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Cambodia Keeps Tax Breaks as Shortage of Cash Prevents Stimulus

By Daniel Ten Kate, 26 January 2009

Cambodia, reliant on overseas aid to finance a quarter of the national budget, said it will extend tax breaks for clothing manufacturers and invest in power plants as a cash shortage restricts its ability to provide economic stimulus.

"We cannot distribute cash to the people," Hang Chuon Naron, secretary-general of the Ministry of Economy and Finance, said in a telephone interview from Phnom Penh on Jan. 23. "What we can do is give targeted tax cuts to garment factories and spend more on infrastructure so we can prepare for economic development in the future."

Cambodia needs to reduce business costs because it can't afford the stimulus measures adopted by richer neighbors Thailand, Singapore and Malaysia. The International Monetary Fund said the economy, Southeast Asia's second poorest, may grow 4.75 percent this year, the slowest pace in 11 years.

Opposition leader Sam Rainsy said the government should ask for more grants and loans to fund a $500 million stimulus package he has proposed. The money would go to stabilizing crop prices and the construction of irrigation and road networks, he said.

"The Cambodian government is disconnected with reality and when the fallout materializes, it will be a terrible awakening," Sam Rainsy said in an interview from Phnom Penh. "Every country around the region has announced a stimulus package, but Cambodia has done nothing so far."

The government will extend a 2006 profit tax exemption for garment factories until the end of this year, Hang Chuon Naron said. That will help cut costs for an industry that accounted for 12 percent of gross domestic product in 2007 by supplying clothes for retailers such as Gap Inc. and Stockholm-based Hennes & Mauritz AB.

Donor-Funded

The tax breaks will be coupled with donor-funded investments in rural roads, power plants, irrigation systems and telecommunications networks, he said. More than two-thirds of the nation's labor force work at least some of the time in the countryside, according to the Economic Institute of Cambodia.

Tourism, construction and garments, which together make up more than 60 percent of the economy, all face threats to growth this year, Hang Chuon Naron said. The number of foreign visitors may fall by 20 percent, construction will slow and garment exports might drop more than the 2 percent decline in 2008, he said.

"It's very difficult to make a judgment about garment exports this year because we don't sell high-end products," he said. "We have to look at the real figures for the first quarter, which will be crucial."

Dwindling Factories

The number of garment factories fell 10 percent to about 260 last year, leaving 20,000 workers without jobs, said Roger Tan, secretary-general of the Garment Manufacturers' Association of Cambodia. The industry, which employs about 320,000 of Cambodia's 14.2 million people, sells 70 percent of its products to the U.S., where retail sales have fallen for six straight months.

"Even if factories want to operate on the same scale, they may be forced to reduce their scale on account of reduced credit lines," Tan said in an interview. "Buyers in Europe and America are telling us to ship on consignment."

Cambodian lawmakers last month passed a $1.8 billion budget for 2009, increasing spending by a third from last year. The passage came days after donor countries pledged $950 million in aid, almost 40 percent more than they offered in 2008.

Last year marked an end to four straight years of economic growth in excess of 10 percent spurred by foreign-investment friendly policies such as 99-year leases for agricultural land, tax holidays and low import tariffs. The boom helped Prime Minister Hun Sen's party win 73 percent of seats in a July election.

Stock Exchange

The country plans to open its first stock exchange in December, undeterred by a global financial crisis that halved the value of markets in neighboring Thailand and Vietnam last year. Government coffers may soon get a boost from petroleum concessions in the Gulf of Thailand, where Chevron Corp., the second-biggest U.S. oil company, struck oil in 2005.

The government doesn't have many options to boost the economy besides tax cuts and tackling corruption to ensure a more efficient use of donor funds, said Kang Chandararot, an economist with the Cambodia Institute of Development Studies. Transparency International, a global non-governmental organization, ranked Cambodia 166 out of 180 countries in its 2008 Corruption Perceptions Index.

"Not wasting the money we received from donor countries is the only way to induce private investment," he said by phone from Phnom Penh. "Confidence in the real estate and construction sectors is in free fall."

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