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Foreign Direct Investment and Economic Transformation in Cambodia: Opportunities, Challenges, and the Path to Sustainable Growth

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A B S T R A C T:

This study examines Cambodia's economic transformation driven by foreign direct investment (FDI) within an outward-oriented, export-led growth framework. Leveraging its comparative advantages—such as low-cost labor, political stability, and strategic location—Cambodia has attracted substantial FDI inflows, particularly in labor-intensive sectors like garments and footwear, fueling rapid industrialization, job creation, and deeper integration into global markets. Special Economic Zones (SEZs) and pro-investment policies have facilitated this growth, while complementary sectors including tourism, construction, and agriculture have contributed to a diversified economic base. However, the long-term sustainability of Cambodia's FDI-led development hinges on overcoming institutional weaknesses, such as governance deficits, corruption, and limited human capital, which constrain technology transfer and industrial upgrading. Employing a mixed methods approach, this research analyzes secondary quantitative data alongside qualitative grounded theory to explore how FDI interacts with domestic institutions, nation-building narratives, and comparative advantage to shape Cambodia's development trajectory. Findings highlight the critical need for institutional reforms, human capital development, and stronger domestic linkages to transition Cambodia from a low-cost, labor-intensive model to a diversified, resilient economy. The study contributes to understanding the complex dynamics of FDI-driven growth in emerging economies and offers policy insights for sustainable economic transformation.

Keywords: Foreign Direct Investment (FDI), Economic Transformation, Export-Led Growth, Institutional Quality, Comparative Advantage, Special Economic Zones (SEZs), Economic Diversification, Labor-Intensive Industries, and Sustainable Development

1. Introduction

Cambodia's integration into the global economy, driven by the government's outward-oriented economic strategies, has produced significant benefits for the nation. The country's openness to international trade and investment has facilitated substantial inflows of foreign direct investment (FDI), particularly in the garment industry, owing to its low trade barriers, political stability, and simplified business procedures. Additionally, rising global commodity prices have supported Cambodia's predominantly agricultural economy, reducing the immediate pressure for a rapid shift away from agriculture. Complementing these factors, the continuous decline in trade costs, along with the availability of a highly mobile, low-skilled, and inexpensive labor force, has further stimulated investments in the garment sector, accelerating the nation's structural transformation (Cunningham & Hollweg, 2019).

This favorable investment environment has attracted growing interest from international investors, including seventeen major U.S. corporations seeking to explore opportunities in the Kingdom. According to Prime Minister Hun Manet, the Cambodian government actively promotes investment by ensuring peace, political stability, and social order. In addition, pro-investment policies offer incentives for foreign investors and introduce innovative business models, such as specialized economic zones tailored to the requirements of particular industries and partner countries (Vanyuth, 2024).

Cambodia's active participation in international trade reflects the outcomes of these strategies. In January 2025, the country's total trade volume exceeded $5 billion, with exports reaching $2.3 billion and imports $2.8 billion. While Cambodia experienced a widening trade deficit with China, where imports continued to surpass exports, trade relations with the United States remained favorable, maintaining a surplus despite ongoing tariff concerns (Seng, 2025).

As part of its long-term growth strategy, Cambodia is also prioritizing economic diversification, with a shift from agriculture toward manufacturing. The Electrical and Electronics (E&E) sector has emerged as a crucial driver in this transition, promoting the country's integration into the global value chain. However, the sector's foreign direct investment (FDI) remains heavily dependent on imported primary components, limiting the potential for domestic industrial development. Strengthening linkages between local factories and FDI projects could enhance domestic production, boost competitiveness, and enable Cambodia to fully capture the benefits of industrialization (Meng, 2025).

Building on these developments, it becomes clear that foreign direct investment (FDI) lies at the heart of Cambodia's economic transformation, driving industrial growth, job creation, and integration into global markets. Yet, the long-term success of this FDI-led model depends on more than just attracting capital—it requires the country to leverage its comparative advantages, strengthen institutional frameworks, and forge meaningful connections between foreign investors and domestic industries. Moreover, Cambodia's growth trajectory is intertwined with broader nation-building efforts, where economic strategies, cultural promotion, and industrial upgrading converge to shape sustainable development. These dynamics give rise to critical research questions that explore how FDI drives Cambodia's economic development and how the nation can transition from a reliance on low-cost, labor-intensive production toward a diversified and resilient economy.

1.1 Research Questions

1. How does foreign direct investment (FDI) drive Cambodia's economic development, and how are its outcomes shaped by comparative advantage, institutional quality, and nation-building strategies?
2. How can Cambodia transform its FDI-led growth model from a reliance on low-cost, labor-intensive industries into a sustainable and diversified economy through institutional reforms, human capital development, and stronger domestic linkages?

1.2 Research Method

This research employs a mixed methods approach, integrating both qualitative and quantitative techniques to provide a comprehensive understanding of Cambodia's FDI-driven economic development. The study primarily relies on secondary data sources, including government reports, trade statistics, investment records, academic articles, and international economic databases. These data sources offer extensive insights into foreign direct investment trends, sectoral growth, trade balances, and institutional developments relevant to Cambodia's economic transformation.

For the qualitative component, a grounded theory approach is utilized to systematically analyze the collected secondary data. This method allows for the development of a theoretical framework grounded in empirical evidence, identifying patterns, concepts, and relationships regarding the role of FDI, institutional quality, and nation-building in Cambodia's growth model. The iterative coding process involves open, axial, and selective coding stages to refine emerging themes and explain how various factors influence the sustainability and diversification of FDI-led development.

By combining quantitative secondary data analysis with grounded qualitative interpretation, this mixed method approach provides both empirical rigor and theoretical depth, enabling a nuanced exploration of Cambodia's economic trajectory and policy implications.

2. FDI-Driven Development in Cambodia

2.1. FDI-Driven Economic Development in Cambodia

Foreign Direct Investment (FDI) plays a central role in Cambodia's economic transformation, fueling industrial growth, employment creation, and integration into global markets. Investments from countries such as China, South Korea, Japan, Singapore, Vietnam, and select Western nations provide the capital, technology, and managerial expertise that underpin Cambodia's economic expansion. FDI not only finances factories, infrastructure, and services but also generates jobs, particularly in labor-intensive sectors such as garments, footwear, and construction.

FDI Origins and Magnitude: Between 2018 and 2023, Cambodia attracted more than $48.4 billion in FDI, with China as the dominant investor, accounting for 45.6% of inflows. Other key sources included South Korea (11.8%), Singapore (6.5%), Japan (6.2%), and Vietnam (5.3%), alongside contributions from Western firms (David, 2024). In 2024, Cambodia achieved a record $6.9 billion in FDI, nearly half from China, while other prominent investors included South Korea, Japan, Singapore, Vietnam, Malaysia, Thailand, Canada, and the UK (Whitehead, 2025). These inflows highlight Cambodia's growing attractiveness to foreign capital, especially in export-oriented and infrastructure-related industries.

Labor-Intensive Manufacturing: FDI has concentrated heavily in garments, footwear, and apparel, as well as in manufacturing, infrastructure, energy, construction, real estate, and tourism (Uon, 2025). The garment industry alone remains the backbone of the economy, accounting for roughly 80% of exports, employing nearly one million workers—80% of whom are women, and contributing about 16% to GDP. Approximately 90% of garment factories are foreign-owned, primarily by investors from China and Taiwan–China, demonstrating the sector's dependence on FDI (Sharpe, 2022).

Special Economic Zones (SEZs), heavily supported by Chinese, Korean, and Japanese investors, have become focal points for industrial activity. These zones cluster factories near Phnom Penh and other industrial hubs, providing tax incentives and infrastructure that attract manufacturing and processing projects. By early 2025, hundreds of SEZ-based projects had collectively created tens of thousands of jobs, solidifying FDI's role as a catalyst for industrial employment (VDB Loi, 2024).

Job Creation, Technology Transfer, and Management Know-How: FDI in Cambodia generates significant employment opportunities while also facilitating technology transfer and managerial skill development. In Q1 2025, Chinese-backed projects alone created an estimated 120,000 new jobs across multiple provinces, primarily in industrial sectors (Whitehead, 2025). Between 2023 and 2024, 315 new investment projects were registered, generating over 252,000 jobs in manufacturing, electronics, agro-processing, and tourism-related industries (Uon, 2025).

Beyond employment, FDI contributes to enhancing production efficiency, export compliance, and industrial standards. Foreign firms often introduce modern machinery, quality control systems, and managerial expertise, which are critical for boosting Cambodia's competitiveness in the global market. This combination of capital, knowledge, and employment underscores FDI's centrality to Cambodia's development model, which relies on export-oriented, labor-intensive industries to drive structural transformation (Iammarino, 2023).

2.2 Cambodia's Hybrid Model of Export-Led Growth

Cambodia's economic development has largely been shaped by an export-led growth model, but it functions as a hybrid system supported by tourism, construction, and agriculture. Unlike resource-dependent economies that rely heavily on natural endowments or domestic consumption, Cambodia's growth strategy is outward-looking, oriented toward producing goods for international markets—especially garments, footwear, and light manufacturing exports to the United States and the European Union. This approach has positioned foreign direct investment (FDI) as a central driver of the country's industrialization, while complementary sectors like tourism and real estate contribute to economic diversification.

Cambodia's Export-Led Economy: Exports are the backbone of Cambodia's growth model. The country's garment, footwear, and travel goods industries dominate its export profile, collectively representing around 80% of total exports (Open Development Cambodia, 2016). Nearly all garment factories are foreign-owned and clustered in FDI-supported Special Economic Zones (SEZs), which provide the infrastructure and incentives for export-oriented production.

Cambodia's trade relationships are primarily with advanced economies. The United States and the European Union absorb the majority of Cambodian exports, accounting for approximately 38% and over 40% of the total, respectively (Petty, 2025). Regional linkages have also strengthened, with ASEAN, China, Japan, and the UK serving as important destinations for garments, bicycles, and electronics. In 2020, Cambodia's export value reached $17.2 billion, illustrating the centrality of export-led growth in the nation's economic model (Open Development Cambodia, 2021).

Hybrid Support from Tourism, Construction, and Agriculture: While exports drive the economy, Cambodia's growth is hybridized through contributions from tourism, construction and real estate, and agriculture.

Tourism has historically been a major pillar, contributing up to 19–20% of GDP by 2019. However, the sector faced a steep decline during the COVID-19 pandemic, dropping to 3.6–5% of GDP by 2022 (Chamrong, 2024). Key heritage destinations like Angkor Wat have fueled long-term growth, with international visitors rising from 7,650 in 1993 to over 2 million annually in the 2010s (Steinmetz, 2019). To revive the sector, Cambodia has invested in infrastructure projects such as the Siem Reap–Angkor International Airport (opened 2023) and the Techo International Airport (scheduled for July 2025), aiming to re-establish tourism as a major growth engine.

Construction and real estate also form a vital component of the hybrid model. In 2023, construction spending reached $9.3 billion, driven by urban megaprojects like Phnom Penh's Mekong Quay and Koh Norea developments (ASEAN Briefing, 2025). SEZs have further supported this sector, receiving 53% of committed FDI between 2015 and 2019, while tourism and agriculture accounted for 41% and 6%, respectively. These projects not only attract foreign capital but also create significant spillover effects in employment and urbanization (Open Development Cambodia, 2021).

Although its share of GDP has declined, agriculture continues to support a large portion of Cambodia's population. The government's Pentagonal Economic Strategy emphasizes agribusiness, agro-processing, and value-added agriculture, aiming to integrate the sector more closely with industrial and export growth. This linkage strengthens rural livelihoods and contributes to the inclusivity of the hybrid model (Food and Agriculture Organization of the United Nation (FAO), 2025).

Hybrid Model in Practice: In practice, Cambodia's hybrid export-led model reflects a development path that goes beyond simple reliance on manufacturing exports. Garments and light manufacturing remain the primary drivers of foreign exchange earnings, but tourism, construction, and agriculture provide critical support, cushioning the economy against external shocks and contributing to job creation. Sectors benefiting from this FDI-diversified model include manufacturing, hospitality, commercial real estate, and infrastructure development, highlighting a growth trajectory that is both outward-oriented and partially diversified.

This hybrid approach underscores the importance of balancing export dependence with sectoral diversification, allowing Cambodia to integrate into global markets while leveraging tourism and urban development to support broader economic transformation.

2.3 Cambodia's FDI Strategy Shaped by Comparative Advantage

Cambodia's economic growth has been strongly shaped by its comparative advantage in low-cost labor and regional market access. This advantage has made the country a key destination for foreign direct investment (FDI) in labor-intensive industries, particularly garments, footwear, and light manufacturing. Foreign investors view Cambodia as an attractive alternative to its regional neighbors, as production costs are lower than in Vietnam or Thailand, allowing companies to maximize efficiency in global supply chains.

Low Operating Costs and Labor Advantage: Cambodia stands out in Asia for its exceptionally low operating costs. According to a TMX consultancy report, Cambodia offers the lowest operational expenses in the region, even lower than Myanmar, Vietnam, and Thailand, with Thailand's average monthly costs nearly double those of Cambodia. In manufacturing, labor accounts for up to 55% of total costs, and Cambodia, along with Myanmar and the Philippines, ranks among the cheapest destinations for labor-intensive production. Vietnam, although competitive, ranks slightly higher in cost, while Thailand is significantly more expensive (The Khmer Daily, 2022).

This cost advantage has made Cambodia particularly attractive for garment and footwear production, which are heavily labor-dependent. The sector accounts for approximately 80% of Cambodia's exports, and the country now ranks as the 8th largest global exporter in garments. The industry is almost entirely foreign-owned and export-oriented, reflecting how FDI leverages the country's comparative labor advantage to serve international markets (Open Development Cambodia, 2016).

Why Investors Choose Cambodia Over Vietnam or Thailand: International investors view Cambodia as a cost-efficient alternative within Southeast Asia's manufacturing landscape. Verisk Maplecroft's labor cost index places Cambodia among the most competitive countries globally for cheap labor, a key factor for labor-intensive industries (Karamida, 2015). A Wall Street Journal report highlights how U.S. companies relocating production from China benefit from labor costs of around $1 per hour in Cambodia, compared to $3 per hour in China, alongside increasing export access to Western markets (Miao, 2025).

While Vietnam offers better infrastructure and larger industrial clusters, Cambodia's lower wages and lighter regulatory environment make it particularly attractive for the initial stages of production. Reddit and fDi Intelligence commentary often compare the regional cost hierarchy, noting that while Vietnam competes effectively against Thailand, Cambodia undercuts both in cost competitiveness, drawing in investors for labor-intensive and cost-sensitive industries.

Access to Regional Markets: In addition to its labor advantage, Cambodia benefits from strategic geographic positioning within the Cambodia–Laos–Vietnam (CLV) Development Triangle, which enhances its connectivity to ASEAN and China (Khmer Times, 2024). This proximity allows foreign-owned factories in Cambodia to integrate efficiently into regional supply chains, particularly for textiles and electronics, where intermediate goods often move between Vietnam, Thailand, and southern China before reaching final markets.

Regional trade agreements and cross-border infrastructure projects further enhance Cambodia's logistics appeal, ensuring that low production costs are complemented by access to major export markets in both Asia and the West (Hong, 2024).

2.4 FDI Benefits Moderated by Institutional Quality in Cambodia

While foreign direct investment (FDI) plays a crucial role in Cambodia's economic growth, its benefits are not automatic. The effectiveness of FDI depends heavily on the quality of domestic institutions—including the legal system, governance structures, anti-corruption mechanisms, and human capital development. Weak institutions not only limit the scale of FDI inflows but also reduce the extent to which investment translates into sustainable and inclusive development. Cambodia's persistently low scores on rule of law, corruption control, and workforce capacity demonstrate how institutional weaknesses moderate the gains from FDI.

Legal System and Investor Confidence: Cambodia's Investment Law and commercial arbitration framework theoretically provide a foundation for foreign investor protection, including dispute resolution mechanisms (Open Development Mekong, 2022). However, in practice, these legal safeguards are underutilized. Commercial arbitration is rarely employed, and investors frequently resolve disputes through informal negotiations with government agencies, reflecting low confidence in Cambodia's court system (VIAC, 2019).

The U.S. State Department's 2024 Investment Climate Statement highlights that despite Cambodia's generous tax incentives and open investment regime, persistent corruption, limited transparency, and preferential treatment for well-connected firms discourage many foreign investors. This legal uncertainty reduces the predictability of doing business, particularly for long-term investments in sectors such as real estate, manufacturing, and infrastructure (US Department of State (USDOS), 2015).

Rule of Law and Governance Indicators: Global governance assessments consistently place Cambodia among the lowest-ranked countries for rule of law and institutional quality. The World Bank's 2024 CPIA property rights and rule-based governance rating stood at 2.5 out of 6, according to the World Bank's official development indicators (reported July 2025), indicating a limited capacity to enforce contracts, protect investments, and regulate fairly (Trading Economics, 2025).

The World Justice Project's 2023 Rule of Law Index ranked Cambodia 141st out of 142 countries, with particularly low scores in civil justice, corruption control, regulatory enforcement, and constraints on government powers (Lay & Meng, 2023). These indicators illustrate how fragile legal institutions undermine Cambodia's ability to maximize the developmental impact of FDI.

Corruption and Institutional Weakness: Corruption remains one of the most significant barriers to effective FDI utilization. Transparency International's 2024 Corruption Perceptions Index (CPI) gave Cambodia a score of 21/100, ranking 158th out of 180 countries, which reflects pervasive public-sector corruption. Although the 2022 score of 24/100 indicated a marginal improvement from prior years, Cambodia remains among the most corrupt countries in ASEAN (Seoung, 2025).

Widespread corruption affects licensing, land registration, and judicial processes, creating unofficial costs and business risks for investors. Local business forums and Reddit-based commentary from Cambodian business communities describe the justice system as biased toward elites and unreliable, reinforcing perceptions that formal legal mechanisms cannot be fully trusted. This institutional weakness discourages long-term, high-value investment and fosters a preference for short-term or enclave-style projects rather than deeply integrated development initiatives (Noy, 2021).

Skilled Labor, Education, and Workforce Capacity: The ability of FDI to contribute to sustainable, knowledge-intensive growth also depends on the quality of human capital. Independent assessments from the IMF and regional risk reports consistently note that Cambodia faces critical skills shortages (B2B Cambodia, 2025). Low labor productivity, limited vocational training, and an underdeveloped higher education system constrain the country's capacity to move beyond labor-intensive, low-value production (The Phnom Penh Post, 2025).

As a result, FDI inflows are concentrated in simple assembly and garment manufacturing, where low wages are the primary attraction. Without greater investment in education, skills training, and workforce development, Cambodia risks being trapped in a low-skill equilibrium, unable to fully leverage FDI for industrial upgrading or technology transfer (Sharpe, 2022).

2.5 Influenced by Nation-Building Narratives in Tourism

Tourism in Cambodia is not only an economic engine but also a vehicle for nation-building and cultural identity. Anchored by the global appeal of Angkor Wat and Khmer heritage, the tourism sector supports Cambodia's efforts to rebuild its post-conflict image, foster national pride, and position itself in international cultural diplomacy. By intertwining heritage conservation, cultural storytelling, and economic growth, Cambodia uses tourism as both a development strategy and a tool of nation-building.

Angkor Wat and National Symbolism: At the heart of Cambodia's nation-building narrative lies Angkor Wat, the country's most iconic heritage site. Scholars emphasize that Angkor Wat is more than a tourist attraction—it is a symbol of national identity, historic grandeur, and economic promise (Richard, 2024). The temple's prominent place on the Cambodian flag and its deep integration into Khmer cultural consciousness make it a powerful national emblem. Millions of visitors are drawn to Angkor annually, making it central to both economic activity and the symbolic project of nationhood (UNESCO, 2020).

Tourism historian Tim Winter argues that post-conflict tourism development around Angkor received significant international funding, linking tourism directly to Cambodia's reconstruction, international image recovery, and nation-building agenda. The development of Angkor as a global tourist destination thus reflects both economic imperatives and the revival of national pride (Winter, 2008).

Heritage Conservation and Cultural Storytelling: Cambodia's tourism strategy is tightly linked to heritage conservation and cultural storytelling, emphasizing the preservation and promotion of Khmer civilization. The National Ecotourism Policy (2019–2028) explicitly ties tourism growth to sustainable heritage conservation, showcasing how the government aligns identity and economic strategy (Open Development Cambodia, 2018).

Academic studies highlight that tourism often encourages the "invention of tradition"—reconstructing or reinterpreting Khmer traditions to appeal to global visitors, while reinforcing domestic narratives of pride, unity, and cultural continuity. By curating its cultural heritage for international consumption, Cambodia simultaneously strengthens its internal nation-building narrative (Chheang, 2009).

Cultural Diplomacy and Nation Branding: Tourism in Cambodia also functions as a form of cultural diplomacy and nation branding. Initiatives such as the "Kingdom of Wonder" campaign, supported by GIZ and IFC, position Cambodia's heritage and Angkor Wat as the core of its international identity (Ministry of Tourism, 2008). Through this branding, Cambodia leverages tourism as a form of soft power, projecting an image of cultural richness and historical depth to the world.

Additionally, cultural diplomacy extends to culinary initiatives such as Food Diplomacy (Khmer Times, 2024) and "Angkor Kitchen" (Mey, 2024), which promote Khmer cuisine and cultural traditions abroad. These strategies create a holistic approach to tourism, where economic goals, national pride, and international influence are intertwined.

Economic and Cultural Significance: Economically, tourism has emerged as Cambodia's second-largest sector, contributing up to 18.2% of GDP before the COVID-19 pandemic, second only to the garment industry (Khut, 2024). Beyond its economic role, tourism reinforces heritage preservation as an economic strategy, linking cultural conservation to revenue generation.

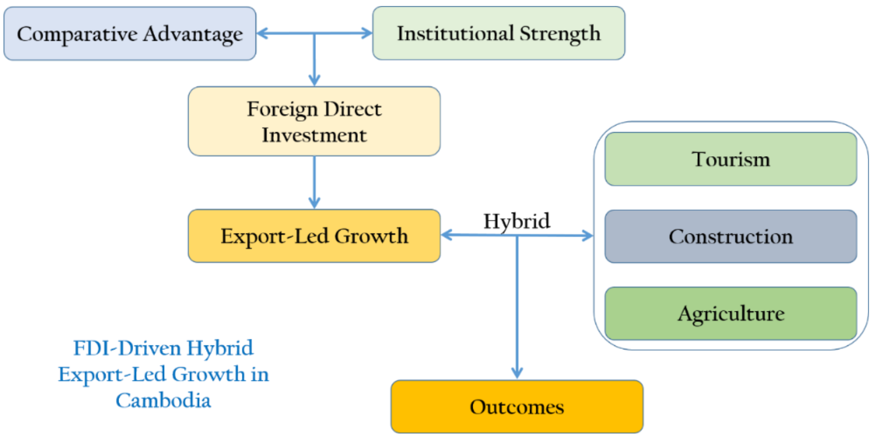
Efforts to protect Angkor Wat and other heritage sites are thus strategically aligned with tourism and nation-building objectives. By integrating cultural identity with economic development, Cambodia ensures that tourism growth supports not only income generation but also the long-term project of cultural revival and international recognition (UNESCO, 2020).

3. Opportunities and risks of an FDI-dependent growth model

3.1 FDI-Driven Hybrid Export-Led Growth in Cambodia

Cambodia's economic development has been fundamentally shaped by foreign direct investment (FDI), which serves as the primary engine for industrialization, employment creation, and integration into global markets. In contrast to economies driven largely by domestic consumption or natural resource extraction, Cambodia has adopted an outward-oriented growth model that relies heavily on foreign capital. This model has been particularly effective in labor-intensive, export-oriented industries such as garments, footwear, and travel goods, which dominate the country's manufacturing sector.

FDI acts as a catalyst for growth by financing industrial infrastructure, supporting the development of Special Economic Zones (SEZs), and creating pathways for the production of goods that meet international quality and compliance standards. Through the inflow of financial resources and operational expertise, Cambodia is able to overcome domestic savings constraints and accelerate its structural transformation. By relying on FDI to drive its growth, the country not only strengthens its manufacturing base but also achieves deeper integration into regional and global supply chains. This dependence on external capital reflects Cambodia's strategic focus on export-oriented industrialization.



The theoretical model of FDI-driven hybrid export-led growth in Cambodia can be understood as a multi-layered process. At the foundation are Comparative Advantage and Institutional Strength, which are interdependent. Strong institutions reinforce Cambodia's comparative advantages—such as its young labor force and low production costs—thereby enhancing the country's attractiveness to foreign investors. These elements collectively channel investment into FDI, which operates as the central mechanism for mobilizing external capital and stimulating economic activities.

FDI subsequently drives Export-Led Growth, which forms the core pathway of Cambodia's economic expansion. This growth interacts with key economic sectors, notably tourism, construction, and agriculture, which both benefit from foreign investment and contribute to sustained export capacity. As these sectors develop, they generate a chain of positive outcomes, including higher income, increased employment opportunities, and broader socio-economic development.

In essence, Cambodia's FDI-driven hybrid model of export-led growth integrates comparative advantage, institutional capacity, and sectoral linkages to achieve national development goals. By attracting and leveraging foreign investment, the country positions itself within regional production networks while simultaneously fostering growth in domestic industries like tourism, construction, and agriculture. This process illustrates how external capital and domestic institutional readiness converge to produce tangible development outcomes, reinforcing Cambodia's trajectory toward a more globally integrated economy

3.2 Mechanisms of FDI Impact on Cambodia's Economy

3.2.1 FDI and Capital Formation in Cambodia

The impact of foreign direct investment (FDI) on Cambodia's economy manifests strongly through capital formation, where foreign investors supply the financial resources necessary to build factories, industrial zones, energy projects, and urban infrastructure. Such investment directly contributes to expanding the host country's capital stock, which is a critical driver of economic growth in the neoclassical growth framework (Solow, 1956).

In developing economies like Cambodia, domestic savings are often insufficient to finance large-scale industrial and infrastructural projects. The Harrod-Domar model and Two-Gap theory explain how FDI helps bridge the savings–investment gap and provides the necessary capital for sustained economic growth (Chenery & Strout, 1966). Additionally, FDI supports structural transformation as described by modernization theory, allowing the adoption of capital-intensive technologies and urban-industrial development patterns common in advanced economies (Rostow, 1960).

However, dependency theorists caution that heavy reliance on foreign capital may generate vulnerability, as host countries can become dependent on external investors and global market fluctuations (Frank, 1967). Cambodia's reliance on FDI for capital formation thus delivers rapid industrial gains but also carries long-term structural risks if domestic capital accumulation and institutional capacity remain weak.

3.2.2 FDI-Driven Employment and Income Generation in Cambodia

Foreign direct investment (FDI) contributes significantly to job creation and income growth in Cambodia, particularly in labor-intensive sectors such as garments, footwear, tourism, and construction. These industries absorb large numbers of low-skilled workers from rural areas, providing wage income and opportunities for social and economic mobility. This dynamic reflects the Lewis dual-sector model, which explains how surplus agricultural labor is gradually absorbed into modern, wage-based industrial employment, contributing to structural transformation and poverty reduction (Lewis, 1954).

Additionally, FDI stimulates broader income growth through the Keynesian multiplier effect, as wages earned in export-oriented industries circulate in the domestic economy, creating indirect employment in retail, transportation, and local services (Keynes, 1936). Cambodia's reliance on export-oriented FDI, particularly in garments and footwear, also aligns with the export-led growth hypothesis, which links increased trade participation to rising employment and income (Balassa, 1978).

In the long term, FDI facilitates human capital development, consistent with endogenous growth theory, by providing workers with skills and experience that enhance productivity and can lead to higher incomes over time (Lucas, 1988). Together, these theoretical perspectives explain how FDI serves as a catalyst for immediate job creation while also laying the foundation for longer-term income improvements.

3.2.3 Technology and Knowledge Transfer

Foreign Direct Investment (FDI) plays a pivotal role in driving economic growth, particularly in developing countries like Cambodia. Various economic theories provide insights into how FDI contributes to development through mechanisms such as technology transfer, human capital accumulation, and industrial upgrading. Four key theories help explain the dynamics and impacts of FDI on host economies: Endogenous Growth Theory, FDI Spillover Theory, Product Life Cycle Theory, and Learning-by-Doing with Industrial Upgrading.

The Endogenous Growth Theory emphasizes that long-term economic growth is driven primarily by knowledge accumulation, human capital development, and technological innovation rather than by capital accumulation alone (Romer, 1990). Within this framework, FDI acts as a conduit for new technologies and managerial practices that increase productivity in recipient countries. The transfer of knowledge through FDI fosters learning-by-doing among local firms and workers, which can generate sustained growth if local actors adopt and improve upon the introduced technologies. This theory is particularly relevant for Cambodia, where foreign investment in labor-intensive manufacturing and services introduces innovations that local enterprises can absorb and build upon.

Complementing this perspective, the FDI Spillover Theory focuses on the positive externalities that multinational enterprises (MNEs) create for domestic firms (Romer, 1990). These spillovers occur in several ways: demonstration effects enable local firms to imitate advanced foreign technologies and processes; labor mobility allows workers trained by foreign firms to transfer skills and knowledge when moving to local companies; and linkages between suppliers and buyers disseminate best practices throughout the economy. In Cambodia's garment and manufacturing sectors, FDI has been shown to improve quality standards and export readiness, suggesting that spillovers are critical for enhancing the capabilities of domestic firms and integrating them into global value chains.

The Product Life Cycle Theory proposed by Vernon (1966) offers a dynamic explanation of how production relocates internationally. Initially, firms in advanced economies develop and produce new products domestically, but as products mature and competition intensifies, production shifts to countries with lower labor and operating costs to maximize efficiency. This relocation process is observable in Cambodia, which attracts mature production lines from more developed countries. As a result, Cambodia benefits from the transfer of equipment and production expertise, creating opportunities for industrial learning and expansion within its manufacturing base.

Finally, the concepts of Learning-by-Doing and Industrial Upgrading highlight the importance of experiential learning in production processes for improving skills and technologies over time (Arrow, 1962). By participating in global value chains, Cambodian workers and firms accumulate production experience that leads to incremental improvements and potential industrial upgrading. However, this process depends on supporting factors such as vocational training and education to ensure that local capabilities evolve beyond basic assembly tasks toward higher-value production.

3.3 Determinants of FDI Attraction to Cambodia

3.3.1 Low-Cost Labor and FDI in Cambodia

Cambodia's ability to attract foreign direct investment (FDI) is deeply influenced by its structural economic characteristics, particularly its comparative advantage in low-cost labor. This cost advantage appeals strongly to multinational enterprises (MNEs) seeking efficiency in global supply chains. Industries such as garments, footwear, and assembly-based light manufacturing have flourished because Cambodia offers competitive operating costs and an abundance of unskilled labor, creating an ideal environment for labor-intensive production.

This dynamic can be explained through comparative advantage theory, which asserts that countries benefit from specializing in the production of goods and services where they have a relative cost advantage (Ricardo, 1821). Cambodia's low wages and labor-intensive production provide it with a clear advantage in sectors that require large amounts of unskilled labor, making the country a preferred destination for FDI in garment and footwear production. Similarly, the Heckscher-Ohlin factor endowment theory extends this logic by linking trade and investment patterns to a country's factor endowments. Since Cambodia is relatively labor-abundant and capital-scarce, it tends to attract FDI in labor-intensive industries where its resource endowment aligns with investor needs (Ohlin, 1952).

Moreover, Dunning's eclectic paradigm, also known as the OLI framework, offers an additional lens to understand FDI flows. According to Dunning (Dunning, 1980), foreign firms invest when three conditions are met: ownership advantages (O) in technology or brand, location advantages (L) in the host country, and internalization advantages (I) that make direct investment preferable to outsourcing. Cambodia's location advantage is particularly significant—its low labor costs, favorable investment laws, and access to international markets provide the conditions that encourage multinational firms to establish production facilities in the country.

Finally, product life cycle (PLC) theory supports this trend by emphasizing that mature industries in developed countries often relocate production to lower-cost developing countries (Vernon, 1966). In Cambodia's case, global garment and footwear brands relocate their labor-intensive manufacturing stages to benefit from the country's low wages and integration into regional supply chains. This relocation reinforces Cambodia's role in the global production network while explaining why FDI flows primarily to labor-intensive sectors.

3.3.2 Cambodia's Regional Market Access and FDI Attraction

Cambodia's capacity to attract foreign direct investment (FDI) is strengthened by its strategic regional market access. The country's position within the Cambodia–Laos–Vietnam (CLV) Development Triangle and membership in the Association of Southeast Asian Nations (ASEAN) provide extensive trade connectivity and support cross-border supply chain integration. Investors benefit from the ability to use Cambodia as a production base while accessing both regional and global markets. Moreover, preferential trade agreements, such as the European Union's Everything But Arms (EBA) initiative and ASEAN-led free trade agreements (FTAs), enhance the country's appeal by reducing tariffs and improving export competitiveness.

Several economic and investment theories explain this dynamic. New trade theory emphasizes the role of market size, network effects, and economies of scale in driving trade and investment flows (Krugman, 1979). By joining ASEAN and participating in regional supply chains, Cambodia provides foreign investors with the ability to scale production for broader markets, thereby reinforcing its attractiveness as an FDI destination. In parallel, regional economic integration theory highlights that trade blocs and preferential trade agreements lower trade barriers, increase market efficiency, and promote cross-border investment (Balassa B. A., 1973). Cambodia's membership in ASEAN and participation in initiatives like the EBA illustrate how such integration can boost FDI inflows.

Additionally, Dunning's eclectic paradigm (OLI framework) explains Cambodia's appeal through its location advantage, which derives from its strategic position and preferential market access. Multinational firms investing in Cambodia can efficiently access ASEAN, East Asian, and European markets, creating an incentive for export-oriented FDI (Dunning, 1980). This is closely linked to global value chain (GVC) theory, which posits that firms fragment production internationally, locating each stage in the most cost-effective and strategically advantageous setting (Gereffi, Humphrey, & Sturgeon, 2005). Cambodia's role in regional garment, footwear, and assembly-based industries exemplifies this process, as firms integrate the country into broader supply chains while benefiting from preferential trade terms.

3.3.3 Diversification and Sustainable Growth in Cambodia

Economic diversification is widely regarded as a critical strategy for achieving sustainable and resilient growth, especially for developing economies like Cambodia. Multiple economic theories provide insights into how diversification, foreign direct investment (FDI), and structural transformation interact to enhance long-term economic stability and attractiveness to investors.

Diversification Theory emphasizes that economies with a diversified structure are less vulnerable to external shocks and are better positioned for sustainable growth. According to Imbs and Wacziarg (2003), spreading economic activity across multiple sectors reduces the risks associated with dependence on a single industry. Cambodia demonstrates this principle by combining its manufacturing and export-led growth with complementary sectors such as tourism, construction, and agriculture. This multi-sector approach mitigates the effects of global fluctuations in garment demand, safeguarding overall economic stability.

Portfolio Theory applied to economies draws an analogy from finance, suggesting that diversifying economic activity reduces risk exposure. Acemoglu and Zilibotti (1997) argue that nations with broader sectoral bases are less prone to volatility. Cambodia's strategic expansion from garment manufacturing to tourism and construction reflects this concept, as it spreads economic risks across industries. This diversified economic base also supports consistent FDI inflows, as investors perceive reduced vulnerability to sector-specific downturns.

Endogenous Growth Theory further complements the argument for diversification. Romer (1990) posits that long-term growth depends on sectoral linkages, knowledge spillovers, and the accumulation of human capital. In Cambodia, growth in tourism and construction stimulates the domestic service sector and facilitates skills development, reinforcing the benefits of FDI-driven manufacturing. These interactions generate positive feedback loops that enhance productivity and foster sustainable growth.

The Eclectic Paradigm (OLI framework), particularly its location advantage component, also highlights the role of diversification in attracting FDI. Dunning (1980) explains that foreign firms are drawn to countries offering favorable conditions for multi-sector investment. A diversified economy signals both stability and growth potential, enhancing Cambodia's attractiveness to multinational firms that seek to spread their operations across multiple sectors to minimize investment risks.

Finally, Structural Transformation Theory provides a broader perspective on economic evolution. Lewis (1954) and Kuznets (1971) describe economic development as a shift from agrarian dependence to a diversified economy incorporating manufacturing and services. Cambodia exemplifies a hybrid model of structural transformation, where the agricultural base is complemented by rapid growth in manufacturing and services such as tourism. This transition not only supports domestic economic resilience but also strengthens Cambodia's appeal to foreign investors seeking a dynamic, multi-sector environment.

3.4 Moderating Variables in Cambodia's FDI-Led Growth

3.4.1 Institutional and Structural Conditions for FDI-Driven Growth in Cambodia

The benefits of foreign direct investment (FDI) in Cambodia are not automatic but are contingent on the country's institutional and structural conditions. While FDI has played a significant role in driving economic expansion, particularly in labor-intensive sectors such as garments, footwear, and assembly-based manufacturing, the long-term developmental impact depends on the quality of domestic institutions and their capacity to foster spillover effects.

Institutional Theory provides a primary lens for understanding these dynamics. North (1990) emphasizes that the effectiveness of economic activity depends heavily on the strength of formal rules, governance structures, and enforcement mechanisms. In Cambodia, weak rule of law, corruption, and limited regulatory capacity reduce the ability of FDI to generate technology transfer and industrial linkages. Without credible institutions, FDI risks functioning as an isolated enclave that leverages low-cost labor but contributes minimally to domestic capacity building.

These concerns are also reflected in Dependency Theory, which argues that developing economies can become trapped in subordinate positions within global production chains if they remain reliant on foreign capital without building local capacity (Frank, 1967). Cambodia's heavy reliance on low-skill garment and footwear production mirrors this scenario, as foreign investors often extract labor value without fostering domestic upgrading or innovation. This pattern can reinforce economic dependency and limit the country's movement up the global value chain.

Furthermore, insights from the FDI trap and resource-curse literature underscore that inflows of foreign capital, like natural resource rents, do not automatically lead to long-term growth if institutional quality is weak. Sachs and Warner (1995) highlight that in resource-dependent economies, poor governance often leads to rent-seeking behaviors rather than productive investment. Similarly, in Cambodia, the absence of robust legal and regulatory frameworks may prevent FDI from translating into knowledge spillovers or industrial diversification, leaving the economy locked in low-value-added production.

The challenge is compounded when examined through the lens of Endogenous Growth Theory, which stresses that sustained economic growth requires human capital accumulation and knowledge spillovers (Romer, 1990). FDI can catalyze this process only if Cambodia's institutions enable skills development, R&D activities, and technology absorption. Without these measures, the country risks remaining in a low-skill FDI equilibrium, vulnerable to external shocks and rising regional competition.

Lastly, the Eclectic Paradigm (OLI framework) complements this discussion by emphasizing that the developmental impact of FDI is mediated by the host country's absorptive capacity (Dunning, 1980). In Cambodia's case, institutional weaknesses may prevent the internalization of knowledge and the creation of local linkages, resulting in limited benefits from foreign investments.

3.4.2 Nation-Building Narratives and Tourism in Cambodia's Development Strategy

Tourism in Cambodia serves a dual function, operating as both an economic engine and a nation-building instrument. Beyond generating revenue, tourism plays a central role in cultural soft power and identity formation, contributing to Cambodia's broader development strategy. By promoting iconic heritage sites such as Angkor Wat and embracing the "Kingdom of Wonder" branding, Cambodia strengthens its international image while simultaneously cultivating national pride. These narratives intertwine cultural revival with economic growth, attracting both tourists and foreign investment.

Nation-Building Theory highlights the importance of shared narratives, symbols, and heritage in fostering national identity and cohesion. Smith (1991) emphasizes that cultural elements such as historical monuments and traditional practices are crucial for creating a unified national consciousness. In Cambodia, Angkor Wat and other Khmer heritage sites are deployed as central pillars of the nation-building project. These cultural landmarks not only inspire domestic pride but also communicate Cambodia's rich history to the world, linking historical identity with modern economic strategy.

The role of tourism in nation-building aligns closely with soft power theory. Nye (2009) defines soft power as a country's ability to shape the preferences of others through attraction rather than coercion. Cambodia leverages cultural soft power by presenting itself as a nation of unique heritage and resilience, enhancing its appeal to international tourists and foreign investors alike. This process improves global perceptions, which can indirectly facilitate foreign direct investment (FDI) and support broader economic diplomacy.

Closely related is place branding and destination marketing theory, which focuses on how nations create strategic images to attract tourism, investment, and global attention (Anholt, 2006). Cambodia's "Kingdom of Wonder" campaign is an example of nation branding that combines cultural storytelling and economic promotion. This branding not only drives tourism growth but also signals political stability and cultural vitality, which are attractive to potential investors.

Additionally, heritage tourism and cultural economy theory underline the transformation of cultural assets into economic value. Ashworth and Tunbridge (2000) argue that heritage tourism allows countries to link identity formation with local development. In Cambodia, the conservation and promotion of UNESCO World Heritage Sites generate economic benefits while reinforcing cultural identity. This creates a virtuous cycle, where economic gains from tourism fund heritage protection, and the preservation of heritage strengthens the nation's cultural narrative.

Finally, insights from post-conflict development theory suggest that countries recovering from conflict can utilize cultural narratives and tourism to rebuild their image and economy (Richards, 2018). Following decades of civil war and the Khmer Rouge period, Cambodia's emphasis on cultural revival through tourism reflects a strategic effort to heal national identity, stimulate economic recovery, and improve international legitimacy.

3.5 Outcomes of Cambodia's FDI-Driven Development Model

3.5.1 The Impact of FDI on Cambodia's Short-Term Economic Transformation

Cambodia's development trajectory, significantly influenced by foreign direct investment (FDI), can be understood by examining its short-term and long-term outcomes. In the short term, FDI has played a crucial role in generating rapid employment growth, accelerating urbanization, and fostering industrialization through Special Economic Zones (SEZs). Particularly, the garment and footwear industries have become major employers, absorbing large numbers of rural laborers and thereby contributing to poverty reduction and the formation of new urban centers.

The inflow of FDI has also driven a notable increase in export earnings, bolstering Cambodia's macroeconomic stability and enhancing its foreign exchange reserves. This aligns with the Export-Led Growth Theory, which posits that expanding exports can stimulate industrialization and generate foreign exchange critical for economic stability (Balassa, 1978). Cambodia's export-oriented garment sector exemplifies this dynamic, serving as a vital engine of economic growth.

The rapid absorption of rural labor into manufacturing also reflects the principles of the Lewis Dual-Sector Model (Lewis, 1954), which describes development as a process where surplus labor from traditional agriculture is transferred to the modern industrial sector. This transfer not only increases industrial output but also fosters urban growth, as seen in Cambodia's expanding urban centers around SEZs.

Further, Cambodia's SEZs and garment industries serve as growth poles (Perroux, 1955), dynamic centers that stimulate broader regional economic development by attracting investment, creating jobs, and promoting infrastructure expansion. These growth poles catalyze urbanization and economic diversification, which are critical for sustained development.

Lastly, Cambodia's overall development pattern fits within Modernization Theory (Rostow, 1960), which describes economic progress as a series of stages including industrialization, urbanization, and integration into global markets. The FDI-driven industrialization and export growth in Cambodia exemplify this progression towards modernization.

3.5.2 Long-Term Outcomes of FDI in Cambodia: The Role of Institutional and Structural Reforms

The long-term benefits of foreign direct investment (FDI) in Cambodia are conditional on institutional and structural reforms. While FDI has generated short-term employment growth, export earnings, and industrialization, its capacity to sustain development depends on the country's ability to upgrade industries, enhance human capital, and strengthen domestic linkages. Without these reforms, Cambodia risks remaining trapped in low-value segments of global production chains, whereas effective reforms could enable a transition toward high-value, diversified, and resilient economic structures.

Institutional Theory underscores the critical role of governance and institutional quality in determining economic outcomes. North (1990) argues that credible institutions—encompassing rule of law, property rights, and regulatory enforcement—are essential for translating investment inflows into sustainable development. In Cambodia, weak governance, corruption, and limited institutional capacity can restrict technology transfer and industrial linkages, preventing FDI from contributing to structural transformation. Conversely, improving governance enhances investor confidence and domestic absorptive capacity, creating conditions for long-term growth.

Endogenous Growth Theory further highlights the importance of human capital and knowledge accumulation in sustaining economic development. Romer (1990) and Lucas (1988) posit that long-term growth depends on skills, innovation, and learning effects. For Cambodia, enhancing labor productivity, vocational training, and R&D capacity is vital for moving from labor-intensive assembly industries to higher-value production, such as electronics, automotive components, or design-based manufacturing. Without such investments, FDI remains confined to low-skill, low-wage industries, limiting its developmental impact.

Additionally, the Product Life Cycle and Global Value Chain (GVC) upgrading perspective explains Cambodia's current development stage and potential trajectory. Vernon (1966) and Gereffi (1999) note that developing countries often begin with labor-intensive, low-value production and can upgrade through learning, innovation, and stronger supplier linkages. Cambodia's garment and footwear industries illustrate the early stage of this cycle; only through structural reforms and industrial policies can the country transition toward higher-value segments of global supply chains.

From a critical perspective, Dependency Theory and the FDI Trap caution that economies relying heavily on foreign capital without building domestic capacity risk remaining dependent on low-value activities (Prebisch, 1950). In Cambodia, a failure to improve institutional quality and domestic linkages could perpetuate reliance on low-wage FDI, limiting diversification and long-term resilience. Conversely, strategic reforms—including local supplier development, technology partnerships, and industrial clustering—can break dependency cycles and amplify the developmental benefits of FDI.

Finally, Structural Transformation Theory provides a broader framework for understanding Cambodia's long-term development path. Lewis (1954) and Kuznets (1971) emphasize that economic growth requires shifting from agrarian dependence to diversified manufacturing and services, with productivity gains and industrial linkages driving sustainable development. Cambodia can leverage FDI to accelerate this transformation if supported by institutional strengthening, human capital investments, and export diversification strategies.

4. Conclusion

Cambodia's foreign direct investment (FDI)-led development presents a complex and multi-layered phenomenon. On one hand, it has proven to be economically productive, catalyzing industrial growth, job creation, and export expansion. On the other hand, this growth has been structurally uneven, highlighting significant disparities within the economy that risk limiting the country's long-term developmental trajectory. To fully realize the potential benefits of FDI, Cambodia must pursue comprehensive institutional reforms alongside inclusive policies that promote broader participation and equitable growth.

The economic productivity of Cambodia's FDI-driven growth is evident in its rapid industrialization, particularly in labor-intensive sectors such as garments, footwear, and electronics assembly. These industries have absorbed large numbers of workers from rural areas, contributing to poverty reduction and urban expansion. Foreign investments have brought much-needed capital, advanced technologies, and managerial expertise, thereby enabling Cambodia to integrate more deeply into global value chains. Special Economic Zones (SEZs), supported by government incentives, have become dynamic hubs of production and export activity, underscoring the tangible gains from FDI inflows.

However, beneath this promising economic performance lies a more uneven structural reality. Cambodia's reliance on low-cost, low-skill manufacturing has created a dual economy characterized by significant income and opportunity gaps. While certain sectors and urban centers flourish, many regions and demographic groups remain marginalized, with limited access to quality education, vocational training, and economic opportunities. Furthermore, the predominance of enclave-style FDI projects—where foreign firms operate with minimal linkages to domestic industries—hinders the development of a robust local supplier base and weakens technology spillovers. This structural unevenness perpetuates dependency on foreign capital and exposes Cambodia to vulnerabilities, including shifts in global demand and competition from lower-cost producers.

To address these challenges and unlock the full developmental potential of FDI, Cambodia must strengthen its institutional framework. Robust governance, transparent regulatory systems, and the rule of law are essential to foster an environment conducive to innovation, technology transfer, and sustainable investment. Institutional reforms that improve contract enforcement, reduce corruption, and enhance public service delivery will build investor confidence while enabling domestic firms to engage more effectively with multinational enterprises. Equally important is the need for inclusive policies that emphasize human capital development, social protection, and equitable access to economic resources. By investing in education, vocational training, and infrastructure, Cambodia can empower its workforce to move beyond low-skill jobs and participate more fully in higher-value sectors.

In conclusion, Cambodia's FDI-led development offers significant opportunities but is accompanied by structural challenges that demand strategic policy responses. Economic productivity alone cannot guarantee sustainable growth unless complemented by institutional reforms and inclusive strategies that ensure benefits are widely shared. By pursuing these reforms, Cambodia can transform its current growth model into a more resilient and equitable development path, harnessing FDI as a catalyst not just for economic expansion but for comprehensive national progress.

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