INCLUSIVE AND SUSTAINABLE GROWTH ASSESSMENT

1. Cambodia has achieved in the past two decades strong economic growth and poverty reduction, underpinned by structural transformation from an agrarian economy to one led by industry and services. It became an attractive destination for export-oriented garment manufacturing and foreign direct investment (FDI) as a result of its low labor costs, favorable investment policies, and preferential trade treatments from advanced markets, especially the United States (US) and the European Union. It has also received large inflows of concessional official development assistance (ODA). The economy is open but undiversified, making it vulnerable to external shocks such as the global financial crisis of 2008–2009 and the coronavirus disease (COVID-19) pandemic. The pandemic, in particular, severely hit the economy and reversed some progress made in poverty reduction and human capital development.

2. Cambodia is currently categorized as a least-developed country (LDC) by the United Nations but is expected to graduate from this category by 2027. Graduation from the LDC status will mean less access to preferential trade treatment and concessional ODA, affecting its long-term growth path. Cambodia is also highly vulnerable to climate change despite being a low emitter of greenhouse gases. This vulnerability will affect the country’s long-term inclusive and sustainable growth path and hamper the realization of its vision of becoming an upper middle-income country by 2030 and a high-income country by 2050. This assessment identifies key development challenges to inclusive and sustainable growth in Cambodia, which will inform the proposed Asian Development Bank (ADB) country partnership strategy, 2024–2028.

A. Recent Growth, Poverty, Inequality, and Other Development Dynamics

1. Growth and Macroeconomic Performance

3. Cambodia is a small and open economy where trade equaled 172.0% of the gross domestic product (GDP) in 2019, higher than the 109.2% average in the Association of Southeast Asian Nations (ASEAN) countries. Trade has contributed significantly to economic growth, which averaged 7.3% per year during 2010–2019. However, the COVID-19 pandemic and consequent global trade disruption contracted GDP for the first time in decades by 3.1% in 2020. Swift and effective pandemic control measures including a successful vaccination program allowed Cambodia to reopen its borders in December 2021, and GDP to expand by 3.0% in 2021 and 5.2% in 2022. GDP is forecast to grow by 5.5% in 2023 and 6.0% in 2024.

4. Cambodia’s economy is undiversified and has only four main sources of growth: garment exports, rice exports, tourism, and construction largely financed from overseas. Since 2010, Cambodia’s export basket has been dominated by garments, footwear, and travel goods, which made up 62% of all exports in 2022. Cambodia’s top 20 export products ranked low in the complexity index, indicating little value addition. A government’s objective is to shift away from heavy reliance on garment exports toward light manufacturing and the assembly of electronics and automotive parts for global supply chains. ADB product space analysis shows the number of Cambodian exported products with comparative advantage increasing from 61 in 2010 to 84 in

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1 Cambodia met the criteria for LDC graduation for the first time in 2021 with gross national income per capita of $1,377 (versus a graduation threshold of $1,200), a human assets index of 74.3 (>66.0), and an economic and environmental vulnerability index of 30.6 (<32.0). Cambodia will be assessed again in 2024 and, if it meets the criteria again, will graduate from the LDC category in 2027.

2 ADB, 2023, Asian Development Outlook, Manila.

3 The high share of garments in total exports is a consequence of the Generalized System of Preferences provided by the United States, and the Everything But Arms preferences provided by the European Union.
2020 but the complexity remains low. While Cambodia has started to export some higher value-added products such as construction materials and equipment, electronics, and processed minerals, the share of medium- and high-tech exports in all manufactured exports increased from 2010 to 2020 by only 4 percentage points to 12%.4

5. Further, Cambodia’s export destinations are highly concentrated, with the US alone accounting for 43.6% of total export value in 2022. When the 2008 global financial crisis hit, Cambodia suffered one of the largest growth contractions in ASEAN because of its heavy export reliance on the US market. The People’s Republic of China (PRC) accounts for one-third of Cambodia’s imports, notably materials for garment production. The high degree of market concentration for both exports and imports leaves Cambodia vulnerable to external shocks from its main trading partners. This was evident recently as the pandemic and the Russian invasion of Ukraine disrupted supply chains and lowered global demand.

6. On the supply side, industry accounted for 36.8% of GDP in 2021. Garment manufacturing has been the primary driver of industry growth, with value addition in industry alone amounting to one-quarter of Cambodia’s real GDP. With phenomenal growth in tourism, the services sector has grown rapidly in recent years to 34.2% of GDP. International tourist arrivals ballooned from 2.5 million in 2010 to 6.6 million in 2018, and international tourism receipts during this period averaged 26% of all exports. Agriculture remains important to the economy, with value added in agriculture contributing 22.8% to GDP, one of the highest rates among lower middle-income countries. Yet, growth in agriculture value-added has been stagnant since 2013, averaging just 0.9% per year.5 Just 10% of agricultural output is processed within the country, leaving processed agricultural exports at only 8% of all official exports by value. Some diversification has been achieved in production, increasing the output of bananas, cassava, mangoes, and other higher-value crops.

7. On the demand side, private consumption accounts for the largest share of GDP, at 74.9% in 2020. Investment in real estate has risen considerably in recent years, spurring the development of high-rise condominiums, commercial centers, and other buildings. Public investment rose from the equivalent of 17.1% of GDP in 2011 to 24.9% in 2020 but remains low for a country at Cambodia’s current stage of development and compared with neighboring countries. In 2021, gross fixed capital formation equaled 26% of GDP, significantly less than the 30% in Myanmar, 31% in Indonesia, and 32% in Viet Nam.6 Public investment in infrastructure equaled 2.9% of GDP in 2019, much lower than the regional average of 5.3%. Export value grew from 38.0% of GDP in 2011 to 68.7% in 2022, but Cambodia continues to experience multiyear current account deficits funded by FDI, remittances, and ODA inflows. In 2021, the current account deficit widened significantly because of subdued tourism demand and unexpectedly large and unexplained gold imports. The deficit started to narrow in 2022 and, with gradual recovery in tourism, is expected to continue to shrink.

8. Monetary and fiscal policies have been supporting economic growth, especially during the pandemic. Despite being affected by volatile import prices and external shocks, Cambodia has experienced relatively low inflation and stable exchange rates. Average inflation was kept at 3.1% during 2010–2021 before rising to 5.3% in 2022 because of the surge in global commodity prices. During 2013–2022, growth in the money supply (M2) averaged 19.9% per annum, while private

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5 ADB. 2021. Cambodia agriculture, natural resources, and rural development sector assessment, strategy, and road map. Manila.

sector credit growth averaged 26.0%. Cambodia is a highly dollarized economy, with the ratio of foreign currency deposits to M2 at 83% at the end of June 2022. Monetary policy targets price stability to promote greater use of the riel and keep the exchange rate stable. Fiscal policy was expansionary during 2020–2021 but was wound back in 2022 as the economy improved. The fiscal deficit was 3.8% of GDP on average during 2020–2022 and is budgeted to widen to 5.0% in 2023. The government is planning for fiscal consolidation in 2024. External public debt rose from 29.5% of GDP on average during 2010–2019 to 35.2% during the pandemic. At the end of 2021, external public debt was $9.5 billion, of which 42.7% was owed to the PRC. Public external debt declined to 33.3% of GDP in 2022 but is expected to rise to 34.7% in 2023. However, Cambodia’s external public debt remains low for an LDC, and the latest International Monetary Fund Article IV assessment rated risks of external and overall debt distress low.\(^7\)

<table>
<thead>
<tr>
<th>Selected Macroeconomic Indicators</th>
<th>2010</th>
<th>2015</th>
<th>2019</th>
<th>2020</th>
<th>2021</th>
<th>2022(^a)</th>
</tr>
</thead>
<tbody>
<tr>
<td>GNI per capita Atlas method (current $)</td>
<td>750.0</td>
<td>1,070.0</td>
<td>1,560.0</td>
<td>1,530.0</td>
<td>1,580.0</td>
<td>...</td>
</tr>
<tr>
<td>Real GDP growth (% change)</td>
<td>6.0</td>
<td>7.0</td>
<td>7.1</td>
<td>(3.1)</td>
<td>3.0</td>
<td>5.2</td>
</tr>
<tr>
<td>Inflation (period average)</td>
<td>4.0</td>
<td>1.2</td>
<td>1.9</td>
<td>2.9</td>
<td>2.9</td>
<td>5.3</td>
</tr>
<tr>
<td>Revenue(^b) (% of GDP)</td>
<td>12.6</td>
<td>19.6</td>
<td>26.8</td>
<td>23.9</td>
<td>21.6</td>
<td>22.2</td>
</tr>
<tr>
<td>Expenditure(^b) (% of GDP)</td>
<td>21.4</td>
<td>20.2</td>
<td>23.8</td>
<td>27.3</td>
<td>28.6</td>
<td>20.5</td>
</tr>
<tr>
<td>Fiscal balance(^b) (% of GDP)</td>
<td>(8.8)</td>
<td>(0.6)</td>
<td>3.0</td>
<td>(3.4)</td>
<td>(7.1)</td>
<td>0.3</td>
</tr>
<tr>
<td>Broad money (M2, % change)</td>
<td>21.3</td>
<td>17.0</td>
<td>18.2</td>
<td>15.3</td>
<td>16.4</td>
<td>8.2</td>
</tr>
<tr>
<td>Current account balance (% of GDP)</td>
<td>(8.4)</td>
<td>(8.8)</td>
<td>(10.8)</td>
<td>(3.4)</td>
<td>(40.4)</td>
<td>(25.3)</td>
</tr>
<tr>
<td>Foreign direct investment, net ($ million)</td>
<td>1,384.0</td>
<td>1,735.0</td>
<td>3,561.0</td>
<td>3,498.0</td>
<td>3,391.0</td>
<td>3,428.0</td>
</tr>
<tr>
<td>Gross official reserves ($ million)</td>
<td>3,802.0</td>
<td>7,377.0</td>
<td>18,763.0</td>
<td>21,334.0</td>
<td>20,265.0</td>
<td>17,805.0</td>
</tr>
<tr>
<td>Gross official reserves (months of imports)</td>
<td>6.0</td>
<td>5.7</td>
<td>8.8</td>
<td>11.1</td>
<td>7.4</td>
<td>6.1</td>
</tr>
<tr>
<td>External public debt (% of GDP)</td>
<td>27.1</td>
<td>31.0</td>
<td>28.1</td>
<td>33.9</td>
<td>35.2</td>
<td>33.3</td>
</tr>
<tr>
<td>Poverty incidence (%)</td>
<td>...</td>
<td>...</td>
<td>17.8</td>
<td>17.8</td>
<td>...</td>
<td>...</td>
</tr>
<tr>
<td>Gini coefficient</td>
<td>...</td>
<td>...</td>
<td>32.2</td>
<td>32.2</td>
<td>...</td>
<td>...</td>
</tr>
</tbody>
</table>

\(^{...}=\) unavailable, ( ) = negative, GDP = gross domestic product, GNI = gross national income, M2 = broad money including cash and highly liquid accounts.
\(^a\) Estimate.
\(^b\) General government.


2. **Poverty, Inequality, Employment, Human Capital Development, and Gender**

9. **Poverty and inequality.** Cambodia has made remarkable progress in poverty reduction since 2009. The percentage of Cambodians living below the national poverty line of $2.66 per day plunged from 33.4% in 2009 to 17.8% in 2019.\(^8\) The poverty rate in rural areas declined quickly but was still 18.9% in 2019, well above the 5.1% in urban areas, showing persistent rural–urban disparity. About 30% of Cambodians still cluster around the poverty line, one-third of the population subsisting on less than $3.20 per day in 2019 and at risk of slipping back into poverty because of illness, natural hazards, or economic shocks. The pandemic reversed progress in poverty reduction, as poverty rose in 2020 for the first time in decades. An estimated 460,000 Cambodians fell into poverty in 2020, raising the poverty rate by 2.8 percentage points. Without government intervention, the pandemic would have increased poverty by an estimated 4.7 percentage points in 2020.\(^9\) Economic growth also has been inadequately inclusive, as income inequality, measured by the Gini coefficient, worsened from 29.9 in 2014 to 32.2 in 2019, after

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\(^7\) International Monetary Fund. 2022. *Cambodia: Article IV Consultation Staff Report.* Washington, DC.


having remained stable from 2009 to 2014. Without the government’s cash transfer program in
2020, the Gini coefficient would have worsened by 0.4 percentage points, doubling the 0.2
percentage point deterioration recorded that year (footnote 9).

10. Employment. Cambodia’s has a growing workforce but a high rate of informality and low
wages. With a working-age population of 9 million people aged 15–64, the labor force participation
rate was 83.7% (78.9% female and 88.7% male) in 2021.10 The employment rate increased from
75.7% in 2016 to 85.4% in 2020 before falling back to 82.8% in 2021 under the pandemic. The
International Labour Organization estimated working hour losses at 1.1 million full-time equivalent
jobs in 2020 and 1.3 million in 2021. While unemployment was low at 1% in 2021,
derelated underemployment at 11%, meaning at least one in 10 people either want to
work additional hours or are available to work additional hours if given opportunities. The informal
sector employs about 80% of all workers, and 88% of female workers, mostly in low-paid jobs
with no social protection or job security. Agriculture provides the largest share of employment at
39.1% overall (42.4% male and 36.4% female), followed by services at 35.1% overall (32.8%
male and 38.7% female) and industry at 27.0% overall (28.0% male and 26.0% female).11 The
percentage of youth not in employment, education, or training in 2019 was 11.4% (10.0% male
and 12.6% female).12 Labor productivity has been rising but remains below the ASEAN average.
In 2020, Cambodia’s labor productivity per worker per day was only $2.89, less than the $14.78
in Thailand, $12.04 in Indonesia, $9.83 in the Philippines, and $6.58 in Viet Nam.13

11. Human capital development. From 2000 to 2018, the Human Development Index
progressed from 0.425 to 0.598. However, progress has slowed in recent years, especially during
the pandemic when the index slipped marginally to 0.593. Cambodia currently ranks in the
midrange of human capital development at 146th out of 191 countries.14

12. Education. Education quality, as measured by the education index, is 0.352, below the
Southeast Asian average of 0.714.15 Cambodia ranked 119th out of 141 countries in terms of
access to quality education systems.16 The country scored poorly in the (i) quality of primary
education (121st), (ii) quality of the education system (120th), and (iii) ease of access to quality
education (126th). Access to early childhood education has improved over the years, with 50% of
children aged 3–5 years old receiving preprimary education services in 2023 compared to 24% in
2019. Primary education approached universal enrollment and gender parity, with a net
enrollment rate of 95.8% (female 95.9%) in 2023.17 While basic education is free for all children
up to 15 years old, access to secondary education remains a challenge, especially in rural areas.
The net enrollment rate for lower secondary education in 2023 was 45.3% (female 50.3%) and
for upper education 32.6% (female 37.6%). The school dropout rate remains high, at 7.5% in 2022
in primary education, 18.2% in lower secondary education, and 15.3% in upper secondary
education.18 Among the 72.3% of grade 12 graduates in 2022, only 32.5% specialized in science,
technology, engineering, and mathematics (STEM), raising concerns about skill mismatch as

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many professions in the fourth industrial revolution (4IR) require STEM backgrounds. The share of the workforce engaged in medium- and high-level technical occupations such as technicians, professionals, and plant and machine operators was only 10.7% in 2021. Cambodia currently ranks eighth among 10 ASEAN economies for current and future workforce skills (footnote 15).

13. **Health.** Cambodia also trails behind in health care resources and outcomes. Life expectancy at birth is 69.6 years, the second-shortest lifespan in ASEAN. In 2020, the mortality rate for children under 5 years was 34 deaths per 1,000 live births, worse than the regional average of 20. The maternal mortality ratio of 154 deaths per 100,000 live births in 2021 was higher than the regional average of 125. In 2019, 32.4% of children under 5 suffered stunting, higher than the Asian average of 21.8%. Chronic malnutrition in children under 5 is severe at 22%. Government spending on health increased from the equivalent of 1.2% of GDP in 2015 to 2.0% in 2020 but languishes below the average of 2.8% in low-income countries. Out-of-pocket expenditure of $70 per person per year accounts for 64.4% of total health expenditure, among the highest levels in ASEAN.

14. **Gender equality.** Gender equality performance in Cambodia is complex. On the one hand, Cambodian women have broadly equal access to basic health care and education. The gender development index has shown a positive trend, improving from 0.934 in 2010 to 0.947 in 2021. The gender parity index for gross enrollment in primary schools improved from 0.95 in 2011–2021 to 0.99 in 2021–2022. On the other hand, adult literacy in 2021 was only 79.8% for women versus 88.4% for men. In the same year, more than 53% of women were in vulnerable employment versus 41% of men. The gender pay gap for equivalent work continues to be significant, estimated at 19%. The pandemic disproportionately affected women as many are employed in vulnerable sectors such as tourism and manufacturing. In 2019, only 10% of agricultural land was owned by women, and women held only 20% of seats in the parliament and 29% of senior and middle management positions. Gender-based violence remains an issue, with 32% of Cambodian women reporting in 2019 to have experienced physical, sexual, or emotional violence from their partners at some point in their lives.

3. **Governance, Business Environment, Infrastructure, and Climate Change**

15. **Governance.** Worldwide Governance Indicators from 2017 to 2021 indicate progress in Cambodia toward political stability and the absence of violence and terrorism. However, significant concerns persist regarding democratic processes, corruption, and regulatory quality. The institutional setup and governance arrangements overall remain fragile. Public financial management is improving but from a low base. Public expenditure and financial accountability strengthened from 2015 to 2021, with the rating for budget credibility improving from C+ to B, and for budget comprehensiveness and transparency from C to C+. Ratings remained stable at C+ for the predictability and control of budget execution, and at C for accounting, recording, and reporting. However, the rating for policy-based fiscal strategy and budgeting worsened from B+...
Improvements have been made in fiscal and budget management, while further improvements are required in medium-term budgeting, fiscal transparency, public investment management, accounting, reporting, and audit. Cambodia's legal and regulatory framework for public procurement has improved, but gaps exist in e-procurement, procurement operations and market practices, and government capacity.

16. **Business environment for private sector development.** Cambodia's economy is dominated by private micro, small, and medium-sized enterprises (MSMEs), mostly informal, with fewer state-owned enterprises than in neighboring countries. About 50,000 registered companies operate in Cambodia, of which 96.4% are microenterprises with fewer than 10 employees and less than $50,000 in assets, and only 0.2% are large enterprises with more than 100 employees and $500,000 in assets. The business environment does not generally encourage the private sector to formally incorporate, operate, grow, and expand, mainly because of cumbersome procedures. Reform undertaken to improve the business environment notably includes the enactment of the Investment Law, 2021 and the launch of a new online business registration system allowing investors to register their businesses and file their taxes using a single digital platform. Online business registration has cut startup costs by half and business registration time from 2 months to 8 working days and includes online applications for business licenses and permits. To support ongoing business operations, the government issued regulations to streamline procedures for granting building permits and certificates of occupancy. To facilitate tax payment, the government implemented e-filing management and an e-payment system, relaxed tax audit requirements, and expedited audit procedures.

17. **Finance sector.** Cambodia’s finance sector is dominated by banks. In recent years, it has experienced rapid credit growth, building up a large stock of private sector credit, which equaled 178% of GDP in 2022. Its lending portfolio is increasingly exposed to real estate, which accounted for almost one-third of banks’ gross loans in 2022. Microfinance has grown significantly, with aggregate assets of $9.1 billion at the end of 2021, or 11.5% of all finance sector assets. Despite having a competitive banking industry, Cambodia has only moderate access to finance, which impedes private sector development. One-third of adults are completely excluded from financial services, and among those with access, only 30% have bank accounts. Only 19.9% of firms have a bank loan or line of credit, among the lowest rates in Asia. The financing gap for MSMEs in Cambodia is estimated to be $7.7 billion—$4.2 billion for MSMEs owned by women and $3.5 billion for MSMEs owned by men. The capital market is nascent and illiquid, with only three listed government bonds and seven listed corporate bonds. The stock market has nine listed companies, with a total market capitalization of $2.4 billion. The nonbank segment, including insurance and mutual funds, is small, and the handful of regional private equity and venture capital funds invest mainly in later-stage companies.

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28 In 2022, the banking system comprised 59 commercial banks, nine specialized banks, five deposit-taking and 82 non-deposit-taking microfinance institutions, 16 financial leasing institutions, and 223 rural credit institutions.

29 Reported nonperforming loans were low at 3.2% as of September 2022, but this figure may understate the problem because of lenient prudential regulations enacted during the pandemic. Restructured loans as of June 2022 were estimated to equal 13% of GDP. The liquidity coverage ratio is 143%, well above the required benchmark of 100% but down from 152% in 2021. Profitability ratios remained stable, with a return on assets of 1.7% in 2021. Source: National Bank of Cambodia.

18. **Infrastructure development and urbanization.** Cambodia also trails behind many countries in infrastructure development, ranking 10th out of 11 Southeast Asian economies.\(^{31}\) Road transport underperformed the region, scoring 3.6 out of 7.0 on road quality, with the Lao People’s Democratic Republic at 3.7, Thailand 4.4, and Malaysia 5.3. Only 30% of provincial roads and 10% of rural roads are paved.\(^{32}\) The Global Infrastructure Hub estimated that Cambodia requires $1.1 billion per year in infrastructure investment from 2024 and 2040 to sustain economic growth, but current investment falls far short. Like most countries at a similar stage of development, Cambodia has seen its urban population grow rapidly, from 18.6% of the total in 2000 to 25.5% in 2020.\(^{33}\) Current urbanization remains below what would be predicted based on GDP per capita, however, suggesting that urbanization may accelerate in the coming years. Despite the economic benefits of urbanization—notably increased productivity, job creation, investment, and entrepreneurship—rapid urbanization poses several challenges, such as adequate provision to growing urban populations of housing, urban transport, and basic services including clean water, sanitation, and electricity. With the number of extremely hot days expected to rise with climate change, infrastructure such as schools and hospitals need to be retrofitted or reconstructed to cope with heat stress. Further, urbanization pushes up urban temperatures with the construction of roads and buildings that cause a heat island effect, as the built environment absorbs and re-emits more solar heat than did the natural landscape it replaced.

19. **Water and sanitation.** Water and sanitation remain a challenge as sector performance is far off-track to meet the government target of universal access to safe drinking water and sanitation by 2025. In 2020, only 28% of the population used safely managed water supplies, 18% in rural areas and 57% in urban areas, and more than half of the population still lacked piped water supply (64% in rural areas and 20% in urban areas).\(^{34}\) About 30% of rural Cambodians do not have basic handwashing facilities with soap and water in their homes. Cambodia has the highest rate of open defecation in ASEAN, with 80% of the poorest rural Cambodians defecating in the open and thus contaminating land and water resources and exposing the population to infectious disease. Climate change will likely put government targets for the sector further out of reach by diminishing water supply, worsening water quality, and damaging water and sanitation infrastructure such as urban drainage systems.

20. **Energy.** Total energy supply increased from 142,499 terajoules in 2000 to 328,778 terajoules in 2020.\(^{35}\) Electricity supply increased more than eightfold from 2008 to 2022 to reach 15,456 gigawatts (GW). At the end of 2022, domestic power generation capacity totaled 3,465 megawatts, of which hydro power provided 38%, followed by coal at 30%, fuel oil at 19%, and solar at 13%. Over 88% of households had access to electricity in 2022, up from 17% in 2008.\(^{36}\) However, population expansion, accelerated economic activity, and urbanization are driving up electricity demand, which increased fivefold from 2,515 GW in 2010 to 12,601 GW in 2023. Cambodia imports all its fossil fuels and one-third of its electricity. Dependence on energy imports significantly hinders energy security, reliability of supply, and affordability, hurting poor households and undermining the competitiveness of industry and commerce. As climate change worsens drought, it threatens shocks to energy production as about 60% of Cambodia’s current hydro power capacity is in areas now experiencing increased dry days.

\(^{32}\) PwC. 2022. *Capital Projects and Infrastructure*.
\(^{33}\) The biggest urban centers are Phnom Penh with 2.3 million residents, Siem Reap with 0.2 million, and Battambang with 0.1 million. The government forecasts that the urban population will reach 7.8 million by 2030.
\(^{36}\) Electricity Authority of Cambodia (accessed 9 May 2023).
21. Environment, natural hazards, and climate change. Cambodia is vulnerable to climate change, ranking 149th out of 182 world economies in the 2022 Notre Dame Global Adaptation Index for its vulnerability and readiness to improve climate resilience. Vulnerability derives from the country’s extensive floodplains, weak governance, and high dependence on climate-sensitive industries such as agriculture, manufacturing, construction, and tourism. Flooding poses the highest risk to Cambodia. The 2024 Index for Risk Management (INFORM) scored Cambodia’s flooding risk at 9.5 out of 10.0, making it the second most vulnerable country in the world to flooding. Climate change is expected to increase the frequency and intensity of flooding and drought, raise average temperatures and sea levels, and worsen saline intrusion in Cambodia.

22. Cambodia became a party to the United Nations Framework Convention on Climate Change in 1996 and ratified the Paris Agreement in February 2017. In 2020, it updated its intended nationally determined contribution (NDC) with a more ambitious emission reduction target of 41.7% compared to business as usual by 2030. The updated NDC also set an ambitious target of halving the deforestation rate by 2030 and included new mitigation targets in agriculture and waste handling, as well as more detailed actions for energy efficiency. Cambodia also strengthened its climate policy framework with several strategies on low-carbon development, including the Cambodia Climate Change Strategic Plan, 2014–2023; National Strategic Plan on Green Growth, 2013–2030; National Environment Strategy and Action Plan, 2016–2023; Long-Term Strategy for Carbon Neutrality by 2050; National Energy Efficiency Policy, 2022–2030; and Power Development Masterplan, 2022–2040.

23. Progress toward development goals. Cambodia has made moderate progress toward achieving the Sustainable Development Goals (SDGs), improving its overall score from 48.74 in 2000 to 63.52 in 2021. It currently ranks 107th out of 163 countries on the SDG index. Of 17 SDG indicators, Cambodia is on track to achieve two SDGs (responsible consumption and production, and climate action), has moderately improved for nine SDGs, and has stagnated for four. Significant challenges remain in gender equality (measured as seats held by women in the national parliament); decent work and economic growth (adults with an account at a financial institution and fundamental labor rights); industry, innovation, and infrastructure (logistics performance index measuring the quality of trade and transport-related infrastructure); and life below water (environmental degradation from dredging and fish caught from overexploited or collapsed stocks or by trawling).

24. Regional cooperation and integration. Cambodia is an active member of the Greater Mekong Subregion (GMS) program and is at the heart of GMS economic corridor development. It hosted the Seventh GMS Leaders’ Summit in 2021, which endorsed the GMS Strategic Framework 2030. The framework fully aligns with the National Strategic Development Plan, 2019–2023 in promoting economic diversification and private sector development. Cambodia has actively established free trade agreements, including recent agreements with the PRC, Republic of Korea, and United Arab Emirates. It was one of the first countries to ratify, in October 2021, the

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Regional Comprehensive Economic Partnership, which is expected to boost Cambodia’s exports by 9.4%–18.0% annually, GDP growth by 2.0%–3.8%, and employment growth by 3.2%–6.2%.46

B. Key Impediments to Inclusive and Sustainable Growth

25. Cambodia is approaching a development crossroads with its imminent graduation from LDC categorization. While graduation will send positive signals to potential international investors on the country’s development prospects and generate more investment opportunities, it will also introduce new challenges by reducing access to the concessional ODA and preferential trade treatment that have underpinned the country’s economic growth and development progress in recent decades. To successfully transition to upper middle-income country status and beyond along a growth trajectory that is inclusive, sustainable, and resilient, Cambodia will need to address several impediments clustered in three areas: (i) a narrow base for economic growth with low diversification led by the private sector, (ii) lagging human capital development, and (iii) high vulnerability to climate change. Tackling other crosscutting constraints will require strengthened governance and institutional capacity, reduced gender inequality, expanded innovation and technology, and enhanced regional cooperation and integration.

1. Narrow Base for Economic Growth with Low Private-Sector-Led Diversification

26. Persistent dependence on textile, garment, and footwear manufacturing. A narrow economic model highly dependent on garments and tourism is inadequate to sustain Cambodia’s long-term growth. The combined share of the top three manufacturing industries—textiles, garments, and footwear—in total manufacturing value added has remained high at 88% since 2005, with no decline recorded since 2015. While there has been some progress in diversifying export products, the diversification of export markets remains limited, with the US and the European Union continuing to be the biggest markets for Cambodian exports. Impediments to the pursuit of new industrial activities and exports include (i) indecision about what kinds of new ventures to promote and what incentives to use to attract new investment; (ii) continued industrial concentration in a few large companies; (iii) the slow formalization of small and medium-sized enterprises for lack of information about the benefits of registration, deficient business management skills, and hesitation to incur tax obligations upon formal registration; (iv) weak industrial innovation to pivot into higher value addition; and (v) a lack of understanding of climate change risks and opportunities.

27. Inadequate investment in climate-resilient infrastructure. A key impediment to economic diversification is the high cost of business inputs, mainly because of the inadequate provision of infrastructure. The conditions of roads, especially rural roads, are poor because of underinvestment and inadequate maintenance, raising the cost of transporting goods, especially agricultural products, from farms to markets. Easing constraints on the movement of goods through improved transport, logistics, and trade facilitation would bring large benefits to the economy, including diversification of traded goods and export markets. Dependence on energy imports; limited grid connectivity, especially in rural areas; and slow improvements in energy efficiency result in very high electricity costs, making it difficult for firms to maintain their competitiveness in production and limiting upgrades within manufacturing supply chains in the electronics and automotive industries. Expensive and unreliable electricity supply constrains the transition from labor-intensive assembly toward higher value-added but energy-intensive production of parts and components. Finally, Cambodia needs to improve its urban infrastructure,

especially to cope with the effects of climate change as orderly urbanization and agglomeration in special economic zones promises further diversification and economic growth.

28. Uncompetitive business environment. Despite recent reforms to improve competitiveness, several challenges continue to hinder private sector development and diversification. Cambodia’s legal and regulatory frameworks are complex, with major business laws and regulations suffering from lack of enforcement. A Eurocham business confidence survey in 2021 found that opaque practices and unofficial fees remain the biggest obstacles.\(^{47}\) Competition is weakened by vested interests and unfair competitive practices. An only nascent commercial judicial system makes contract enforcement time-consuming and expensive. The legal framework for insolvency is incomplete and little known to stakeholders. Large infrastructure requirements to maintain economic growth are far beyond government means using its own financing capacity and available ODA. Public–private partnership (PPP) law and regulations exist but are rarely implemented. PPP projects are still developed on an unsolicited basis with limited transparency. A central PPP unit has been created, but line ministries have no mandate for pipeline development, leaving a dearth of bankable PPP projects, especially green projects that can deliver stakeholder value for money.

29. Limited access to finance. Despite being the backbone of the economy, MSMEs, especially those in rural areas, still struggle to access finance. Financial institutions almost always demand collateral, mostly land, for lending but few MSMEs have enough collateral to put up for bank loans. Most businesses, therefore, resort to informal borrowing for investment and working capital—a trend likely to have been exacerbated by the COVID-19 pandemic. Further, borrowers generally enjoy little protection from unfair lending practices. The regulatory framework is not yet complete and still lacks an enforcement framework for consumer protection. Supervision capacity requires strengthening, and effective coordination mechanisms between key oversight ministries need to be established. The sector also sees little innovation or technology adoption despite their potential to significantly widen financial inclusion. Weak corporate governance hinders businesses’ ability to raise funds in the nascent capital market. Key barriers to private sector finance are uncertainty regarding the policy and regulatory environment; weak pipelines for green and social projects; concerns over fast-growing debt per capita and cases of over indebtedness; and deficient consideration of environmental, social, and governance considerations. Finally, transaction costs incurred in origination, due diligence, and portfolio management tend to be high for small markets such as Cambodia.

30. Low productivity, diversification, and commercialization in agriculture. Low value addition in agriculture is attributed to chronically low labor productivity in the sector, which stems from adverse weather and a preponderance of rice production sold without processing. Farmers have little access to improved seed varieties, pesticides, or fertilizers, posing challenges to modernization and productivity enhancement. To boost labor productivity and farm earnings, mechanization needs to be expanded. During 2017–2020, the average farm machinery per worker was almost 3.5 times lower than in Viet Nam and 16 times lower than in the Philippines.\(^{48}\) Only 22% of the country’s 4.5 million hectares of arable land currently has access to irrigation schemes, many of which are poorly operated and maintained. Agricultural production lacks diversification, mainly reflecting poor market access and little opportunity for farmers to experiment with new crops. Inadequate infrastructure for transportation, storage, and processing are key constraints on market access, leaving farmers reliant on traditional subsistence farming and informal markets. The potential for contract farming remains largely untapped because the


\(^{48}\) Measured by 1,000 metric horsepower per 1,000 agriculture workers.
pool of private agro-processors is small, leaving farmers few partner choices and therefore little negotiating power. Finally, the sector is vulnerable to climate change, which increases the frequency and intensity of floods and droughts as well as the number of extremely hot days. Apart from damaging crops and agriculture infrastructure and reducing farm productivity, climate change also threatens Cambodia’s food security and dietary nutrition. For example, climate change is expected to reduce average rain-fed rice yields by an estimated 30% between 2031 and 2060 under the highest emission scenario. It is also causing ocean acidification, rising water temperatures, and changing currents, affecting inland and marine fisheries, an important nutrition source for Cambodians.

2. Lagging Human Capital

31. **Low quality, access, and retention in secondary education.** The low quality of education offered by the current system reflects mainly poor teacher recruitment and preservice training, suboptimal teacher deployment, and a lack of continuing professional development. Professional teacher licensing is not yet required, and professional standards are absent from annual performance appraisals. Further, the educational leadership capacity of school directors and management is weak. Gaining access to secondary education remains a challenge and was exacerbated by COVID-19. Many students struggle to move up because of failure in primary education to teach basic literacy and numeracy, such that they drop out at the end of basic education. Dropout rates also are high in secondary education because schools are often far from home, qualified teachers are lacking, core textbooks are in short supply, teaching methods are uninspiring, and the few scholarships available are hard to secure. Early school leaving is especially prevalent in rural areas because children must work to support their families. The education sector is ill-prepared for distance learning as the curriculum, instruction, and assessment have traditionally been based on the teacher-classroom model, and few teachers command adequate skills in technology for education. A lack of information and communication technology (ICT), especially in rural schools, has led to high dropout rates during prolonged school closures.

32. **Deficient science, technology, engineering, and mathematics education.** Low STEM enrollment largely reflects a lack of classrooms with science laboratories, ICT equipment, and other learning resources required to effectively teach and learn science subjects. Poor public understanding of the benefits and career choices enabled by STEM further depresses STEM enrollment. The absence of a multiyear expenditure framework based on a minimum service level has precluded effective budget planning for upper-secondary education access and quality improvement. The quality of STEM education is low because (i) teachers specializing in STEM are in short supply, (ii) teachers fail to make STEM learning more connected and relevant to students or to effectively integrate STEM with other course work, and (iii) knowledge of pedagogical content and teaching strategies falls short. Finally, Cambodia’s education system lacks the capacity to manage, deliver, or monitor quality improvements.

33. **Skills mismatched with industry requirements.** Skill gaps have emerged in almost all employment categories where higher-level skills are needed. As Cambodia moves up the value chain, many low-skilled, repetitive jobs are being automated and more demand for skilled workers emerges. Future jobs will require higher skills, such as people management, decision-making, evaluation, communication, and analytical reasoning. Better matching skills with industry requirements requires strong coordination within and among the government, educational and training institutions, and industry. However, understanding of 4IR requirements remains poor across ministries, as is coordination between academic and technical education streams, and even communication between industry and training institutions. Challenges to technical and vocational education and training (TVET) include low institutional capacity within the sector to
meet the demands of 4IR, a lack of qualified trainers, the low availability and quality of TVET programs offered by the government, poor interagency coordination, and inadequate budget allocation to TVET.

34. **Low-quality health care.** Cambodia’s health services face several challenges. Most health centers and hospitals need significant investment and upgrading to make public health care accessible and affordable. The health system’s capacity to respond to public health threats is low, with only 60% compliance with the core health system capacity requirements of the International Health Regulations. Health emergency management, points of entry and border health, and financing are among the top challenges for regional health care. Finally, the challenges posed by noncommunicable diseases and the impact they have on the health system is an ongoing concern. In 2018, noncommunicable diseases cost Cambodia $1.5 billion in direct health care costs and attendant productivity losses, equal to 6.6% of GDP.

3. **High Vulnerability to Climate Change**

35. **Climate adaptation.** The consequences of climate change on Cambodia’s economy and people are already significant because of high dependence on climate-sensitive sectors and industries (such as agriculture, construction, and manufacturing), and are expected to worsen without adequate adaptation measures. Extreme temperatures and changing hydrological cycles have brought unpredictable rainfall patterns, droughts and floods, sea-level rise, and saltwater intrusion. Such disruption is expected to reduce labor productivity in agriculture, fisheries, and manufacturing and otherwise harm tourism and forestry. A once-in-a-decade flood could slash GDP by 7%–11%, with smaller impacts where businesses were well prepared. Floods can impose indirect costs by lengthening travel time to hospitals, schools, and markets and disrupting freight and supply chains. Droughts are especially hard on rural populations who rely on subsistence agriculture, as lack of rainfall and the strangling of the Mekong River by upstream damming decrease water availability and depress agricultural yields and production. Extreme heat alone is projected to lower labor productivity by more than 20% by 2050 while reducing tourism revenue by 8%. One estimate has climate change slashing Cambodia’s GDP by 9.8% by 2050.

36. **Climate mitigation.** Cambodia is a low emitter of greenhouse gases, contributing only 0.02% to global emissions, but its emissions are worsening with deforestation, expanded rice cultivation, and rising energy consumption. Nearly half of its emissions are from land-use change and forestry. Agriculture is the second highest emitter, followed by energy, industry, and waste management. A transition to net zero will improve competitiveness and create new growth potential, especially as graduation from LDC categorization will require adherence to higher environmental standards for export to advanced economies. It will contribute to economic diversification, generate higher-quality jobs, and attract higher FDI from global investors increasingly looking for green investments.

37. **Challenges to pursuing climate actions.** Cambodia’s vulnerability to climate change is exacerbated by weak adaptive capacity, low human and financial resources, poor infrastructure, and constrained institutional capacity and access to technology. Many policies and strategies addressing climate change have been developed, but their implementation is undermined by low

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50 Ministry of Economy and Finance. 2019. *Addressing Climate Change Impacts on Economic Growth in Cambodia*. Phnom Penh. The Climate Economic Growth Impact Model for Cambodia indicates that, in 2050, reduced labor productivity will account for 57% of all loss and damage caused by climate change, with manufacturing and construction worst affected. Damage to assets will account for 26%, spread across sectors but hitting services hardest. Loss of income will account for 17%, concentrated in agriculture.
institutional capacity and financial constraints. The National Adaptation Plan, for example, requires an estimated $865.5 million for implementation but only 7% of this amount has been made available. Public expenditure on climate change constituted only 3.2% of all public expenditure in 2017. \(^{51}\) Cambodia’s updated NDC estimates funding requirements of over $5.8 billion for mitigation and $2.0 billion for adaptation. Both funding commitments are, however, entirely conditional on international support.

4. Crosscutting Challenges

38. Weak governance and institutional capacity. The government has introduced broad governance reform to improve public financial management and procurement systems. However, reform effectiveness is hampered by operational shortcomings. More needs to be done to close gaps between budgeted amounts and actual expenditure. The government’s budget process for externally funded projects leaves ODA funds inadequately integrated with the country’s public financial management systems. Capacity for budget implementation in line ministries and agencies is constrained by a lack of technical capacity and unhelpful bureaucratic processes. An integrated financial management information system has been rolled out to line ministries, but more is needed to strengthen estimates, budget expenditure controls, and the tracking of expenditure arrears. A budget strategic plan has been adopted and medium-term fiscal and budget frameworks introduced but implementation varies in line ministries such that most expenditure proposals do not align with strategic plans. The public internal control system and internal audit need improvement. In procurement, direct contracting is used for 90% of government capital expenditure despite a requirement for competitive bidding. Meanwhile, procurement information is hard to find, and a nationwide collection and reporting mechanism for procurement data has yet to be realized. No government agency currently uses e-procurement, and civil society organizations are not actively invited to observe the procurement process.

39. Gender inequality. Cambodia has a strong policy framework for gender equality but not all sector policies for gender mainstreaming have been updated at the ministry level. Most gender mainstreaming action plans lack detailed gender statistics or analysis. The most common gender issues arise from rigid gender norms about the roles and responsibilities of women in society that do not economically empower them. Gender-based violence and workplace sexual harassment persist across all sectors, as no laws or policies define their scope and they are little understood in the Cambodian context. Gender-based violence against marginalized populations is not well addressed in the policy framework, and a proper protection mechanism is lacking. The social inclusion process is extremely weak, disadvantaging such marginalized people as women with disabilities or from ethnic minority groups. Multiple obstacles impede women’s economic empowerment, not least a lack of opportunity for women to upskill for better employment. Women similarly lack access to the finance and business networks they need to expand their businesses, which are mostly small and informal. Finally, there is no framework to measure the scale or impact of investment in gender equality.

40. Limited innovation and technology adoption. Cambodia recently launched the Digital Cambodia 2025 initiative, which aims to transform the country into a digital economy by improving digital infrastructure, promoting e-commerce, and encouraging tech start-ups. However, the country continues to rank low in innovation and technology adoption. In the Global Innovation Index 2022, Cambodia ranked 97th out of 132 economies. \(^{52}\) The biggest challenges include poor


infrastructure, which constrains online public services and drives up electricity costs; low business sophistication, including a lack of knowledge workers; a dearth of knowledge and technology outputs as measured by the low number of patents and of scientific and technical articles published; and few creative outputs.

41. **Regional cooperation and integration.** New growth drivers need to be identified, along with pathways to sequence private sector investments, for benefits from GMS economic corridors to be sustained. Proper planning and management of free trade zones and industrial parks can spur the further development of economic corridors. The pandemic highlighted the importance of technological solutions that streamline border procedures and strengthen regional public health measures. Coordinated action on climate change, disaster risk management, and transboundary water resource management are required to promote regional public goods. Finally, stronger policy action is required to enable economic actors to navigate implementation challenges and ensure that Cambodia fully realizes the benefits offered by the Regional Comprehensive Economic Partnership.

C. **Implications for ADB Country Engagement**

42. **Lessons from past engagements.** The final review of the country partnership strategy (CPS), 2019–2023 made the following recommendations for ADB engagement under the new CPS. First, ADB should remain flexible to ensure timely responses to emerging and unexpected needs such as those that arose during the pandemic. Second, the program should leverage ADB’s comparative advantage in the country in, e.g., human capital and infrastructure development. Third, with the frequency and intensity of floods and droughts increasing, and the impact of these weather events on economic growth, climate resilience should be built into project designs and closely monitored during implementation. Fourth, ADB should adopt a One ADB approach to improve the business environment by scaling up private sector operations and helping mobilize private sector investment in development projects. Fifth, more robust due diligence in project preparation and appraisal would ensure that project and program designs are realistic and achievable within the anticipated time frame and budget. Finally, integrated multisector approaches should be pursued, where feasible, to maximize development impacts.

43. **Alignment with national development priorities.** ADB’s CPS, 2024–2028 should be aligned with the government’s Pentagonal Strategy, Phase I, 2024–2028, which focuses on human capital development; economic diversification and competitiveness; private sector development and jobs; inclusive, sustainable, and resilient development; and a digital economy. ADB should continue to support the government’s commitment to implement its NDC, which targeted 41.7% greenhouse gas emissions by 2030 compared to business as usual.

44. **ADB’s comparative advantage and value addition.** ADB’s comparative advantages include climate-resilient infrastructure, human capital development, and structural reform to improve governance, finance, and private sector development. As a trusted lender with strong due diligence capability and a proper system of safeguards, ADB can support large and complex investments that may include innovative and novel approaches. As Cambodia’s largest multilateral development partner, ADB is well positioned to mobilize development finance to support larger and more integrated projects that offer transformational benefits. With its advantage of having both sovereign and nonsovereign operations under one roof, ADB can tailor solutions that encompass upstream policy dialogue, midstream advisory services, and downstream project financing, as well as innovative finance, to help Cambodia address its emerging development challenges. As Cambodia’s top external source of climate finance, ADB

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can focus its support on implementing the country’s NDC. Given the country’s vulnerability to climate change, the primary focus should be on climate change adaptation. However, support should include climate mitigation using renewable energy, which has additional benefits of improving energy security and affordability. Finally, with its regional knowledge and operations, ADB can deliver best practices in such areas as domestic resource mobilization, capital market development, and climate change.

45. **Strategic framework and priorities.** Reflecting on lessons learned, government priorities, and the economic context, the new CPS should aim to strengthen pathways to a more sustainable, inclusive, and resilient economy by accelerating economic diversification, advancing human development, and strengthening climate resilience. Other crosscutting targets are enhanced gender equality, strengthened governance, greater regional cooperation and integration, and facilitated innovation and technology adoption.

46. **Sector selectivity and synergies with other development partners.** Given constraints on its development resources, ADB should remain selective in its sector engagement and pursue integrated multisector solutions where feasible, in parallel with sector-specific interventions. ADB should consider exiting sectors in which it has less comparative advantage. For example, in transport, given a large amount of bilateral funding available for rural road development, ADB should redirect its resources toward more complex multisector interventions like developing climate-resilient urban infrastructure, including multimodal transport solutions; climate-smart agriculture; and renewable energy. At the same time, ADB is a leading development partner in education and skill development, urban infrastructure development, energy transition, agriculture, and natural resource management, which positions it well to mobilize cofinancing from development partners for more transformational projects. Finally, given the importance of the private sector and its persistent lack of access to finance, ADB should deepen its upstream support, especially for small and medium-sized enterprises and climate finance, to facilitate downstream investment.

47. **Managing implementation risks.** More robust due diligence in project preparation and appraisal will be critical to ensuring that project designs are realistic and achievable within anticipated time frames and budgets. To improve project implementation, ADB should (i) support the establishment of a project design facility to finance detailed engineering designs prior to project approval and ensure the high quality of project proposals; (ii) encourage the selection of engaged candidates for project steering committee membership; and (iii) support improvement in the training and accreditation of social safeguard consultants, insisting on such qualifications as prerequisite for being contracted.