weights.

and technology transfers from the modern to traditional sector. Large, export oriented firms manage to grow with relatively high productivity, but the majority of small firms, serving domestic market are struggling to survive. In garment and textiles, a key growth engine, job growth vis-à-vis sales growth is low. Employment elasticity with respect to growth is low, owing to weak FDI sector linkages (figure S14). Rising wages have made the garment sector, which absorbs a third of wage workers, less competitive; this is risky for jobs growth.

Figure S14: Employment elasticity with respect to growth is low

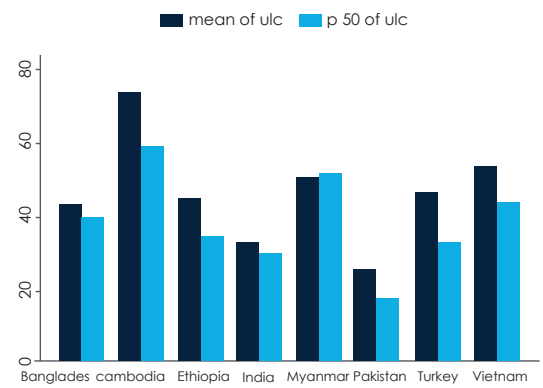


Source: World Bank Enterprise Survey.

Note: coefficients - cross section - p<0,05

Slow productivity challenges job quality. Firms pursue high labor productivity and therefore link pay increases with productivity improvements. However, during the past several years, the minimum wage has increased faster than productivity, resulting in higher unit labor costs in textile firms in Cambodia than its peers (figure S15). Consequently, there is less room for further wage increases if Cambodia wishes to remain competitive in the garments and textiles sectors. Currently, the minimum wage (excluding allowances) for the garment and footwear sector is US$170 a month.[27] Since 2013, the minimum wage has been rapidly rising, increasing at an average of 17.6 percent per year during the period 2013-17, compared with only 7.4 percent during the period 2008-13. Slow productivity growth results in less job quality improvements and upgrades.

Figure S15: Mean and median for unit costs (% of value added) **of textile firms in comparator countries**



Source: World Bank Enterprise Survey data.

Note: ulc = Unit labor costs (weights, last year of ES available).

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

c) Trade and FDI

Cambodia's external trade and the foreign private sector are closely linked. The export sector, except agriculture commodity trading, comprise mainly the FDI sector. FDI inflows underpin not only Cambodia's export-led growth but also job creation for the country's labor force. As depicted in table S3, the export sector, especially garments and tourism has played an important role in job creation. During the past several years, FDI inflows have boosted the construction and real estate sector which in turn drives economic expansion and jobs growth. FDI inflows into the manufacturing, accommodation, construction and real estate sectors combined is estimated to have reached almost 50 percent in total inflows in 2016.[28]

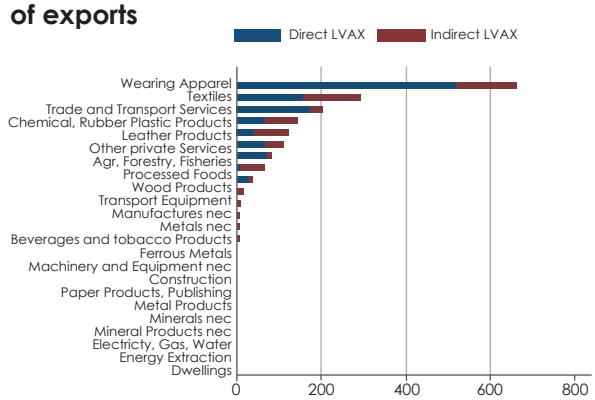
Table S3: Depleting jobs in agriculture were only partly offset by high jobs growth in garment and construction sectors, leaving lower job creation

	2004-07	2007-11	2011-15
Agriculture	433,572	533,124	-945,646
Textile, leather, and footwear	16,477	307,737	335,156
Construction	95,047	-1,190	358,734
Other industry	98,252	-24,162	1,218
Hotel & restaurant	2,710	130,892	132,612
Trade	-3,514	121,663	-6,364
Real estate & professional services	137,944	82,003	109,978
Other services	-37,345	8,901	274,457
Total net employment creation	743,144	1,158,968	260,145

Source: Authors' computation using CSES.

However, the labor intensity of exports (wages per USD of gross exports) ranks low when compared to peers. Indirect labor content of exports accounts for only one fourth, compared with one half in regional peers (figure S16), implying weak FDI sector linkages and a large gap in productivity

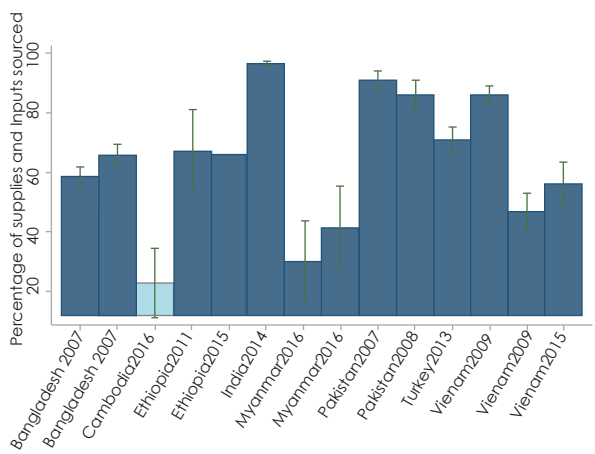
Figure S16: Direct and indirect labor content of exports



Source: World Bank Labor Content of Exports Database.

between direct and indirect exporters. This affects how exports support jobs in Cambodia. Wages and jobs supported through indirect linkages with exporters remain weak. In other words, jobs with indirect exporters are not allocated to the

Figure S17: Percentage of inputs sourced domestically



Source: World Bank Enterprise Survey data.

28 Estimates of FDI by sector,the National Bank of Cambodia.

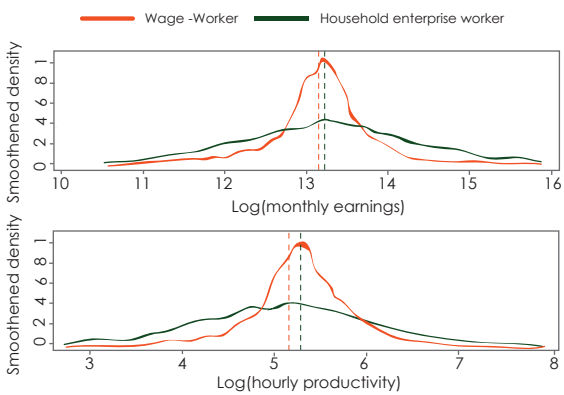
most productive firms (unlike with direct exporters). In addition, the percentage of inputs sourced locally is among the lowest in the region due to underdeveloped domestic sector (figure S17), pointing out the importance of generating better jobs through domestic firm development.

d) Nonfarm household enterprises

As discussed above, nonfarm household enterprises currently provide approximately 1.41 million jobs or 18 percent of total employment; thus, promoting them, especially those that lag behind, is necessary to achieve higher job, income and productivity growth. Cambodia's nonfarm household enterprises are heterogenous. More than half of urban households own a small enterprise, as do 23 percent of rural households. Half are in retail and the other half provide a range of services and manufactured products. A higher share of working women (19 percent) than men (13 percent) own a household enterprise. On average, earnings and productivity of nonfarm household enterprises are as good as those of wage workers (figure S18); this is particularly the case in household enterprises that operate in wealthier communities. However, large distribution of income and productivity suggests that half of the enterprises are doing great jobs, while the other half are underperforming.

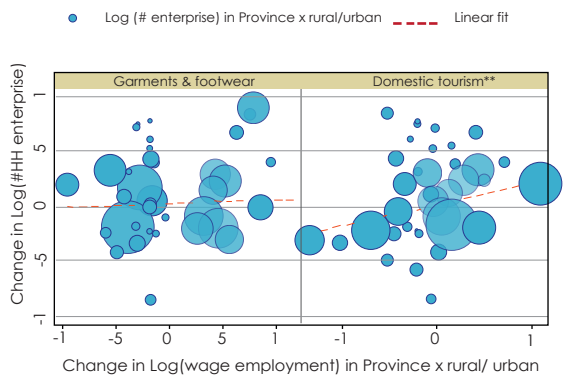
Although household enterprises are linked to larger firms, they benefit little from the most dynamic industry in Cambodia: garments and footwear. As the Cambodian-owned firms multiply and foreign-owned non-garment firms enter the market, household enterprises are established to serve them (figure S19, right chart). The linkages between these very small enterprises and larger firms are not only a source of profits but also of positive spillover that improve the standards and processes - and therefore the productivity and earnings – within the small enterprises. In contrast, the expansion of the garment and footwear sector does little to promote household enterprises to grow (figure S19, left chart). Again, this points to the weak leakages between this FDI-driven sector with the rest of the economy.

Figure S18: Distribution of income (top) and productivity (bottom) by employment type



Source: Authors' estimates using 2014 CSES.

Figure S19: Growth in wage employment and growth in nonfarm enterprises



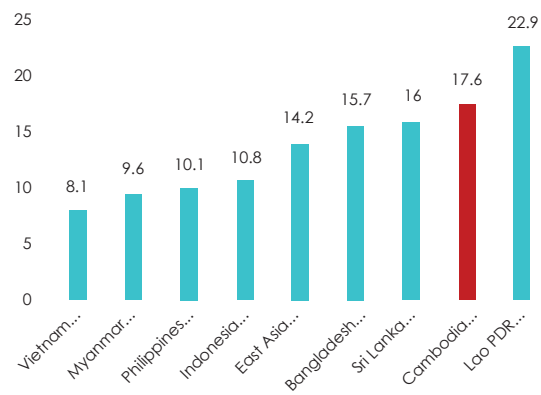
Source: Source: Authors' estimates using 2014 CSES.

e) Workers

Cambodia's labor force is growing — a golden opportunity to boost growth. Unlike many other regional countries, namely Singapore, Japan, Australia, Vietnam and China that are rapidly ageing with an increasing dependency ratio, growth of Cambodia's working age population is expected to outpace population growth until 2045, resulting in declining dependency ratio until 2050 and beyond. This means that the working population – particularly women – will have more time to dedicate to jobs as the number of workers per dependent is somewhat high. Once the dependency rate begins increasing, workers may have less work time or fewer job options as they increasingly dedicate time to eldercare.

However, having a growing labor force alone is not sufficient to attract and create good employment, especially when employers face significant skills shortages. Cambodia's employers are particularly dissatisfied with the skills that the labor force offers. While many regional countries face the same constraint on "inadequate skilled labor force", Cambodia has been hit hardest by it, second only after Lao PDR (figure S20).

Figure S20: Cambodia's employers are affected more by inadequately skilled labor force than other countries

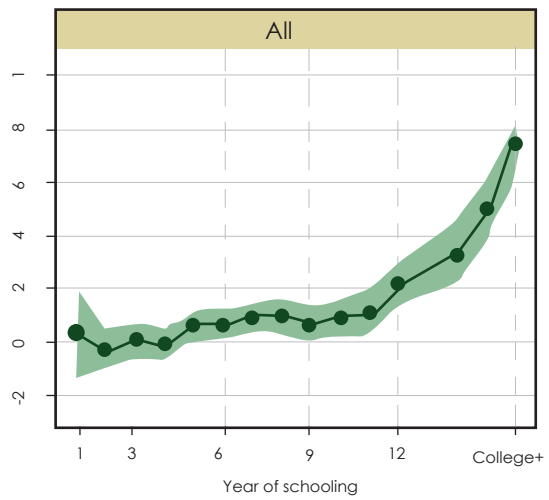


Source: Enterprise Survey, 2016.

Small and medium-sized enterprises, where potential job growth remains untapped, mention inadequately skilled labor force among their top 3 constraints. For large firms, the constraint ranks lower.

Addressing the constraint on inadequately skilled labor force is further confronted by Cambodia's low rates of return to education (figure S21). Although the latest efforts to reform the education system may have yielded better outcome, based on Cambodia socio-economic survey conducted in 2015, employers in Cambodia gave very little value of education below 12 years. This may suggest that the value addition for each incremental year of schooling up to primary completion and even senior high school education is not sufficient for the labor market to reward.

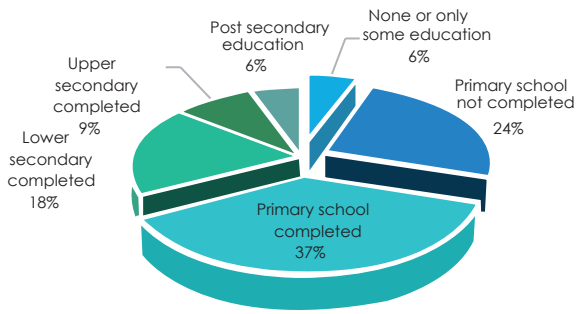
Figure S21: Low rate of return to education



Source: Author's calculations using CSES 2014.

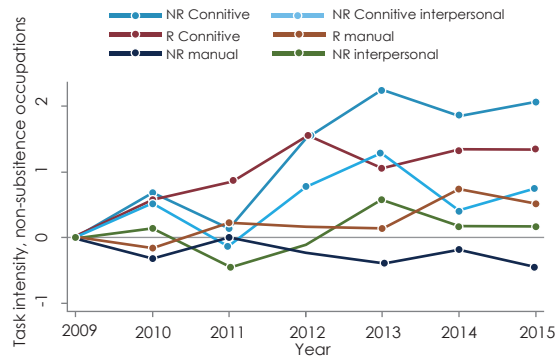
Although there has been some recent progress, education attainment of the labor force remains low. Cambodia's labor force with primary school completion and below accounts for 67.5 percent of total (figure S22). Improving quality of primary school education may mean better prepare

Figure S22: Educational attainment of the labor force (percent, 2015)



Source: Cambodia socio-economic survey.

Figure S23: Cambodia's job market has evolved with the use of different skill sets



Source: Authors' calculations.
Note: R : routine; NR: non-routine.

primary school graduates for the job market, reducing the constraint for job growth. At the same time promoting continued schooling to complete secondary education may attract good jobs.

However, it will take more than a generation for today's improvements in the education system to shift the skills profile of the labor force. While new entrants bring higher educational attainment rates, there is a large stock of current workers – numbering 8 million people – who have low education levels. It will take time for the less educated to retire and for a sufficient number of new graduates to take their places. In fact, if today's secondary school completion rates are maintained over the next 20 years, the share of the labor force with completed secondary school will only increase from 18 percent (today) to 38 percent (by 2040).

Skills constraints are likely to become worse as Cambodia moves toward "knowledge-economy jobs". Occupations in 2015 have been found to have a different mix of skills than in 2009 (figure S23). As discussed in box 3 on structural transformation — policies, strategies and reforms, the constraints caused by Cambodia's inadequately educated workforce have been found to be the second-most-severe obstacle for the operation of manufacturing enterprises in 2016, up from the fifth-most-severe obstacle in 2013 (figure B3.1). More importantly, there is an increasing share of knowledge-intensive jobs, meaning jobs that require creativity, leadership, problem-solving, languages, and a myriad of more sophisticated skills. The growth in these jobs is not a result of a boom in any particular occupation, but instead it is a quiet and steady expansion of many knowledge-intensive occupations that are not yet core to the Cambodian jobs market. Large firms need technical and management competencies which are not offered in higher education institutions. SMEs need a broad range of skills. A variety of skills is demanded by newly emerging occupations which include:

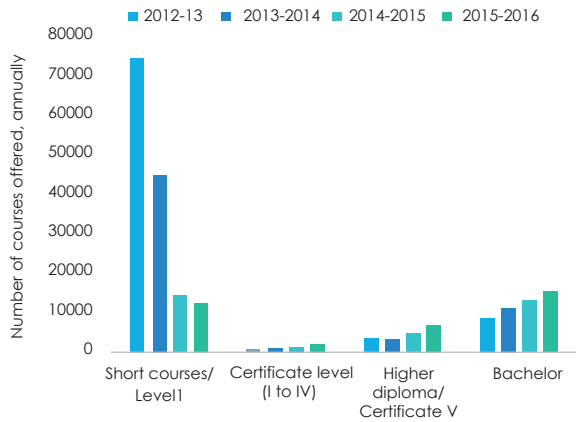
- Higher-order cognitive: oral communication, foreign language;
- Socio-behavioral: customer service, team work, taking initiative;
- Digital literacy: IT literacy, adapting to new equipment/procedures; and
- Some traditional skills: manual dexterity

The education system has a role to play, but can only address part of the challenge. There is a large gap in educational attainment, especially when considering that benefits really accrue after secondary completion.[29] The new Education Strategy is expected to help provide the wide-range of job-relevant skills to new labor force entrants. But some skills are not practical to be taught in a school context. And changing the composition of the labor force — moving from the current stage of labor force development which comprises largely unskilled to semiskilled and skilled workforce takes time (stocks versus flows). In addition, most of the labor force cannot rely on the education system to upskill.

Alternative sources of skill development are technical and vocation education and training (TVET). Establishing TVET training programs to meet the wide-range of job-relevant skills is however a challenge. In addition, the current TVET system needs further improvements to serve a rapidly evolving jobs picture and could be a constraint to better jobs and economic diversification, if not addressed in an efficient and cost-effective manner. The first important step is to improve TVET courses as the demand for them has experienced a steady decline (figure S24).

Further analysis is required to ascertain what has caused the decline in TVET courses, whether it is related to market demand or quality and skills mismatch. For instance, the distressing decline in the supply of short-courses, exactly the modalities needed by an adult labor force is the issue that needs further investigation. Currently, it appears that there are few opportunities to acquire skills, especially once leaving school. Therefore, analysing the supply and demand for "adult education" in Cambodia will be fundamental for establishing an effective skills development system.

Figure S24: Number of course, by skill level



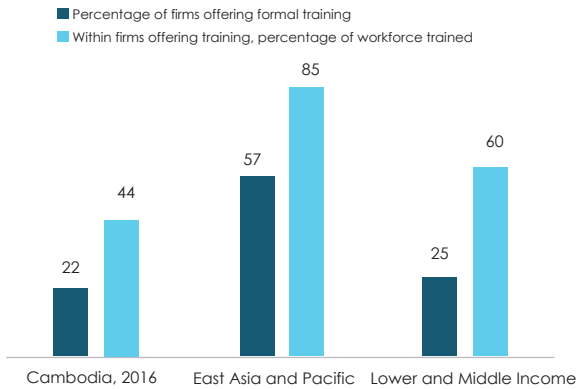
Source: Ministry of Labor and Vocational Training, 2012-15.

Three important components for successful skills development system are strategic framework, system oversight and service delivery. For an effective intervention, it is necessary to look at how Cambodia's skills development system (outside of the education system) fares relative to best practice including the supply and potential for private sector skills development services which are discussed below.

Alternative sources of skill development are firms. In Cambodia, there is limited skills training provided by firms. The percentage of firms offering formal training is well below East Asia and Pacific regional average (figure S25). If informal training is included, the percentage of firms may be double.

29 2/3 of 6th graders are not proficient in reading or writing (EGRA 2013).

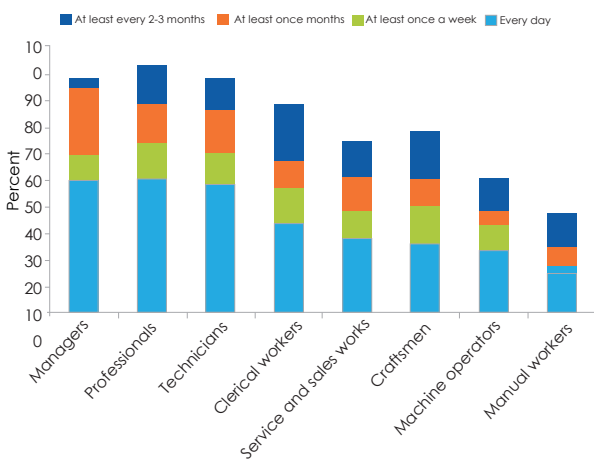
Figure S25: In-Firm Training (percent offering and percent of workforce trained)



Source: Authors' analysis using World Bank Enterprise Survey data.

In addition, there has been limited firm-TVET collaboration.[30] While for some sectors and jobs, high levels of education will be necessary, others, the skills required are not necessarily built through formal learning, but rather on the job. In Cambodia, there is no accounting for learning-by-doing. Data from Vietnam, however, show that large proportions of Vietnamese labor force learns new skills while working. The most learning occurs among the top occupations, namely managers, professionals and technicians (figure S26). It is therefore crucial to engage the private sector to provide, guide and advocate for skills development.

Figure S26: Vietnamese labor force that learned new skills while working, by occupation (percent)

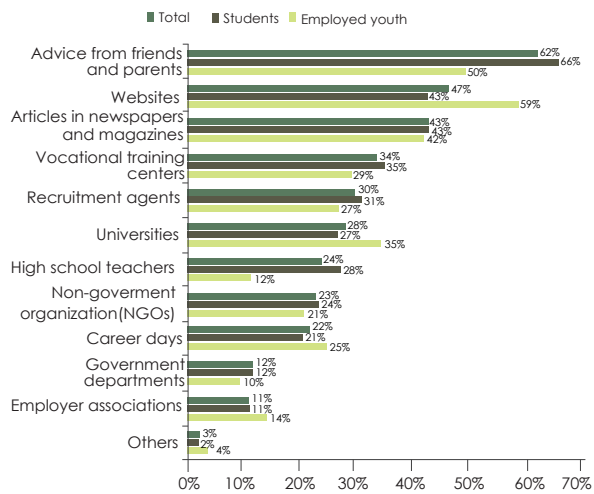


Source: Bodewig and Badiani –Magnusson (2014).

30 Skills report (2015), Asian Development Bank.

Job matching is a challenge as most preparation for jobs and job search is through informal mechanisms. This proves that access to information on study and careers remains an issue. The majority of students and employed youth depend on informal channel — advice from friends and parents — for study and careers (figure S27). However, unlike in most countries, Cambodian job seekers use multiple sources of information, and internet usage is quite high. Nearly 60 percent of employed youth searched for information on study and careers, especially for job placements, on websites. Even with the multiple sources of information, job turnover is inefficient. Turnover is high: 13.7 percent of the wage-earning workforce left their jobs in 2015 and a large proportion — half of firms (in an 8-industry sample) had a vacancy in 2015 and half of them found it hard to fill that vacancy. This indicates a labor market where firms and workers do not have the tools to find each other, and it may also signal a shortage of appropriately skilled workers that are willing to work for market wages.

Figure S27: Source of information on study and careers



Source: Survey of youth conducted by HRINC Cambodia, March 2011.

4. STRATEGIC DIRECTIONS FOR FUTURE JOBS – TOWARD BETTER AND INCLUSIVE JOBS

a) Sectoral policy options

Small- and Medium-sized Enterprises (SMEs) — promoting jobs growth by broadening "job base" by addressing missing middle is a priority. The missing middle suggests that there is a lot of room to boost Cambodia's domestic private sector. Addressing the missing middle means promoting entry and growth of SMEs which account for about 90 percent of firms. In other words, this pertains to narrowing the gaps in worker productivity, while improving spillover effects and technology transfers including managerial and entrepreneurship skills from the modern to traditional sector — a process called domestic and FDI sector linkages. To this end, identifying and addressing key bottlenecks on infrastructure investments, business climate and incentive system hampering domestic private sector to grow is the first important step.

Moving up existing value chains and into new value chains will underpin inclusive and better jobs in the short- and medium-term timeframe. Large potential in agro-value chains remains untapped, given rapid expansion of the tourism sector. This can be particularly important for rural areas when pursuing inclusive jobs. In this regard, the authorities recently introduced a number of initiatives, including the injection of relatively low-interest loans into the rice sector, investing in building rice storage and drying facilities. However, inadequately trained workforce together with relatively high costs of logistics and electricity remains to be addressed; this limits the economy's ability to move up and integrate into new value chain jobs which often require functional upgrade and introduction of new skills.

Nonfarm household enterprises — introduction of policy supports to promote nonfarm household enterprises will help boost job creation. An important first step is to analyze factors preventing nonfarm household enterprises to grow, identifying priority public goods to be introduced in the short and medium term. This is to enhance their productivity and competitiveness. As discussed above, nonfarm household enterprises account for 1.41 million jobs or 18 percent of total employment. So far, limited attention is paid to nonfarm household enterprises and there has not been a lot of policy and program supports provided to them. Potential policy supports may then include skills development for firm owners, development and access to digital and internet technologies which are relevant to the current stage of economic developments, and brokering to expand linkages to larger industries.

b) Cross-cutting policy options

Invest to develop human capital — this is for both traditional and "new" skills for the short term, given that Cambodia is facing inadequately skilled labor force than other countries. To this end, the success of any policy intervention will likely depend on the effectiveness of incentives and processes to facilitate the enterprise sector's role in providing, guiding, and advocating for a skills development system that responds to the demands of industry (see also Box S2: Training Levy System: Experiences

Box S2: Training Levy System: Experiences from Korea, Malaysia and Singapore

To mobilize more resources for various training programs, some developing countries launched innovative extra-budgetary programs, such as training levies, which imposed semi-taxes (0.5%–2.0%) on the wage bills of enterprises. These resources have been channelled mostly to the national training institutions and the disadvantaged groups, the unemployed, and small employers. The training levy system became bureaucratic and costly in collecting levies and operating training programs. It even became a source of corruption for public officials when the system allowed exemptions or deductions of the levies for those enterprises carrying out training programs for their workers.

To overcome the disadvantages of the training levy system and adjust to the changing needs of the macroeconomic environment, some developing countries transformed the levy system into a levy grant system (e.g., the Republic of Korea, Malaysia, and Singapore). Instead of channelling the payroll levy revenues into public training programs, the levy fund reimburses or rebates the training costs incurred by enterprises. The advantage of this system is that it encourages employers to voluntarily offer in-service/on-the-job training for their workers, either through in-house training programs or external training programs purchased from recognized training institutes, by rebating the enterprise's training expenses as a grant. In this way, the training levy fund can be used to benefit enterprises that pay training levies, and training programs can be more demand-driven to meet the needs of those enterprises.

Indeed, a greater number of enterprises have benefited from this levy grant system than from the levy system, and more workers have been trained on account of the levy grant system. For example, in Singapore, where the Skills Development Fund was established in 1979 to provide incentives for development of higher-level skills needed for economic restructuring, the number of trained workers tripled and the number of enterprises benefiting from the fund more than doubled by 1991.

Also, mobilization of training levies has become more efficient under the levy grant system. Corruption and irregularities can be avoided since all enterprises are obligated to pay the training levy first, irrespective of the existence of their plan for training workers and training expenses incurred are reimbursed from the training levy fund. No special exemptions or discounts of training levies are needed. Moreover, training programs have become more relevant since they are organized or purchased by the enterprises themselves in accordance with their needs. Both public and private training institutes and programs become more efficient since they compete in the training market for the selection by enterprises.

from Korea, Malaysia and Singapore). Development of and access to agile and rapid skills-development modules will therefore be necessary. In the medium term, the economy will benefit from a greater focus on education quality and learning. In a nutshell, it is important to build basic cognitive skills – both for students in the national education system, but also among the current workforce.

Introduce labor market information systems for job matching — expanding modalities of support to job matching. Establishing labor market information on study and careers for public access by leveraging the use of digital and internet technology is a priority, and can be accomplished within a relatively short period of time. This includes crowding in privately-developed technology for job vacancies, while integrating public and private job search services. Strengthening employment centers and university/school career centers with application of digital and internet technology to provide data on vacancies and job matching.

Extract greater value from labor mobility (international and internal) — facilitating return migration to bring back skills and knowhow acquired abroad to create jobs at home. Establishing strategic (and functioning) bi-lateral agreements with countries, especially aging countries that potentially provide (outsourced) jobs including aged care nursing to Cambodia by leveraging Cambodia's relatively large proportion of English and Chinese speaking workforce. Lower the costs (days and monetary) for legal migration for jobs domestically and internationally to acquire skills and knowhow for job creation in addition to remittances.

CAMBODIA: KEY INDICATORS

	2015	2016	2017e	2018p	2019f	2020f
Output and Economic Growth						
Real GDP (% change, yoy)	7.0	7.0	6.8	6.9	6.7	6.6
GDP, expenditure shares (%, current prices)						
Private Consumption	75.4	74.0	72.0	70.5	69.0	68.8
Government Consumption	7.0	7.3	7.4	8.1	7.7	7.2
Gross Fixed Investment	21.4	21.7	21.9	22.2	23.1	23.5
Exports, GNFS 1/	61.7	61.3	60.7	61.0	62.0	62.8
Imports, GNFS	66.6	65.7	64.2	63.6	63.6	64.0
Domestic demand (% change, yoy)	8.5	9.5	8.4	9.4	9.7	10.1
GDP per capita (US$, nominal)	1,171.0	1,264.9	1,374.9	1,493.0	1,617.9	1,764.4
Money and Prices						
Inflation, consumer prices (annual %, period average)	1.3	3.5	3.4	3.2	3.4	3.3
M2 (% of GDP)	66.6	70.9	79.5	86.9	93.8	100.8
Domestic Credit to the Private Sector (% of GDP)	75.0	92.0	109.0	120.7	126.7	131.1
Nominal Exchange Rate (local currency per USD)	4,025.0	4,058.0	4,062.0	4,067.0	4,075.0	4,050.0
Real Exchange Rate Index (2010=100)	104.5	105.5	106.7	108.1	109.8	113.8
Short-term interest rate (% p.a.)	11.6	11.8	11.7	11.6	11.7	11.8
Fiscal						
Revenue (% of GDP)	17.6	18.5	19.7	18.7	18.7	18.8
Expenditure (% of GDP)	21.1	22.0	22.3	24.6	24.1	24.0
Overall Fiscal Balance (% of GDP)	-3.5	-3.6	-2.7	-5.9	-5.4	-5.3
Primary Fiscal Balance (% of GDP)	-3.2	-3.1	-2.3	-5.6	-5.0	-4.9
General Government Debt (% of GDP)	31.3	32.4	33.8	35.3	36.1	36.7
External Accounts						
Export growth, f.o.b (nominal US$, annual %)	7.5	9.0	9.4	10.6	11.8	12.1
Import growth, c.i.f (nominal US$, annual %)	8.4	8.2	7.8	9.2	10.0	11.3
Merchandise exports (% of GDP)	45.4	45.5	45.2	44.8	45.2	45.2
Merchandise imports (% of GDP)	57.8	56.9	55.6	55.1	55.0	55.3
Services, net (% of GDP)	7.5	7.0	7.0	7.6	8.3	9.0
Current account balance (current US$ millions) 2/	-2,093.9	-2,041.4	-2,160.6	-2,286.9	-2,452.8	-2,927.6
Current account balance (% of GDP)	-11.5	-10.2	-9.8	-9.4	-9.2	-9.9
Foreign Direct Investment (Net, current US$ millions)	1,668.8	2,164.4	2,381.0	2,664.7	2,850.5	3,104.8
Foreign Direct Investment, net inflows (% of GDP)	9.1	10.8	10.8	10.9	10.6	10.5
Gross international reserves (current US$ millions)	5,672.1	6,730.8	8,757.9	9,852.6	10,936.4	12,030.1
(prospective months of imports of g&s)	5.2	5.7	6.8	6.9	6.9	6.8
Memo: Nominal GDP (current US$ millions)	18,241.7	20,020.2	22,095.9	24,355.5	26,777.0	29,614.6

Sources: Cambodian authorities, IMF and World Bank staff estimates and projections
e = estimates; f = forecast; p = projection
1/ Goods and Non-Factor Services (GNFS)
2/ Excluding transfers.

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