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IMF: How to Grow Cambodia

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Cambodia's economic take-off has been truly impressive. With peace and stability, and the government's focus on export-led development, growth has averaged about 8 per cent in the last decade, doubling per capita income and halving the poverty rate.

Cambodia is now poised to enter the next phase of its development and with aspirations to soon join the ranks of emerging markets, the focus now, understandably, is on the continuity of that take-off.

That prompts some deeper questions: What is the recipe for igniting and sustaining take-offs in developing countries? What can Cambodia learn from the previous generation of countries on how to navigate the next phase?

With over one-third of Cambodians below 15 years and the vast need for job creation, these questions and their answers have profound real life implications for so many.

Researchers at the IMF have analyzed precisely these questions in the April 2013 World Economic Outlook, which has been published worldwide and presented to policy makers in Phnom Penh a few days ago.

The research project has sifted through the experience of more than 60 low-income or developing countries over the last 60 years. To add to that, it has featured Cambodia as one of the impressive growth stories since the 1990s.

Before we highlight the main findings, let's touch a bit on the global growth context.

In recent economic history, there have been two waves of growth take-offs among low-income countries over the past 60 years. The first wave started around the 1960s and 1970s; the second around the 1990s.

Cambodia has solidly been a part of the second wave.

Here is some good news: growth take-offs are now more likely and longer-lasting.

What explains the higher probability of take-offs? It is mostly due to better structural and macroeconomic conditions, findings the policy makers in Cambodia can fully relate to.

Unfortunately, the promise of the first wave fell short as many take-offs fizzled out, when the global economy turned sour in the late 1970s and 1980s.

In fact, one-third of take-offs prior to the 1990s ended with a currency, debt, or financial crisis, and some countries even saw reversals in per capita income levels within 15 to 20 years after take-off. That's why understanding the shared features of successful take-offs is so critical.

Although many roads lead to growth take-offs, they usually involve strong investment and export growth, underscoring the importance of policies to improve the investment and business climate and foster trade integration in developing countries.

Furthermore, recent take-offs have been supported by stronger FDI, higher education levels, lower regulatory burden for businesses, lower income inequality and more stable political conditions. Fortunately, many of these are outcomes of policy choices, not accidents.

What are the lessons for Cambodia?

Cambodia's open trade and investment regimes, and proximity to some of the most dynamic economies in the world, have served it well and provided immense opportunities to continue to attract foreign direct investment and deepen trade links in regional and global markets.

This will further improve productivity and support activity. But to get there, it has to address many policy challenges.

First, removing infrastructure bottlenecks, most urgently with respect to power supply and roads, and improving the business climate will remain critical for continuing to attract private investment and further diversify its economy.

Second, in light of the rapid growth of Cambodia's banking system and the introduction of new financial instruments and markets, such as the stock exchange in 2012, it is important to keep in mind that financial deepening must continue without compromising financial stability, one critical lesson from the first wave of take-offs.

That will require managing financial deepening by enabling market participants to better manage risks, and continuously upgrading prudential supervision and regulation. This is especially important in a system like Cambodia's that is also marked by a high degree of dollarisation and capital account openness.

Third, mobilising fiscal revenue will help build fiscal buffers and generate the resources necessary to cushion the economy against adverse shocks and meet the country's development needs.

The latter concerns in particular human capital development through improved health and education, a goal the government has also embraced.

It is worth noting that the IMF's regular policy dialogue with Cambodia has over the years led to a convergence of views on these lessons and has also guided the IMF's technical assistance in Cambodia, from financial supervision to economic statistics to fiscal management.

An old Khmer proverb advises us to "negotiate a river by following its bends". Cambodia is fast approaching the proverbial bend of the river of development – transitioning from a developing to an emerging market economy.

One efficient way to navigate the bend would be to internalise the lessons from the sustained growers and design policies accordingly.

The IMF is happy to be a part of that journey and to think together with Cambodia's policy makers on how best to get ready for the next phase