

V. LONG-TERM ACTION PLAN FOR PRIVATE SECTOR DEVELOPMENT

A. Overview

318. An effective private sector development action plan should focus on building an enabling environment, infrastructure, financial system and regulatory system, which allows firms of all sizes to compete on an even playing field. The private sector action plan for Cambodia focuses on creating such an enabling environment based a sound legal and regulatory framework, as well as by providing services to assist the private sector through trade promotion and capacity building.

319. The private sector development action plan¹¹³ is based on key lessons drawn from the experiences and reforms in other countries. The action plan is divided into three phases, which are in general the planning stage (2004 – 2006), the implementation stage (2007-2010) and expansion phase (2011-2013). The first phase focuses on developing the legal framework and designing programs to assist the private sector. Phase 1 also addresses one of the main issues facing the private sector in Cambodia, which is the pervasive informality of most of the economy. Therefore, an important step in the first phase will be to bring more enterprises into the formal sector by simplifying the registration process and providing incentives to formalize. The second phase of the action plan focuses on enhancing the capacity of the private sector through the implementation of policies and programs to strengthen the business environment. Phase 3 emphasizes expanding and improving policies and programs to support the private sector in order to make Cambodia a globally competitive business environment.

320. There are many challenges the action plan will try to address including:

- limited governance and legal infrastructure;
- high costs of inputs, including infrastructure, raw materials, labor and capital;
- lack of government support for trade promotion and capacity building; and
- limited access to markets and information.

The private sector action plan addresses each of these challenges by identifying specific policy measures to achieve the targets set but also by sequencing these policy measures. It is recognized that merely establishing the laws and regulations is not enough and that emphasis must be placed on implementation. It is also recognized that the private sector needs assistance to jump start growth and that the RGC can play an active and constructive role in private sector development by helping to reduce input costs, supporting trade promotion and capacity building and facilitating access to markets, information and technology.

B. Formalization

321. Enterprise registration is a key element in establishing a formal economy in which legal entities operate within the commercial law framework. It is also the basis for establishing a directory of enterprises and obtaining information on the private sector. Licensing is also an important aspect of formalizing and regulating business activities. The RGC should strengthen the registration system to bring more enterprises into the formal sector. It should also review licensing and inspection procedures in order to reduce the burden on the private sector.

¹¹³ Appendix 1 provides a detailed matrix for the Private Sector Development Action Plan.

1. Registration

322. The first phase for strengthening enterprise registration involves simplifying procedures to reduce cost and encourage more enterprises to formalize. It also focuses on creating an enterprise registry to assist policymakers by providing information about the private sector. The second phase focuses on implementing a computerized registration system, expanding registration requirements and creating incentives for formalizing. The third phase emphasizes improving automation and efficiency in the registration system through on-line registration.

323. **Phase 1a - Simplify and streamline the current registration system.** Simplifying registration requirements will make it easier and less expensive for enterprises to formalize. It will also remove the necessity of paying facilitator fees for what should otherwise be a straightforward process. The RGC needs to streamline licensing requirements by eliminating the need to provide certificates from local authorities and for presenting land titles or lease agreements. Except for companies in industries requiring a minimum amount of capital, which should be clearly defined in the regulatory framework, documents verifying legal capital should be removed from the application. Enterprises should also have more flexibility in establishing articles of association to meet their specific requirements. To facilitate registration the RGC needs to establish a uniform one-door process to be implemented nationwide in order to ensure consistency and provide convenience to applicants. Procedural points such as requiring the principal owner of a newly registered company to appear in person at the MoC should also be eliminated by allowing an authorized representative to carry out the task on behalf of the company.

324. In Vietnam, the example of the registration reforms resulting from passage of the Enterprise Law in 2000 shows that reducing paperwork requirements and eliminating the “ask and give” culture in the process by making registration a right and not a privilege significantly increased the number of registered enterprises. The new law reduced the documentation requirements for the establishment of new enterprises from 8 documents to only 3 main documents: 1) Application form; 2) company charter and list of owners, shareholders and founders (for limited-liability, joint-stock and partnership companies); and 3) verification of legal capital (only for companies in industries requiring a certain minimum level of legal capital as stipulated by relevant laws). The law established a consistent business registration process to be executed throughout the country and set registration fees at a reasonable rate.

325. **Phase 1b - Establish a computerized registration system.** In neighboring countries such as Thailand, Singapore and increasingly in Vietnam, the registration process provides the government with important data on the number of establishments and employees by various industries and geographic locations. To accomplish this task the enterprise registry must be computerized with an effective database to manage the information. In addition to compiled data, individual enterprise information such as the name, location, products, registration date, employee number and ownership details should also be maintained and disseminated both in the form of a directory and on the Internet. The RGC should create a computerized database of registered enterprises by determining information requirements, selecting an appropriate information technology system and establishing procedures for maintaining the system.

326. **Phase 2 - Expand registration requirement.** In the second phase of enterprise registration reform, the government should extend the requirement for registration to a wider segment of the economy. Following the example of Singapore, Thailand and the majority of countries in the region, enterprise registration should be a prerequisite for operating a business. In most countries it is a basic requirement to formalize a business by establishing the business

as a legal entity. Requirements and procedures for registration should be clearly established by law. In Cambodia the Law on Commercial Rules and Registration only stipulates that enterprises paying profit tax are required to register. In practice that has meant that only enterprises under the real regime tax system must register and that enterprises under the estimated profit tax regime are not required to register. This creates incentives for avoiding registration and creates an unclear registration policy. The RGC should amend the Law on Commercial Rules and Registration to clearly define requirements for registration and should extend these requirements to a broader segment of the economy.

327. In Singapore there are two laws covering registration, the Company Act and the Enterprise Act. The Company Act governs all companies while the Enterprise Act governs sole proprietors. The definitions of each are very clear and the requirements for registration for each category are outlined in the law. In Thailand the Commercial Registration Act of 1952 requires all companies and entrepreneurs to register while clearly identifying businesses exempt from registration. In Cambodia the law is unclear regarding who must register and how the process should be carried out. The RGC should strengthen the legal framework for registration in order to broaden the base of registered enterprises and to create the procedures and mechanisms in the law. One way would be to create separate company registration and enterprise registration laws as in Singapore so that the specific requirements of each group could be clearly delineated. Under this framework, a simplified framework for SME registration could be established.

328. Accompanying the requirement for all businesses and entrepreneurs to register should be a package of incentives to provide a benefit for registration. The following incentives should be provided to make registration worthwhile for enterprises:

- Free listing on government published business registries, databases and websites;
- Access to financing programs;
- Low cost land title transfer to company or enterprise;
- Differentiated tax filing requirements based on enterprise size;
- Access to RGC business promotion services;
- Access to training and capacity building programs; and
- Low cost and convenient registration.

329. **Phase 3 - Expand computerized registration system.** In the third phase of registration reform, the RGC should introduce on-line registration to improve the convenience for businesses and reduce RGC administrative costs. A legal framework for on-line registration is required along with detailed operating procedures and determination of technology requirements. On-line registration should speed up the process of registration, reduce the administrative costs for both the government and businesses and ensure transparency in the process by significantly reducing the human intervention. In this phase it may be possible for third parties such as business associations to maintain the computerized registration system through an outsourcing mechanism.

2. Licensing and Inspection

330. Government officials at all levels of administration from the municipal-provincial level to the ministry are involved in the operations of private enterprises through the issuance of licensing certificates as well as through regular inspections of facilities. The official, unofficial administrative costs involved are a burden to businesses and reduce the competitiveness of Cambodia as an investment location.

331. Phase 1 – Establish an inter-ministerial body to review all business licenses. Enterprises in Cambodia face a plethora of licensing requirements. For example, manufacturers require a host of licenses from MIME, MoC, MEF, MOE, MOSALVY, MOH and the MOI. While each individual ministry may have a legitimate reason for requiring such licenses based on their legal mandates, from the enterprise point of view there are many overlaps and redundancies. For example, manufacturers are often required to obtain operating permits from both the MoC and MIME, receive safety inspections from MIME, MOI, and the MOSALVY, receive quality inspections from MIME and Camcontrol and receive environmental inspections from MIME and MOE. There is clearly duplication in the roles of the ministries, which should be streamlined.

332. To examine this issue in greater detail, the RGC should establish an inter-ministerial task force to review the licensing and inspection requirements at all concerned ministries, determine redundancies and overlaps and make recommendations for streamlining licenses. Through this process the task force should compile a comprehensive list of licenses and the requirements for obtaining the licenses. This information should be disseminated to enterprises at the time of registration as well as to business associations. The task force should look for ways to streamline paperwork and other requirements as a means for simplifying procedures, improving transparency and reducing costs. For example, the licensing procedure for hotel operators involves many steps, including obtaining as many as eight separate certificates, permits and licenses before applying for the hotel license. Clearly this process needs to be streamlined to reduce the cost of licensing to the operator.

333. After reviewing the licensing procedures, the task force should develop an action plan with the relevant ministries for simplifying the procedures and improving transparency. The action plan should assign responsibility for implementation to units in the ministries and should map out a schedule and process for revising licensing procedures. The task force should prepare a report outlining all the measures to be taken by each ministry and request progress reports from each ministry on a semi-annual basis. The task force should compile the progress reports and compare them to the action plan schedule.

334. Phase 2 – Streamline licensing procedures. In phase 2 the RGC should issue a decree on simplifying licensing procedures and reduce unnecessary licenses based on the recommendations of the task force. Each ministry should be responsible for implementing the recommendations of the task force according to the action plans.

335. Phase 3a – Enforce new procedures. Phase 3 should focus on assuring that new licensing and inspection procedures are implemented in a transparent and efficient manner. Clear guidelines should be well established in the regulatory framework. Regular audits of licensing and inspection procedures should be carried out by Ministries' General Departments of Inspection as well as by the National Audit Authority. Clear lines of accountability should be established to assure rules and regulations are implemented appropriately. The Chamber of Commerce should establish a hotline where business owners can register complaints about licensing and inspection practices and should report these grievances to the relevant counterparts. Efforts should be made at the highest levels of government to ensure that the penalties and risks of not following the rules are greater than the rewards.

336. Phase 3b – Strengthen rights of businesses in licensing and inspection. Enterprises are often unaware of the inspection requirements they face. The laws governing inspection rarely provide guidance regarding the rights of the businesses being inspected. Clear guidelines of what inspectors may and may not do should be made available to enterprises. In

addition, any citations by inspectors should be made in writing providing full substantiation of the problem and should reference the specific article of the relevant regulation being violated. Businesses should be provided with ample information and time necessary to remedy the situation and fines should be commensurate with the infractions and clearly specified in the regulation.

C. Enforcement of Legal Framework

337. All the best intentions of policymakers are meaningless if laws and regulations are not enforced properly. The success of governance reforms relies heavily on the ability of the judicial system to enforce the rules of the game and to establish an incentive system, which ensures compliance. Improving transparency so that everyone knows what the rules are is an important first step in strengthening enforcement. Strengthening the capacity of the judicial system and public administrators is another important step. The RGC needs to improve the public's access to legal and regulatory information and strengthen the ability of the judicial system in enforcing the legal framework as intended. The RGC also needs to address corruption, which significantly weakens the enforcement of laws.

338. **Phase 1a – Improve dissemination of legal and regulatory information.** The first step toward improving enforcement of the legal framework is to make sure that the laws and regulations are well known by the public. The RGC needs to publish a regular legal gazette, which includes all laws, sub-decrees and regulations affecting the private sector. The Ministry of Justice should be provided with the support necessary to obtain the needed documents from the ministries and organize them into a publishable document. The legal gazette should be the official method of publicly announcing new laws and regulations. The legal gazette should be widely distributed to public libraries, business associations and local government offices, as well as to paying private sector subscribers. All laws and regulations currently in force, which have yet to be published, should be compiled and published in volumes by year. In order to make the legal gazette a useful tool for the public, an effective indexing system is needed to make referencing as convenient as possible.

339. **Phase 1b – Implement commercial arbitration.** As a means for avoiding lengthy court cases related to commercial disputes, it is necessary to create a commercial arbitration panel by enacting the Law on Commercial Arbitration. The law will determine the forms of arbitration agreements, composition and jurisdiction of arbitration panels, the conduct of the arbitration proceedings and how awards are made and enforced. Commercial arbitration will help to reduce the time needed to resolve disputes and by creating a specialized panel to resolve commercial disputes.

340. **Phase 1c - Establish anti-corruption legal framework.** A system of good governance relies on fair, honest and transparent government administration. Anti-corruption legislation should be enacted in order to hold public officials legally accountable for mismanagement of funds and other abuses of public office. The anti-corruption law should include provisions requiring public officials to declare assets and the creation of a national anti-corruption commission. The anti-corruption law should establish clear rules of accountability and a code of conduct for public officials. The RGC should also establish clear rules for public procurement to increased transparency and ensure that government contracts are issued fairly. The RGC needs to reevaluate the legal framework governing public procurement and introduce legislation to promote efficiency, transparency and accountability.

341. **Phase 2a – Disseminate legal information on the Internet.** To further improve the dissemination of legal information, the RGC should establish a website dedicated to providing laws, sub-decrees and regulations. Although the MoC website contains many laws, sub-decrees and prakas, the RGC legal website should be established centrally, rather than by ministry, so that all information is located in one place and that one agency is responsible for the content. The gazettes published in the first phase of the action plan should be utilized to create the website.

342. **Phase 2b – Establish a commercial court.** The Governance Action Plan states that the RGC will examine the relevance of establishing a commercial court. While little action has been taken in this regard so far, it is important that a specialized court be established to resolve commercial disputes. It will be necessary to establish the legal framework for the court by determining its jurisdiction, the conduct of proceedings and the requirements for the judges. By creating greater specialization in the judicial system, commercial and economic disputes can be resolved more effectively, while enforcement of decisions will be more certain. To enhance the effectiveness of the commercial court, judges will be required to undergo specialized training in business and commercial law. A code of ethics and a requirement for judges to declare their assets would further enhance the effectiveness of the commercial court by better ensuring transparency and fairness in the system. Upon establishment of the commercial court, the Ministry of Justice should establish a committee to ensure that rules are being upheld and to investigate any allegations of corruption or wrongdoing.

343. **Phase 2c – Strengthen implementation of anti-corruption measures.** The RGC should strengthen the capacity of Ministry General Departments of Inspection in the fields of internal audit and the National Audit Authority in external audit. Significant capacity building efforts should be made to enhance their efforts to ensure government contracts are issued through fair competition. In addition, the media should play a role in assuring transparency by exposing corruption in public procurement.

344. **Phase 3 – Reform public administration.** As recommended in the Governance Action Plan, the RGC should implement civil service pay reforms so that salary levels are high enough to ensure a satisfactory standard of living and a classification system more conducive to career professionals. Career development should be emphasized in order to create incentives to increase productivity. The RGC should introduce a merit based career advancement system by strengthening human resource planning and establishing measurements and targets for performance evaluation. Curriculum in universities should be developed in the field of public administration to produce highly qualified public officials.

D. Improve Market Access and Information

345. Assisting to improve market access is one of the most important tasks the RGC can carry out. The fundamental problem facing most businesses is to find markets for their production. Assistance to match buyers with suppliers is necessary as are promotional efforts and increased market information to help producers meet customer quality and design demands. Assuring competitive market access for local producers through reduced smuggling is also necessary. Strengthening the role of business associations will assist in improving quality through information exchange on technology and market trends. Improving access to export markets through simplified export processing and improved export promotion will make Cambodian products more competitive in foreign markets.

1. Trade Promotion and Information

346. The RGC needs to play a stronger role in promoting business by helping to disseminate information about companies and increasing trade promotion efforts as a short-term measure. In the medium and long-term the RGC should enhance its trade promotion efforts by developing an effective website and by providing matching services.

347. **Phase 1 - Strengthen trade promotion and market information activities.** The RGC together with business associations should strengthen trade promotion activities to increase awareness of Cambodian products. The MoC should establish a trade promotion center and showroom to exhibit products made in Cambodia. This center should be well promoted and located centrally in Phnom Penh to attract both foreign and local buyers. The center should organize trade fairs featuring products from various regions in the country. The trade promotion center should provide information about local companies and provide assistance in matching buyers with suppliers.

348. To improve the provision of market information, the capacity of the MoC needs to be strengthened. In particular, stronger capacity to provide market research support to the private sector is needed. Under ideal circumstances, market research is carried out at the firm level or by business associations. However, in Cambodia this function is not yet fully developed. In order to improve the provision of market information, the MoC should assist by sponsoring, most likely with donor assistance, market studies in strategic sectors to be carried out by the private sector to expand the knowledge base and disseminate market information.

349. The RGC should initiate a “buy Cambodia” campaign to promote local products. The campaign should promote the benefits of buying domestic products and work on increasing the image of Cambodian products. The “buy Cambodia” campaign should be coordinated with tourism promotion efforts.

350. The RGC needs to provide more assistance in bringing together buyers and sellers. The first step should be to publish a business directory for wide distribution. Additionally, MIME and MoC should cooperate in publishing a regular newsletter featuring high potential local products and businesses for both foreign and domestic markets. Through these activities the RGC can assist in disseminating more information to the domestic and foreign marketplace, resulting in greater business opportunities for local producers.

351. **Phase 2a – Develop website to promote local products.** The RGC should develop a trade promotion website to promote local products and companies. The website should be combined with the enterprise registry and should include information on trade promotion activities of the RGC. The website should include information about producers sorted by sector and industry and should provide company profiles, product descriptions and contact information. The website should be linked with foreign chambers of commerce and trade promotion agencies. The RGC should also promote e-commerce by creating the necessary legal framework.

352. **Phase 3 – Enhance trade promotion services.** In Phase 3 the RGC should enhance its trade promotion services by working with the Chamber of Commerce to provide matching services with both local and foreign companies. The RGC should also encourage the Chamber of Commerce to become more involved in efforts to bring potential suppliers together with larger manufacturers and assist in identifying subcontracting potential for local producers. In particular, the RGC and Chamber of Commerce need to work with foreign governments and businesses to

help identify business opportunities for local producers and to organize meetings between local and foreign business leaders. The RGC should also provide assistance to local businesses to participate in overseas trade fairs and to meet international businessmen.

2. Customs Reform

353. To combat smuggling the RGC must take serious measures to reduce the incentive for smuggling and strengthen border controls. Strengthening the capacity of the anti-smuggling task force headed by the CED is a key factor in reducing illegal imports, including the increased automation of customs processing. Strengthening Khmer labeling requirements would also have a positive affect on reducing smuggling.

354. **Phase 1 – Strengthen anti-smuggling efforts.** The RGC should reduce incentives for smuggling by lowering the cost of official imports and increasing the cost of smuggling. Reducing the cost of official imports means lowering customs duties on consumer products and streamlining import processing procedures to make the inflow of goods smoother. It is also vital that the valuation system be fair and transparent. Increasing the cost of smuggling means increasing the possibility of being caught and assuring that the penalties are high enough. The anti-smuggling task force needs to redouble its efforts to control illegal trade by strengthening border controls as well as controls at product destination in stores and markets. While progress has been made since the establishment of the CED's new Phnom Penh branch, more training and better incentives are needed to strengthen anti-smuggling efforts at the product destination. Regulations requiring Khmer labeling should also be strictly enforced. The RGC should set specific targets for the anti-smuggling task force based on the number of cases filed and the amount of contraband confiscated and provide pay incentives to task force officials based on their performance. The results of the task force activities should also be announced publicly.

355. The RGC should also enact the Law on Customs, which has been submitted to the National Assembly, and develop the implementing regulations needed to support the new legislation. These should be incorporated into a Policy and Procedures Manual. The draft law provides a sound legal basis for customs administration and fully complies with WTO requirements and international standards set by the World Customs Organization (WCO).

356. **Phase 2a – Strengthen capacity of Customs and Excise Department.** Under the Technical Cooperation and Assistance Program (TCAP) efforts to strengthen CED organization and human resources are underway. Under TCAP the CED should develop a human resources plan as well as a training program to strengthen management skills and technical expertise. The CED should also implement the customs integrity program envisioned by TCAP, which will encompass an internal audit unit, an updated code of ethics, a policy of strict disciplinary action for employee malfeasance, an improved system of internal controls and monitoring and a publicity plan.¹¹⁴ Assistance in developing the program should be sought from the WCO. The CED should develop a plan to maximized benefits from WCO membership through active participation in regional WCO programs including technical assistance and training. The CED also needs to prepare steps to implement the information technology program to improve automation and improve statistics gathering. The CED should implement a code of conduct for customs officials and enhance the accountability of officials. It is also necessary to rationalize the number of agencies involved in checkpoints in order to establish accountability.

¹¹⁴ Annual Progress Report 2002, Strengthening Economic and Financial Management Project/Technical Cooperation and Assistance Program, Ministry of Economy and Finance.

357. **Phase 2b – Implement computer system.** CED has a manual system of cargo reporting, declaration processing and revenue accounting. A small computer system has been upgraded to compile statistics from manually completed forms. A fully computerized system is required to improve efficiency of customs clearance, revenue counting, data collection and analysis. By implementing a computerized system all transactions would be processed in a consistent manner reducing opportunities for under assessing import quantities and value.

3. Business Associations

358. Business associations will play an increasingly important role in supporting trade promotion, capacity building and technology development. In particular, industry based associations will grow in importance. The formation of business associations will require assistance from donors and the RGC to provide facilities, capacity building and organizational support.

359. **Phase 1 – Support formation of business associations.** The RGC should support the development of business associations through assistance with facilities and organizational capacity building. The RGC should encourage donors to support the formation and organizational development of industry and rural based associations. The role of Commune Councils should be enhanced at the local level by encouraging them to carry out duties similar to a chamber of commerce to promote local businesses and build linkages outside the community.

360. Business associations should be encouraged to set up cooperatives to carry out commercial activities such as establishing markets and storage facilities and improving processing capacity by jointly investing in necessary machinery. The associations should arrange technical training and other capacity building activities to help improve quality and management of members. RGC and donor training programs should be organized together with business associations to better facilitate activities and to provide long-term relationships between the service providers and enterprises. Associations should also be included in the policy dialogue with the RGC through the private sector forum and discussion groups at the ministry level. The associations will require able secretariats to gather ideas from members and prepare policy papers and recommendations during the dialogue process.

361. **Phase 2 – Strengthen function of business associations.** In phase 2 the role of associations in marketing and quality improvement will need to be enhanced through capacity building efforts led by donors. The role of associations should also be enhanced in developing marketing and distribution channels. Funding should be provided to assist associations to create distribution networks to allow them to sell members' products directly to the market rather than relying on middlemen and other ineffective distribution channels.

362. **Phase 3 - Strengthen role of associations in financing.** In phase 3 the role of associations should be further strengthened by assisting them to establish credit cooperatives, which would mobilize savings and provide lending to members. Funding support to start the credit unions should be provided through RGC rural finance and SME lending programs as well as through donor support.

4. Export Development

363. Since the size of the domestic market is limited, an effective export strategy is necessary to promote economic growth. This strategy depends on the RGC's ability to provide export

promotion services, reduce the cost of trade facilitation and diversify its production base to meet demand in foreign markets. Establishing industrial zones for exporters would also promote exports by providing infrastructure for manufacturers.

364. Phase 1a – Develop export promotion potential. As mentioned above, the RGC should establish a website to promote local products and build linkages with overseas buyers. The website would provide an opportunity for companies without their own English-language websites to promote their products to foreign buyers.

365. The RGC should establish an export marketing fund, which would provide grants to registered enterprises, particularly SMEs, for participating in overseas trade fairs, exhibitions and study missions as well as for local trade fairs and exhibitions, which are export oriented. The fund would assist enterprises to gain experience and obtain information regarding export markets. The management of the fund should be coordinated with the activities of business associations so that fund recipients are able to share information obtained from the trade fairs. The RGC should also organize international trade fairs and exhibitions and allow local producers to participate free of charge. The RGC should coordinate its tourism promotion activities with trade promotion to reach a larger audience of potential buyers, particularly for handicrafts and processed foods.

366. Phase 1b – Reduce trade facilitation costs. The RGC should put special emphasis on reducing trade facilitation costs to encourage exports. Duplication of agency functions in processing exports and imports adds to the processing time and cost. While CED is in charge of customs valuation, clearance and collection of duties other agencies are also involved. MAFF is responsible for agricultural controls, the Frontier Defense Department is responsible for checkpoint security for the prevention of smuggling, the Ministry of Interior Economic Police control for fraud and illegal contraband and the MoC's Camcontrol is responsible for monitoring the quality of imports and exports. At border checkpoints provincial offices are also involved. Although, measures to rationalize the presence of government agencies at border checkpoints were introduced through Sub-decree 84 in 2001, much uncertainty remains about the roles and responsibilities of government agencies.¹¹⁵ The RGC needs to address this issue by assuring implementation of the sub-decree and delegating more authority to CED for import and export processing. Fee structures at the Sihanoukville port, which are as much as four times higher than in Thailand, need to be reduced as well.¹¹⁶

367. Phase 2a – Establish industrial zones for exporters. The creation of industrial zones is aimed at facilitating export development by creating high quality infrastructure and utilities needed to attract investment. To improve infrastructure for exporters the RGC should support the development of industrial zones. The RGC first needs to enact the Law on Industrial Zones to establish the legal framework for their establishment. Development of industrial zones should be carried out by the private sector. The institutional arrangement, including the fiscal incentives for companies moving to the zone and the structure of the industrial zone authority in charge of customs clearance, tax collection, labor relations and SME promotion should be determined in the legal framework. The RGC needs to study carefully the best location for industrial zones, which will facilitate exporters. The Japanese Government has carried out a significant feasibility study for establishing an export processing zone in Sihanoukville. Other locations with strong potential due to their proximity to export markets are Koh Kong, Poipet and Battambang.

¹¹⁵ Cambodia: Integration and Competitiveness Study, Ministry of Commerce, January 2002.

¹¹⁶ Ibid.

Suburban Phnom Penh is also a strong candidate due to the availability of human resources. The location of the industrial zones should be based on the demand of the private sector.

368. **Phase 2b - Provide export incentives.** The RGC should provide incentives to exporters, including export finance in the form of pre-shipment financing, term loans for export related projects, letters of credit, export credit insurance and export advisory services. The RGC should provide incentives for FDI such as improved infrastructure through industrial zones and streamlined licensing. To facilitate manufacturers of export-oriented products, the RGC should provide more incentives for the duty free import of equipment and raw materials. The LOI allows such duty free access only for large investment projects. Small-scale exporters should be given similar incentives to promote their export potential and assure a level playing field for all businesses. One option for streamlining import processing for export oriented enterprises would be to declare a zero tariff on goods most frequently used by exporters. This would create more transparency in the system and simplify administration.

369. **Phase 3 – Strengthen overseas trade promotion.** The RGC should establish a national agency for export promotion within the Ministry of Commerce to formulate policy and establish guidelines for encouraging and supporting the expansion of exports, provide information services and market co-ordination, implement and co-ordinate export promotion and expand the range of export products and markets. The agency should establish a website providing up-to-date information about trade enquiries, market briefs, product offers and trade fairs. The website should have e-commerce potential. The agency should also provide information services such as newsletters for overseas buyers, a buyer's guide to Cambodian products and a directory of exporters. These publications should be distributed to overseas business people, business organizations, government agencies and international institutions. The agency should also prepare studies of overseas markets and carry out workshops and training. The export promotion agency should assign representatives to work overseas to carry out trade promotion and gather information on markets.

E. Access to Finance

370. The key elements for improving access to finance involve establishing a sound legal framework to protect property rights and enforce contracts. To strengthen the banking system the legal infrastructure for commercial activities needs to be in place along with mechanisms for enforcement. Improved credit information is needed to allow financial institutions to make well-informed credit decisions. An expansion of financial services into the areas of insurance, leasing, consumer finance, and equity and bond finance would increase financing options and promote new investment. Improving the ability of financial institutions to manage liquidity through money markets would provide more flexibility for banks to make term loans, while developing the capacity of professionals would improve credit appraisal and risk management.

1. Contract Enforcement

371. Effective enforcement of contracts depends upon a strong commercial law framework and effective enforcement by the courts. The RGC needs to implement key commercial infrastructure and strengthen law enforcement to reduce the risks of lending.

372. **Phase 1 – Create key commercial legal infrastructure.** Many commercial laws are being drafted, which will underpin financial sector development. The RGC needs to adopt the civil code and procedures and the draft laws on commercial contracts, commercial enterprises, insolvency, and secured transactions to provide the legal framework for financial institutions to

more confidently provide financing. An improved legal framework combined with judicial reform will establish clearer rules and give banks necessary legal rights in handling defaults. With an improved legal framework in place financial institutions will be better able to expand their services to a wider client base than to just to well known and related borrowers. The RGC should also establish a regulatory framework for a secured transactions registry to allow registration of real estate and moveable property as collateral. Land titling efforts being carried out at the Ministry of Land Management should also be strengthened by improving dispute resolution mechanisms and reducing the fees involved. The cost of land title transfers should also be significantly reduced to encourage more widespread and up to date land titling.

373. **Phase 2 – Strengthen law enforcement.** In phase 2 the RGC should establish a public secured transactions registry for real estate. Procedures for registering property should be in place and financial institutions should have direct access to the registry. By the end of phase two, titling of commercial land should be completed to facilitate business lending and eliminate the possibility of land disputes. The establishment of a commercial court should also be completed to speed up legal proceedings and create specialization in the judiciary. Commercial court jurists should receive adequate compensation and training.

374. **Phase 3 – Enhance legal infrastructure.** In the third phase the RGC should allocate more resources to improve and enlarge the legal infrastructure to underpin commercial activities, including strengthening of the commercial court, establishment of public registry for movables and completion of land titling of residential and agriculture land.

2. Credit Information

375. A strong system of credit information is the backbone to creating a sound lending environment. The development of accounting and auditing systems is vital for banks to understand the financial condition of borrowers. Effective auditing will help to ensure the accuracy of the financial information. Credit information also includes knowing the borrowing history of loan applicants. Information sharing between financial institutions through informal and formal arrangements is a key to gauging the creditworthiness of potential borrowers.

a. Accounting/Auditing Standards

376. **Phase 1 – Establish accounting/auditing standards and enforcement system.** The RGC needs to strengthen the National Accounting Council established under the Law on Enterprise Accounting and Audit. The Khmer Institute of Certified Public Accountants and Auditors established under the law should also be strengthened in order to develop professional standards, training programs and eventually to certify auditors. It will also be responsible for establishing a code of ethics for auditors and accountants.

377. **Phase 2 – Strengthen accounting/auditing standards enforcement.** In phase 2 the RGC needs to strengthen enforcement of accounting and auditing standards. By promoting competition in the local accounting industry new entrants will be encouraged to participate resulting in reduced cost to the private sector for accounting and auditing compliance and improved quality. The RGC should also promote the accounting industry through the strengthening of university curriculum and the build up of vocational training in order to develop a pool of professional accountants and auditors.

378. **Phase 3 – Enhance accounting/auditing standards enforcement.** In phase 3 the RGC should expand the application of IAS to the private sector by requiring companies to implement IAS. Independent auditing of IAS should also be mandatory.

b. Credit Information

379. **Phase 1 – Establish credit information exchange.** The Association of Banks in Cambodia (ABC) is currently developing a credit information exchange, which will formalize to some degree arrangements between banks for sharing borrower credit information. Establishment of such arrangements also requires the collaboration of the NBC to create the regulatory framework governing the sharing of information between commercial banks. Procedures for establishing the credit information exchange need to be established as well as for the expanded credit information bureau.

380. **Phase 2 – Expand scope of arrangements for credit information sharing.** In phase 2 the ABC should establish a full credit bureau by determining membership and information sharing arrangements and mobilizing the resources needed to set up the required hardware and software system. The regulatory framework will need to be further developed to encompass issues regarding the right to privacy of borrowers.

381. **Phase 3 – Diversify and upgrade credit information system.** In phase 3 the RGC will need to further develop financial information systems by encouraging the development of a credit rating industry to support debt markets. The ABC will also need to further develop the capacity of the credit bureau through increased investment in information technology.

3. Expansion of Financial Services

382. The expansion of non-bank financial services and insurance is critical for the development of the private sector. The development of non-bank financial services is dependent upon improvements in the legal and regulatory framework, which will create demand for new services. To expand the use of insurance, the legal and regulatory framework needs to be strengthened and supervision of the industry needs to be enhanced. In this way awareness of the benefits of insurance will be developed as will public confidence in the industry.

a. Non-bank financial services

383. **Phase 1 – Establish foundation for non-bank financial services and capital markets.** Leasing offers many advantages for banks in an environment where term financing is ineffective by providing the equivalent of term loans for capital equipment. Under the current Banking Law, banks are allowed to carrying out leasing. However, implementing regulations are needed before banks are willing to initiate lease financing. The NBC should establish the basic procedures for banks to carry out leasing by issuing appropriate regulatory guidance.

384. To encourage the development of capital markets the RGC must prepare the legal, regulatory and institutional groundwork for capital markets. Regulations are needed on securities brokers and dealers to allow banks to undertake securities businesses. The RGC also needs to develop the legal framework for a securities exchange as well as for the formation of securities companies and subsidiaries. The legal framework for the development of a capital market supervisor should also be put in place.

385. **Phase 2 – Promote non-bank financial services.** To promote leasing the RGC should develop appropriate fiscal and financial incentives to attract investment in leasing from both domestic banks as well as to encourage FDI. The RGC should implement effective measures for supervising the leasing industry and assist in building the capacity of professionals in the field of lease finance.

386. To assure sound development of capital markets, diverse institutional investors need to be developed such as trust businesses, investment/management companies, mutual funds and venture capital companies. In phase 2 the RGC needs to build the legal and regulatory framework for these institutional investors as well as to establish a securities market regulator.

387. **Phase 3 – Develop capital markets.** In phase 3 the RGC should establish a securities exchange. It should also encourage the development and diversification of institutional investors to provide investment services and stimulate market growth. Arrangements for bond financing should be in place including rules for underwriting and issuance. Secondary markets for bonds should also be developed. The RGC should strengthen the capacity of capital market participants by developing a securities brokers and dealers association, which could build capacity in the industry and act as a market self-regulatory organization.

b. Insurance

388. **Phase 1 – Promote market based development of insurance industry.** The RGC needs to implement the Sub-decree on Insurance by establishing an enforcement and monitoring framework for compulsory insurance. To date enforcement of compulsory insurance has been weak because of the lack of a coordinated effort among concerned ministries to establish an efficient enforcement and monitoring mechanism. The RGC needs to establish an inter-ministerial working group to improve compulsory insurance, which is vital for creating policy driven demand in the industry. To maintain fair competition in the insurance industry and maintain its market orientation the RGC should privatize the state-owned CAMINCO through a joint venture.

389. **Phase 2 – Promote public confidence in the insurance industry.** To increase public confidence in the insurance industry the RGC should refine and adopt new regulations to address the increased delivery of insurance products and should allocate more resources to reinforce the regulatory and supervisory body. Capacity building of regulators will insure that prudential regulations are upheld. The RGC should institute policies to encourage private companies to enter the market by streamlining procedures for foreign insurance companies, developing reinsurance institutions and by divesting all government ownership in insurance companies. The RGC should strengthen prudential regulation of the insurance industry by creating an independent supervisory body staffed by qualified specialists with a competitive compensation scheme. The independent supervisor should enhance supervisory capacity and prudential regulations in accordance with the Core Principles of the International Association of Insurance Supervisors. Enhanced supervisory capacity would bolster public confidence and facilitate the development of the sector.

390. **Phase 3 – Strengthen capacity of insurance sector.** The RGC needs to establish an insurance training institution, which will play an essential role in capacity building in the sector by attracting international assistance and best practices to Cambodia. As the insurance sector grows the RGC needs to develop an actuarial professional body and adopt a relevant legal and regulatory framework, including a code of ethics and professional standards.

4. Financial Management Efficiency

391. The development of money markets is necessary for financial institutions to manage liquidity. In the first phase it is necessary to establish the foundation of a short-term unsecured interbank market, which will be followed by the issuance of T-bills and diversified money market instruments and the development of a primary dealer system. The third phase aims at broadening interbank / money markets by creating a framework for non-financial issuers of money market instruments such as commercial paper. In addition to developing money markets, financial management efficiency will be enhanced by building capacity in the banking sector by providing the necessary training to develop a strong base of banking professionals.

392. **Phase 1a – Establish money market.** Commercial banks should initiate the development of short-term unsecured interbank lending. At the same time the RGC needs to put in place the legal and regulatory framework for the development of money markets, especially the adoption of a negotiable instruments law. The NBC should develop a framework for supervising and monitoring the liquidity position of banks and should provide detailed procedures for issuing interbank/money market instruments. The RGC should adopt a medium-term plan and regulatory framework for establishing a T-bill market.

393. **Phase 1b – Establish capacity building.** To develop the financial management efficiency capacity building efforts will be needed. The Center for Banking Studies needs to strengthen its capacity for training central bankers by appointing full-time instructors with competitive pay packages, establishing a central banking course for professionals at the NBC and developing mandatory training programs for incoming central bankers. To strengthen the capacity of banking professionals it is necessary for the ABC to establish a banking institute for training commercial bankers.

394. **Phase 2 – Expand money market instruments.** The RGC should issue T-bills and other government securities. Regulations to enable the use of repurchase agreements based on T-bills and negotiable certificates of deposit should be established by the NBC. The NBC should also consider issuing central bank securities to speed up the development of money markets. To develop a vibrant T-bill market the RGC needs to establish a primary dealer system for government securities and regularize the issuance of T-bills.

395. **Phase 3 – Further develop money markets.** The RGC should deepen money markets aiming to develop integrated interbank/money markets to expand their use to less experienced institutions. This would be accomplished by scrutinizing the regulatory framework to enhance the confidence of all players in interbank/money markets. The RGC will also need to establish a regulatory framework for the issuance of commercial paper and trade bills by non-financial institutions. The introduction of money market instruments should be synchronized with the development of private bond markets and the establishment of money market intermediaries such as investment companies and finance companies.

F. Sub-sectors

1. Agriculture

396. Growth in agriculture rests on increasing the per capita growth of the sector through commercialization and diversification towards higher value-added products. Diversification of crop production from rice to higher-value crops would raise the incomes for farmers and provide greater potential for exports. This diversification involves the development of agro-industry to

increase cultivation of high-value produce and the integration of smallholders with agro-enterprises to increase the potential of urban and international markets. To support agro-industry the legal framework surrounding land concessions needs to be strengthened and domestic and foreign investment is needed. Developing the potential of smallholders involves much capacity building, the strengthening of rural finance and the development of agro-enterprises with capacity to process, package and market food products. The development of agriculture also hinges on improvements in irrigation and road infrastructure.

397. The fisheries sub-sector has potential to add significant income to the agriculture sector. Legislation needs to be enacted to improve community fisheries management. Industry associations should be formed to encourage the sharing of market and technical information and assist in reducing distribution costs. In the medium-term it is necessary to enhance the value-added of fisheries through improvements in storage and distribution and the development of improved processing capabilities. In the long-term the industry needs to develop capacity in aquaculture in order to reduce dependence on natural fish stocks, increase production capacity and enhance export. Fish farming will be vital for increasing the income of the industry.

a. Agro-industry and processing

398. **Phase 1a – Support development of agro-industry.** The development of large-scale agro-industry will enhance the potential for diversification into high-value products. To enhance private sector investment in agro-industry, the RGC needs to establish land tenure through concessions. If large-scale land concessions are awarded, it is important that they are transparent and are provided only to investors who plan to cultivate the land, particularly with crops that have export potential such as high-grade rice, vegetables and fruits, industrial crops such as rubber, sugarcane, palm oil, coffee, pepper, soybeans, sesame, mung beans, and cashew nuts. For this reason enforcement mechanisms for concession agreements, such as establishing a monitoring team for inspecting concessions, must be created.

399. With the major export potential of Cambodian rubber it is necessary that management of rubber production be improved to restore its competitiveness in international markets. The RGC should improve the efficiency of public rubber enterprises through reorganization and eventual privatization. Privatization would result in improved efficiencies in the management of the plantations and the restructuring of management. It would also likely result in greater investment in technology and quality enhancements that would improve the competitiveness of Cambodian rubber.

400. **Phase 1b – Support development of smallholders.** Due to the large number of smallholders in the country it is vital for the RGC to find ways to improve their incomes. The core strategy for improving incomes of smallholders is to assist them to diversify production to high-value added products by integrating them with agro-enterprises to provide stable markets for farmers and an incentive to switch from rice to other cash crops. The RGC should strengthen the integration of smallholders and agro-enterprises by improving access of smallholders to land, seeds, inputs, and water and by supporting extension services. To this end it is necessary for the RGC to implement the Sub-decree on Social Land Concessions to assure land tenure to smallholders and provide land to the landless. It is also necessary to improve the access of smallholders to the knowledge and credit necessary for the production and marketing of high-value products. At the same time the RGC should support the development of small and medium agro-enterprises by reducing transaction costs and risks associated with accessing credit and by providing capacity building and advisory services through regional resource centers. The RGC can promote product diversification by creating a rural financing program to

enhance longer-term investments of farmers and agro-enterprises, building farmers' technical and marketing capacity through education and extension services and encouraging the use of contract farming to assure smallholders will have markets for their diversified produce. Farmers can help themselves by establishing associations to organize access to inputs, distribution, marketing and capacity building efforts.

401. **Phase 2a – Enhance development of agro-enterprises.** Enhancing the development of agro-enterprises should be a major part of the RGC's action plan to strengthen the agriculture sector. To improve access to markets the RGC should assist agro-enterprises to improve quality, packaging and distribution in order to be more competitive. The RGC should establish capacity building programs targeting SME agro-enterprises. The RGC should also support agro-enterprise associations, which would also play a large role in developing the technical, marketing and financing efforts of agro-enterprises. The Rice Millers Association acts as an excellent example of the benefits of forming industry based associations and should be further promoted in other industries.

402. **Phase 2b – Improve agriculture infrastructure.** The RGC needs to enact a water law and policy to improve access of farmers to water control and irrigation. The RGC should continue to concentrate on the rehabilitation of existing irrigation schemes rather than constructing totally new schemes with an emphasis on small-scale schemes where the farmer beneficiaries can be involved in contributing to management, operation and maintenance costs. Training of farmers in management, operations and maintenance are important components of new irrigation developments. The legislative and administrative framework for formation and operation of Water User Groups/Associations developed under the World Bank Agriculture Productivity Improvement Project should be implemented in order to ensure the sustainability and management of irrigation infrastructure by collecting fees from participating farmers and using the funds for system operation and maintenance.

403. **Phase 3 – Develop agro-enterprise export potential.** The RGC should assist in establishing an Agricultural Trade Promotion Center, which would provide a forum for agro-enterprises to promote exports of Cambodian agricultural products. The center should facilitate fairs and exhibitions to promote agricultural exports. The center should provide information about procedures related to export financing, shipping and standards. Assuring consistent quality will also be vital to gaining access to foreign markets. MAFF needs to assist in developing food safety standards for agro-produce, while MIME and MoC should set industrial standards for processed foods to assist Cambodian producers to enter foreign markets.

b. Fishery

404. **Phase 1 – Support development of fisheries.** The RGC needs to establish the legal framework and administrative provisions for fisheries management and operation of the industry by enacting the draft Fisheries Law and the Sub-decree on Community Fisheries. The legal framework will establish and maintain community-based fisheries management systems and procedures under the national supervision and control of the DOF. Along with the legal framework, the RGC will need to develop local capacity to operate community-based fisheries management and administration by: 1) defining the administrative and operational framework for community-based fisheries management; 2) establishing local fisheries management authorities (fisheries councils) to carry out fisheries management and administration under the guidance of the DOF; 3) carrying out training and awareness building activities to introduce the new legal and administrative framework for fisheries and fisheries management; 4) providing support to fisheries councils and the fisheries service to effectively monitor and evaluate activities in the

fisheries sector; and 5) supporting the fisheries councils and the fisheries service to manage conflict resolution and law enforcement.

405. The formation of private business associations in the fishery industry is necessary to upgrade managerial, marketing and technical capacity and to generate financing. The RGC should encourage the formation an association of fish traders, processing and marketing enterprises to increase linkages in the industry and provide an organization to strengthen the capabilities of fishery enterprises.

406. **Phase 2 – Enhance value-added of fisheries.** To enhance the value added of fisheries capacity needs to be built in the areas of storage, transportation, processing and packaging. While private business associations can play an important role in this process, the RGC needs to assist by providing capacity building services to distributors and processors. The RGC should support associations to form cooperatives to establish storage facilities at major markets, to increase economies of scale in distribution and improve transportation efficiency. To improve processing and packaging, the RGC should assist in developing facilities near landing places and trading points. In the first stage these facilities could be developed as a public-private partnership with the public sector providing infrastructure and the private sector operating the facilities based on concessional agreements. In the second stage the facilities should be privatized so that the private sector is in charge of all maintenance and management.

407. It is also important that the RGC assures market competition in the industry by eventually privatizing the state-owned fishery import/export company KAMFIMEX. This will assure that fishery trade is carried out based on market mechanisms and will create efficiencies in distribution. The RGC should also consider removing export taxes on live fishery exports to improve the competitiveness of Cambodian exports.

408. **Phase 3 – Strengthen aquaculture industry.** In the long-term term the development of aquaculture will be an important step to ensuring the sustainability of the fishery industry and developing export markets. Increased demand for fishery products will lead to an aquaculture based fishing industry in Cambodia. The private sector needs to play the leading role in developing the aquaculture industry through investment in infrastructure and management of facilities. The RGC should support small-scale aquaculture by arranging financial and technical support from the donor community and by providing extension service and training to farmers in developing fishponds and rice-fish culture. The RGC can also play a role in developing breeding programs to assure a supply of certified and disease free brood stock and fish fries to private sector aqua culturists. The RGC should establish and maintain “Best Practice” guidelines for the different types of aquaculture and for different habitats and work together with local fisheries councils to develop and implement localized aquaculture management plans. The RGC should develop and maintain a continuous flow of technical, scientific and general information on aquaculture to local communities.

2. Households

409. **Phase 1 – Improve market access.** Household businesses suffer from a lack of market access due to poor infrastructure and a lack of market information. The key for developing households is to improve access to market information. This can be achieved through the development of commune based associations, which improve information sharing on pricing, design and quality. These associations can provide an organizational framework for building the technical and marketing capacity of local producers. These associations can also facilitate regional specialization through clustering and the advancement of a one commune-one product

strategy. With the associations acting as private sector counterparts, the RGC should strengthen the capacity of local government offices to provide market information. In cooperation with the associations, the departmental offices of relevant ministries such as MoC and MIME should arrange training and information services at the commune level, which focus on providing market information to household businesses and assisting them to meet quality, design and distribution requirements. The RGC should also assist the household businesses to create and strengthen linkages with larger enterprises by arranging trade fairs, providing matching services and creating incentives for local sub-contracting.

410. **Phase 2 – Enhance formalization of household sector.** The high level of informality in the household sector means that they do not benefit from being a member of the acknowledged business community. To assist these enterprises in entering the formal sector it is necessary for the RGC to enact legislation to simplify registration for household enterprises. As mentioned above, one method is to enact separate company and enterprise laws as Singapore has which provide distinct guidelines and fees structures based on the legal status of the business. The key to bring more enterprises into the formal sector is to create a legal framework, which makes registration convenient and inexpensive, and to establish incentives to convince enterprise owners of the benefits of formalizing. Possible incentives would be a simplified tax structure for SMEs, access to formal financing, access to business promotion and training activities, the ability to bid for government supplier contracts and access investment incentives.

411. **Phase 3 – Enhance competitiveness of household sector.** In Phase 3 the RGC should focus on enhancing the competitiveness of the household sector. Since more of these enterprises will have been formalized in Phase 2, it will be possible to design financing, marketing and capacity building programs targeting the household sector. The RGC will also be able to utilize tax and other investment incentives to encourage household enterprises to expand. Tax incentives could include duty exemptions on imported equipment and raw materials or special VAT treatment, which would reduce investment and operating costs. The RGC should also open procurement opportunities by establishing targets for procurement from household enterprises.

412. Business development services to improve marketing, management and technical skills should be developed by the RGC. These services are explained in section 5(e) below focusing on SME development.

3. Formal Domestic Sector

413. As the country becomes more industrialized, the formal domestic sector has great potential for creating economic growth and reducing poverty through labor-intensive manufacturing. The key to developing this sector is to create an enabling business environment based on fair competition and good governance, so that the risk of making large investments in facilities, equipment, materials and distribution is commensurate with the reward. This sector also depends upon the cost structure of the economy and the ability to provide quality products and services to be competitive with foreign competitors. The RGC needs to facilitate the strengthening of the domestic formal sector by providing a competitive business environment with a transparent governance framework and low cost infrastructure. It should also assist local producers to improve quality standards to meet market demand.

414. **Phase 1a – Improve governance.** The formal domestic sector will benefit significantly from improvements in governance, in particular the streamlining of registration and licensing mentioned above. Strengthening the anti-smuggling efforts of the RGC will also greatly benefit

domestic formal enterprises since they are most likely to produce import competing products, such as processed foods, beverages, metalwork, shoes, construction materials and other manufactured goods. The RGC should also streamline import processing to improve access to imported raw materials and equipment through measures such as selective inspection and verification of goods and the release of goods prior to duty payment. Compulsory inspection of all imports is the result of the low level of importer compliance with the self-assessment system in which many importers falsely understate the value of their imports and miss describe them to reduce their tax liability. Programs to educate importers and encourage higher levels of voluntary compliance are needed to support the implementation of modern streamlined customs procedures and trade facilitation measures. Introduction of an automated customs processing system is also critical for customs reform and will likely have a significant impact on trade facilitation and improving trader compliance.

415. Companies in the domestic formal sector are affected heavily by the tax code since they participate in the real regime tax system, pay minimum taxes on revenues, participate in the VAT system and pay withholding salary taxes. It is vital for the RGC to assure that implementation of the tax code is uniform to assure that all companies are operating on a level playing field. The implementation of Cambodian Accounting Standards will play a large role in assuring uniform compliance to tax codes. Formal domestic enterprises would also benefit from policies to broaden the tax base so that their tax burden could be reduced as a portion of total RGC revenues.

416. **Phase 1b – Develop industrial standards.** The development of industrial standards will help to increase product quality as well as increase consumer confidence in Cambodian made products. MIME's Department of Industrial Standards is responsible for certifying the quality and safety of local manufactured products. So far the main target for certification has been processed foods and beverages, especially bottled water and carbonated drinks. MIME needs to build its capacity in establishing industrial standards through close cooperation with donors and foreign governments. As it builds its capacity to certify quality and safety, the RGC should also promote public awareness of industrial standards to encourage consumers to look for the mark of industrial standard on the packaging when making purchasing decisions. If consumers begin to demand industrial standards, producers will have a greater incentive to obtain certification.

417. **Phase 2a - Improve cost competitiveness.** The cost structure in Cambodia is high compared to neighboring countries. The RGC needs to adopt policies to improve cost competitiveness. Labor costs in Cambodia are high considering the low level of productivity. The RGC should consider reforming its labor policies, which provide for generous benefits such as high minimum wages, double overtime pay at night and on weekends and many paid holidays.

418. Infrastructure costs associated with transportation and electricity are also a major cost disadvantage to domestic formal enterprises. The RGC should continue efforts to improve road infrastructure especially on Route 5 to Thailand and Route 1 to Vietnam. Improvements in these and other major thoroughfares would significantly reduce the time and cost of delivering raw materials for production and finished products to foreign and domestic markets. Electricity fees in Cambodia are also the highest in the region. In order to reduce electricity costs, the RGC should continue with plans to construct a high-voltage grid in the area west of Phnom Penh and Tonle Sap, connecting to Viet Nam in the south and Thailand in the northwest. With this grid it will be possible to import cheaper power from Thailand and Vietnam. The RGC should also continue to explore the development of the country's hydropower potential as well as renewable

energy sources such as solar and biogas. The RGC should encourage the participation of private power producers by using competitive tendering procedures for all significant power projects and encouraging public-private partnerships.

419. To improve the competitiveness of manufacturers, it is important that they are able to source equipment and raw materials at world prices. The amendments to the LOI enacted in early 2003 state that domestically oriented QIPs will be entitled to import production equipment exempt of duties. The law also states that “supporting industry” QIPs will be allowed to import equipment and raw materials exempt of duties as specified in the future implementing sub-decree. The RGC should assure that the implementing sub-decrees clearly define domestically oriented and supporting industries and that the investment amount necessary to qualify for the incentives is low enough to allow broader participation from enterprises targeting domestic markets.

420. With improved accounting standards the RGC should also revoke the minimum profit tax and introduce a system of quarterly self-assessment of profit taxes in order to remove disincentives for investment.

421. **Phase 2b – Implement industrial standards.** In phase 2 the RGC should fully implement international level industrial standards and provide incentives such as promotion, matching services and access to government contracts for manufacturers meeting these standards. The RGC should also draft product liability legislation in phase 2 in order to further develop safety standards and increase the confidence level of consumers. The RGC should encourage the development of private sector consumer advocacy and watchdog groups to monitor and report on product safety and quality.

422. **Phase 3 – Further enhance business environment.** In phase 3 the RGC should enact anti-monopoly legislation to assure open and competitive markets for domestic producers. An anti-monopoly law would prohibiting private monopolization, unreasonable restraint of trade and unfair trade practices by preventing excessive concentration of economic power and by eliminating unreasonable restraint of production, sale, price, technology and all other unjust restriction of business activities through combinations, agreements and otherwise. The law should aim to promote free and fair competition.

423. The RGC should also enhance the use of industrial standards by providing additional incentives to firms meeting the standards. These incentives could include export promotion services, support for trade fair participation, matching services and showroom exhibitions. By encouraging more firms to implement industrial standards, the RGC will be able to assist in raising quality of domestic products and improve access to export markets.

4. Foreign Invested

424. Foreign invested industries provide the bulk of exports and contribute significantly to job creation. The RGC should make significant efforts to attract FDI in labor-intensive industries. The RGC should implement policies to improve access to land for foreign investors, reduce labor costs, streamline import/export procedures and reduce port fees. The RGC should also focus on improving physical infrastructure and developing the capacity of the workforce through improvements in basic education and vocational training.

425. **Phase 1 – Attract investment in labor-intensive industries.** The RGC should promote FDI in agro-industry by enacting the Sub-decree on Economic Land Concessions and assuring

its implementation. By guaranteeing access to land, foreign investors will have an incentive to invest in agro-industry, which has great potential in Cambodia due to an abundance of land and labor resources.

426. Assuring that labor policies concerning minimum wages, overtime, night pay and holiday pay do not inhibit the competitiveness of labor-intensive industries will be important for attracting investment to Cambodia. Poor labor-management relations have created a negative image for foreign investors. Strengthening dispute resolution mechanisms through arbitration and negotiation between unions and management will reduce the prevalence of strikes and other work stoppages, which create unpredictability for foreign investors. The RGC should improve the arbitration process involving labor-management disputes by strengthening the role of the arbitration council provided for in the labor law.

427. Since most FDI is export-oriented, the RGC needs to assure that export processing procedures are efficient and that costs are kept to a minimum. Ways also need to be found to give exporters access to inputs at world prices in a low cost way. Evidence points to the importance of this access in attracting export oriented investment.

428. **Phase 2 – Improve infrastructure for foreign investment.** As mentioned above the RGC should focus on improving infrastructure by improving the supply of low cost electricity and continuing with road improvements. The establishment of industrial zones in strategic locations may be an appropriate strategy for attracting FDI in manufacturing, especially for higher value-added products such as basic consumer electronics parts and supporting industries.

429. **Phase 3 – Create globally competitive investment environment.** In Phase 3 the RGC should strive to make Cambodia a globally competitive business environment. Improvements in infrastructure and governance and development of a highly skilled labor force are necessary. The RGC should also create incentives for the development of supporting industries, which could act as suppliers to foreign-invested manufacturers.

5. SME Sector

430. Supporting the SME sector is vital to the development of the Cambodian economy. The RGC should focus on creating an enabling environment for SMEs, while at the same time providing support in the areas of financing and business development services to strengthen the capacity of enterprises. The RGC currently lacks a legal framework for SME development. The RGC has yet to establish a government-wide SME policy and has no defined institutional framework for establishing policies and programs to support SMEs. The RGC strategy for the SME sector should focus on developing the legal, policy and institutional framework necessary to establish effective SME support programs.

a. Legal Framework

431. **Phase 1 - Develop SME legal framework.** An SME promotion law or sub-decree is needed to determine the institutional framework for SME development, including the development of an inter-ministerial body to coordinate SME policy. Such legislation is also required for establishing incentive programs and other targeted support programs.

432. The law or sub-decree would also establish an officially recognized definition of SMEs in Cambodia. Various options for defining SMEs are available including the number of employees, revenues and fixed assets or a combination of these variables. The SME definition should also

be based on the industry or sector since the characteristics of companies vary significantly based on what they do. In most countries, SMEs are defined differently by sector or industry. For example, the maximum number of employees to be considered an SME in the service sector is usually much lower than for manufacturers.

433. **Phase 2 – Implement SME legal framework.** In phase 2 the RGC should enact an SME law or sub-decree as well as the necessary implementing legislation for establishing and carrying out the Government’s SME promotion policies. The institutional framework should be established and the roles of relevant ministries in SME promotion should be clearly demarcated.

434. **Phase 3 – Enhance enforcement of law.** In phase 3 the RGC should review the legal framework for SME promotion and make necessary enhancements if deficiencies are found. Gaps in implementation of laws and regulations should be identified and solutions should be recommended. At this stage policy reforms may be necessary to strengthen government-wide implementation of programs.

b. SME Policy

435. **Phase 1 – Develop policy framework for SMEs.** Cambodia currently lacks a policy framework for SME development. The RGC should immediately draft a strategic plan for SME development, which reflects the policy measures planned for the future. The strategy should provide an action plan for the RGC to implement incentives, financing schemes and capacity building programs to benefit SMEs. One of the main targets of the strategy should be to formalize SMEs through enterprise registration. The strategy and action plan should also include mechanisms for coordinating SME policies among ministries and local authorities. Some ideas for policies to promote SME finance and business development services are outlined below.

436. **Phase 2 – Implement SME policy framework.** The SME strategy and action plan should be approved by the SME Committee, defined below, which will act as the lead SME policymaking body. The SME strategy and action plan should also be incorporated into the next poverty reduction strategy of the RGC.

437. **Phase 3 – Enhance SME policy framework.** Based on annual progress reports on the SME sector, the RGC should review the SME policy framework and evaluate the implementation of SME support programs. The results of the evaluation should be incorporated into the RGC’s SME strategy and action planning for the next period.

c. Government Institutional Framework

438. **Phase 1 – Determine government institutional framework for SME development.** The lack of an inter-ministerial body in charge of SME development hinders efforts to coordinate policies and programs. As a first step to developing the institutional capacity for SME development the RGC needs to establish an inter-ministerial committee in charge of SME policy reporting to the Prime Minister comprised of representatives of the relevant ministries and the private sector. This SME Committee would be in charge of developing and approving policies for SME promotion. The committee would be supported by an SME policy office, which could be located in SNEC or created as an independent agency. The duties of the SME policy office would be to act as a secretariat for the SME Committee, coordinate the efforts of the various line ministries in charge of SME development and publish annual reports on the status of the SME sector. These annual “White Papers” would serve to update progress on SME policies and

identify major issues and obstacles facing SMEs. Another role of the SME Committee should be to clearly define the roles of each line ministry in SME development. Each relevant ministry should have a department in charge of SME development policy to coordinate activities within the ministries.

439. **Phase 2 – Strengthen activities of institutions.** To ensure that policies are well formulated and implemented, capacity building of SME development institutions is needed. SME policymakers should be trained in areas of policy, finance and the provision of business development services. An option would be to train a core group of individuals from relevant ministries and the SME policy office to act as trainers within their respective organizations. Field surveys of SME related organizations in neighboring countries would be a good training tool. Technical assistance would also be needed to raise the capacity of SME policymaking. The SME policy office, in particular, would need capacity building to develop the expertise needed to formulate a policy framework.

440. To ensure effective coordination of ministerial activities, an SME working group, organized by the SME policy office, should be established consisting of the Directors of the departments in charge of SME policy at each ministry. These regular SME working group meetings should assist the SME Committee in policy making and act as a mechanism for tracking policy implementation at each ministry.

441. **Phase 3 – Consolidate SME support functions.** In phase 3 all SME related functions should be combined to a specialized SME Administration or agency, which will coordinate SME promotion activities and policies. This specialized organization will combine all the existing SME promotion activities related to financing, business development services, capacity building, incubation, product development and trade promotion under one roof in the RGC. It will also be in charge of recommending policies regarding incentives, access to government contracts and other matters related to SME promotion.

d. SME Financing

442. **Phase 1 - Improve regulatory framework.** As mentioned above, the legal framework for financial services needs to be strengthened by enacting laws to strengthen the enforcement of loan contracts. Enacting the laws on commercial contracts, commercial enterprises, secured transactions and insolvency will help to establish the necessary legal framework to improve SME access to financing. Establishing a secured transactions registry and improving land titling is needed to strengthen SMEs' ability to pledge collateral. Strengthening the capacity of the judicial system by establishing a commercial court and strengthening training of judges is also necessary.

443. The RGC should examine the feasibility of establishing a fund to finance SMEs through lending or credit guarantees. The study should examine SME borrowing demand and capacity, mechanisms for financing, potential obstacles to disbursing funds and options for managing the funds. The study should also examine the feasibility of establishing a lease financing scheme for SMEs.

444. **Phase 2a – Develop lending environment.** It is necessary to strengthen the capacity of commercial banks and micro-finance institutions to efficiently lend to SMEs. In addition to strengthening enterprise accounting standards and improving credit information through the establishment of a credit bureau, the financial institutions need to develop their capacity to appraise and process loans to improve the efficiency of SME lending. Bank staff should receive

training on cash-flow oriented lending, analysis of business risks and mitigation of risks related to lending to SMEs. Streamlining of appraisal processes through credit scoring methodologies and IT improvements would also strengthen the lending environment for SMEs by improving efficiencies and reducing operating costs. However, for credit scoring methodologies to work an efficient credit information system should be established through the bankers association.

445. **Phase 2b – Create SME targeted programs.** Based on the implementation of the regulatory framework, the RGC should consider establishing an appropriate SME financing scheme. The scheme should utilize private sector lending infrastructure through commercial banks, MFIs and credit unions organized by business associations. It should not distort market mechanisms by providing financing at below market rates. The scheme should be used to promote investment and innovation through term financing, by providing credit lines to banks, MFIs and credit unions. To promote SME exports, an export financing scheme should be developed to provide pre-shipment financing, term loans for export related projects, export credit insurance and export advisory services. As capital markets develop, support for equity financing should also be considered.

446. **Phase 3 – Implement SME lending programs.** The RGC should implement SME lending programs and strengthen the institutions involved. The RGC should emphasize capacity building of SMEs in business planning, management and accounting in order to improve their creditworthiness. Lending programs conditions should be clearly established as well as risk management procedures. Capacity building of lenders should be an important part of any lending program. Performance measures should be established in order to evaluate the effectiveness of the program.

447. To increase the reach of SME financing in rural areas, the RGC should encourage the development of credit unions and cooperatives. Such institutions would increase the outreach of the formal banking sector and create competition needed to improve the quality of banking services in rural areas. To achieve this target the RGC needs to establish legal and regulatory frameworks for credit unions and cooperatives and assure adequate supervision of their operations.

e. Business Development Services

448. **Phase 1 – Establish mechanisms for delivering business development services.** The RGC needs to establish mechanisms for providing business development services to SMEs. These services should focus on firm-level training in the fields of business management, technology and marketing. The RGC should establish an institute in charge of providing business development services to SMEs. The institute should be established as an autonomous body with a board of directors representing the public and private sector as well as educational institutions and outside experts. The institute should provide management training, business counseling, information services and networking opportunities for SMEs. Business associations such as the PSMIA should also be supported to provide similar services to its members.

449. The RGC should establish a trade promotion center as a one-stop shop for information on business opportunities and assistance programs. The trade promotion center would provide information to SMEs on laws and regulations, markets, buyers and suppliers. The trade promotion center would also organize trade fairs and exhibitions to promote SME products and would assist enterprises in foreign marketing efforts. The trade promotion center should act as an information repository as well as provide advisory services to SMEs on marketing. The RGC

should operate the center at the early stages with the intention of establishing a public-private partnership to manage its operations at a later date.

450. The RGC should establish a design and innovation center affiliated with the University of Fine Arts to build capacity for SMEs in product labeling and packaging design. The design and innovation center should provide vocational training and consultancy to SMEs to assist in improving the design and safety of products. The center should emphasize industrial design so as not to duplicate efforts by donors and NGOs in the field of handicrafts. The programs of the design center should encompass mainly human resources development, consulting, research and development and quality management.

451. The newly established PSMIA can play an important role in providing training and building networks. However, much capacity building is needed for the PSMIA to be able to fulfill this role. The RGC should support efforts to build the capacity of the PSMIA so that it can provide business development services to its members.

452. **Phase 2 – Strengthen delivery of services.** In phase 2 the RGC should strengthen its capacity to provide business development services. The RGC should develop the capacity of business associations and other private sector training providers to support SMEs. The RGC should also establish a pilot incubation program to assist start-up companies. Incubation services should include providing assistance for facilities, management consulting and start-up financing for SMEs in selected industries such as information technology.

453. The RGC should establish a website to assist SMEs in trade promotion. The website should provide company profiles, production information, contact information and links to company websites. Since most SMEs do not have the capacity to establish their own websites, the trade promotion website should provide space and design assistance to SMEs to establish their own small websites. In the future, the website should be developed as a marketplace allowing for e-commerce transactions.

454. The RGC should combine the trade promotion website with an SME portal offering SMEs a wide range of services, including information on exporting, SME promotion institutions, legal problems and regulations, financing, online-training, consulting services, news and forums for discussion. The portal site would provide SMEs a platform for information access, inter-company communication and a channel for delivery of services, such as e-consulting and e-learning.

455. **Phase 3 – Expand delivery of services.** In phase 3 the RGC should expand its delivery of training and business development services by creating a national network of SME training centers affiliated with educational institutions. The formation of SME associations should also be promoted nationwide. A federation of SME associations should be established to strengthen business linkages among SMEs and improve delivery of business development services.

G. Government Implementation of PSD Action Plan

456. Since the private sector development action plan will be a key element in promoting economic growth and poverty reduction in the future, it is necessary to develop an institutional framework for implementation. As a first step, it will be necessary to prepare a final version of these private sector development recommendations to be delivered to a higher authority. Since the recommendations are cross-cutting and cover the activities of all ministries, the RGC should establish a task-force in charge of developing a time bound action plan for private sector

development. This inter-ministerial task force should be given the authority to determine the overall priorities for the Government and further develop the recommendations to meet these priorities.

457. The Council of Ministers should establish an inter-ministerial coordinating body to formalize the action plan for private sector development and monitor its implementation. This coordinating body should report directly to the Prime Minister and be comprised of high-level officials from the ministries responsible for implementing the private sector action plan. The coordinating body should issue regular updates on the progress of implementation and make adjustments according to the changing market conditions. While implementing the private sector development action plan may need further refined policy actions, its primary aim should always be to create an enabling environment for business and assure an even playing field for all market participants.

VI. PRIORITIES FOR PSD IN CAMBODIA

458. From the many recommendations provided in this PSA it is necessary to determine priority areas for private sector development in Cambodia. To support the business enabling environment and social and physical infrastructure the RGC should concentrate on the following key areas of private sector development and remain engaged in these areas until results are fully achieved. These key areas are:

- A. Support SME development;
- B. Governance reform through improved enforcement of laws;
- C. Continue support for financial sector reforms;
- D. Develop RGC's capacity to provide assistance to the private sector;
- E. Strengthen capacity building; and
- F. Continue infrastructure development.

A. Support SME development

1. Strengthen formalization of business through registration and licensing reform

459. The RGC needs to reform the business registration process by reviewing the legal framework for registration and making necessary changes to encourage more enterprises to formalize. Business registration procedures should be simplified to reduce the cost and time necessary to register. The RGC should also carry out licensing reform by reviewing private sector licensing requirements. The RGC should also carry out reforms to streamline processes and procedures and eliminate unnecessary requirements. The goal of the licensing reform should be to reduce the burden of licensing and inspections on the private sector, while at the same time assuring that necessary regulation and oversight is maintained.

2. Establish legal, policy and institutional framework for SME development

460. The RGC has identified the importance of SME development in Cambodia by requesting ADB to begin preparations for an SME Program Loan, which will commence in 2004. Since no legal, policy or institutional framework has been established for SME development, it is important for the ADB to assist the RGC in these areas. Since the SME sector accounts for such a large share of employment and GDP, support of the sector will have a positive impact on private sector development and poverty reduction by creating sources of employment and wealth creation.