REPORT

MINISTRY OF COMMERCE, CAMBODIA

Integration and competitiveness study — Part B

Component reports — macro assessment, trade policy, trade facilitation, poverty assessment

A pilot study prepared under the Integrated Framework for Trade Related Technical Assistance

26 November 2001

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Boxes, charts and tables

Preface

IN AUGUST 2001, a team of consultants worked with Ministry of Commerce (MOC) officials in Cambodia to conduct a diagnostic study of Cambodia's trade policy issues and technical assistance needs. The terms of reference for this study were designed to support the Royal Government of Cambodia (RGC) in developing its Pro-Poor Trade Policy Strategy. Ministry of Commerce officials involved were H.E. Sok Siphana, Secretary of State; In Vothana, Bureau Chief; Ung Sovithiea, Deputy Bureau Chief; Keomuny Kong, Deputy Bureau Chief; Sophann Tauch, Director; and Oeur Samrith, Assistant Director. The team members were Kelly Bird, Consultant — Trade Policy; Sandy Cuthbertson, Consultant, Centre for International Economics (CIE) —Team leader; Martin Desautels, Consultant, Gide Loyrette Noel (GLN) — WTO Accession; Curtis Hundley, Consultant — sector studies on tourism and fisheries; Hiau Looi Kee, World Bank — market access survey and analysis; Ray Mallon, Consultant — sector studies on rice and labour services; Philippe Marciniak, IMF — macroeconomic assessment; Andrew McNaughton, Consultant — sector studies on diversified agriculture and handicrafts; Maika Oshikawa, WTO — trade policy, Sopanha SA, IMF — macroeconomic assessment; Isidro Soloaga, Consultant — poverty assessment; Ieng Sovanarra, Consultant — sector study on garments; and Geoff Wright, Consultant — trade facilitation. The review of investment regulation was carried out by Ross Chapman and Lee Davis of the CIE as a parallel study working directly to the Government. The World Bank Task Manager was Ataman Aksoy.

Following this fieldwork, team members prepared drafts of the following reports.

- Part A: Overview.
- Part B: Component reports — macro assessment, trade policy, trade facilitation, poverty analysis.
- Part C: Sector studies — rice, diversified agriculture, handicrafts, fisheries, garments, tourism, labour services.
- Part D: Review of the Law on Investment.

These drafts were discussed at a workshop held in Cambodia on 19 and 20 November 2001. Following that workshop, draft reports were finalized particularly taking into account participants' suggestions for technical assistance.

Glossary

ADB	Asian Development Bank
AFTA	ASEAN Free Trade Area Agreement
ASEAN	Association of South East Asian Nations
CBA	Currency board arrangements
CDC	Cambodian Development Commission
CED	Customs and Excise Department
CEPT	Common Effective Preferential Trade
CSES	Cambodia Socioeconomic Survey
CP	Certificate of processing
ELVIS	Electronic visa implementation system
EPZ	Export Processing Zone
ERP	Effective Rate of Protection
ESCAP	Economic and Social Commission for Asia and the Pacific
EU	European Union
FDI	Foreign Direct Investment
FMV	Fair market value
FTB	Foreign Trade Bank
GAP	Governance Action Plan
GDP	Gross domestic product
GMAC	Garment Manufacturer’s Association of Cambodia

GSP	Generalized System of Preference
ICS	Inventory control system
IMF	International Monetary Fund
LOI	Law on Investment
MAFF	Ministry of Agriculture, Forestry and Fisheries
MEF	Ministry of Economy and Finance
MFN	Most favored nation
MIME	Ministry of Industry, Mining and Energy
MOH	Ministry of Health
NAA	National Audit Authority
NBC	National Bank of Cambodia
NGO	Non government organizations
PRGF	Poverty Reduction and Growth Facility
PSI	Pre-Shipment Inspection
RGC	Royal Government of Cambodia
ROF	Report of Findings
SEDP	Socioeconomic Development Plan
TEA	Temporary Export Authorization
TCAP	Technical Cooperation Action Plan
TPD	Trade Preference Department
UN	United Nations
UNTAC	United Nations Transitional Authority in Cambodia
VAT	Value Added Tax
VSS	Valuation Support Service

WB	World Bank
WTO	World Trade Organization

1 Macroeconomic assessment

Since late 1998, when peace was secured and a coalition government formed, Cambodia has initiated fundamental reforms in many crucial areas and significant progress has been made in promoting economic recovery, and reducing inflation to low levels. However, much remains to be done to rebuild a society and economy shattered by almost three decades of civil strife and to address the country's areas of vulnerability. Sustained development, and the alleviation of pervasive poverty, will critically hinge upon continued implementation of broad based actions aimed at strengthening governance, deepening fiscal and bank restructuring, and establishing a sound legal framework. Political and financial instability together with sizable capital inflows in the 1990s led to the dollarization of the economy with the US dollar becoming the *de facto* legal tender. While Cambodia has largely benefited from widespread dollarization of transactions and financial assets, this situation may not be desirable in the long run, as the lack of a more flexible exchange market could obstruct further regional integration and affect the country's competitiveness. However, any reversing of dollarization is a long term process and would require continued stabilization and completion of key structural reforms, especially financial sector reform. Moreover, it would need to rely on market based policies rather than administrative measures.

This section highlights the key features of Cambodia's macroeconomic environment and the government's strategy for alleviating poverty in the long run; it also reviews the country's existing exchange rate arrangement and discusses some policy implications of dollarization in Cambodia. The second section summarizes key macroeconomic developments and outlines the medium term macroeconomic framework underlying the government's poverty alleviation strategy, as spelled out in the *Interim Poverty Reduction Strategy Paper (IPRSP)* (EBD 2000). The third section describes the emergence of dollarization in Cambodia in the last decade and reviews the main benefits and costs associated with continued dollarization. The fourth section describes the evolution of the national currency and highlights some policy implications of dollarization. The fifth section identifies the core technical assistance requirements for achieving the government's stabilization and financial reform objectives.

Cambodia's key macroeconomic developments and prospects

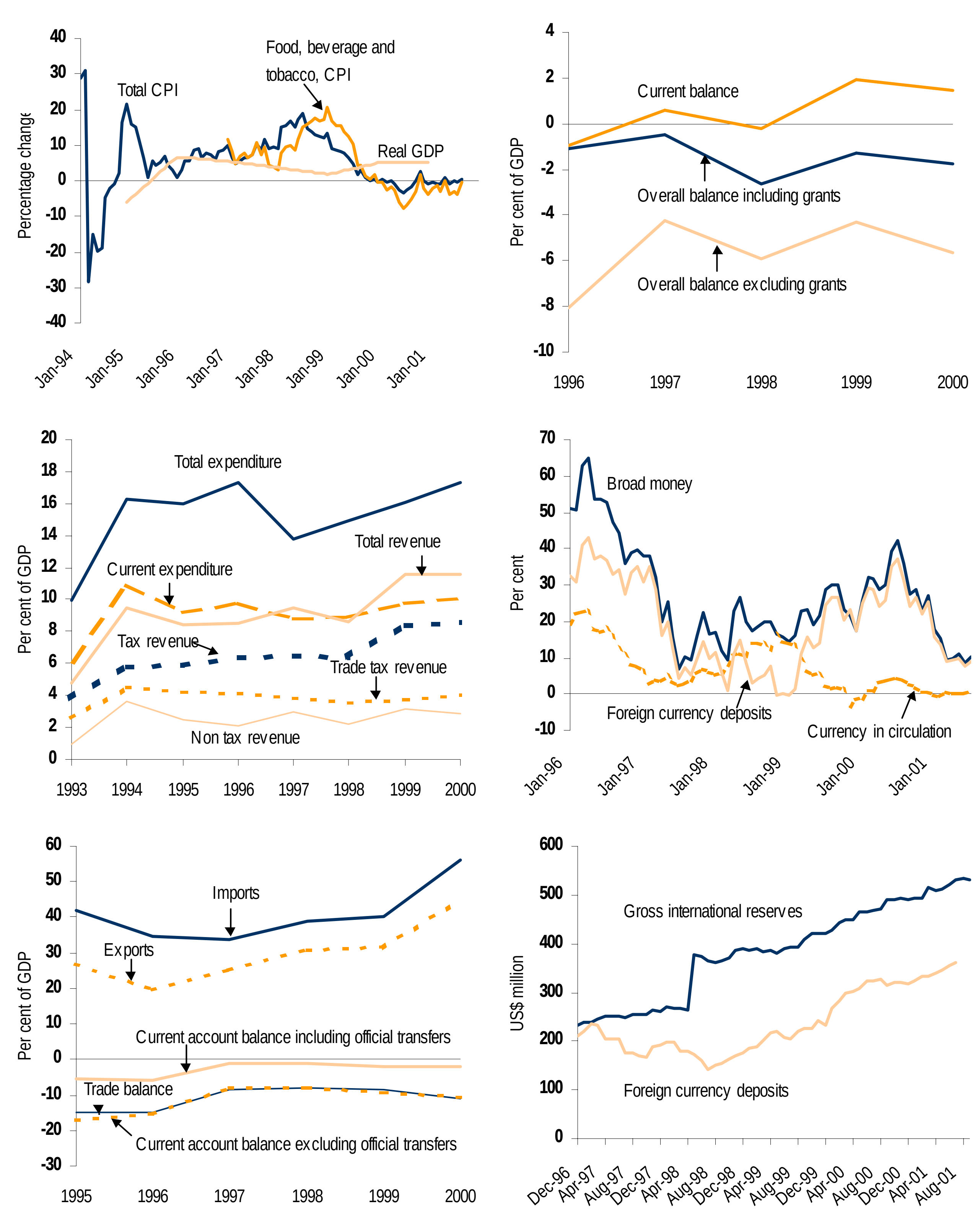
Recent economic and financial developments

In the early 1990s, Cambodia first attempted to reconstruct an economy that had been ruined by almost three decades of civil strife. This effort was supported by a United Nations (UN) sponsored peace agreement and large inflows of international assistance. Strides were made toward stabilizing the economy in 1994-95 under the recovery program supported by the first *Enhanced Structural Adjustment Facility (ESAF)*. However, economic performance deteriorated gradually in 1996-98, as a result of political instability. At that time, growth slowed down and inflation picked up to double digits, with central bank financing of the budget resuming in 1998 (see chart 1.1). Reflecting this period of macroeconomic instability and the large inflow of foreign aid, the ratio of foreign currency deposits to broad money began to rise steadily.

It was not until late 1998, that the political environment stabilized under a coalition government committed to press ahead with an ambitious reform agenda. Since late 1999, the government's efforts to restore macroeconomic stability, accelerate economic reconstruction, improve governance, and reduce poverty have been supported by a three-year *Poverty Reduction and Growth Facility (PRGF) (1999-2002)* in an amount of $81 million. As a result, crucial measures have been initiated to address weaknesses in budgetary management, tax and customs administration, banking system management, economic statistics, the legal framework, and natural resource management. These reforms are also being supported by a comprehensive Technical Cooperation Action Plan (TCAP) sponsored by various multilateral agencies and donors, and by financial support and technical assistance by other development partners, including the World Bank (WB) and the Asian Development Bank (ADB).

Macroeconomic performance has strengthened significantly since 1999 (chart 1.1 and table 1.2). Economic growth has reached 5–6 per cent annually, despite adverse severe flooding in 2000. Buoyant garment exports, a recovery in tourism, and a continued increase in agricultural output have been the chief elements spurring economic growth. Inflation has been subdued, reflecting fiscal and monetary restraint, improved food supply, and cheaper imports largely stemming from the depreciation of neighboring countries' currencies *vis à vis* the US dollar.

1.1 **Cambodia: Selected Economic Indicators, 1995-2001**



[a] Annual per cent change. [b] 12 months per cent change

Data source: Data provided by the Cambodian authorities and IMF staff estimates

1.2 **Cambodia: medium-term macroeconomic framework, 1995–2006**

	Unit	*1995*	*1996*	*1997*	*1998*	*1999*	*2000*	*2001[p]*	*2002[p]*	*2003[p]*	*2004[p]*	*2005[p]*	*2006[p]*
Real sector													
Real GDP	% change	6.7	5.5	3.7	1.8	5.0	5.0	6.0	6.0	6.0	6.0	6.5	6.5
CPI Inflation	end-period; % change	1.1	10.0	9.2	13.3	-0.5	-0.8	3.0	3.7	3.7	3.7	3.7	3.7
GDP deflator	% change			6.0	13.1	3.8	1.5	5.0	3.7	3.5	3.5	2.0	3.7
Per capita GDP	US$	299	296	282	249	257	260	276	295	317	341	359	387
National saving	% of GDP	7.3	7.4	11.8	11.8	13.8	14.1	14.1	14.9	15.6	16.3	17.0	17.5
Of which: government saving	% of GDP	-0.8	-1.2	0.7	-0.3	1.8	1.5	1.3	1.4	1.5	1.4	1.6	1.4
Domestic investment	% of GDP	12.7	13.5	13.0	12.9	15.8	16.0	16.5	18.0	17.5	18.0	18.5	19.0
Fiscal sector													
Revenue	% of GDP	8.5	9.0	9.6	9.0	11.7	11.8	12.2	13.0	13.5	13.5	13.5	14.0
Of which: tax revenue	% of GDP	5.9	6.4	6.5	6.5	8.4	8.6	8.7	9.7	10.2	10.3	10.3	10.8
Of which: non tax revenue	% of GDP			3.0	2.2	3.1	2.9	3.3	3.2	3.1	3.1	3.1	3.1
Expenditure	cash basis	16.0	17.3	13.8	14.9	16.1	17.3	18.3	18.3	18.2	18.1	17.8	18.4
Current	% of GDP			8.8	8.9	9.8	10.0	10.8	11.5	11.9	11.9	11.9	12.5
Capital	% of GDP			4.9	6.0	6.3	7.3	7.6	6.8	6.3	6.2	5.9	6.0
Current balance	% of GDP			0.7	-0.3	1.8	1.5	1.3	1.4	1.5	1.4	1.6	1.4
Overall balance	% of GDP	-7.5	-8.3	-4.1	-6.0	-4.4	-5.5	-6.1	-5.3	-4.7	-4.6	-4.3	-4.4
Domestic financing	% of GDP	0.0	-0.1	-0.6	1.1	-0.4	-0.1	0.0	-0.1	-0.1	-0.1	-0.1	0.0
Monetary sector													
Broad money	% change	45.0	40.5	16.6	15.7	17.3	26.9	23.7	18.0	18.0	18.0	16.0	16.0
Velocity	GDP/M2	11.6	9.1	9.7	9.5	8.5	6.9	6.7	6.1	5.6	5.2	4.9	4.6
External sector													
Domestic exports	% change		10.1	81.0	13.0	17.5	55.1	8.7	5.5	5.4	7.1	10.2	8.2
Retained imports	% change		7.9	3.5	4.2	16.5	48.6	5.9	5.7	5.9	5.8	6.7	7.5
Current account balance (excluding transfers)	% of GDP	-16.7	-15.5	-7.9	-8.0	-9.4	-10.4	-10.4	-9.8	-9.2	-8.5	-8.0	-7.7
Current account balance (including transfers)	% of GDP			-1.2	-1.1	-2.0	-1.9	-2.4	-2.1	-1.9	-1.7	-1.5	-1.5
Overall balance	% of GDP	-2.6	-2.2	-2.9	-3.7	-3.2	-2.0	0.1	0.3	0.3	0.0	0.1	0.2
Financing gap	US$m			...	0.0	0.3	-0.2	-0.1	16.6	11.9	50.8	47.0	49.4
Gross official reserves	US$m		234	262	390	422	484	531	602	661	740	820	904
Gross official reserves	in months of imports		2.1	2.4	3.5	3.3	2.8	2.8	3.0	3.1	3.3	3.5	3.6
External debt[a]				66.0	72.7	67.4	66.2	35.9	33.5	30.9	27.8	25.2	22.1
External debt (NPV)[a]				...	60.5	72.0	58.3	21.4	19.6	17.8	16.2	14.6	12.9
Debt service ratio[b]				24.5	20.9	18.8	4.7	4.2	4.0	3.9	4.5	5.0	4.7

[a] Figures include bilateral debt with former CMEA countries and the United States. The scenario reflects the impact of completing rescheduling agreements for this debt in 2001. [b] The decline in 2000 reflects the end of the large part of the scheduled payments to the Russian Federation. [P] Projections.

Sources: Data provided by Cambodian authorities and IMF staff estimates and projections.

Cambodia's reform efforts have been hampered by the undeveloped state of basic institutions necessary to support a market economy. For example, the fiscal position is severely constrained by an extremely low ratio of revenue to gross domestic product (GDP) by international standards and a pressing need to rebuild infrastructure and increase social outlays. Accordingly, the highest priority has been granted to strengthening revenue collections, while redirecting military and security expenditures toward health, education and rural development. Cambodia has already increased revenue by about 3 percentage points of GDP since 1999, but further revenue efforts are needed to meet expenditure needs over the medium term. Military expenditure has been reduced in tandem with increased social expenditure relative to GDP and further reductions are underway under a recently initiated demobilization program supported by the WB and donors. Progress in fiscal restructuring has been achieved while maintaining macroeconomic stability, as current budget surpluses have remained at about 1½ per cent of GDP; and overall deficits, including development expenditure, have been contained below 6 per cent of GDP (excluding grants). Cambodia has avoided domestic financing of the budget since 1999, thus providing room for an expansion in private credit.

Since 1999, the authorities have simultaneously pursued a prudent monetary policy aimed at low inflation and a stable exchange rate. The increase in broad money has been largely accounted for by an increase in net foreign assets, while net domestic assets of the banking system declined, owing to the improved fiscal position. On the liability side, the bulk of the increase in broad money has stemmed from foreign currency deposits. Interest rates have stayed relatively high, reflecting the perception of a high risk premia in the lending market. Mirroring the monetary policy stance, the riel has been relatively stable in US dollar and real effective terms since late 1998; and official international reserves have increased to about three months of imports of goods and services. The external current account deficit has remained broadly stable at around 10 per cent of GDP (excluding official transfers), largely due to the strong performance of garment exports and tourism receipts. The liberalization of the trade regime is underway in the context of meeting requirements of the Association of South East Asian Nations (ASEAN) and the World Trade Organization (WTO). Cambodia's exchange system is free from restrictions on payments and transfers for current international transactions.

Cambodia has made substantial progress in implementing key structural reforms since 1999, although there were delays in some important areas. In an effort to improve governance and combat corruption, the government established a National Audit Authority (NAA) and approved a comprehensive Governance Action Plan (GAP) in early 2001. Initial steps to improve governance in the forestry sector have also been taken in recent years, through increased monitoring of illegal logging and forestry concessions and preparation of a new forestry law. The authorities have made strides in restructuring the country's banking system and further efforts are underway to broaden financial intermediation and establish a modern payments system. In addition to military demobilization, Cambodia has also embarked, with WB and donor support, on a broad administrative reform program. Following a census of civil servants, the creation of a computerized civil service payroll, and the design of comprehensive reform strategy for 2002–06, civil service reform is aimed at providing higher incentives to senior managers and strengthen capacity-building, while maintaining fiscal sustainability.

Medium term macroeconomic framework

While initial performance under the reform effort is commendable, there is little room for complacency given Cambodia's vulnerability and pressing need to alleviate poverty. Significant actions will be needed in the period ahead to firmly establish a basis for promoting sustainable growth and reducing poverty. Governance and transparency issues are at the forefront of Cambodia's reform agenda. In this regard, strict adherence to the actions and timetable set forth in the GAP will be critical. As part of the latter, facilitating independent operations of the NAA and establishing a modern legal and judiciary system that provide for a clear rule of law and modern commercial laws and regulation are crucial. In addition, efforts to improve fiscal transparency and establish a reliable statistical framework will be instrumental in strengthening governance.

Further fiscal restructuring will be required in the period ahead and the main challenge to that end is to improve revenue mobilization and reorient spending away from defense and security toward social sectors. The government's medium term framework is centered on maintaining a current budget surplus of at least 1½ per cent of GDP. Overall fiscal deficits, inclusive of development expenditure, are expected to be contained below 6 per cent of GDP and fully financed by concessional foreign assistance. Cambodia's external viability will depend on sustained and timely implementation of reform policies. The current account deficit (excluding transfers) at around 10 per cent of GDP is expected to decline steadily to 8 per cent by 2006. Significant official financing on concessional terms and debt relief will continue to be required over the medium term.

The baseline scenario presented below (see Appendix A and tables 1.2 and 1.3) is derived from an assessment based on the macroeconomic conditions that prevailed in mid 2001. At this juncture, it is premature to assess the full impact of the recent events in the US on Cambodia's economy. The medium term framework also includes a sensitivity analysis reflecting four alternative trade related scenarios. The downside risks stemming from the deterioration of internal security and political situation and policy implementation slippages that could thwart the medium term outlook are not addressed in this exercise.

1.3 **Cambodia: balance of payments, 1997–2006**

	Unit	*1997*	*1998*	*1999*	*2000*	*2001*[p]	*2002*[p]	*2003*[p]	*2004*[p]	*2005*[p]	*2006*[p]
Current account (excluding official transfers)	US$m	- 246	- 224	- 282	- 331	- 357	- 365	- 375	- 384	- 393	- 429
Current account (including official transfers)		- 37	- 30	- 61	- 60	- 83	- 80	- 79	- 75	- 73	- 96
Trade balance [a]		- 263	- 227	- 259	- 338	- 328	- 350	- 377	- 382	- 358	- 389
Exports		786	867	971	1 396	1 498	1 570	1 645	1 746	1 898	2 026
Domestic exports		534	604	709	1 100	1 196	1 262	1 329	1 423	1 569	1 690
Of which: GSP (including garments)		279	392	564	1 012	1 113	1 167	1 221	1 290	1 376	1 482
Forestry		224	178	111	49	43	50	58	78	133	142
Re-exports		252	263	261	296	302	309	315	322	329	337
Imports, f.o.b.		-1 050	-1 094	-1 230	-1 734	-1 826	-1 920	-2 021	-2 128	-2 256	-2 416
Retained imports, f.o.b.		- 798	- 831	- 968	-1 438	-1 524	-1 611	-1 706	-1 805	-1 927	-2 079
Garments sector		- 195	- 275	- 363	- 658	- 724	- 759	- 794	- 838	- 894	- 963
Petroleum		- 91	- 111	- 121	- 299	- 292	- 283	- 274	- 262	- 251	- 252
Other retained imports		- 511	- 445	- 484	- 481	- 508	- 570	- 638	- 705	- 781	- 864
Imports for re-export, f.o.b		- 252	- 263	- 261	- 296	- 302	- 309	- 315	- 322	- 329	- 337
Services and Income (net)		- 43	- 57	- 93	- 63	- 100	- 88	- 74	- 80	- 119	- 125
Services (net)		4	- 9	- 17	19	39	72	93	93	59	58
Of which: tourism		55	59	94	149	182	222	245	257	270	283
Income (net)		- 47	- 48	- 76	- 81	- 139	- 160	- 166	- 173	- 178	- 183
Of which: interest [b]		- 3	- 2	7	18	- 16	- 15	- 11	- 8	- 2	6
Private transfers (net)		60	60	70	70	70	73	75	79	83	85
Official transfers (net) [c]		210	194	220	271	274	285	296	308	321	333
Capital and financial account		- 53	- 75	- 33	- 11	88	90	92	77	78	78
Medium and long term loans		- 77	- 69	- 63	- 5	101	82	68	37	22	- 4
Disbursements		38	46	56	115	137	118	106	76	77	67
Amortization		- 115	- 115	- 119	- 119	- 36	- 37	- 38	- 39	- 55	- 71
Foreign direct investment		168	121	146	110	110	116	127	140	154	169
Short term flows and errors and omissions		- 144	- 126	- 115	- 116	- 123	- 108	- 103	- 100	- 98	- 87
Overall balance		- 90	- 105	- 94	- 70	5	10	13	2	5	- 18
Financing		90	105	94	70	- 5	- 10	- 13	- 2	- 5	18
Change in gross official reserves		- 28	- 11	- 32	- 62	- 47	- 71	- 59	- 79	- 79	- 85
Use of Fund credit		0	- 1	8	4	9	9	- 1	- 9	- 8	- 5
Debt rescheduling [d]		0	0	0	0	1 356	36	35	35	35	32
Change in arrears (- = reduction)		118	117	119	120	-1 320	0	0	0	0	0
Memorandum items:											
Trade balance	(in percent of GDP)	- 8	- 8	- 9	- 11	- 10	- 9	- 9	- 8	- 7	- 7
Current account balance											
Excluding official transfers	(in percent of GDP)	- 8	- 8	- 9	- 10	- 10	- 10	- 9	- 9	- 8	- 8
Including official transfers	(in percent of GDP)	- 1	- 1	- 2	- 2	- 2	- 2	- 2	- 2	- 1	- 2
Gross official reserves [e]		262	390	422	484	531	602	661	740	820	904
In months of imports of goods and services		2	3	3	3	3	3	3	3	3	4
In months of core imports of goods and services [f]		4	4	6	5	6	6	6	6	6	7
Net international reserves		197	323	349	411	451	511	571	659	746	836
Nominal GDP	US$m	3 105	2 813	3 008	3 172	3 440	3 739	4 102	4 500	4 889	5 311

[a] Includes estimates for unrecorded forestry exports and unrecorded petroleum imports. [b] Variations in interest payments in 2000–01 are linked to assumptions on debt restructuring. [c] Official aid flows are based on the current trend and the additional funds mobilized at the Consultative Group meeting (June 2001). [d] Assumes the implementation of the 1995 Paris Club flow rescheduling on Naples terms (67% NPV reduction) in 2001. [e] Includes $117 million associated with the return of Cambodian gold holdings by the BIS in 1998. [f] Imports excluding imports for re-export and imports for garment sector. [p] Projections.
Sources: Data provided by the Cambodian authorities and IMF staff estimates and projections.

INTEGRATION AND COMPETITIVENESS STUDY — PART B

Dollarization in Cambodia

This section describes the historical process underlying the emergence of dollarization in Cambodia, and assesses the main benefits and costs associated with dollarization.

Background

Cambodia's monetary system is characterized by a high degree of dollarization. Dollarization is a monetary phenomenon whereby foreign currency is used both as medium of exchange and store of value. Dollarization is commonly twofold: currency substitution and asset substitution. Currency substitution occurs when foreign currency is used as a means of payment. Asset substitution occurs when foreign currency denominated assets serve as financial assets (store of value function). Due to data limitations, dollarization is traditionally proxied by the ratio of bank foreign currency deposits to the broad money stock.

The share of foreign currency deposits in broad money currently exceeds 70 per cent, making Cambodia one of the most dollarized economies (table 1.4 and charts 1.5–1.10). During the decade ended in 2000, foreign currency deposits grew rapidly from $1 million in 1991 to $318 million as of end 2000, equivalent to 1 and 68 per cent of broad money in 1991 and 2000, respectively. Foreign currency deposits at the end of 2000 were equivalent to about 66 per cent of gross official reserves.

1.4 **Cambodia: Monetary Survey, December 1995–June 2001**

	1995	***1996***	***1997***	***1998***	***1999***	***2000***	***2001***
	Dec.	***Dec.***	***Dec.***	***Dec.***	***Dec.***	***Dec***	***Jun.***
					(in billions of riels, end of period)		
Net foreign assets	550	878	1 172	1 728	2 019	2 588	2 807
National Bank	304	533	808	1 425	1 649	2 102	2 257
Deposit money banks	246	346	363	304	370	486	550
Net domestic assets	99	33	-109	-498	-576	-758	-821
Domestic credit	446	567	697	839	876	904	866
Government (net)	148	128	54	179	103	3	-82
Public enterprises	5	5	6	6	10	3	1
Private sector	293	435	637	655	763	898	947
Other items (net)	-347	-534	-805	-1 337	-1 453	-1 662	-1 687

(Continued on next page)

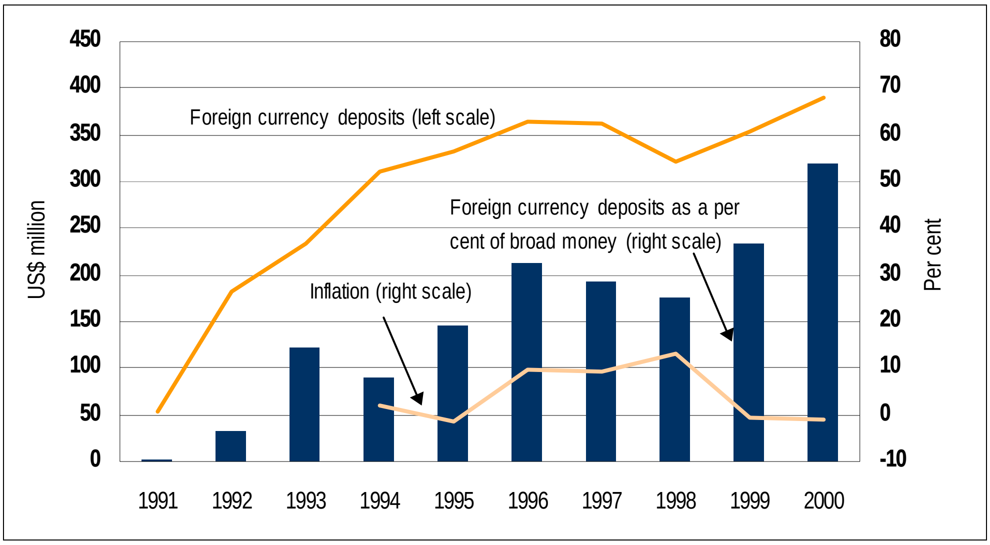
1.4 **Cambodia: Monetary Survey, December 1995–June 2001** (continued)

	1995	***1996***	***1997***	***1998***	***1999***	***2000***	***2001***
	Dec.	***Dec.***	***Dec.***	***Dec.***	***Dec.***	***Dec***	***Jun.***
Broad money	649	912	1 063	1 230	1 443	1 831	1 985
Narrow money	278	329	385	543	532	540	544
Currency in circulation	251	300	356	509	490	495	510
Demand deposits	27	29	29	34	42	45	35
Quasi-money	371	583	678	687	911	1 291	1 441
Time deposits	5	8	13	20	32	46	52
Foreign currency deposits	366	575	665	667	879	1 245	1 390
		(contribution to annual growth of broad money, in per cent)					
Broad money		40.5	16.6	15.7	17.3	26.9	8.4
Net foreign assets		50.6	32.2	52.4	23.6	39.5	16.2
Net domestic assets		-10.2	-15.6	-36.6	-6.3	-12.6	-7.8
Domestic credit		18.6	14.2	13.4	3.0	2.0	-2.3
Government		-3.1	-8.1	11.7	-6.1	-6.9	-6.7
Other		21.8	22.3	1.7	9.2	8.9	4.4
Other items (net)		-28.8	-29.7	-50.1	-9.4	-14.5	-5.5
Narrow money		7.8	6.1	14.9	-0.9	0.5	0.3
Of which: currency in circulation		7.5	6.2	14.4	-1.6	0.3	0.8
Quasi-money		32.7	10.5	0.8	18.2	26.4	8.2
Of which: foreign currency deposits		32.3	9.9	0.2	17.2	25.4	7.9
					(in millions of U.S. dollars)		
Memorandum items:							
Gross official reserves [a]	182	234	262	390	422	484	530
				(in per cent of foreign currency deposits)			
	125.6	110.3	136.1	221.1	181.4	152.2	149.7
						(millions of U.S. dollars)	
Net official reserves [b]	110	164	197	323	349	411	441
					(in millions of U.S. dollars)		
Foreign currency deposits	145	212	193	176	233	318	354
					(in per cent of broad money)		
	56.3	63.1	62.6	54.2	60.9	68.0	70.0
Velocity [c]	14.4	10.7	9.7	9.5	8.5	6.9	6.9
						(in percent of GDP)	
Seignorage	0.4	1.6	1.0	2.4	1.1	1.9	…
				(in per cent of government revenue)			
	4.8	21.0	12.7	29.2	13.5	17.3	…
					(riels/U.S. dollar; end-period)		
Exchange rates	2 526	2 713	3 452	3 780	3 775	3 910	3 920
						(billions of riel)	
Nominal GDP	7 543	8 325	9 149	10 531	11 470	12 225	12 897

a Foreign assets of the National Bank of Cambodia (NBC) less unrestricted foreign currency deposits of commercial banks held at the NBC. **b** Gross official reserves, less foreign liabilities of the National Bank of Cambodia. **c** Nominal GDP divided by average stock of broad money.

Source: Data provided by the Cambodian authorities and IMF staff projections.

1.5 **Cambodia: foreign currency deposits, 1991–2000**



Data source: Data provided by the Cambodian authorities and IMF staff estimates.

Dollarization in Cambodia is the direct legacy of the destruction of economic and financial institutions after the 1970s, economic mismanagement in the 1980s, and the large inflows of US dollars in the early 1990s. After gaining independence in 1953, Cambodia experienced a peaceful period of steady economic growth for 17 years, with the riel as the main currency used in transactions and assets. In contrast, the period 1970–75 was plagued by a civil war that brought the Khmer Rouge regime to power in April 1975. The radical economic experiments launched during 1975–79 led to bans on private property, money and banking, and trade. Monetary transactions resurfaced in 1979, in the aftermath of a new regime. As a result, the riel was reintroduced as the domestic currency in 1980. A parallel currency, the Khmer riel, was also introduced in March 1993 in areas still under Khmer Rouge control.

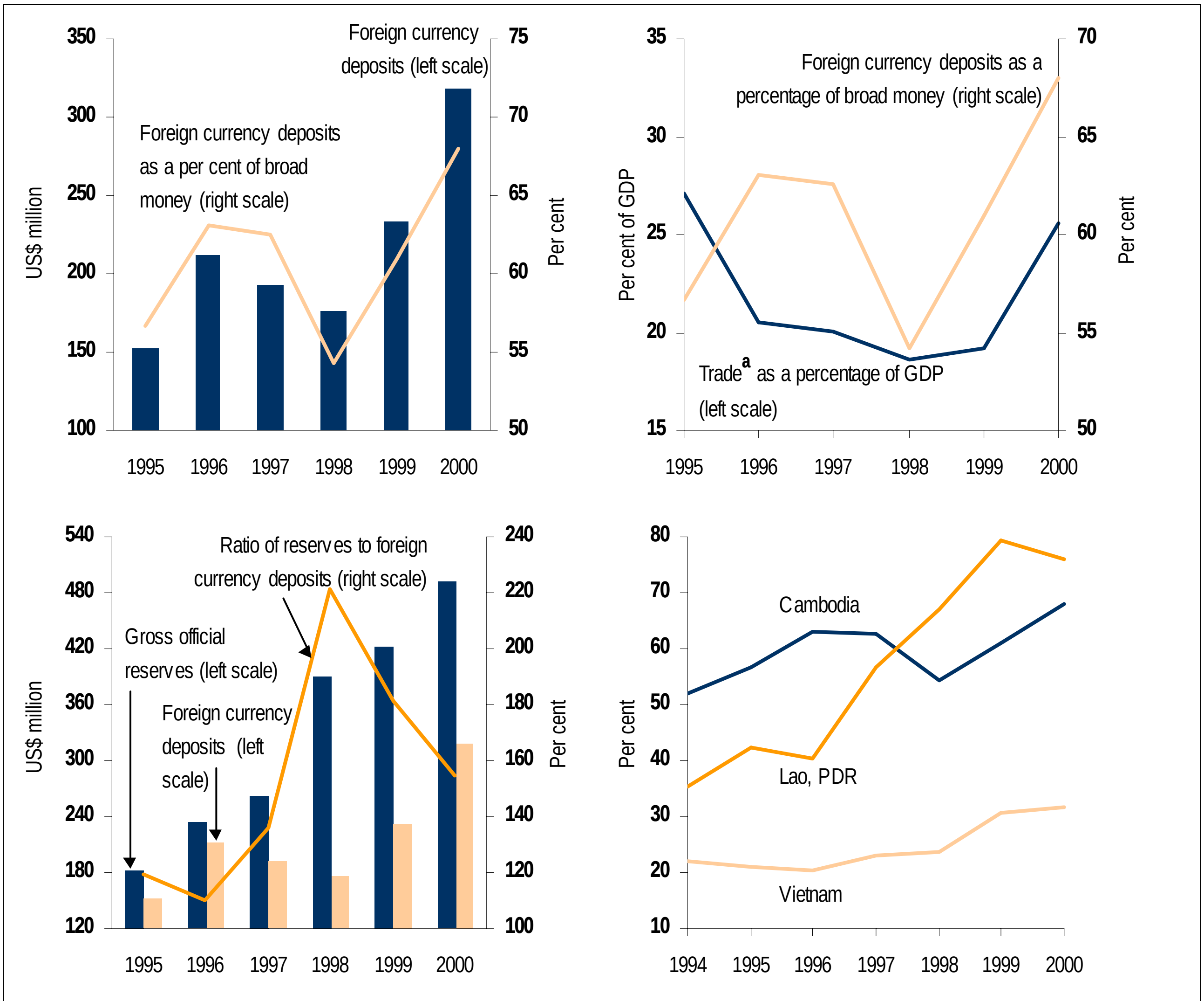
The period 1980–92 was still affected by the unsettled political structure and the security situation. Substantial monetization of budget deficits during 1988–92 resulted in triple-digit inflation, leading to deep erosion of public confidence in the domestic currency. Large foreign exchange inflows associated with the return of refugees from abroad in the early 1990s and in 1991-92 with extensive operations of the *United Nations Transitional Authority in Cambodia (UNTAC)* largely fueled soaring bank foreign currency deposits. The cumulative cost of UNTAC intervention was $1.7 billion (that is, about half of estimated GDP in 2001) one of the most costly UN operations.

Dollarization has been facilitated by the government's commitment to an open economy and the existence of an active foreign exchange market managed by licensed money changers that ensured effective access to foreign currency. There are no restrictions on current international transactions and virtually no restrictions on capital transactions.

Increasing confidence since late 1998 has been reflected in increased bank foreign currency deposits, with their share in broad money exceeding the pre 1997 level. Three separate phases in Cambodia's dollarization process are highlighted in chart 1.5. In an initial phase (1991–96), the steady rise of dollarization largely reflected accelerated monetization and formal financial intermediation, against the background of increased capital inflows. In a second phase (1996–97), increased political uncertainties and economic mismanagement led to capital outflows and a decline in foreign currency deposits, resulting in a measured decline in dollarization. In the third phase (1998–2000), dollarization increased again in line with economic recovery. This development reflects the permanent background of continued monetization, increased financial intermediation, and sizable capital inflows. The acceleration of dollarization in recent years, despite successful stabilization, can be explained by a traditional 'hysteresis' phenomenon of non-reversibility in the process of dollarization. This phenomenon commonly occurs in dollarized economies, because changing the behavior of individuals regarding the settlement of transactions and holding of financial assets is always a slow process involving deep institutional changes. Moreover, the persistence of capital inflows and a still fragile banking system lacking financial instruments denominated in riels will continue to imply a high degree of dollarization in the foreseeable future.

The extent of dollarization, as measured by the share of foreign currency deposits in relation to broad money or total deposits is largely under-estimated, owing to the lack of reliable information on foreign currency in circulation and cross-border deposits. As a result, it is difficult to ascertain with precision to what extent dollarization in Cambodia stems from currency or asset substitution Nevertheless, in Cambodia transactions are predominantly in cash and unrecorded foreign currency in circulation — US dollar and, to a lesser extent, Thai baht, is the dominant form of money holding. It is estimated that foreign currency cash holdings are in the range of 85–95 per cent of total currency in circulation, thus implying a money stock significantly larger than measured broad money. In contrast, the domestic currency, the riel, is used only for small cash transactions and mostly in rural areas, and is injected into circulation primarily through government payments for goods and services, including civil service salaries (chart 1.7).

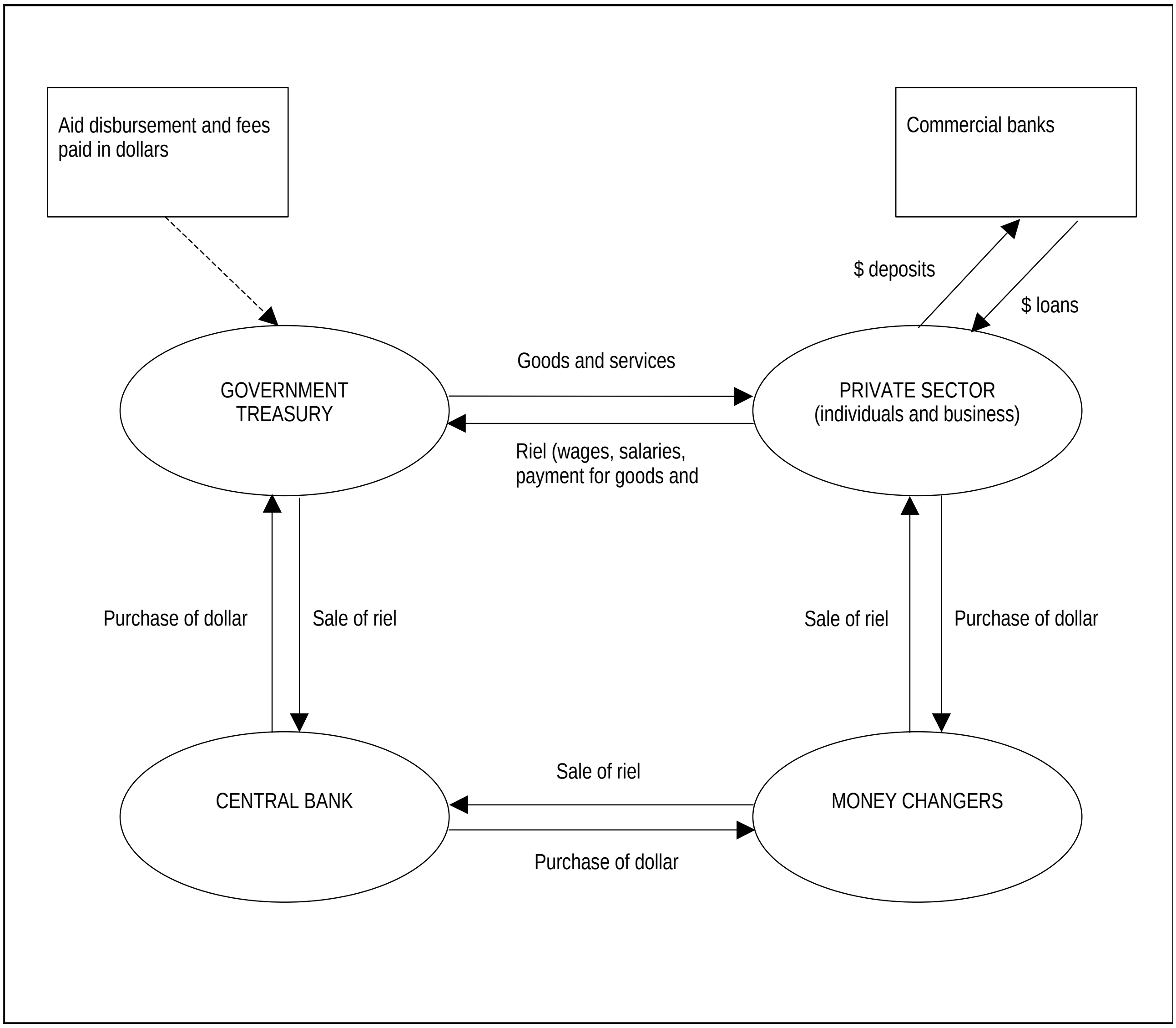
1.6 **Foreign currency deposits in Cambodia and neighboring countries**



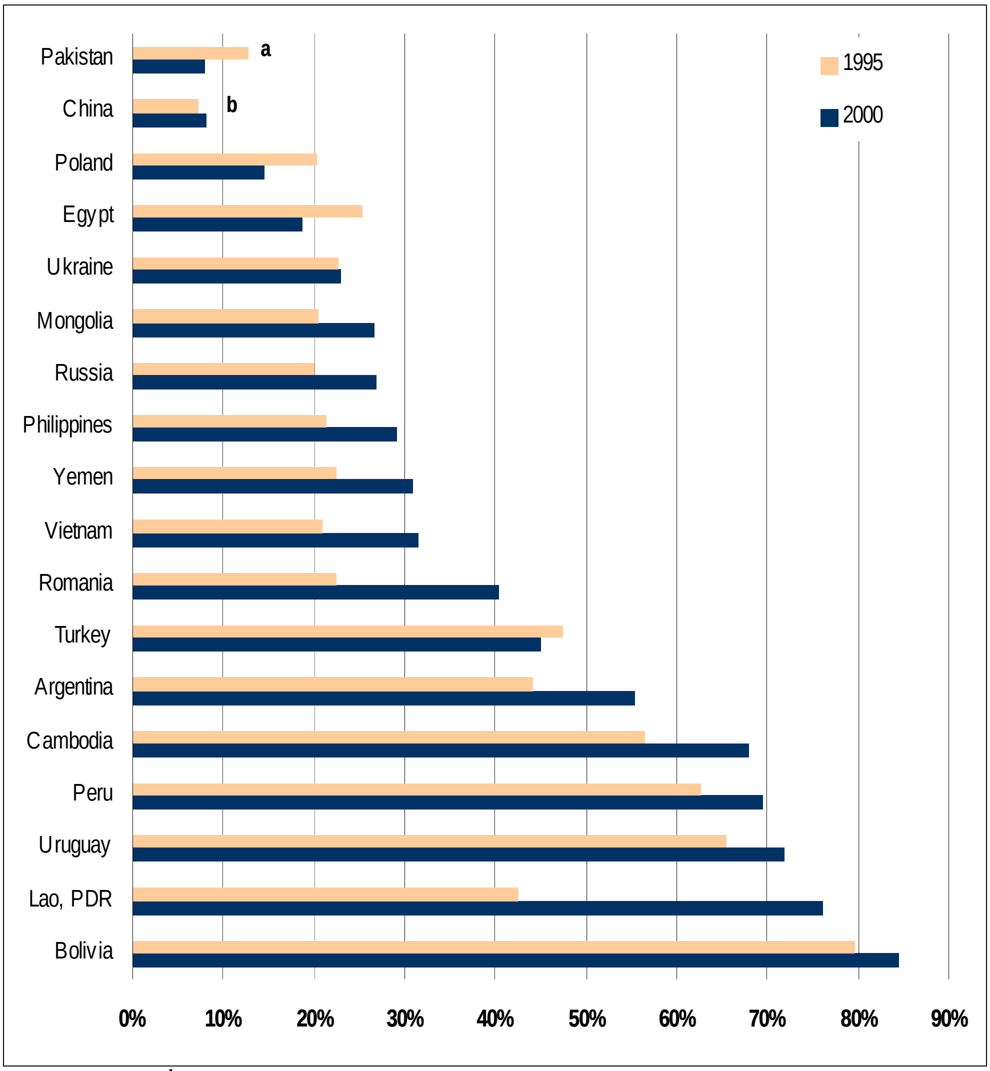
[a] measured as sum of exports and imports

Data source: Cambodian authorities and staff estimates

1.7 Cambodia riel circulation



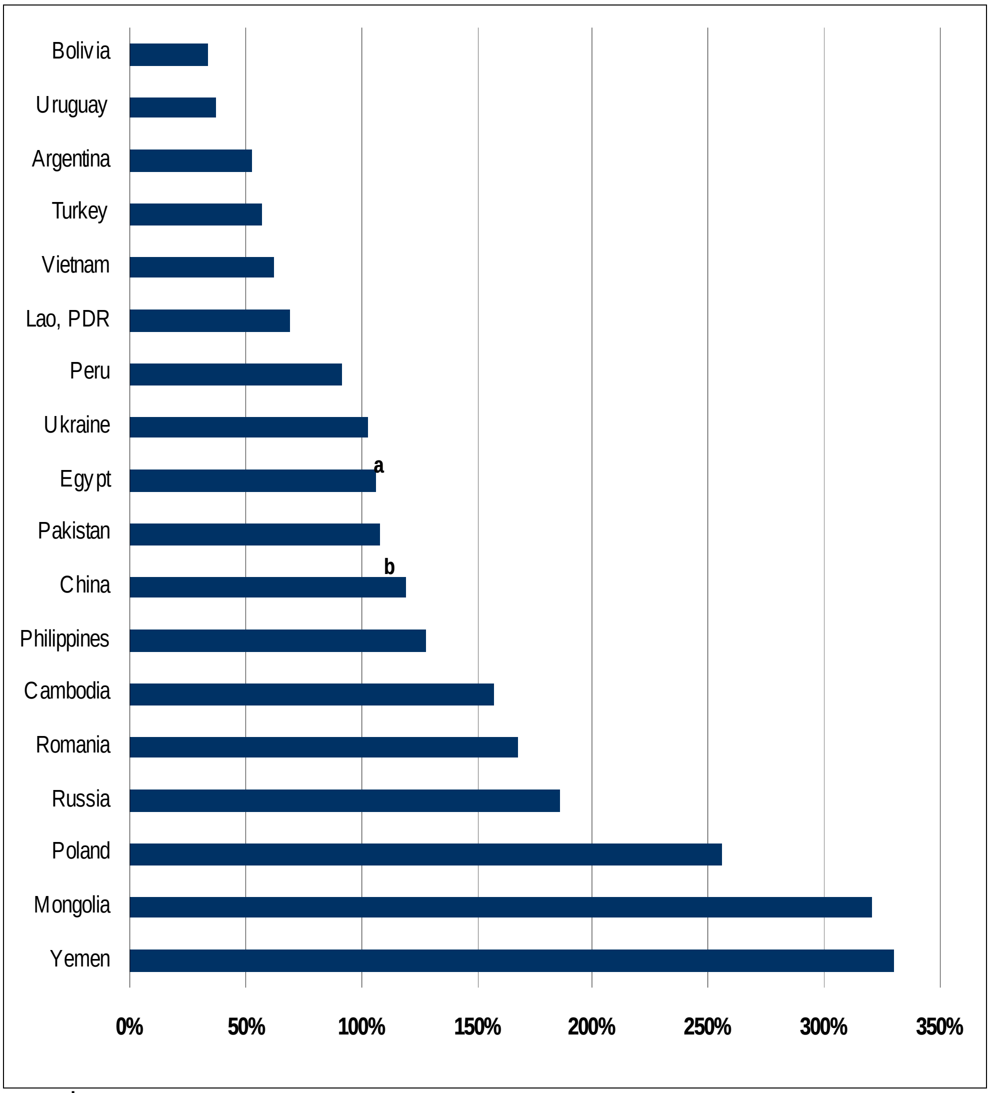
1.8 **Ratio of foreign currency deposits to broad money, 1995 and 2000**



[a] end of June data. [b] 1998 and 2000 data.

Data source: International financial statistics and IMF staff estimates

1.9 **Ratio of gross official reserves to foreign currency deposits – 2000**



[a] 1999. [b] end of June data.

Data source: International financial statistics and IMF staff estimates

Benefits and costs of dollarization in Cambodia

Dollarization in Cambodia has provided substantial benefits as it has helped cushion the impact of economic and political shocks and supported economic reconstruction in the aftermath of several decades of civil strife, economic mismanagement, and political instability. More specifically, dollarization has facilitated the re-monetization and financial deepening of Cambodia's banking system and shielded the economy from the spillover effects of the 1997 Asian crisis, as the impact of the riel's depreciation remained limited (see figures 1.10 and 1.11). Dollarization has also provided a strong protection against exchange rate risks, as the bulk of trade related transactions are effected in US dollars.

The costs of high dollarization in Cambodia are both macroeconomic and microeconomic. Macroeconomic costs stem mostly from both the loss of seignorage for the government, and the constraints imposed on monetary policy, because National Bank of Cambodia's (NBC) operations in riels have almost no impact on monetary aggregates, and control of liquidity growth by the NBC is severely hampered by the limitations of policy instruments available. Currently, in addition to restraint on credit to government and public enterprises, monetary instruments include flexible use of foreign exchange market intervention to influence growth in riel liquidity, changes in reserve requirements, and possible issuance of government or central bank securities. At the microeconomic level, banks hold high unremunerated cash US dollar balances, owing to the lack of a lender of last resort facility in US dollars and Cambodia's highly cash based economy.

One of the main costs of dollarization is forgone seignorage. Seignorage represents the profits accruing to the monetary authorities from their right to issue a legal tender currency, which in turn gives rise to non-interest bearing debt. The monetary authorities can use seignorage revenue either to acquire interest earning assets (that is, foreign currency reserves, government securities, and loans to the banking sector) or to finance a fiscal deficit. The annual flow of seignorage is commonly measured as the increase in the money base net of any interest payments on bank reserves.

Using a foreign currency for domestic transactions is equivalent to providing interest-free credit to the foreign country issuing that currency, in the case of Cambodia to the United States and to a lesser extent to Thailand. Forgone seignorage in 2000 is estimated at about 2 per cent of GDP and 17 per cent of total government revenue (table 1.2). Under a fully de-dollarized situation seignorage would accrue to the NBC and would be transferred to the national budget. However, in the event of full de-dollarization, net revenue derived from seignorage would be lower than estimated here, because of profits from unremunerated bank's required reserves in foreign currency would also be forgone. The loss of an external adjustment mechanism provided by a flexible exchange regime in a de-dollarized environment is also a disadvantage of a highly dollarized regime. However this disadvantage is mitigated to the extent that flexible labor and goods markets are maintained.

Exchange rate arrangements

Current exchange rate arrangements

Cambodia's exchange rate arrangements have undergone drastic modifications since the country became independent in 1953. The country maintained a multiple currency practice until 1970. In 1971 a flexible exchange rate system was introduced, while the exchange rate was unified. A dual exchange rate system was reinstated in 1973, including a 'basic' rate for most transactions and a 'preferential rate' for aid-related imports and services. Under the Khmer Rouge regime (1975–79), the Central Bank was closed and the national currency was abolished. In March 1980, a new transition government reintroduced the Cambodian riel as the domestic currency, together with a dual exchange rate system for the official rate. The official exchange rates, however, were unified in 1990. Since March 1994 the NBC has pursued a flexible exchange rate policy, broadly keeping a fixed spread with the parallel market through interventions on the latter.

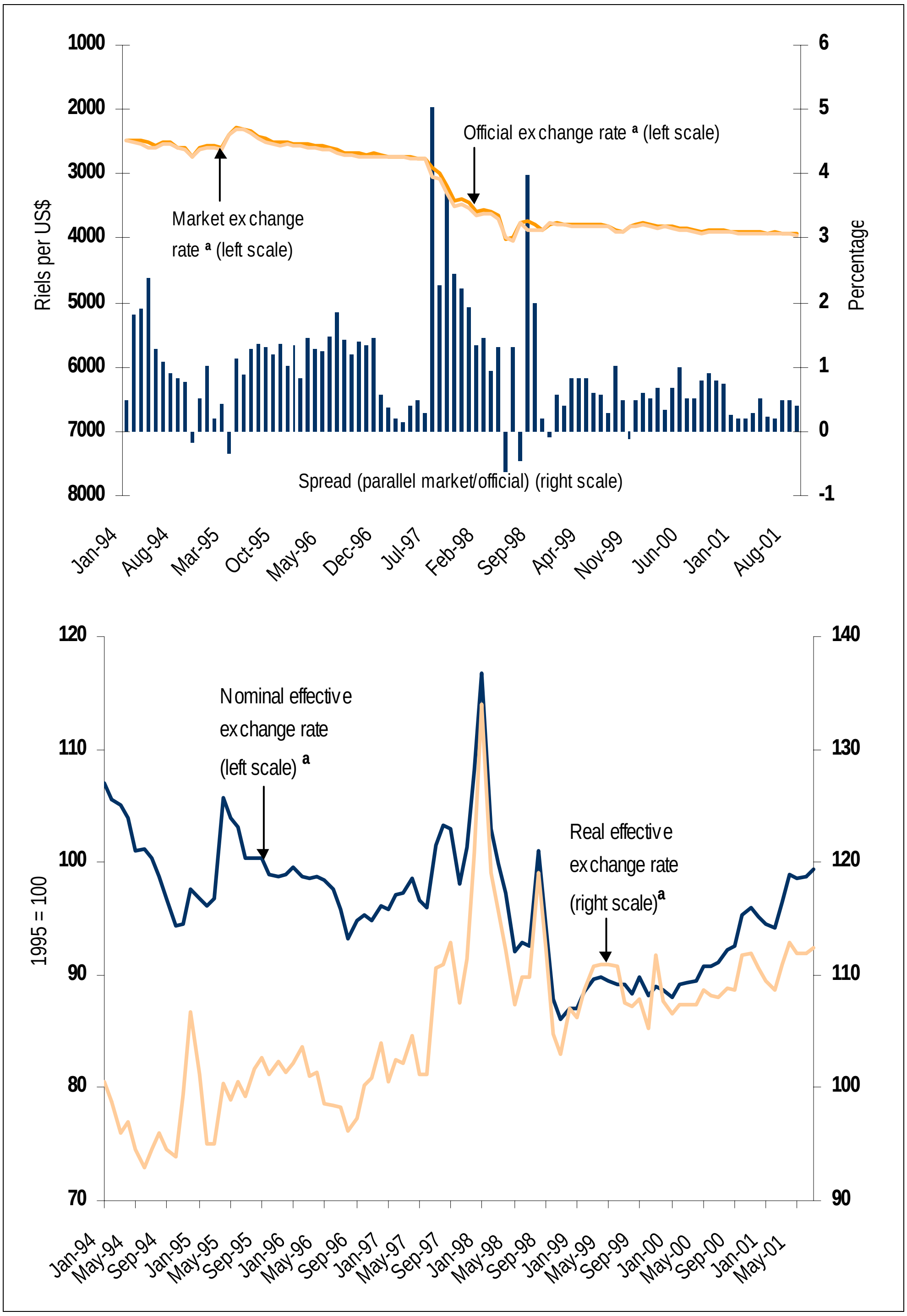
In parallel, since 1989, Cambodia has gradually switched from a monobank to a two-tiered bank system. In 1990, treasury operations were transferred to the Ministry of Economy and Finance (MEF), and the NBC was created as a ministry mainly responsible for ensuring government budget financing. Foreign exchange management was centralized within the NBC in late 1995 and NBC was established as a central bank in 1996 under the Central Banking Law. The banking system was further strengthened under the 1999 Financial Institutions Law and associated decrees. The 1999 Law has served as the legal framework for a major restructuring that has entailed bank recapitalization, a sharp reduction in the number of banks — from 31 in 1999 to 16 as of mid 2001 — the establishment of sound business plans under close monitoring by the NBC, and a strengthening of banking supervision. There is no securities market in Cambodia. A comprehensive Financial Sector Blueprint (2001–2010) aimed at deepening the financial system has been prepared with ADB support. A liberal exchange system, precluding restrictions on payments and transfers for current international transactions has been operating since early 1996. With full convertibility of the national currency achieved, the authorities intend to accept the International Monetary Fund's (IMF) obligations under Article VIII, sections 2, 3, and 4 in the near future.

The national currency is the Cambodian riel, although the US dollar circulates freely and is predominantly used for payments and asset building. The exchange rate system comprises two rates: the official rate and the market rate. Adjustments to the official rate are made daily by the

NBC to limit the spread between the official and parallel market rates to less than 1 per cent. The official exchange rate applies mainly to transactions conducted by the government and state owned enterprises. The NBC quotes daily official rates, at which the Foreign Trade Bank (FTB) buys and sells foreign exchange. Other commercial banks are free to buy and sell foreign exchange at their own rates. Exchange transactions take place at the market rate. Foreign exchange dealers are permitted to buy and sell banknotes and traveler's checks at the market rate. The responsibility for the management of foreign exchange rests with the MEF and the NBC. The NBC is authorized to license commercial banks and other agents in foreign exchange transactions and to regulate current and capital transactions. In practice, no restrictions apply. Exports and imports of foreign banknotes are not limited but are subject to prior notification beyond $10 000. There are no limits on resident's balances of foreign currency accounts held in domestic banks, and the deposits may be used to settle all types of domestic obligations. Exporters and importers of goods and services must make payments for their commercial transactions with the rest of the world through authorized intermediaries.

The parallel foreign exchange market is very thin, comprising mostly small money changers, and involving limited amounts of daily transactions. Some 30 money changers handle about 80 per cent of foreign exchange transactions in the parallel market. With the exception of the state owned FTB, commercial banks generally do not participate in the foreign exchange market, because their assets and deposits are predominantly in foreign currency. The parallel market has been widely accepted by the authorities since the early 1990s as it provides a key benchmark for setting the official rate. In November 1992, the NBC began maintaining the official exchange rate within a 5 per cent margin of the average parallel market rate over the previous two week period. In August 1993, the maximum spread was limited to 3 per cent. At the beginning of 1994, the spread was redefined and applied to the daily parallel market rate and was further reduced to 2 per cent. From March 1994, the NBC has aimed at setting the daily official rate within a 1 per cent spread of the daily average parallel market rate based on surveys of the rates quoted by three major money changers in the previous day. However, the NBC effectively met that objective from early 1999 onwards (see chart 1.10). Significant deviations from that policy occurred mainly in mid 1997 and mid 1998, largely owing to the political situation, but were short lived.

1.10 **Cambodia: exchange rate developments**



[a] based on the official exchange rate: an upward movement indicates an appreciation of the exchange rate.
Data source: Data provided by the Cambodian authorities and IMF staff estimates.

Although the authorities are committed to formally unify the exchange market in the medium term, they have so far resisted to do so, on the ground that the official exchange rate has an important signaling effect on a very limited foreign exchange market. NBC's intervention policy on the foreign exchange market is aimed at smoothing exchange rate fluctuations while strengthening the international reserve position. Accordingly, the NBC is committed not to intervene in the market to support the exchange rate, should sustained downward or upward pressures on the exchange rate arise. However, in the event of a surge in capital inflows, or upward pressure on the exchange rate, the NBC intends to bolster its international reserve position by providing adequate amounts of riel to the market rather than let the exchange rate appreciate excessively. Conversely, with a surge in capital outflows, NBC would not intervene by selling reserves to resist a depreciation of the exchange rate in line with market pressures. NBC's periodic foreign exchange auctions have generally proven to be effective in smoothing exchange rate fluctuations.

Exchange rate developments in Cambodia since the early 1990s have closely mirrored the authorities efforts to establish credible economic management and the impact of unsettled domestic political events. The riel initially appreciated in the early 1990s relative to the US dollar, as confidence returned in the aftermath of the transition government but gradually depreciated during 1994–97. The riel depreciated sharply in the period mid 1997 to late 1998, reflecting waning confidence in the political and economic situation, and increasing inflation. The riel has been broadly stable since mid 1999 relative to the US dollar, and has appreciated slightly since then, both in nominal and real effective terms, largely reflecting the dividends of economic and political stabilization.

Policy options for the exchange system

While the analysis of costs and benefits of dollarization sheds some light on which country characteristics would likely make dollarization an appropriate choice, the balance of the analysis is difficult to draw, since important considerations are hard to quantify. There is also only limited historical experience to draw from, as most economies that have adopted a foreign currency are small and politically-dependent. In addition, given the near irreversibility of dollarization, considerations must be given to events that may be rare but cannot be ruled out from a long-term perspective, such as extreme terms of trade shocks.

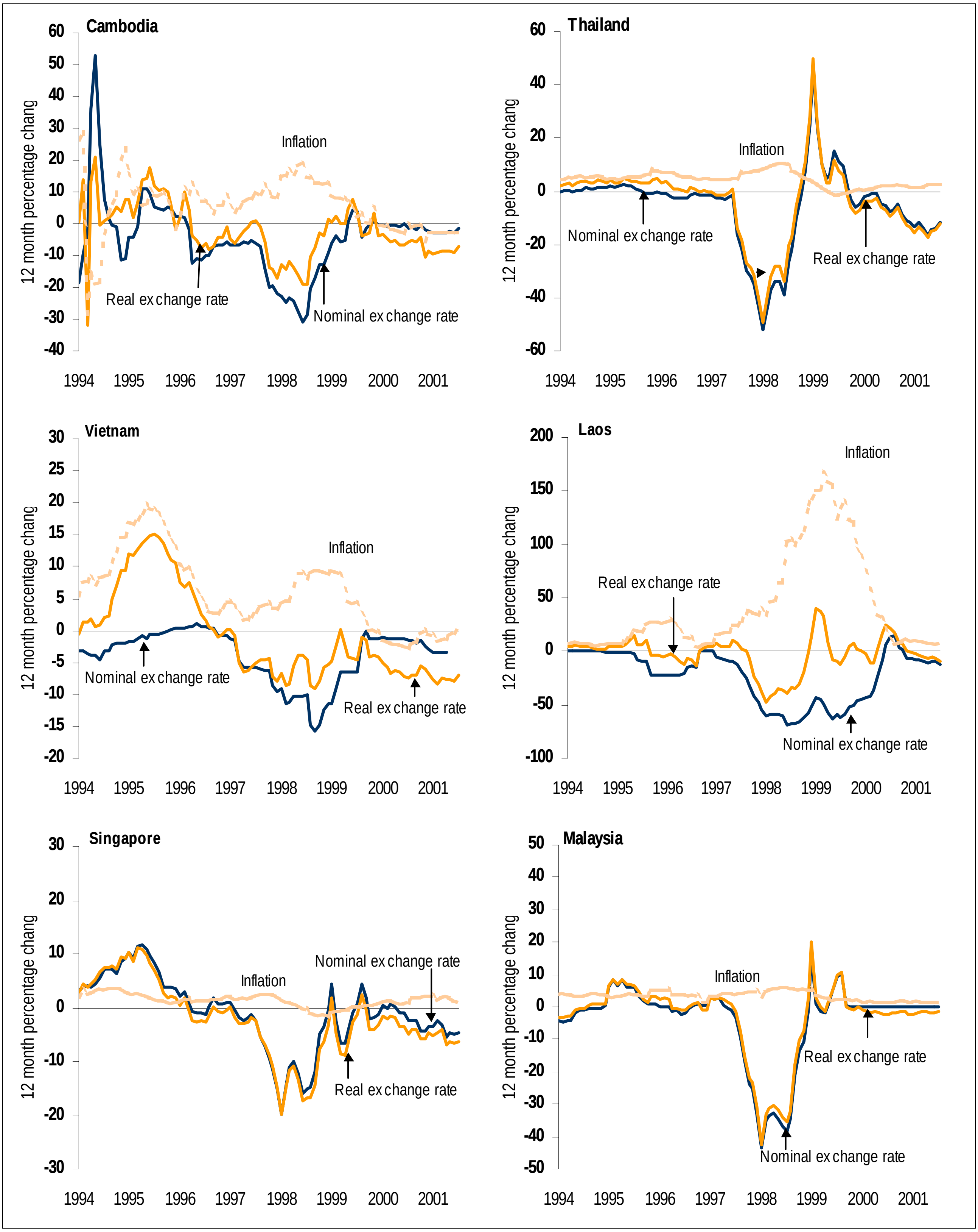
There are essentially two monetary and exchange rate options for Cambodia: move to full dollarization, or proceed with policies expected to promote de-dollarization. A currency board arrangement is an obvious option consistent with the government's stated policy of de-dollarization while maintaining much of the benefits of stability and confidence associated with dollarization. However, any potential choice of monetary and exchange rate regime requires the maintenance of sound fiscal and monetary policies (and political stability) to be effective. At present, neither the fiscal position nor the soundness of the banking system in Cambodia would appear to be sufficiently strong to support a move to full dollarization or a currency board. Therefore, it is crucial for Cambodia to continue to strengthen its fiscal position and the banking system before making any changes in the monetary regime. In view of these circumstances, the authorities' current policy is to support non-administrative and gradual de-dollarization through continued strengthening of macroeconomic performance.

Experiences in other countries have shown that once dollarization has occurred, it usually takes a long time for market perceptions to change. In fact, a return of confidence in the initial stages of reform often leads to an inflow of foreign currency deposits, therefore an *increased* degree of dollarization, as experienced by several Latin American countries and Cambodia in the 1990s. This points to some form of 'hysteresis', as changing the uses and practices regarding the settlement of transactions is a slow process that involves institutional changes. Therefore, direct administrative measures to reverse dollarization, such as regulatory limits on foreign currency usage, will simply drive dollars offshore, further reducing financial intermediation, and are ultimately counterproductive. On the other hand, introducing high quality riel-denominated assets and paying a premium on domestic currency denominated reserves may play a catalytic role in financial deepening in the domestic currency. In addition, increasing economic integration of the rural area may also promote the use of national currency, as the riel is more widely used in the countryside. These steps, together with the maintenance of low inflation, would be expected to lead to a gradual increase in the underlying level of seignorage over time as confidence in the local currency is further strengthened.

Medium term technical assistance requirements

This section outlines the medium term technical assistance requirements for fostering Cambodia's macroeconomic environment. Key technical actions in that area would include: i) strengthening macroeconomic management capabilities; ii) developing sound banking and payments systems; and iii) establishing a financial market relying on government securities and other riel denominated assets. Broad technical assistance support aimed at strengthening capacity building within the MEF and the NBC is already being provided by foreign development partners. In this regard, the MEF will benefit shortly from the support of resident advisors on budget management and customs and tax administration assigned under the TCAP (2001–03) jointly sponsored by the IMF, United Nations Development Program (UNDP), ADB and several donors. The WB is also supporting administrative reform through an Economic Capacity Building Operation and a Population and Human Resource Development (PHRD) grant. The IMF's Monetary Affairs and Exchange Department will continue providing support to bank restructuring and payments system reform in the medium term. Further support would be required to establish a government securities market. The IMF is also in the process of assigning a resident statistical advisor to the Ministry of Planning to enhance the statistical framework in the medium term, including data dissemination. Discussions are also under way with the ADB to develop the financial market over the medium term through a financial sector development program.

1.11 **Bilateral exchange rates and inflation in selected ASEAN countries**



Source: Data provided by the Cambodian authorities and IMF staff estimates.

2 Developments in trade policy

Introduction

Cambodia has made considerable progress in establishing a modern trade regime. During the 1960s, it was an exporter of agricultural products (mainly rice, rubber and corn) and the balance of payments was relatively stable. However, as the regional conflict spilled over into Cambodia in the 1970s, foreign trade virtually collapsed. Under the trading system adopted in the early 1980s the level and composition of trade was effectively controlled through quantitative restrictions and state owned trading bodies, and tariffs and trade taxes played little or no role other than as a means to collect revenue. This has changed with the move to a market economy and the wide range of reforms that have since been implemented.

A process of market oriented liberalization began in the late 1980s. The state monopoly for foreign trade was abolished in 1987 and the foreign investment law was promulgated in 1989, enabling private companies to engage in foreign trade. In 1993, initiated as part of the UNTAC assisted transition, trade policies were greatly liberalized. Restrictions limiting the ability of firms and individuals to engage in international trade were largely removed. There are few binding quantitative restrictions and the rates of taxes on imports and exports are for the most part not prohibitive. Nevertheless, tariff rates and other trade taxes are still high and variable. This structure of duties taxes some activities and benefits others, creates obstacles to the growth of efficient industries, gives rise to pressures for exemptions, hurts revenue and compounds problems of Customs administration. The evidence from around the world is that dismantling obstacles to trade is good for growth and that benefits from this growth as much as anyone (see box 2.1 for a brief summary of this literature). These are core issues for this report on the Trade Policy component of this Integrated Framework Diagnostic Study. Other important issues cover conditions of restricted access to preferred markets and priorities for WTO accession.

2.1 Trade, growth and poverty: assessments of the evidence

Over the last thirty years or so the trade policies of many countries provide a wide range of experiences for countries such as Cambodia to learn from. In the 1960s and 1970s many countries adopted an industrialization strategy based on import-substitution. Tariffs were used to provide incentives (effective protection) for selected industries. In the early stages of this strategy, activities engaged in the manufacture of consumer goods were viewed as the easiest targets for industrial development and the tariffs for these goods were raised relative to those of other goods. The idea was that when these 'infant' industries matured other final good manufacturers would have their tariff protection raised followed by increased protection for the domestic production of intermediate goods, processed raw materials and capital goods in subsequent stages, thus, fostering industrial backward linkages. Experience in the 1970s and 1980s demonstrated this approach had serious flaws. The first stage of the strategy was implemented and high levels of protection were established for many types of consumer goods. But in doing this the seeds of failure were sown. Many of these firms remained uncompetitive, which made it politically difficult to proceed to the second stage where the tariffs for intermediate goods used by these firms would be increased. As a result a powerful constituency was created that was able to block further implementation of the import strategy. For many of these countries, the industrial base remained small in terms of contribution to value added and employment and relatively high-cost when measured against international competition. As world markets became more integrated those countries that adopted import-substitution strategies tended to grow slower than those countries that were more export-oriented.

This experience led many countries to implement substantial trade policy reforms in the late 1970s and 1980s. Studies of the trade liberalization episodes in the 1970s support the conclusion that trade creates and sustains higher growth (Srinivasan and Bhagwati 1999). Similarly, studies of more recent experiences with liberalization reinforce this conclusion. The so-called list of post 1980 globalizers includes China, India, Indonesia, Thailand, Mexico, Argentina, Uganda, Vietnam, Bangladesh and Nepal. All these countries cut their tariffs and otherwise streamlined their trade regimes. All have had large increases in trade and most have had large increases in foreign investment as well. Growth rates have accelerated from an average of 1.7 per cent per year in the 1970s, to 2.6 per cent in the 1980s to 5.3 per cent in the 1990s (Dollar and Kray 2000).

So if liberalization of policy and increases in trade are good for growth, is that growth good for the poor? The answer appears to be that growth in trade reduces poverty (Dollar and Kray 2000). Trade liberalization creates 'winners' and 'losers', but different 'winners and 'losers' also arise when trade barriers are high. Thus, trade policy, whether it be open or closed cannot guarantee that nobody will lose. In either case poverty must be addressed by more direct measures such as targeted investments in education and health. However, some countries have done better out of trade liberalization than others. For example, the Asian economies have generally done better than comparable Latin American countries in terms of growth, employment generation, income increases, and poverty reduction. According to a recent Asian Development Bank (ADB) (2001) review, trade liberalization has been an important factor in Asia's success in reducing poverty over the last decade.

Why did many Asian countries do better than countries in other regions? Part of the answer lies in a combination of factors including stable macroeconomic policies, such as low inflation and prudent fiscal policies and the fact that product markets and factor markets (that is, labour and capital) are relatively more flexible than many Latin American and African countries. Unlike many Latin American countries, most Asian economies have far fewer domestic price controls and few interventions in the labour and capital markets, which allowed their economies to maximize the gains from greater trade as well as allow their economies to adjust faster to external shocks.

While these general conclusions are widely endorsed by professional economists and by the preponderance of political leaders who have opted for liberalization – often unilaterally – in recent years, there is not universal agreement. Some commentators have criticized the use of cross-country comparisons to draw such conclusions (Rodriquez and Rodrik 1997, Rodrick 1998). Skepticism about the pay off to open trade is also sometimes based on theoretical possibilities whereby in some circumstances trade opening can hurt efficiency and output (Rodrick 1999).

(Continued on next page)

2.1 **Trade, growth and poverty assessments of the evidence** (Continued)

But reviews of these issues generally conclude that while cross-country models do oversimplify the relationships between openness and growth, the relationship is adequately demonstrated by the in-depth studies of country experiences (Srinivasan and Bhagwati 1999). On the question of circumstances where trade could theoretically hurt efficiency most proponents of the benefits of open trade have come to that position, fully aware of the theoretical exceptions and have, after careful consideration judged them to be insignificant.

Finally, lessons from the recent Asian financial crisis also tells us that in addition to trade and regulatory reforms other supporting institutional reforms promoting open access to economic opportunities are fundamentally important for achieving high quality economic growth and therefore poverty alleviation in the long term. These include good governance practices, and better laws and judicial system to ensure proper, transparent and predictable administration.

Measures affecting imports

Tariff policy

Recent changes in tariff policy

The Cambodian government continues to reform its tariff rate system. In April 2001 the number of tariff bands was reduced from 12 to 4 with the maximum tariff rate falling from 120 to 35 per cent (see table 2.2). Tariff rate reductions covered several major finished goods as well as some intermediate goods and raw materials. One of the major tariff decreases under this reform package covered completely built up passenger cars (from 40 to 120 per cent to 35 per cent) and spare parts (from 50 to 35 per cent); tobacco products (from 50 to 35 per cent); and alcoholic beverages such as wines and distilled beverages (from 50 to 35 per cent). However, these changes have had a minor impact on the overall tariff structure since only a small percentage (3.8 per cent) of tariff lines had rates above 35 per cent in 2000. For example, the percentage of tariff lines duty free or subject to the minimum 7 per cent tariff rate only increased from 44.3 per cent in 2000, to 44.8 per cent in 2001 and the percentage of tariff lines with tariff rates 15 per cent or less only increased from 71.6 per cent to 73.2 per cent. Consequently, the average tariff rate fell only slightly from 17.3 per cent to 16.5 per cent indicating that tariffs, on average, still remain high. A standard deviation of 11.9 per cent indicates that there is still a large dispersion of tariff rates. Under a program agreed with the IMF, the Government intends to reduce the unweighted average tariff rate to 14 per cent by 2002. While achieving a low average tariff is a useful indicator of progress with tariff reform, it is an incomplete one. Indeed it would be possible to reduce the average rate yet leave pockets of highly protected industries. As a rule of thumb, a the fewer the number of rates, the narrower the range of rates, and the lower the average rate, the less costly the tariff structure will be to the economy in terms of misallocation of resources.

Almost half tax revenue is from border taxes. Tariff rate reductions on the many high revenue yielding imported excisable (petroleum and petroleum products, autos, motorcycles, beverages and cigarettes) raised concerns that the tariff changes would have resulted in a drop in government fiscal revenues. As a revenue compensatory measure for the tariff changes, the government increased excise tax rates on these major products (see annex B for details of changes). As result of these tax increases, the average applied rate of taxes on imports (import duty plus excise tax) virtually remained unchanged at 18 per cent between 2000 and 2001. The advantage of shifting away from tariffs to excise taxes as a revenue raising measure is that it avoids the negative effects of high tariffs on domestic resource allocation, as an excise tax applies equally to domestically produced goods and imports.

2.2 **Cambodia's tariff rate structure**

Tariff band	*1997*		*2000*		*2001*	
	Number	*Share*	*Number*	*Share*	*Number*	*Share*
		%		**%**		**%**
0	107	2.1	290	4.3	297	4.4
0.3	7	0.1	9	0.1		
7	2112	40.7	2731	40	2758	40.4
10	14	0.3	14	0.2		
15	1184	22.8	1861	27.3	1936	28.4
20	46	0.9	68	1.0		
30			4	0.1		
35	1575	30.4	1569	23	1832	26.9
40			8	0.1		
50	133	2.6	256	3.8		
90			6	0.1		
120			6	0.1		
Total	5 186	100	6 823	100	6 823	100 %
Average tariff						
Unweighted average tariff rate		18.4		17.3 (13.6)		16.5 (11.9)
Import weighted average tariff rate		15.9		15.4		14.2[a]
Effective tariff rate		na		10.8 (12.4)		na

[a] Figures in parenthesis are standard deviations, which measure the dispersion of tariff rates. Effective tariff rate is the ratio of revenue from tariffs over the value of imports. Import weighted average tariff rate for 2001 calculated using year 2000 import data.

Sources: Customs Department and Ministry of Economy and Finance.

Additional information about the structure of tariffs is revealed when we examine the distribution of imports by tariff lines. Imports by tariff band are presented in table 2.3. First semester 2001 import data was not available and so we calculate import weighted average tariff for 2001 using 2000 import data. Some caution should be taken with these figures, as many believe the data on imports are not complete due to several factors such as smuggling activities, weaknesses in data compilation and customs valuation procedures, which we discuss later. Bearing this in mind, one striking feature is that the shares of imports by tariff band are similar to the distribution of tariff lines. Still, a fifth of all imports are subject to the highest tariff rate of 35 per cent. The tariff peaks (tariff rate of 35 per cent) protect several semi processed goods and consumer goods such as processed meat and dairy sectors, processed vegetables and fruits, wheat flour; beverages and tobacco; garments and footwear; plywood and jewelry. All major ‘excisable goods’ are included in this band for revenue raising purposes. Based on import data for 2000, the import weighted average tariff rate fell from 15.4 per cent in 2000 to 14.2 per cent in 2001. These statistics do not take into account the extensive use of tariff concessions in connection with investment and export incentive schemes. These exemptions are discussed below.

2.3 **Tariff rate structure**

Tariff band	*Tariff lines*	*Imports*
	%	%
0	4.4	8.1
7	40.4	45.6
15	28.4	25.9
35	26.9	20.4

Source: Calculated from customs data.

In addition to the customs duty, two indirect taxes are levied on the value of imports: excise tax and value added tax (VAT). Overall, Cambodia gets almost 80 per cent of its tax revenue from taxes on imports, of which these two indirect taxes represent approximately 51 per cent of total taxes on imports in 2000. As noted earlier, excise taxes are levied on five product groups: beverages (including mineral water), tobacco, passenger vehicles, motorcycles and petroleum products. The VAT is a uniform 10 per cent rate. With few exceptions, both taxes are levied on imports at the same rates and conditions as on domestic traded goods. Exporters are VAT zero rated for imported materials used for producing exportable goods. There are unofficial taxes on imports and exports, which can add up to significant amounts. For example, according to one estimate, informal trade facilitation taxes can amount to $150 per container of imported or exported goods. These ‘hidden’ costs are discussed in detail in the trade facilitation section.

Duty concessions and exemptions

Import duty concessions and exemptions are available to certain types of importers. Items imported for the purpose of re-exporting (for example, cigarettes) are charged a concessionary duty rate (see box 2.8). Imports of goods by international donors, NGOs and the Cambodian government are all exempt from paying import duties. Investors who export more than 80 per cent of their production are entitled to duty exemption on capital goods, raw materials and intermediate inputs under the law of investment. Other investors approved by the Cambodian Development Commission (CDC) under the Investment Law are entitled to duty exemptions on imported goods, normally for one year, although a one year extension of duty exemptions is possible. According to customs data about half of imports came in duty and tax exempt in 2000 and forgone tax revenue was estimated at $207 million (see table 2.4). In the first semester of 2001, forgone revenue amounted to $128 million (or CR501 billion), compared with customs collection of $112 million (or CR436 billion). Almost eighty per cent of trade tax exemptions arise from imports of raw materials (mainly fabrics) and capital goods used by garment producers (table 2.5).

2.4 **Trade tax revenue collected and forgone in 2000**

	Dutiable imports	***Non dutiable imports***
	US$m	US$m
Value of imports	733.3	684.5
Type of tax	Trade tax revenue collected	Trade tax revenue forgone
Customs duty	94.2	124.6
Excise tax	24.6	3.3
RPP	0.8	0.0
Export tax	4.0	0.2
Others	3.1	—
Total	209.4	207.4

Source: Calculated from customs data.

2.5 **Value of trade tax exemptions by recipient**

Garment projects	***Other exporters***	***Re-exports***	***Other investors***	***Grant aid***	***Embassies***	***NGOs***	***RGC***
$	$	$	$	$	$	$	$
162.9	0.2	16.8	4.7	8.8	3.2	4.8	6.3

Source: Customs Department, Ministry of Economy and Finance.

Given the widespread availability of import duty exemptions, nominal tariff rates applied in practice are quite different from listed tariff rates. Moreover, there are other trade taxes that tend to be somewhat less visible, but are often no less important (for example, see implicit surcharges below). As a result the average burden of tariffs on traded goods will be quite different from the listed tariff rates. Annex B reports estimates of effective tariff rates on trade goods for 2000, defined here as the ratio of total collected tariff revenue (revenue from tariffs less exemptions) to the value of total imports, or exports.

Of course, there are good economic reasons to have a low effective tariff rate on most imported goods, but accomplishing this goal through an ad hoc, unsystematic tax exemption scheme is not an effective way of doing this. In particular, the differential tariff treatment creates unpredictability and non transparency for importers and investors. Also, since this system requires an elaborate customs administration process, this becomes timely and costly for both the government and the investor with all the negative effects of a discretionary process (see section on trade facilitation).

Examining the effective tariff rates on imports, it is apparent that there is a heavy reliance in a relatively narrow base of imports in these statistics. The traditional excisable goods petroleum, alcoholic beverages, tobacco and autos — account for more than 60 per cent of customs tariff revenue. According to customs data the ratio of total collected tariff revenue to the total value of imports is 6.7 per cent. The fact that this ratio includes a large proportion of tariff revenue on a small number of excisable goods means that the average burden of tariffs is in fact much less. If the major excisable goods are eliminated, the ratio is 3 per cent.

Reflecting in part the various exemptions along with preferential rates applied under CEPT, the average effective tariff rate for all imports is 10.8 per cent, much lower than the average listed nominal rate of 16.5 per cent. Nevertheless, the ad hoc nature of the various exemption schemes has created as much variability or distortions in the tariff structure as implied by the listed nominal rates. This is indicated by the fact that the dispersion of effective tariff rates (measured by the standard deviation of 12.8 per cent) is not much smaller than the dispersion of listed rates (13.4 per cent).

As indicated above, officially recorded trade taxation of exports (that is, through customs) is relatively limited. The average effective trade tax for exports was 5.7 per cent. Wood, rubber and fish are the primary goods burdened with significant export taxes (see table 2.6).

2.6 **Average effective trade tax on exports, 2 digit HS**

HS	***Product group***	***Export tax***
		%
01	Live animals	10.0
44	Wood products	9.9
03	Fish	9.8
40	Rubber	3.2

Source: Customs Department, Ministry of Economy and Finance.

The estimates presented in annex B also indicate a number of cases where the effective tax rate is less than the listed nominal tariff rate. For example, the effective tax rate for imports of fabrics is much less than the nominal tariff rate of 7 per cent. This undoubtedly reflects significant exemptions from duty granted to garment manufacturers of exports. This raises an important tariff policy issue, which is discussed below in a section on appropriate tariff policy. Briefly, as indicated above garment producers must follow a timely and costly administration process to obtain duty exemptions. Given that producers of garments account for about 80 per cent of total value of duty exemptions, one option for the garment industry could be to reduce tariff rates on all imported materials and accessories to zero. (The tariff rate on most of these items is currently 7 per cent.)

An advantage of a zero tariff policy on fabrics is that garment exporters would not have to maintain a Master List for imports of materials at CDC. (This list provides detail information on the type, volume and value of imported goods, which CDC officials are empowered to modify if they have grounds to believe that the exporter is inflating material requirements.) Many producers complain that the master list involve a timeconsuming and costly administration process. This change would help reduce administration costs for both the garment industry and the government. This policy would have little effect on customs revenue because most imported fabrics and accessories are already exempted from duties.

Valuation of imports and implicit surcharges

Customs operates two valuation schemes for the purpose of calculating dutiable values for import and exports of goods. The first scheme refers to fair market value (FMV), whereby the valuator (SGS under the Pre-Shipment Inspection (PSI) agreement) uses international prices to determine the dutiable value (see customs chapter). The second scheme involves the MEF setting predetermined, minimum or fixed dutiable values for certain products to be used by SGS and customs. Customs duties, excise and VAT are calculated based on these administered prices. For some of these products, SGS is required to use the pre determined minimum values in cases where the pre determined values are greater than the actual SGS valuations based on FMV or c.i.f. value of imports (see table 2.7). For a small number of other products fixed dutiable values are used irrespective of c.i.f. value of imports (for example, petroleum). The stated purpose of this scheme is to circumvent under-valuation of imported items and, thus, ensure stability in customs revenue collection. In cases where the pre-determined minimum value is above the FMV, the amount of the customs duty charged will therefore be larger than otherwise, indicating that there is a specific duty and, thus, the *implicit* ad valorem tariff rate will be higher than the applied tariff rate. Where minimum values are set according to brands (motorcycles, cigarettes) or source country (for example, passenger automobiles) the *implicit* ad valorem tariff rate will often vary across brands and countries. This system gives rise duties which are not transparent and can give rise to high protection and protection increases whenever international prices fall below administered minimum dutiable import values.

Table 2.7 lists selected products subject to administered dutiable values. In addition, more then 400 items made in Thailand and Vietnam are also subject to administered minimum dutiable values. While it is not practical to compare all items subject to administered dutiable values with their corresponding c.i.f. value or FMV of imported goods, selected examples demonstrate the extent to which these prices deviate. For some products the current administered prices are roughly in line with international prices such as for gasoline ($320/ton), although these prices will deviate if international oil prices suddenly change. For other products, the c.i.f. value or FMV value of imports is below their administered prices. For example, the 'FMV' of ordinary portland cement exported to Cambodia between May and July of 2001 ranged between $32–34/ton compared to the minimum administered price of $40. With a tariff rate of 10 per cent applied to the administered price of $40, the *implicit* ad valorem tariff rate on imported cement is approximately 12.5 per cent. Administered dutiable values for used automobiles are generally set above c.i.f. value of imports. For example, the importation of a used, 1999 Toyota Camry (2000cc) in 2001 was subjected to an administered price of $8500, whereas its FMV was estimated at $4634. Thus, the *implicit* ad valorem tariff rate on this imported vehicle was 64 per cent and not the applied tariff rate of 35 per cent. A recent MEF letter instructs SGS to use FMV for mercedes passenger cars and trucks made in Korea; thus, no implicit surcharge is imposed on mercedes models produced in Korea and exported to Cambodia. However, smuggling of automobiles to Cambodia is prevalent and this activity undermines customs duties collection.

2.7 Selected products subject to predetermined minimum dutiable value

Automobiles	Different minimum values according to brand and source of country
Trucks and buses	Different minimum values according to vehicle weight, lower minimum values for trucks and buses produced in Korea
Motorbikes and spare parts	Different minimum values according to brand and spare parts
Used electronics	By product
Cooking oil	$450/ton if canned in 10 liters or more; $480/ton if canned in less than 10 liters
Cement	Portland cement US$40/ton, white cement $75/ton
Used clothing	$0.80/kg for products originating or having direct consignment from US, Canada, Singapore and Japan
	$0.70/kg for products originating or having direct consignment from
	countries other than the above.
Petroleum products	Fixed administered price
	Gasoline (all types) fixed at $320/ton
	Aviation fuel fixed at $235/ton
	Lamp kerosene fixed at $230/ton
	Diesel oil fixed at $275/ton
Generator	New generator set $120–150/kva
	Used generator set $70/kav
Steel and iron	By product
Cigarettes	Fixed price by brand
Monosodium glutamate	$910/ton if packed in bags of more than 1kg; $940/ton if packed in bags of glutamate 1kg or less.

Sources: Customs Department and Ministry of Economy and Finance.

For some products, the fixed dutiable value is deliberately set below c.i.f. value of imports. Two examples are the importation of cigarettes and used motorcycle parts. Cigarettes are a major re-export product, whereby as much as 80 per cent of imported cigarettes are informally re-export mainly to Vietnam. To encourage this activity, as well as to capture some customs revenue from it, Customs applies the normal tariff and excise rate to cigarette imports at a dutiable value set below the c.i.f. value of imports (see box 2.8). Similarly, the government predetermines dutiable values for used motorcycle spare parts, which is set below market value according to an import substitution strategy for the industry as three or four firms assemble these components locally.

Overall, this minimum dutiable valuation regime creates uncertainty in the tariff structure as it creates 'hidden' specific duties or concessions that are not explicitly included in the tariff schedule. Valuation regimes and resulting specific taxes create additional protection and protection increases whenever international prices fall below administered prices. Regimes like this one are also often used as 'back door' ways of protecting certain domestic or foreign producers from competitive imports. The implicit specific duty regime is also discriminatory, as it treats some product relatively differently from each other depending on brand or country of origin. Another problem with this regime is that import (c.i.f. or FMV) prices often deviate from administered prices, especially if the latter are not frequently updated, as appears to be the case (as of December 2000, many administered prices had not been updated for two years). In some cases the fixed administered prices fall below the market price, in which case the government forgoes revenue to the budget. Finally, like high tariffs the imposition of implicit specific duties encourages smuggling of goods across the border. Ad valorem tariff rates are preferred to specific taxes as a tariff instrument because they are less costly to the economy in terms of resource misallocation. This is because whenever international prices of imports change, specific taxes create more variability in domestic prices than ad valorem tariff rates and, thus, greater domestic resource misallocation.

2.8 **Cigarette re-exports and the system of taxes**

Re-exports of goods are handled somewhat differently in Cambodia than in most other countries re-export trade. In most countries, re-exports enter and leave with little or no transformation and are typically permitted to come and go duty free. It is not unusual for duty rebate or bonded warehouse schemes to be in place to ensure that the goods are in fact re-exported. In Cambodia, much of the re-export activity is informal with Vietnam and Thailand as the major destinations for this trade. Goods are identified as re-export goods on admittance, and there is no official documentary evidence of their departure. According to Customs estimates, cigarettes are by far the largest good re-exported, and about 80 per cent of all imported cigarettes are informally re-exported, mainly to Vietnam in response to the latter country's relatively high tariff and excise taxes on cigarettes. Because of the informal nature of this trade (which makes a bonded warehouse scheme or duty draw back facility inappropriate), and recognizing this trade as a source of central government revenue, the Cambodian government admits imported cigarettes at a concessionary tax rate. Until recently, the system of taxes and duties levied on cigarettes involved the setting of three parameters: i) the dutiable value, ii) the domestic consumption coefficient (20 per cent sold domestically), and iii) the tariff refund rate, and subjecting imported cigarettes to the same type of tax scheme as regular imports. In 2000 the government simplified the system by abolishing ii) and iii) and an import tariff and excise tax rate applied uniformly to imported and domestically produced cigarettes. However, concerned that a uniform system of taxes may significantly reduce the re-export trade and therefore customs revenue from cigarettes, the government retained and revised the minimum dutiable value for cigarettes.

Whether any further action to simplify the system of taxes on cigarettes is required by policy makers depends on the extent that the goods are actually re-exported and this is virtually impossible to determine directly. There are two points to note. First, the amounts of cigarette re-exports are large relative to likely domestic demand and, thus, leakages are probably under reasonable control. A second factor to consider is whether re-exports can be expected to be a major source of revenue for very many years. It can be expected that as Vietnam reduces its trade barriers within the ASEAN Free Trade Area Agreement (AFTA) agreement over the next 8 years, the long term future for significant re-export generated revenue is limited. Of course, it is possible to greatly reduce revenues from re-exports if the duties on re-exports are raised sufficiently high. This would likely move this trade outside formal channels. For example, the introduction of a duty draw back system could be expected to have a negative impact on re-exports. Given the informal nature of the re-export trade in cigarettes, and the difficult fiscal constraints facing the RGC continuation of present policies without any further major changes to the system of taxes for cigarettes makes sense.

Import restrictions and controls

With a few exceptions, all official quantitative restrictions on imports were eliminated in 1994 as part of comprehensive trade reform measures. The import license system was also eliminated in 1994, except for selected items such as pharmaceutical products, gold and silver, armaments and ammunitions and various cultural and medical materials. Ministerial authorization is required for importing these items. A few bans on imported goods remain. Recent examples of import prohibitions include pig meat, used motorbike tyres, right hand autos, and used footwear (see table 2.9). Otherwise, firms are unrestricted in importing goods as long as the importer is a registered firm incorporated under Cambodian law. Foreign trading companies are free to operate in Cambodia, as long as they are incorporated under Cambodian law and registered with the Ministry of Commerce. While a few state trading companies continue to operate, for most they compete with private trading companies in the same markets.

2.9 **Selected products subject to import licensing and prohibitions**

Commodity	***Rationale***	***Measures***	***Responsible agency***
Live pigs and pig meat	Public health	Prohibited	Ministry of Agriculture
Armaments & ammunitions	National security	Prohibited, except for military procurement	Ministry of Defence/Internal Affairs
Illicit drugs	Public health	Prohibited	
Firecrackers	Public safety	Prohibited, except for special occasions	Ministry of Defence/Internal Affairs
Printing material	Public morality	Prohibited if deemed to have negative impact on society	Ministry of Education/Culture
Gold bars	Monetary policy	License	Central bank of Cambodia
Cultural items	Protection of culture	License	Ministry of Culture
	Monetary policy	Automatic license as long as declared items above $10 000	Central bank of Cambodia
Pharmaceuticals	Public health	License	Ministry of Health
Artificial sweeteners	Public health	License	Ministry of Health
Right hand drive vehicles	Public safety	Prohibited	
Used motorcycle tyres	Environment	Prohibited	Ministry of Environment
Used footwear and leather bags	Environment	Prohibited	Ministry of Environment

Source: Customs Department, Ministry of Economy and Finance.

Developments in export policy

Export prohibitions, quotas and charges

Licensing is used to administer quotas, conditional prohibitions, and absolute prohibitions on certain exported goods. These measures are typically in place for public health and security reasons as well as to implement arrangements with trading partners, concerning notably textiles and clothing to the US and European Union (EU). Currently, Cambodia has an absolute ban on exports of logs, export quota on rice, and garment quotas (as reported in the sector studies some of these bans are apparently not binding). There are five items that are subject to the export licensing requirements: processed wood products (including furniture, wooden handicrafts etc), garments, weapons, all vehicles and machinery for military purposes, pharmaceuticals and medical materials. Ministerial authorization is required for exporting these items. A state owned enterprise, KAMFIMEX, has a monopoly on fish exports. An export quota on rice has been in place since 1996 as a replacement for a ban on rice exports before 1995. The export quota is an element of the government's food security program. Evidently, the quota on rice exports is not binding since the actual recorded export volume has never reached the ceiling set by the quota. A special inter ministerial working group decides on the annual ceiling for the rice export quota. Individual shipments, which should not exceed 3000 tons, are granted an Export License from the Ministry of Commerce after approval is obtained from the Ministry of Agriculture. However, unofficial (non quota) exports of rice and also padi are apparently substantial, although estimates are not available (CDRI 2001).

An export ban has been imposed on logs and sawn logs since May 1995. Strong economic growth recorded in the Asian countries in the early 1990s had created a substantial increase in the demand for logs. Meanwhile, neighboring countries such as Malaysia and Thailand strengthened their control on log exports; hence the prices of logs substantially increased. These elements, together with limited institutional capacity for proper forestry management, created a strong incentive for illegal log exports from Cambodia. This ban on logs, combined with export taxes on semi processed wood, is believed to be inefficient as it encourages excessive and costly domestic processing of plywood and veneer sheets. The government intends to review the export log ban in the future in line with improvements in overall forestry management.

An export quota has been in place for garment exports to the US since 1999, in response to the surge in garment exports from Cambodia. Quota restrictions were imposed on 12 broad categories of garments. The quota agreement is initially for three years ending in December 2001. Under the current arrangement the quota restriction will be eased by 6 per cent per annum. Up to an additional 14 per cent easing of the quota will be provided if Cambodia 'substantially complies with labor standards' including those set out in Cambodia's labor laws and the four core ILO conventions. Following on from an assessment of Cambodia's labor standards, the US government granted a 9 per cent quota increase (see garments case study for a discussion of labor standards). The government has implemented a flexible quota system whereby about 80 per cent of the quota has been allocated to firms operating in Cambodia in 1998 based on their past export performance and production capacity of the producer. Up to 10 per cent can be allocated to exporters as a reward for current export performance and compliance with the country's labor laws. The remaining 10 per cent is auctioned to garment producers through competitive bidding. The government charges a specified fee (known as visa fees) per dozen of garments sold under the quota to US as well as garments exports to Europe. The fees were introduced when the government introduced the electronic visa implementation system (ELVIS) to identify fake Cambodian exports to the US, as part of the bilateral agreement with the US. The purpose of the fees, however, appear to simply raise revenue (see garments case study for details).

The garment quota arrangement raises several important long term competitiveness issues. First, institutional labor arrangements — such as relatively high minimum wages and restrictions on work shifts as well as compliance costs to these standards are raising the cost structure of the garment sector. While these rigidities may benefit existing workers in the short term, they put expanded employment in the industry at risk, if preferred markets cease to exist, by creating a cost structure that is only viable with preferences. Further, by putting in place these institutional rigidities the development of other potential export sectors are also at risk as they create a relatively high cost structure in labor intensive sectors that Cambodia has a comparative advantage (see garments sector case study for a discussion of labor issues).

The second issue relates to the costly export facilitation process arising from preferential market access to the US and EU. The export facilitation process is cumbersome compared to many other exporting countries in the region. Much of the process involves around ensuring that Cambodian garment exports meet rules of origin requirements. For example, garment exporters require up to 11 documents from three ministries and five departments before their shipments are permitted to leave the port. Further, four government agencies are involved in the product inspection process, essentially duplicating each other's functions. For example, to export to the US or EU, the exporter must obtain a Certificate of Processing from the Ministry of Industry, Mines and Energy (MIME) as proof that the garments are made in Cambodia. Ministry officials will visit the factory to verify origin. In the next step, exporters obtain a Certificate of Temporary Authorization to export from the Generalized System of Preference (GSP) division at MOC. Officials do not carry out verification of origin at this stage. Both Camcontrol and Customs carry out a pre shipment verification of exports at the factory premises and issue a certificate of inspection. Containers are then permitted to leave Cambodia. This process is costly and time consuming for exporters. As it is heavily dependent upon the physical inspection of shipments by three agencies, and is thus very much open to abuse by petty officials. According to one estimate, these informal taxes can amount to $150 per container of garment exports valued at $30 000 f.o.b. One reason for this excessive licensing procedure was in reaction to EU and US concerns about third country garment exports arriving at their ports using fake Cambodian labels (see trade facilitation section).

As is the case for import duties, export taxes in Cambodia consist of statutory rates, stipulated in the Customs Tariff Schedule. In general, the number of products and the level of applied export taxes (except for re-exports) continued to be very low and their contribution to government revenue negligible. However, export taxes on live animals and fish (10 per cent) burden on earnings of farmers and fishermen. In addition to the export tax, the Ministry of Agriculture, Forestry and Fisheries (MAFF) has granted a fish export monopoly to state owned enterprise, KAMFIMEX, which is under the Ministry's purview. Evidently, KAMFIMEX does not take physical delivery of fish, but instead licenses five export distributors to purchase all the fish and transport them across the Thai border. Distributors collect a 4 per cent fee on all fish transported in the province. Apparently, the export price is about 35 per cent of the retail price of fish sold in Phnom Penh, indicating that returns to fishermen are relatively low as a consequence of the distribution monopoly (see fisheries chapter).

Taxes are imposed on raw hides and skins and semi processed skins These taxes reduce the export price received by farmers and benefits producers using them as inputs such as processed (tanned) leather and leather related products. (Cambodia also imposes maximum tariff rates on semi-processed hides and tanned leather imports and on several leather based consumer products such as handbags and footwear.) However, the experiences of several other countries demonstrate that there are significant costs to such a strategy. Hides and skins for most part are by products of farmers' main activity of breeding animals for the food industry. Table 2.10 summarizes export controls and taxes.

An export tax, by reducing the domestic price farmers receive for raw hides, typically reduces the incentive for farmers to take care of the hides and this in turn reduces the quality of locally produced tanned leather. Local producers of leather related goods, especially those who want to compete in the lucrative international market (for example, manufacturers of footwear, handbags, travel cases etc) require international quality leather, which the local industry is typically unable to supply. While large exporters of footwear are able to source high quality leather at international prices through the duty exemption scheme, firms (especially SMEs) supplying the domestic market or who want to export some proportion of their products are restricted to purchasing low quality, higher priced domestically processed leather. This reduces the competitiveness of down-stream industries. Other countries such as Indonesia have recognized these adverse consequences on end users and have recently removed export taxes on local hides and skins as well as reduce tariff rates on imported processed leather.

There is a similar rationale for the export tax on semi processed wood, veneer sheets and sheets for plywood (there are no corresponding export taxes on finished products such as plywood, veneer panels and other laminated panels). Camcontrol, the government’s health standards and product quality inspection agency, also imposes a fee of 0.1 per cent on the value of all imported and exported goods.

2.10 **Selected products subject to export licensing and prohibitions**

Commodity	***Rationale***	***Measures and conditions***	***Responsible agency***
Prohibitions and Licensing			
For Public health, security reasons			
Logs and unprocessed timber	Forestry management	Prohibitions	Ministry of Agriculture, Fisheries and Forestry
Sawn timber	Forestry management	Prohibitions	Ministry of Agriculture, Fisheries and Forestry
Articles of processed wood	Forestry management	License	Ministry of Agriculture, Fisheries and Forestry
Cambodian antiques	Protection of culture	Prohibition	Ministry of Culture
Sandal wood	Protection of rare wood	Prohibition	Ministry of Agriculture, Fisheries, Forestry
Weapons	National security	Prohibition	Ministry of Defence/Interior
Vehicles/equipment for military use	National security	Prohibition	Ministry of Defence/Interior
Illicit drugs	Public health	Prohibited	Ministry of Health
Printing materials	Public morality	Prohibited if negative impact on society	Ministry of Education/Culture
Rice	Food security	Quota	Ministry of Agriculture, Fisheries and Forestry
Precious stones, raw gold	Monetary policy	License as long as declare items above $10 000	Central Bank of Cambodia
For economic reasons			
Textiles and garments	Bilateral agreement provisions	Export quota to US	Ministry of Industry/Commerce
	Bilateral agreement provisions	Export quota to EU	Ministry of Industry/Commerce
Footwear	Bilateral agreement provisions	Export license to EU	Ministry of Commerce
Pharmaceuticals and medical materials	Public health	Export license	Ministry of Health
Fish		Export monopoly granted to state enterprise	Ministry of Agriculture, Fisheries and Forestry
Live animals	Industry policy	Export license	Ministry of Agriculture, Fisheries and Forestry
Export taxes and other charges			
Garments	Visa fees	Implementation of garment visa system	Ministry of Commerce
Live horses and bovine animals	10% export tax		Ministry of Economy and Finance
Fish, live, fresh, chilled, fillet	10% export tax		Ministry of Economy and Finance
Raw hides, skins and semi processed skins	10% export tax		Ministry of Economy and Finance
Semi processed wood	10% export tax		Ministry of Economy and Finance
Veneer sheets and sheets for plywood and veneer panels	10% export tax		Ministry of Economy and Finance
Wood cases, boxes, casks etc	10% tax		Ministry of Economy and Finance
Used clothing	Unspecified export tax	Terminated in July 2001	Ministry of Economy and Finance
Camcontrol	Charges an inspection fee of 0.1% of value of exports and imports		

Source: Customs Department, Ministry of Economy and Finance.

Export promotion and investment incentives

Export and investment promotion policies of the Cambodian government are discussed in detail in the trade facilitation and investment sections below. Nevertheless, as these incentives affect the trade regime, we briefly discuss them in this section. Export and investment promotion, embodied in the law on Investment, has been a cornerstone of the government's investment strategy. Under the investment law, the CDC provides a wide range of tax incentives to investors approved by the agency. The law on investment also provides investor guarantees including: i) free repatriation of capital and profits derived from operations in Cambodia, ii) the purchase and sale of foreign exchange and iii) transfers and all other types of international settlements. These incentives are available to investors operating in sectors listed in the First Schedule of the Law on investment law. Available tax incentives include the following.

- Firms that export 80 per cent or more of their production are entitled to a duty exemption on the imports of capital goods and materials that are required for the production of goods for export.
- Non exporters are entitled to duty exemptions on imported goods up to one year with a possible one-year extension.
- A concessionary corporate profit tax rate of 9 per cent compared to the normal 20 per cent corporate tax rate is available to approved firms.
- A corporate tax holiday of up to 8 years can be awarded.

Based on a published criterion (in the form of a matrix) the government can offer corporate tax holidays of up to eight years. So far only a handful of investors have been awarded a tax holiday and none have been awarded for longer than four years. According to customs, more than 80 per cent of total duty and tax exemptions are derived from the Law on Investment.

Many countries provide various import duty exemption schemes to exporters, since sourcing materials at international prices is considered essential for exporters to remain internationally competitive. Fewer countries provide duty exemptions to investors supplying the domestic market and on imports of capital goods. Duty exemption schemes may include duty drawback facilities or duty suspension schemes or a straight duty exemption to exporters as in the case of Cambodia. All schemes have strengths and weaknesses. The advantage of duty exemption scheme or duty suspension schemes over a duty draw back facility is that they avoid tying up exporters' working capital in the scheme as they do not have to prepay duties, which they would have to do in the draw back facility. When interest rates are high the duty drawback facility can be expensive for exporters, especially if authorities delay the return of prepaid duties, which is a common complaint of exporters participating in these schemes in other countries.

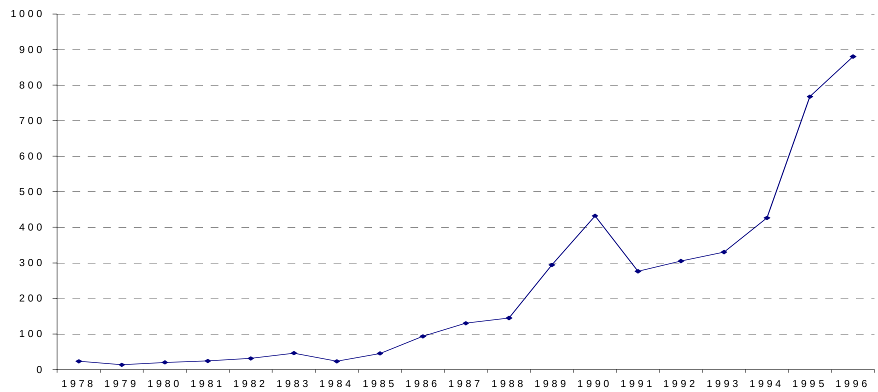
In Cambodia, investors entitled to import duty exemptions must provide the CDC with a detailed list of import requirements over the next 12 months. This list, known as the Master List, provides detail information on the type, volume and value of imported goods. A producer wishing to modify the lists must request permission from the CDC. For most firms, projecting such detailed information in advance is very difficult to do since demand conditions in their markets change frequently. This is particularly the case for garment producers. Demand conditions in the garment market constantly change from season to season and, thus, orders from overseas vary according to the season and the buyer's market. Therefore, to remain competitive it is paramount that garment producers remain flexible in their production process using the right materials and designs and delivering on time. This requires frequent changes in their fabric requirements and often modification of their sewing machines compatible with the requested designs and patterns. To overcome the inflexibility inherent in the Master List, producers need to anticipate all possible material requirements, thus, inflating their projected import needs in their Master List. CDC officials are empowered to modify this list if they have grounds to believe that the exporter is inflating material requirements. This is reported to often result in a 'negotiated' list, with all the attendant problems associated with discretion in the process. The CDC will carry out an audit of this list to ensure that the investor did import the goods as stated. Investors complain that this is a time consuming and costly exercise.

The RGC is currently considering ways to improve the investment process and reviewing the tax incentive regime in view of improving its effectiveness. Apart from import duty exemptions on materials required by exporters, and aside from the issue of WTO consistency, the effectiveness of tax incentives — such as tax holidays — for investment is uncertain. Proximity to markets, availability of skilled manpower at relatively low cost, adequacy of essential infrastructure and a stable economic, political and regulatory environment may be more important determinants than tax breaks on the investment decision process. Further, these arrangements come at a cost in terms of foregone budgetary revenue, impose a greater tax burden on those not entitled to tax breaks, and they cause distortions in terms of resource allocation (for example, oversupply, bottlenecks) between activities that receive concessions and those that do not. The Indonesian experience with tax holidays is recounted in box 2.11. The same lessons emerge from other countries. In Bangladesh, open ended tax holidays have been used extensively with no demonstrable impact on attracting FDI.

2.11 **The Indonesian experience with tax holidays**

Incentives for investment, most notably tax holidays, are common in many developing and developed economies. The main aim of these incentives is to encourage domestic investment and attract FDI, and thereby develop a local industry. While it is difficult to judge the extent to which the incentives have actually increased investment in Cambodia there are grounds for doubting their effectiveness, based on evidence for other countries in the region. Indonesia's own experience with tax holidays provides ample evidence that a country can attract investment without establishing discriminatory tax arrangements. In the 1970s and early 1980s Indonesia offered foreign investors tax holidays. But in 1984 Indonesia became one of the very few developing economies to eliminate tax holidays. At the time tax holidays were eliminated there were concerns that foreign investment to Indonesia would fall and that Indonesia would be left behind neighboring countries (whose government's offered tax holidays to investors) as Indonesia was then considered as a 'high cost' economy. New foreign investment did drop immediately after tax holidays were removed, but soon recovered and grew rapidly until the crisis in 1997. The return of foreign investment is clear from Figure I.

Number of Approved FDI Projects, 1978 to 1996



Source: Indonesian Investment Coordination Board 2001.

Perhaps most striking, Indonesia's share of regional FDI inflows actually increased after the Indonesian government eliminated tax holidays even though neighboring governments continued to offer substantial tax holidays. This is striking because if tax holidays were a decisive factor in the location decisions of investors then one would expect foreign investment in Indonesia to have fallen, or at least lagged behind that in other countries.

Such experiences with evaluation of tax holidays suggests that the cost of such measures (in terms of expenditure or tax revenue foregone) and other taxpayers may exceed the investment generated by the incentives. Their high cost is related to the difficulty in identifying incremental investment (that is, investment that would not be undertaken without the incentive). There are also other costs of a discriminatory tax arrangement. Since tax holidays result in a loss in tax revenues to the government, this would increase the budget deficit, which in turn put pressure on the government to cut back on expenditures. The lost tax revenues could be used for other competing economic and social priorities such as infrastructure development, education and health. Thus, where the government is under pressure to raise revenue for the budget the greater burden of taxation ultimately falls on those taxpayers subject to normal income taxes. In other words, other peoples' taxes must pay for the tax holiday given to selected investors. Under the Law on Investment, the CDC publishes a 'Negative Investment' list, which specifies sectors closed to foreign and or domestic investors and open to foreign investors with special conditions (see annex D for full listing of sectors). There are four categories:

- sectors closed to all investment
- sectors closed to foreign investment
- sectors open to foreign investment with restriction
- manufacturing related services (see table 2.12).

Sectors closed to all investors (12 sectors) are closed on environmental, public health or national security grounds. Two sectors (fresh water fishing, small scale mining) are closed to foreign investors on the grounds of protecting local, small scale enterprises. Sectors open with restrictions to foreign investors (11 sectors) are restricted for a variety of reasons, including local industry protection (cigarette production) or protection of small scale enterprises (food crops and livestock). New foreign cigarette producers are prohibited from producing and selling in the domestic market. Restrictions on the other sectors mainly include local equity participation and partnerships with farmers and small scale enterprises. The list leaves open the percentage of local equity participation indicating that this may be a negotiated outcome. The final category is called Manufacturing Related Services and only includes various forms of media and printing. Foreign participation is restricted to 49 per cent, and investment is subject to discussions with the Ministries of Information and Culture.

2.12 **Sectors included in the negative investment list**

Category	***Number of sectors***
Sectors absolutely closed to investments	12
Sectors closed to foreign ownership	3
Sectors open to foreign investment with certain restriction	11
Manufacturing related services	4
TOTAL	30

Source: Cambodian Development Commission.

With the exception of restrictions on foreign investment in cigarettes, alcoholic beverages and several agricultural sectors, the Investment List does not appear overly restrictive. Most of the sectors closed or restricted are done so on public health and security grounds and not to protect domestic producers. However there are two areas where clarity is needed and would improve transparency in the investment process. First, category three specifies 11 sectors open to foreign investment with certain conditions. This form of specification creates uncertainty for investors, as it does not classify the status of other sectors not included in the list. The investors may ask, if a sector is not included in category three, is it still open to foreign investment without restrictions and conditions? One way to reduce this uncertainty would be to replace category three with ‘sectors closed to foreign investment unless certain conditions are met’. This ‘negative list’ approach would improve transparency and predictability in the investment policy environment, as investors would know which sectors they were not permitted to invest in. A second area where improvement could be made relates to specifying the amount of required local equity participation in category three. As it is currently written category three creates uncertainty and is not transparent. To improve clarity and transparency in the negative investment list, the negative list should also specify these maximum ownership percentages.

The ASEAN Free Trade Area Agreement (AFTA)

Cambodia became the 10th member of ASEAN when it joined the regional grouping in April 1999 and has committed itself to a gradual reduction in almost all of its tariff rates to 0–5 per cent on imported goods from other ASEAN members by the year 2010. The Common Effective Preferential Trade Area (CEPT) process requires Cambodia to allocate all tariff lines or categories into one of three lists.

- Inclusion List: that includes goods for which the CEPT rates will be reduced either along the ‘normal’ or ‘fast’ tracks.
- Temporary Exclusion List: to be made up of goods that are viewed as too sensitive to be subject to immediate rate reductions.
- Sensitive List: products that are declared sensitive and will have a longer time frame for phase into the Inclusion List.
- General Exclusion List: that is intended to include a relatively small number of goods for which trade is restricted on the basis of safety or cultural reasons.

Annex E summarizes the main features of Cambodia’s reduction of tariff rates under the Agreement on the CEPT. Several pertinent features stand out. First, only 46 per cent of all tariff lines are in the Inclusion List. The bulk of goods are in the Temporary Exclusion List while the remaining 2.7 per cent of lines remain are in the restricted lists. The second feature is the very slow pace in reduction in tariff rates. Goods in the Inclusion List will not be fully liberalized to the 0–5 per cent range until 2007. Moreover, goods in the Temporary List will be phased into the Inclusion List only between 2005 and 2010 with the commitment that their tariff rates will be between 0–5 per cent by 2010. In contrast Vietnam intends to reduce all tariff rates in their Inclusion and Temporary Exclusion lists to the 0-5 per cent range by 2006 and Lao and Myanmar intend to phase in their reductions by 2008. It is important to recognize that goods on the Temporary Exclusion List would not be eligible for the lower CEPT tariff rates if exported to other ASEAN member states. A second point to note is that Cambodia can choose to accelerate its tariff reductions anytime.

There are good reasons for Cambodia to transfer virtually all goods from the Temporary Exclusion List to the Inclusion List immediately and accelerate tariff reductions to 0–5 per cent before 2007. First, by accelerating tariff reductions, this will make Cambodia a viable base for exports to ASEAN. But Cambodia will only be a potential site for ASEAN oriented investment only for those goods that can be exported to member countries at the lower CEPT tariff rates. For this to happen, goods must be on the Inclusion List and the transitional CEPT rate must be 20 per cent or less. A more effective way to establish Cambodia's place as a potential investment site would be to ensure that most tariff lines are immediately placed in the Inclusion List, and that the maximum rates are reduced to no more than 20 per cent, preferably less.

A second reason is the strong competition from the other new ASEAN Member States. Vietnam joined ASEAN in 1995 and Laos and Myanmar joined in 1997. While there are some important differences between each of these countries, there are also some similarities in their economies. It is likely that of the new ASEAN members, one or two will emerge as relatively more attractive investment centers than the others. This is because as investors look to locate ASEAN oriented investment in one of the low wage, new members, there will be a tendency to choose sites where other members are starting to grow. In other words, in this type of endeavor, success breeds success. By delaying tariff reductions, Cambodia is not taking the advantage in this process. For Cambodia to emerge as one of the more attractive platforms for investment, it will need to include a rapid and comprehensive integration into AFTA / CEPT framework thereby ensuring the best possible prospects for ASEAN oriented investment relative to her neighbors. This suggests the need for accelerating tariff reductions.

A third reason to accelerate the implementation of CEPT tariff rates is the need to establish predictability in its trade policies. The RGC government has foreshadowed that most goods will have preferential (CEPT) tariff rates between 0–5 per cent by the year 2010. However, nine years is a long time and the less clearly defined is this process, the less confidence investors will have. Stability and transparency are two essential characteristics of an effective industrialization strategy. However, the implementation of the CEPT system entails a large Temporary Exclusion List and this may create significant instability and uncertainty in the policy framework, especially during the next four to nine years when these goods would be phased into the Inclusion List.

It is important to note that in implementing CEPT tariff rates, there would be benefits if the difference between Cambodia's CEPT preferential tariff rates and her MFN rates for the rest of the world remain small. The reason is that the larger the difference between the two rates the greater the probability that the preferential trade area would divert Cambodia's trade away from the rest of the world to AFTA rather than create new trade for Cambodia. Recent analysis suggests that if this occur the benefits to Cambodia of joining AFTA would be small. Indeed, an increasing proportion of Cambodia's trade is with partners outside ASEAN and this will continue for many more years to come. Further, maintaining a big margin between CEPT rates and MFN rates encourages Cambodian firms to source more expensive materials from ASEAN producers. Thus, the Cambodian government might consider ways of reducing MFN rates in parallel with CEPT rates to keep the wedge between the two as small. This is permissible under AFTA. Indonesia, for example, has reduced its MFN rates in tandem with its CEPT rates. In 1999, Indonesia's simple average CEPT tariff rate was 7 per cent, while its simple average applied MFN rate was 9.5 per cent. Since then, Indonesia has reduced its applied MFN rates to 7.3 per cent.

WTO accession issues

Existing legislation, new draft legislation and implementation

The Council of Ministers has adopted a draft Legislation Action Plan which sets forth the legislative agenda for the years 2001, 2002, 2003 and 2004. Under this draft Legislation Action Plan, around 55 draft laws or regulations are planned to be adopted in order to complete the legal framework of Cambodia. In preparing, drafting, assessing and adopting these new laws and regulations, ministries are required to ensure full compliance with requirements under the WTO Agreements. Thus, various technical assistance projects are either underway or in preparation to support Government officials for the drafting and preparation of these laws and regulations and to ensure compliance with WTO requirements. The WTO specialist member of the Diagnostic Study team supported these activities. In order to cover all questions from Members of the Working Party in relation to draft laws and implementation, charts were prepared describing:

- each component of the National Legislation Program
- the Technical Assistance Projects required, and
- needs in training and dissemination to implement fully the laws and regulations in relation to the WTO Agreements.

Because the Cambodian legal framework is being almost entirely rebuilt and many of the new laws being drafted, will need to notably, implement WTO requirements. For other accessing countries, the main emphasis is reforming existing legal frameworks to comply with WTO requirements. However, for Cambodia, the main emphasis will be to adopt and implement new laws and regulations to complete the current deficient legal framework and, at the same time, to implement the provisions of the various WTO Agreements.

Component 1: full assessment of the existing laws and regulations

That said a number of existing laws and regulations need to be examined in order to ensure compliance with WTO requirements. To carry out such an assessment, the Government will need further technical assistance from experts on WTO matters. Such a team of experts could then work closely with Cambodian officials directly implicated in implementing the WTO requirements throughout the various ministries.

In many cases, for laws and regulations of a general nature (that is, commercial laws), no specific provisions of the WTO Agreements relate precisely to these issues. However, the general rules and principles of the WTO Agreements need to be respected by WTO members. The various WTO Agreements contain general rules which are likely to affect national legislation where the impact on international may not be immediately obvious.

Based on the assessment of the WTO Agreements, the fields on which WTO requirements will impact on national legislation are likely to be, mainly, the following:

- customs valuation
- intellectual property
- technical barriers to trade, and
- sanitary and phytosanitary measures.

Another significant priority area for Cambodia will be the due process requirements under Article X of the GATT 1994. Moreover, Cambodian officials preparing the GATS schedule will have to ensure that any restrictions in the services domain is properly recorded in that schedule. This assessment activity could proceed as follows: first, identify WTO requirements; second, identify all relevant laws and regulations; third, analyze those identified laws and regulations to assess their scope and effect on WTO related matters; fourth, propose amendments or additions required in offer to be in full compliance with the WTO agreements; fifth, assess work being done to endure that the identified laws and regulations comply with WTO requirements; and sixth, propose further action required to amend existing laws and regulations under component 2 hereafter.

A TA team could advise governmental entities responsible for the accession of Cambodia to the WTO. Such advisory work could cover, notably:

- the preparation of the various detailed documents required by WTO;
- the supervision and coordination of the technical assistance projects in relation to the drafting of new laws or regulations; and
- the detailed negotiations with other WTO members.

Moreover, as a least-developed country, the WTO agreements provide for Cambodia a number of special treatments and exemptions. These provisions raise technical issues of implementation and policy issues as to whether it is in Cambodia's interest to take advantage of them.

Component 2: detailed plan to adopt new laws and regulations and amend existing laws and regulations

The fields on which WTO requirements will impact on national legislation shall be, mainly, the following:

- customs valuation
- intellectual property
- technical barriers to trade, and
- sanitary and phytosanitary measures.

Another significant priority area for Cambodia will be the due process requirements under Article X of the GATT 1994. In addition, to these priorities areas, the Government intends to create a sound business environment upon joining the WTO by preparing and adopting a full range of new laws in order to establish a complete Commercial Code. The National Legislation Program involves adoption of laws such as Law on Business Enterprises, Law Establishing the Commercial Court, Commercial Contracts Law, Commercial Arbitration Law and laws on intellectual property. At a later stage, the Government will need to consider detailed rules and regulations governing issues such as Rules of Origin, Anti-Dumping and Countervailing Measures and Safeguard Measures.

National Legislation Program **-** The Cambodian Government has prepared a detailed program to adopt many laws and regulation to comply with WTO and built up a comprehensive legal framework. Around 55 legislative instruments have been identified and prepared by the National Assembly, the Council of Ministers and various ministries. Following further research and better comprehension of the WTO Agreements, the Government will add other laws or regulations to be adopted under the National Legislation Program.

As part of the Diagnostic Study, that specialist team members has prepared detailed charts for each law or regulation covering:

- draft law or regulation or contemplated law or regulation and general scope of the contemplated legislation or regulation;
- planned approval date and ministry/ies involved; and
- WTO Agreements implicated including a general outline, provisions on developing countries and least-developed countries and possibilities of technical assistance.

Technical Assistance Projects **-** In order to implement this National Legislation Program, the Government and various ministries have proposed various technical assistance projects, financed multilaterally and bilaterally, implicating foreign experts team. Some projects have been operating for some time, notably with Japanese experts on the Civil Code and the Civil Procedure Code, with the World Bank on drafting a Commercial Code and with the Asian Development Bank on drafting a new Land Law.

However, Cambodia still requires technical assistance to draft and adopt various legislative instruments required under the WTO Agreements. For example, detailed laws and regulations concerning sanitary and phytosanitary measures require a high level of expertise to be drafted and implemented. Moreover, specific agreements on issues such as safeguard measures, antidumping measures and countervailing measures raise issues of the policy desirability of such agreements as well as technical drafting requirements.

Component 3: Implementation and Training

The Working Party has also asked about the effective implementation of the proposed Legislation Action Plan. The 'Legal and Judicial Reform Strategy for Cambodia' has been adopted by the Council of Ministers and aims, notably, at improving the effective adoption of laws and regulations by the National Assembly and the Government. It is been presently implemented by the Government and is composed notably of a significant component on Law Making Process covering the following issues.

- *Implementation of coordination mechanism* - Coordination mechanisms need to cover coordination within Government and the Legislative Branch; coordination with the Private Sector; and coordination with the Civil Society.
- *Law Making Process as a Continuous Process* - Consultations amongst the various branches and agencies need to be a continuous process. Lack of clear policy-dictated direction in developing legislation appears to be the main cause of legislative failure.
- *Capacity Building in Law Making Process* - Capacity building at each of the institutions involved in the policy formulation, drafting, adoption of Cambodian legislation lies at the heart of any sustained effort to ensure the full success of the legal reform, the appreciation of the policies, institutional responsibilities, and the respect of the rights and the legal obligations arising from the adoption of new legislation. The shortage of highly skilled Cambodian lawyers means that much of this legal drafting is being done by international experts. As such, capacity building, while focusing on long-term needs, must also take into account the urgent priorities. When examining the training and retraining needs of government lawyers and legislative officers, one must consider the long or medium term objective of the administration, which is to have competent personnel equipped to deal with the legal issues confronting the country.

In ensuring implementation of new laws and regulations and training of Government officials, the Government will first need to do a full evaluation of the technical skills and expertise currently available in the Cambodian Government and the Cambodian society. Based on such evaluation, the technical assistance projects can be tailored to fulfil such formation needs.

Moreover, various international organizations such as WTO, IMF or ITC can provide permanent training and formation in respect of fields where skills and expertise would need to be developed. Once Cambodia has accessed WTO, permanent governmental entities responsible for monitoring WTO matters will need to be established.

Priorities for implementation

Several issues facing the RGC concerning trade policies and the strategy for implementing WTO trade rules emerged in the course of the diagnostic study. These were:

- the use of fixed or specific duties to overcome valuation issues;
- devising a strategy for Cambodia's binding tariff offers to other WTO member countries; and
- building institutional capacity to implement WTO rules.

An element of Cambodia's trade policy that may not be consistent with WTO rules is the prevalence of administered minimum or fixed dutiable values from which customs calculates trade taxes. This valuation system is clearly inconsistent with WTO rules. The WTO agreement on customs valuation provides for customs valuation based on the transaction value, that is, the price actually paid or payable for the goods when sold for export to the country of importation. Cambodia will need to look at ways of phasing out administered dutiable values currently used for several product groups. In this regard the RGC is seeking assistance from the New Zealand government on customs valuation. A second area where treatment might offend WTO rules is the differential tax treatment between imports and domestically produced goods. The WTO requires that the products of the territory of any WTO Member shall not be subject to internal taxes (for example, excise and VAT) in excess of those applied to like domestic products. In addition, those taxes shall not be applied so as to afford protection to domestic production. One example mentioned earlier was the exemption from VAT on domestically produced motorcycles for the domestic market, whereas imports of motorcycles are not VAT exempt.

A second issue relates to devising a strategy for setting binding tariff offers to other WTO member countries. Binding tariffs are the maximum tariff rates the government commits to when joining the WTO. In other words, the government promises other WTO member countries that it would not raise tariff rates above these bound levels. In practice, most countries set and keep applied tariff rates below these bound rates. There are two approaches on the level to bind rates. The first approach involves setting initially high bound tariff offers; the second view advocates setting low binding tariff offers. Both approaches have advantages and disadvantages. Setting high bound tariff rates might calm concerns of domestic interest groups that oppose trade liberalization by assuring them that the government will not give away the choice of raising tariffs in the future. Setting binding rates relatively low, say equal to or very close to current applied rates also has advantages. In particular low bound rates signal to the international investment community that the country is committed to an open trade regime and wishes to become a platform for investment. Crucially important, low binding tariff rates provide stability and certainty in the country's trade policy framework. As discussed in the section on AFTA, investors like a policy framework that is transparent and predictable. Setting bound rates close to current applied rates would achieve this predictability.

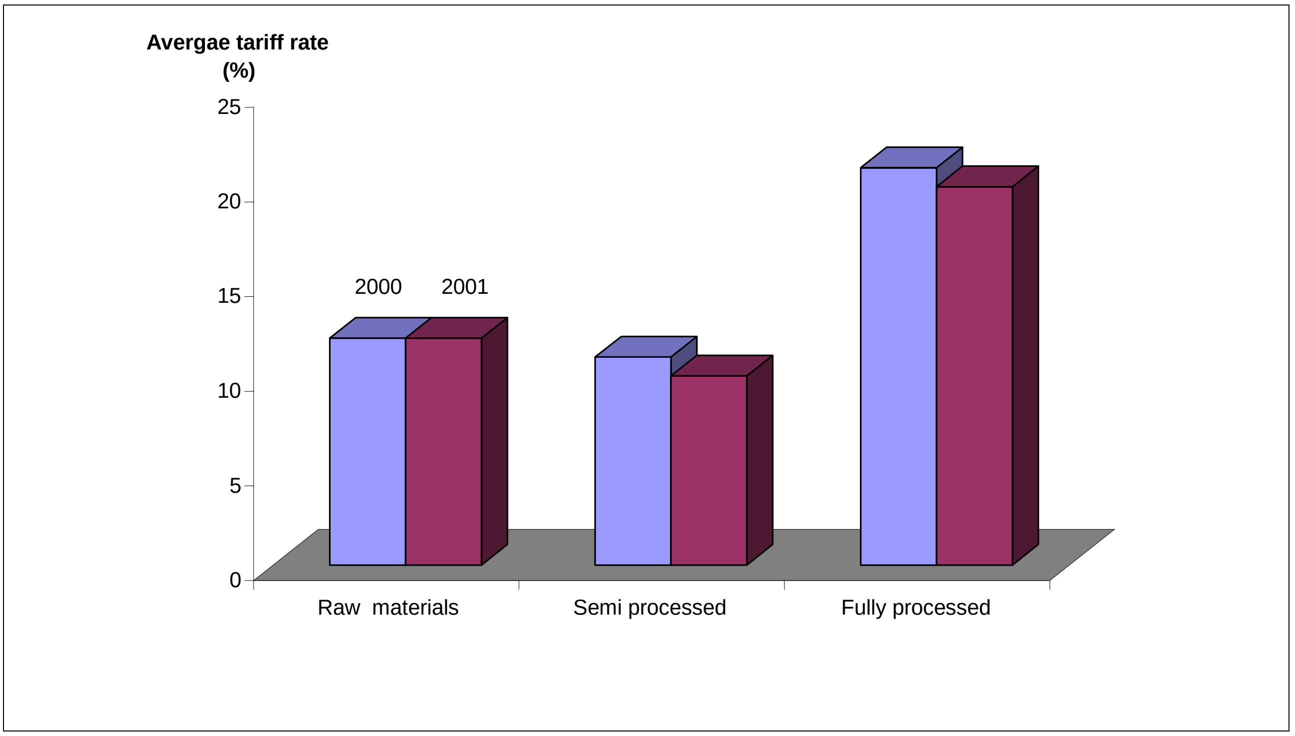
A third issue relates to building institutional capacity to implement WTO rules. As noted the RGC has set out a very ambitious legislative agenda to implement the WTO requirements. Examples include various intellectual property laws (four laws are proposed in this area); competition law, bankruptcy law, law on business enterprises, commercial contracts law, secured transaction law, law on rules of origin and various laws on antidumping and countervailing duties. Most of these laws are complex and will require the establishment of separate agencies to implement them. For example, a competition law would require a separate competition commission with its own staff of highly trained economic and legal technical experts. These laws are in addition to many other laws and institutions that the RGC has or intends to establish in both the economic and non economic areas not related to the government's WTO accession efforts.

Given this legislative load, the RGC administrative capacity will be stretched. It is also becoming clear that at this time and for some years to come the RGC may not have the administrative capacity to implement some of these complex laws. While the technical assistance canvassed in the preceding section will help, there may need to be a strategy to reprioritize legislative efforts. In particular, those commercial laws that are not fundamental to WTO accession or economic efficiency may need to be pushed back in time. Clearly some laws are important for improving economic governance and reducing the risk of doing business in Cambodia such as a land law, contracts law and bankruptcy law. Other laws which though important, may be deferrable include laws on antidumping and countervailing duties and competition. There are strong arguments against introducing laws on antidumping duties as many countries often use them as a disguised form of protection of local industries without considering the economic costs (that is, higher prices) this instrument has on end users and consumers of the product. Similarly, it is not clear that a competition law is appropriate at this stage of Cambodia's institutional development. The implementation of a competition law requires an independent commission with highly trained economic and legal experts as identifying anticompetitive behavior requires elaborate economic analysis and is data intensive. It might be more effective to concentrate limited government and donor resources on the commercial and economic laws that are key to reducing risk of doing business in Cambodia. In this regard technical assistance would be key to assisting the RGC to reprioritize the legislative agenda contemplated for WTO admittance.

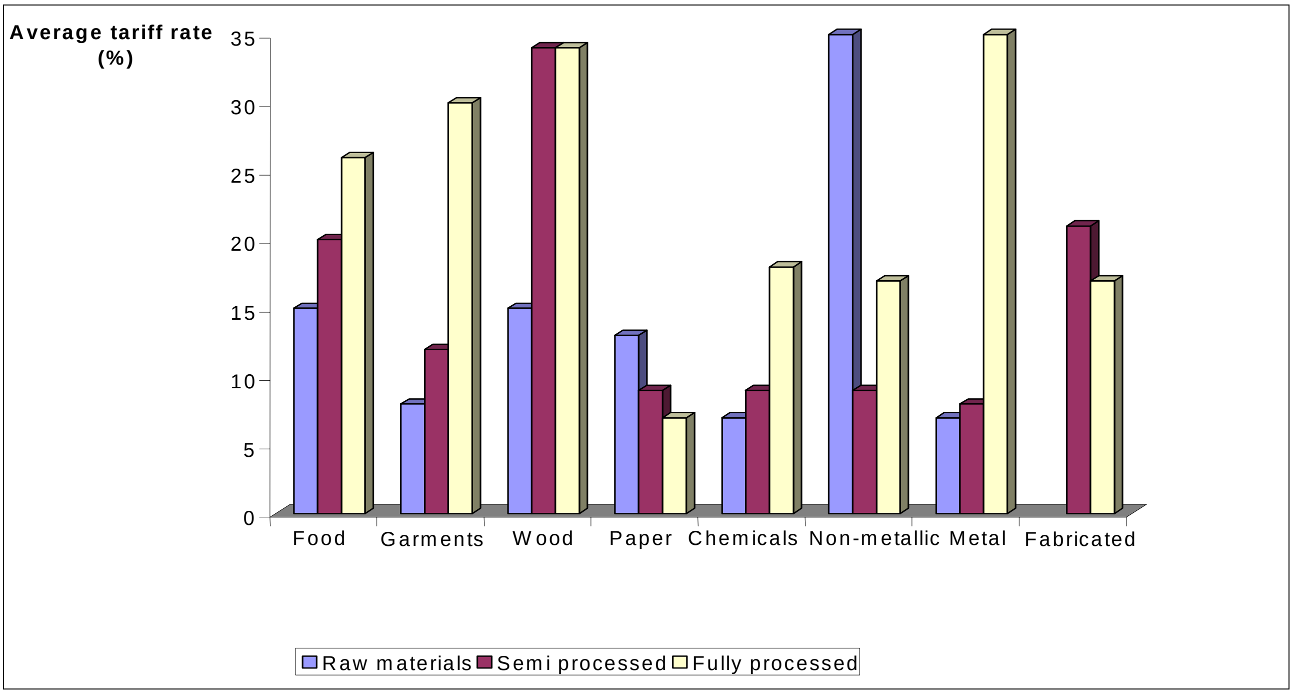
Interface between trade policies, industrial development and poverty alleviation

A notable feature of Cambodia's tariff structure is that the broad tariff bands corresponds more or less to whether goods are final goods or raw materials. This is referred as a 'cascading' tariff structure, since the rates cascade down, with higher rates for finished goods, to lower rates for intermediate goods and raw materials (see chart 2.13). This 'cascading' tariff structure has changed little since 1997. Chart 2.13 presents average tariffs for raw materials, semi processed manufactures and fully processed goods at the International Standards Industry Classification (ISIC) two digit level. It is apparent from chart 2.14 that several major sectors — food and beverages, textiles and garments, basic metal products — have very distinct 'cascading' tariff structures.

2.13 **Cambodia's cascading tariff structure**



2.14 **Cambodia's cascading tariff structure by sector in 2001, ISIC two digit**



This ‘cascading’ tariff structure has important implications for the government’s export led economic development and poverty alleviation strategy. By setting high tariffs on semi processed and consumer goods, Cambodians are required to pay above international prices for basic needs, unless smuggling of imported goods circumvents these high prices. Take the example of locally produced wheat flour. The tariff on wheat flour is 35 per cent. This duty has the effect of protecting the local wheat flour miller from cheaper imports. This means that downstream users of wheat flour (bakers, producers of processed foods, restaurants and home industries) must pay a relatively high price for wheat flour as an important ingredient into production of their goods. The higher costs of production are then passed onto consumers through higher retail prices. Since food makes up a large proportion of poor household’s expenditure, lowering import tariffs on these products would benefit poor households.

The ‘cascading’ tariff structure *is not consistent* with the Governments broad based industrial growth and development strategy. A central platform of the Royal Cambodian Government’s *First Socioeconomic Development Plan, 1996–2000* (SEDP) and the second SEDP2 (2001 to 2006) is reducing poverty by the promotion of rural and labor intensive industries via an export led development strategy. Given Cambodia’s small market size and low per capita income, this strategy seems most appropriate in achieving the RGC goals of high economic growth, employment and poverty reduction. In this context industrial and trade policies are linked. Trade policies, particularly tariffs, influence domestic prices and these in turn impact on investment and production decisions. Industries which do not face import competition because of tariffs, subsidies, and quantitative restrictions have an incentive to produce for the domestic market and not to export. It is sometimes argued that a country can protect designated import competing industries, while at the same time allow exporters to source imported materials at competitive world prices through various duty exemption schemes, thus, achieving the dual objective of promoting exports and import competing industries. Experience of other countries such as Sri Lanka, New Zealand, Indonesia and the Philippines that had adopted ‘import substitution’ strategies in the late 1960s, 1970s and early 1980s clearly show that protected import competing sectors became inefficient and unable to compete in the international market and consequently the country’s economic growth performance lagged behind those countries with a more outward orientation. Moreover, governments in many countries found it politically difficult to remove protection once it has been granted to industry. If a broad based export oriented approach is to be pursued, as in the case of Cambodia, a cascading rate structure inevitably sends the wrong signals (see chart 2.14 and box 2.15 reports on experiences with import substitution strategies in other countries).

Recently estimated effective rates of protection for a selection of Cambodian industries indicate that this is likely what is happening now. Effective rates of protection measure the degree to which trade policy has artificially increased the profitability of producing for the domestic market relative to export activities and, thus, signals a disincentive to produce for the export market. Table 2.16 presents estimates of effective rates of protection for a sample of Cambodian industries. These are rates prevailing in 1996–97. Given that the tariff structure has changed little over the last four years, the estimated ERPs and ranking of these industries will still be relevant. The weighted average ERP for this sample is 111 per cent. This level of effective protection is quite high *if it is indicative of the entire industrial sector*. These estimates were based on a small sample size of 50 firms surveyed in 1996. Thus, further analysis would be needed before the wider applicability of these estimates can be assumed. Nevertheless, the general picture that emerges is of relatively high but variable incentives resulting from tariff policies. Despite the shortcomings in the sample, this is likely to be a reasonable indicator of the results that would be obtained from a larger, more detailed analysis. The implication of these ERP estimates is that Cambodia’s tariff policy is structured in such away that it acts as a disincentive to export a wider range of products than currently being exported.

2.15 Experiences with import substitution strategies

In the 1960s and 1970s many countries adopted an industrialization strategy based on import substitution. Tariffs were used to provide incentives (effective protection) for selected industries. In the early stages of this strategy, activities engaged in the manufacture of consumer goods were viewed as the easiest targets for industrial development and the tariffs for these goods were raised relative to those of other goods (that is, cascading tariff structure). The original intention was that when these infant industries matured more types of final good manufacturers would be targeted and their tariff protection raised. These were to be followed by increased protection for the domestic production of intermediate goods, processed raw materials and capital goods in subsequent stages, thus, fostering industrial backward linkages. As experience in the 1970s and 1980s aptly demonstrated, this approach had serious flaws and the results were not as hoped. The first stage of the strategy was implemented and high levels of protection were established for many types of consumer goods. But in doing this the seeds of failure were sown. Many of these firms remained uncompetitive, which made it politically difficult to proceed to the second stage where the tariffs for intermediate goods used by these firms would be increased. As a result a powerful constituency was created that was able to block further implementation of the import strategy. Another significant outcome was that for many of these countries, the industrial base remained small in terms of contribution to value added and employment and relatively high cost when measured against international competition. As world markets became more integrated those countries that adopted import substitution strategies tended to grow slower than those countries that were more export oriented.

Several Asian countries had followed import substitution strategies in the 1970s and 1980s. The results were not as hoped and in response many of these countries implemented substantial trade policy reforms in the late 1980s and early 1990s. The experience of Indonesia aptly demonstrates that a more outward oriented strategy achieves greater results in terms of employment growth and poverty reduction. Indonesia followed an import substitution strategy in the 1970s and 1980s whereby tariffs followed a ‘cascading’ structure. However, by the early 1980s the industrial base remained small and inefficient, accounting for 16 per cent of gross domestic output. After a period of low economic growth in the early 1980s and a slump in oil prices in 1986, the government began to reform its trade policies. In 1986 the government introduced a duty drawback facility on raw materials and intermediate inputs for exporters and in a series of reform packages from 1986 to 1995 the government eliminated most non tariff barriers and reduced tariff rates on most goods. Unweighted average tariffs fell from over 25 per cent in 1986 to 7 per cent by 1999. As a result, Indonesia’s manufacturing sector grew rapidly, with annual growth in excess of 8 per cent for most years until 1997 when the currency crisis erupted. By 1995 the manufacturing sector accounted for 23 per cent of GDP. The engine of growth was exports of manufactured goods. At first, exports were heavily concentrated in garments, textiles and footwear, which accounted for about 65 per cent of total exports of manufactured goods at the end of the 1980s. Exports began to diversify in the early 1990s to include toys, electronics, furniture, and jewelry. By 2000, exports of manufactured goods accounted for over 65 per cent of total exports, up from 8 per cent in 1984.

2.16 **Estimates of effective rates of protection, 1997**

Activity	***ERP)***
	%
Mfgr of basic chemicals, except fertilizer	2279
Mfgr of wearing apparel	2268
Mfgr of rubber tyres etc	1007
Mfgr of wearing apparel	458
Mfgr of Dairy products	415
Mfgr of Tobacco products	411
Mfgr of metal containers etc	365
Mfgr of wearing apparel	329
Mfgr of other rubber products	273
Mfgr of malt liquors (beer)	144
Distilled beverages	142
Mfgr of soft drinks	136
Mfgr of structural non refactory clay and ceramic products	59
Mfgr of structural non refactory clay and ceramic products	41
Mfgr of structural non refactory clay and ceramic products	35
Mfgr of other rubber products	33
Mfgr of other rubber products	25

ERPs calculated from enterprise data.

Source: Cambodia: Strengthening the Foundation for Trade and Industrial Development, Report presented to the ADB and RGC (ADB TA No. 2570 CAM; 1997)

An appropriate tariff policy

The RGC's economic goals include higher rates of industrial growth and development based on an expansion and diversification of exports and improved competitiveness of import competing industries. If these goals are to be achieved to any significant degree, resources must be employed in their most productive uses. The dominant role of the private sector in allocating resources means that it is essential that policy based incentives do not distort their assessment of the returns to alternative investments. In other words, the large differences in effective rates of protection noted above need to be substantially eliminated. This in turn implies moving away from a cascading tariff structure. This indicates that the primary policy objective for the tariff system should be the adoption of a low, uniform tariff rate structure. In other words, a single tariff rate that applies to all or virtually all imports. The sole purpose of the tariff system would be as a source of revenue. The determination of the appropriate level of tariff rate would be set to achieve the required revenue. A low uniform rate on (or virtually) all imported capital goods, raw materials and finished goods would ensure that local producers are not disadvantaged *vis à vis* competing imports. A low uniform tariff rate typically discourages smuggling of imported goods and a low uniform of say 5 per cent with no exemptions would produce almost as much revenue as the prevailing system with probably much less bureaucratic costs..

To a large extent this is already the government's objective under the AFTA agreement; that is, to move to a 0–5 per cent tariff rate for virtually all goods imported from ASEAN member countries. Thus, the logical extension of this strategy is to reduce MFN rates in tandem with the preferential CEPT tariff reduction schedule. By reducing CEPT and MFN tariff rates in parallel with each other, any trade diversion arising from the ASEAN preferential trade agreement is eliminated. Although as indicated earlier there are good reasons to accelerate implementation of both CEPT and MFN tariff reductions.

Three important implementation issues need to be considered. First, what would be the status of the current duty exemption scheme under a uniform tariff rate policy; second, what is the revenue implication of such a policy; and third, what would be the short term adjustment costs to this strategy.

There is a strong economic case for retaining duty exemptions on materials required by exporters. Exporters need to be able to source materials at international prices to remain competitive. Producers of garments account for about 80 per cent of total value of duty exemptions. One approach for the garment industry would be to reduce tariff rates on imported materials and accessories to zero. (The tariff rate on the great majority of these items is currently 7 per cent.) This treatment would have little effect on customs revenue for the reason that most imported fabrics and accessories are already exempted from duties. Garment exporters would not have to maintain a Master List for imports of materials at CDC, as they are currently required to do under the duty exemption scheme and this would help reduce administration costs for both the garment industry and the government. A zero tariff policy for garment inputs would also help develop a competitive domestic oriented garment industry, as these firms would also be able to source materials at international prices. However, to avoid a distorted incentive regime, tariffs on finished garments (which are currently 35 per cent) would also be set to zero (see box 2.17). This option would only be viable for exporters operating in the garment (and also footwear) sector where it is possible to identify required imported inputs for which their demand dominates the demand of general importers. Rather than a zero tariff a low rate of 2 or 3 per cent combined with streamlining of procedures cold be an improvement over the existing state of affairs for exporters (lower costs overall) and the government (more) revenue but perhaps not for people relying on bureaucratic costs. In the case of new export industries some kind of duty exemption or rebate system needs to be examined.

2.17 Revenue implications of zero tariff rate on imports of textiles and garments

Customs data is used to estimate the lost revenue if the scheduled tariff rate on textile and garments was set to zero. Assume that most raw materials imported by exporters fall under the HS Chapter Headings of 50–55, 56–58 and semi processed and finished garments fall under Chapter Headings 60–62 of the Cambodian tariff schedule. From the Customs data, we are able to identify the total value of imports exempted from customs duty (that is, imports of materials by garment exporters) and the value of imports that were subject to custom duties (that is, general importers). The table below summarizes imports and revenue by textiles and garments.

Structure of Textile Imports and Customs Duty
(CR 000s, Year 2000)

	Exempted imports	*Dutiable imports*	*Revenue collected*
Textiles	1 119 034 502	30 926 780	2 344 220
Garments	588 096 317	3 861 570	1 219 564
Total	1 707 130 820	34 788 350	3 563 785

Notes: textiles refer to HS Chapter Headings 50–55, 56–58; Semi processed and finished garments refer to HS Chapter Headings 60–62.

As the table demonstrates, for those items imported by exporters of garments, the imports by such exporters dominate imports by general importers. In fact they account for 98 per cent of imports of such items and consequently only some CR3–4 billion of revenue would be lost if the tariff rate on all such items under HS Chapters 50–59 and 60–62 were reduced to zero.

Note: First semester 2001 Customs data was not available and 2000 data has been used for this exercise. There may be some underestimation of revenue loss, but since most imports under these Headings are exempted from duties this underestimation should be small. Also, tariff rates on almost all items under these Chapter Headings remain the same between 2000 and 2001 so no bias arises from the tariff structure itself.

There are good reasons for limiting exemptions to trade taxes for non exporters and on capital imports. First, it is always difficult to administer exemptions. This includes exemptions to government, donors, international organizations and NGOs. There are inevitably pressures applied to officials to expand the scope of imports receiving exemptions or to be flexible in applying regulations. Second, duty exemptions can distort purchasing decisions. It may be more efficient to purchase a good locally but it appears less expensive to import the good duty free. While it is often difficult to reduce exemptions for imports by aid and donor agencies, it is straightforward to end exemptions for government imports. This reduces distortions in allocating government resources, and also sets a proper example for the private sector. Moreover, as the tariff structure moves towards a low uniform rate over time, the need for duty exemptions on imports by non exporters will diminish. Finally, in moving towards a low uniform tariff rate, the administered minimum dutiable valuation system will need to be abolished to remove implicit surcharges inherent in this system.

A final issue relates to the adjustment costs of tariff policy reform. Countries that have liberalized their trade policy regimes have experienced to varying degrees short term adjustment costs. In particular, countries that had in the past made extensive use of tariff policy and non tariff barriers to protect their inefficient industrial bases typically experience the greatest adjustment costs. Often these costs included temporary, but high unemployment as inefficient sectors restructure and resources move to more productive uses. However, Cambodia is highly unlikely to face the same short term adjustment costs that some other countries experienced when they liberalized their trade structures. The reason is that, despite the inherent distortions in Cambodia's tariff structure, Cambodia does not have an inefficient industrial sector built around high tariffs. For many activities, remaining high tariff rates are redundant, either because little domestic activity is undertaken in these sectors or because smuggling of goods keeps domestic prices close to world prices.

As indicated earlier, most of the rapid growth in the industrial sector has been driven by export oriented sectors, notably garments and recently footwear. Instead, further tariff reform will produce greater benefits in the medium term. A low, uniform rate would signal to investors that Cambodia wishes to be a platform for investment in activities where Cambodia has a comparative advantage. This should attract new FDI in these sectors. A low, uniform tariff rate would allow investors to source raw materials at world prices (or close to them) and this ensures that producers supplying the domestic market (including SMEs) will not be disadvantaged *vis à vis* imports; this in turn encourages development of competitive import competing industries.

3 *Trade facilitation*

THIS CHAPTER EXAMINES constraints and potential improvements to the process of importing and exporting in Cambodia. Customs activities are discussed in most detail, with some consideration of trade finance and transportation. The chapter concludes by examining the draft law and strategy of the government's plan to introduce export processing zones in order to concentrate scarce infrastructure and trade facilitation resources.

The RGC has made significant improvements in processes and procedures for trade facilitation over recent years. Such improvements include:

- established seven public/private sector consultative working groups and held four public forums chaired by the Prime Minister over the last two years to discuss issues raised at the working groups;
- removed most import and export licensing requirements;
- removed the monopoly of Caminco and introduced new legislation facilitating the entry of foreign insurers;
- entered into a new two year agreement in October 2000 with SGS to conduct Pre-Shipment Inspections on goods imported into Cambodia;
- required agencies operating at border checkpoints to co-ordinate their activities and subject traders to only one inspection;
- attempted to streamline procedures for issuing Certificates of Origin to garment exporters; and
- established visa issuing facilities to individuals entering Cambodia at the major land border crossings.

The Working Groups are: Export Processing Industries; Manufacturing and Distribution; Energy and Infrastructure; Tourism; Law, Tax and Governance; Banking, Financial Services and Insurance; and Agro-processing.

Despite these achievements significant impediments to trade remain. These impediments reflect three themes that run throughout much of Cambodian administration. These themes are:

- procedural interventions by competing government agencies, underpinned by a general acceptance of activities which supplement very low civil service salaries;
- a lack of transparency and equitable enforcement of the law and a lack of redress from public decision making; and
- a lack of capacity in the administration of customs and sporadic enforcement of customs law.

Preconditions for customs reform

Strengthening the ability of the Customs and Excise Department (CED) to fulfil its trade facilitation mandate more efficiently will not be possible until a number of preconditions take place. These preconditions require giving CED the resources to be accountable and rationalizing the environment of external agencies with which CED shares the front line.

Customs accountability

Effective customs reform requires an environment where the interests of customs staff are allied to the efficiency goals of reform. But under existing conditions there are incentives for staff to increase rather than decrease the number and duration of human interventions in the processing of imports and exports in order to maximise their individual 'fee' income. One approach would be to reduce the number of processing steps and bundle informal payments previously paid at each step into one general payment. However, individual staff members would resist such a change unless they believe their share of the bundled 'fees' would not decline.

Cambodia's ratio of average annual civil service salary to GDP per capita was 1.1 per cent in 2001. This compares very unfavourably to the sub Saharan African average ratio of 5.8 in the mid 1990s and is well below private sector wages even for unskilled workers in Cambodia. (The 2001 annual minimum wage for unskilled garment workers in Cambodia is \$600–\$45 per month basic salary and a \$5 per month bonus for zero absentees.) The 1997 Socioeconomic Survey of Cambodia estimated a national poverty income line of \$0.50 per day, just \$0.10 less than the average civil service salary. Thus the pressures for Cambodian civil servants to engage in additional income generating activities just to meet basic household expenditures is substantial. The RGC is undertaking a Civil Service Reform strategy to increase civil service remuneration. However, by 2006 average compensation including allowances is planned to reach $49 a month and $86 per month for category A (non education) staff — expected to be about 21 per cent of the total civil service in 2006.

Few other government positions provide as much opportunity for accepting informal payments as the CED. The CED collected $222 million of revenue from imports in 2000. With 1 150 employees this represents an amount of $190 000 when averaged over every employee. Informally extracting even a small fraction of this sum from importers would significantly increase employee compensation.

Some evidence of the level of extraction is indicated by the size of the informal price ('concession fee') now required to secure a customs border post. It is widely accepted that CED employees bid to be appointed to key customs posts. The successful bidder recovers the cost of the concession fee by subjecting traders to informal fees. The value of the concession fee for a senior post is rumoured to have increased significantly, from $2 000 a few years ago to $10 000 today. Therefore, the successful bidder has to recover informal fees worth five times more from traders than in the past before breaking even. Furthermore, by distributing the informal payments among border staff and whoever receives the concession fee proceeds, a constituency is formed to oppose any change to the status quo.

Match accountability with reward

The recognised challenge is to regularise formal and informal staff remuneration into a transparent and equitable system. The idea would be to have salaries commensurate with the level of service expected from them in a modern customs organisation. Income from non-transparent informal fees could be factored into salaries, and be subject to enforcement of significant penalties for any acceptance of informal fees.

Many countries have improved customs accountability and efficiency by establishing revenue authorities operating independently of other government departments (see box 3.1). In countries where the civil service is constrained by limited labour and financial resources, revenue authorities have been able to enhance revenue collections at little additional cost.

One option for increasing the autonomy and accountability of the Customs Department, would be to negotiate performance targets with senior Customs management and revise the salary structure and level of employment of customs officers.

No matter what systems and incentives are in place to ensure that CED officials and traders act according to the rules, customs administration relies to a large extent upon the voluntary compliance of participants. A sense of fairness and a common respect for the rule of law encourages voluntary compliance. Therefore, enhancing the capacity of CED to achieve its objectives requires commitment at the most senior levels of Government to universal enforcement of customs laws. Traders and CED staff would be willing to co-operate and comply with customs policies and procedures if they knew that their compliance would be respected by all levels of society.

3.1 **Customs and revenue authorities**

Revenue Authorities are independent legal entities, autonomous from traditional line ministry governance. They are generally managed by a board of directors comprising public and private sector representatives and are accountable to the Minister of Finance or directly accountable to the legislative assembly. They are independent of the civil service personnel code and may set their own salary structure, often pegged to the private sector, as well as recruitment and termination policies. Supporting their greater levels of accountability and flexibility is their financial autonomy from budget appropriations. The Board contracts with the Minister to raise an expected level of revenue and to finance the operations of the authority from the revenue raised.

RAs generally combine customs and tax services in order to benefit from efficiencies of sharing administration costs, for example information technology, and joint auditing and intelligence gathering.

Uganda, Tanzania, Rwanda, Zambia, Malawi have recently restructured their customs departments into RAs in Africa, Latin America and Asia. In general, revenue evasion has declined while revenue collected per staff member has increased. In Tanzania revenue collected per customs staff member tripled after a revenue authority was established.

These benefits must be measured against the one-time costs of establishing the RA. Experience in East Africa shows that it is important to continue to address the underlying structural problems after the RA is established, that is, the legal system, procedural issues and information technology.

Rationalise the roles of other agencies at border check points

The public/private sector consultation working groups have been concerned at the number of government agencies involved in processing and inspecting imports and exports at Cambodia's borders. In response, at the fourth Public/Private Sector Forum in August 2001, the Prime Minister stated that the number of inspections at the border on imports and exports would be halved. How this is to be achieved is currently being assessed by concerned agencies. Current legislation permits any one of ten agencies to be represented at international checkpoints, with at least five always present.

A recent regulation, sub-decree number 64 (approved by the Prime Minister in July 2001), has tried to rationalise the presence of government agencies at border checkpoints. The Sub decree sets out the roles and responsibilities of certain agencies authorised to work at Cambodia's border checkpoints. Camcontrol, the Police Frontier Defence Department and CED are to be represented at every border checkpoint. Camcontrol is an agency established by the Ministry of Commerce to monitor the quality of imports and exports. See later in this chapter. KAMSAB is represented at both ports together with the port authority. KAMSAB is the Kampuchea Shipping Agency and Broker. KAMSAB is a state owned enterprise authorised to handle shipping agent and customs brokerage functions within Sihanoukville and Phnom Penh ports. In addition, at the 28 land and river border check points the 'chief' of the border operations is a representative of either the provincial governor or the administrator of the nearest provincial city.

The central government provides the local authorities significant input into the control of each border checkpoint. The responsibilities of the 'chief' include the following wide powers:

- take action to prevent harm to national sovereignty and territory, social safety and public order; and
- review the activities of each competent authority and report to the relevant ministry.

However, despite, the intent of the sub-decree to comprehensively regulate the activities of agencies at the border, the following agencies are authorised by other legislation and government agreements to conduct inspections and collect fees from traders.

- The Ministry of Agriculture administers sanitary and phytosanitary (SPS) controls on live animals, plants and foodstuffs of plant origin at the border (sub-decree number 98, 1983). Ministry officials inspect imports of these products and examine SPS certificates issued by the exporting country.
- Sub-decree 64 provides that the Frontier Defence Department be responsible for check point security and preventing smuggling, particularly of contraband. Another division of the police force, the economic police, have been inspecting goods entering and leaving the county. The formal role of the Economic Police is to assist Camcontrol to suppress fraud; however, they are the subject of numerous complaints from traders for zealously inspecting each shipment. (See WTO Q&A, July 2001.)

- Finally, it appears that at least one private organisation has been licensed by the Government to collect certain fees at the border. The Ministry of Economy and Finance contracted with a company to collect a tax on the export of used clothing at the Poipet border crossing with Thailand. However in *The Cambodia Daily*, page 9, 22 August 2001, the contract was canceled by the Ministry of Economy and Finance in July. Not only does it appear that the tax was not authorised by any law, but the CED considers that the $75 000 paid for the licence was equivalent to only two days of revenue collected from traders.

In addition to rationalising the role of these agencies sub-decree 64 seeks to co-ordinate the activities of the agencies. In this respect policies are having some effect, at least for agencies covered by the sub-decree. Article 25 provides that inspections may take place only once and any agency not present during the inspection cannot inspect the goods a second time. Both Camcontrol and CED state they are complying with this provision.

This duplication of agency intervention in the trading process raises the uncertainty and cost of both importing production inputs and exporting Cambodian products. The CED has the frontline responsibility for ensuring goods are properly declared and revenue collected. The CED could conduct most, if not all, of the inspection functions being conducted by other agencies. Skilled teams could be organised by CED to manage a risk based sample selection system for imports affecting health and safety. These teams may comprise representatives of other agencies Ministry of Health (MOH), MAFF or Camcontrol officials.

Without addressing the activities of other agencies at the borders, strengthening the capacity of CED will not, on its own, meet the Government's trade facilitation goals.

Civil service reform

The RGC has formulated a comprehensive strategy for rationalizing the composition and compensation of government employees. A civil service census began in mid 1999 leading to the elimination of 5 per cent of the workforce who were identified as 'ghost' workers. Between 2002 and 2006 job classification will been simplified into four basic categories based on education levels and a 'super category A' comprising senior officials. Average base salary and allowances will be increased to above the current minimum wage reaching about $49 in 2006. For example, maximum compensation for category A staff would be $92. Additional functional allowances will be provided to 2000 priority staff members. The overall civil service workforce would increase by 4.8 per cent reflecting a 16 per cent increase in education staffing and 18 per cent decrease in other sectors.

Transport

Four container shipping companies compete for the container traffic through Sihanoukville port. More shipping companies compete for the bulk cargo trade. Most containers are transhipped through Singapore.

The port and all transport related services within the port are government owned except for a new oil terminal which was built by a joint venture between Sokimex and Marubeni. Shipping operators regard the port to be well managed. Import volume handled by the port has increased significantly from 0.5 million tonnes in 1995 to 1.5 million tonnes in 2000. Most of this volume is bulk cargo — 0.55 million tonnes of cement and 0.3 million tonnes of fuel. Total exports have remained more stable at a modest 0.15 million tonnes. Exports are dominated by a rapid growth of garment containers making up for declining volumes of timber exports.

Port charges

Shipping profit margins are said to be so fine that the loss of one container can mean the operator makes a loss on that voyage. Competition has reduced the shipping rate for a container from Sihanoukville to Singapore by about 20 per cent over the past 12 months. A fee of $200 per container is charged from Sihanoukville to Singapore (1 000 km), this compares to an approximate fee of $230 for the longer distance from Bangkok to Singapore (1 500 km). Shipping operators blame their small margins on the high port charges. They argue that port charges are the highest in the region and four times higher than a comparably sized feeder port such as Songkhla in Thailand. Songkhla has a maximum annual capacity of 72 000 TEUs. Sihanoukville port handled about 65 000 containers in 2000. Sihanoukville Port provides all services, including stevedoring and cargo storage. The high cost of fuel discourages vessels from bunkering at the port. An example of an adverse effect of the high charges relates to use of the ports two new mobile cranes. High charges prompt shipping companies to serve the port with vessels fitted with on-board cranes, even though such vessels have higher operating costs than vessels without cranes.

Cambodian registered vessels are permitted a 20 per cent discount on all charges associated with navigating through the international channel and a 50 per cent discount on channel dues and 20 per cent discount on tonnage dues if involved in domestic cargo transport (proclamation number 53 PR PWT F, 17 January 1997). The treatment is inconsistent with WTO rules on non discrimination of transport charges.

The high port charges have contributed to a pre-tax port income in 2000 of CR 33 billion, or $5.28 per tonne of cargo handled (WTO Q&A July 2001). By comparison Bangkok port, although larger and able to spread its fixed costs over more ship visits and cargo earned $1.81 per tonne of cargo handled in 2000. The pre-tax income of Sihanoukville Port was exactly 50 per cent of its revenue in 2000, suggesting that the government is extracting a very rate of high return, given the port's position as the main international port in the country.

Port procedures

The pratique committee that greets each vessel comprises about 10 people, representing the port, CED, Immigration, Police and KAMSAB. KAMSAB is a state owned enterprise that is appointed by the port to handle shipping agency and customs brokerage functions within Sihanoukville and Phnom Penh ports. Its operations within both ports earn KAMSAB significant profits — CR 4 billion ($1 million) pre tax profit in 2000 — representing 68 per cent of its total revenue.

The size of the pratique committee appears to be unnecessarily large and involves agencies with little interest in the cargo carried or health conditions on board. The size could be explained by the reported practice of each member of the committee receiving an informal payment of $20.

Ten copies of the cargo manifest are given to CED. This is an unnecessarily high number of copies. The International Maritime Organisation Convention on Facilitation of International Maritime Traffic, 1965, recommends that public authorities require no more than four copies of the manifest. Shipping companies comment that it is possible to purchase copies of the cargo manifest of competitors in order to gain commercial information about rates and customers.

Foreign trade participants argue that for goods not being pre inspected only 25 per cent of the volume of goods shipped to Cambodia are being declared to CED for entry. This evidence derives from a comparison of ship's manifests with import declarations. The CED is apparently unaware of the extent of such under declaration. There appears to be no systematic reconciliation of all ship's manifests with import declarations. This would be an urgent area for change. Before CED becomes fully computerised, a stand alone manifest and declaration database could be constructed to reconcile cargo arrival with cargo clearance.

Although the port is able to handle vessels 24 hours a day, informal payments are necessary to encourage customs and immigration services to operate beyond 5pm (suggested to be $200–$300 per vessel). Also, despite average vessel turn around time of 10–12 hours, customs clearance still takes about 8 days for imports and 10–14 days for exports.

Phnom Penh port

Cambodia has traditionally relied upon river transportation. Phnom Penh port has been rehabilitated and can handle vessels up to 6000 DWT at high water. Over 95 per cent of cargo handled by the port is international. However, cargo volumes at the port have been declining recently and are now about 25 per cent of the volume handled by Sihanoukville port down from equality in the mid 1990s. The port handled about 45 000 tonnes of international trade and 10 000 tonnes of local trade in 1999 down from 640 000 tonnes and 22 000 tonnes respectively in 1997.

There are a number of reasons for this decline.

- The difficult current and variable depth have discouraged shipping.
- Vietnam requires boats transiting to Cambodia to use the Upper Mekong which is farther and is becoming increasingly shallow due to salutation.
- Boats transiting through Vietnam are inspected twice by customs and immigration in each country, upon entry and upon departure.
- Transit documents have to be approved by Vietnamese authorities as much as one month in advance of arrival of the vessel.
- Transit, port and cargo handling charges imposed by Cambodia and Vietnam are high compared to road transport costs from Phnom Penh to Sihanoukville.

In 2000, transit port and cargo handling charges were estimated to be about $20 per tonne, including charter costs, by the Mekong River Commission.(Vinning 2001). It costs about $7 per tonne to transport by road from Phnom Penh to Sihanoukville.

The recent transit trade agreement signed by Vietnam and Cambodia should ease these costs when ratified by the Government of Vietnam. Both governments have agreed to require only one inspection for transit trade within their countries. The agreement provides that the border check point office may approve transit through Vietnam rather than sending the documents to the Ministry of Transport in Ha Noi for approval. It also provides for transit of goods that are prohibited in one country being able to be transited through that country. This will permit certain chemicals to be imported by the Cambodian garment industry via Vietnam, that are prohibited or restricted for import into Vietnam.

Road transport

Inland road transportation has increased by an average of 400 000 tonnes each year since 1994 to 3.2 million tonnes in 1999. This is almost double the volume carried by sea or rail (JICA 2001).

The road transport industry in Cambodia is relatively competitive. Forty four land transport operators are registered with MOC and many more operators are unregistered. The presence of small, unregistered operators places downward pressure on road freight prices. These operators likely evade VAT and income tax and use smuggled petroleum. The 230 kilometre road journey along Cambodia's best road, NR–4, from Phnom Penh to Sihanoukville costs about $120–$185 for a container, which is lower than typical rates for an OECD country. However, rates increase on other roads that are subject to lower driving speeds of 20 to 50 km / hour due to the poor condition of the road. Rates for distances over 100 kilometres vary from 137 to 467 riel / tonne / km. Roads at the village level are often dirt tracks used only by ox carts.

Truck operators not only have to contend with poor road quality on provincial roads but illegal check points have been established by the police around towns and cities. Informal fees amounting to $10 were reported between Battambang and Phnom Penh, and as high as $60 between Takeo City and the Vietnamese border in July 2000. The informal fee for a container being trucked from Phnom Penh to Sihanoukville is $20 or between 11 per cent and 17 per cent of the formal freight rate.

Rail transport

Two domestic rail routes connect Phnom Penh with Poipet and Sihanoukville. Rail freight rates are about 20 per cent lower than road freight rates over these routes, however, the poor condition of the track limits capacity and speed. Rail only carried 270 000 tonnes of freight in 1999, or 8 per cent of the volume carried by road. Almost all freight carried by rail was bulk cement and petroleum. (In 1999 rail freight comprised 78 per cent cement and 10 per cent petroleum.) The RGC has estimated that track and rolling stock rehabilitation projects will cost $70 million. If rehabilitated and linked to the Thai rail network, the cost of bilateral trade could be reduced significantly, especially between provinces outside of Bangkok.

Border trade

Cambodia has opened more than thirty land and river crossing border check points with its neighbours – the majority with Thailand and nine with Vietnam. Exports to neighbouring countries are a small share of total exports that are dominated by the GSP garment trade with Europe and the US. However, Cambodia imported almost one third of its total reported imports from Thailand and Vietnam in the first half of this year – mainly petroleum.

Cambodia imported $46 million (about 10 per cent of total imports) of goods from Vietnam in the first six months of 2001, comprising mainly petroleum and some garment inputs. Cambodia exported $10 million of goods to Vietnam (about 2 per cent of total exports), comprising natural rubber and processed rubber trees, soybeans and disassembled motorcycles. Cambodia imported $93 million of goods (about 20 per cent of total imports) from Thailand over this period, comprising mainly petroleum and sugar, but also new motorcycles, construction material, garment inputs, rice and pharmaceuticals. Cambodia only exported about $2 million of fish, condensed milk and cigarettes to Thailand over this period. Reported trade with Lao PDR was very small.

Border markets have developed on the Thai side of the border where Cambodian farmers can sell their produce and purchase from a wide range of household goods. Cambodian residents of the border area are able to enter into Thailand and Vietnam using day passes authorised by the respective central governments to be issued locally. The cost of the pass is reported to be a disincentive to small farmers trading rice in the markets. However, Cambodians are able to return home and enter non-commercial quantities of goods duty and tax-free into Cambodia.

Cambodian border residents sell low value home grown produce but purchase much higher value household goods. Given their relatively low cost access to Thai consumers, border markets are likely to significantly contribute to the development of border household agricultural production. The RGC is aware of the potential of border markets and is discussing with the Thai Government ways to improve the operation of the markets at their Joint Thai–Cambodian Border Trade meeting scheduled for late September.

The border markets are also contributing to increased smuggling into Cambodia. Petroleum and beverage producers say that border residents are being organised to smuggle goods across the border. For example, border residents are reported to purchase portable tanks of nitrogen gas at the Thai border market carry them into Cambodia without paying duties and taxes and sell them to a local distributor. The distributor takes the tanks to Phnom Penh for resale.

Vietnam has banned the import of cigarettes and second hand goods, including vehicles, spare parts and electrical appliances (Article 5 of September 2000 Agreement on Transit of Goods between Cambodia and Vietnam). These goods are, therefore, at risk of being smuggled into Vietnam from Cambodia. Eyewitness reports suggest that warehouses exist in no man’s land between the two country’s borders. The warehouses are stocked with cigarettes supplied by trucks driven through the Cambodian check point. Individual Vietnamese conceal cartons of cigarettes under their shirts and deliver them over the Vietnamese border. Some observers consider that as much as 80 per cent of the cigarettes imported into Cambodia are smuggled into Vietnam.

The Government of Vietnam recently cracked down on this cigarette trade. One smuggler was sentenced to death, 22 government officials including 11 Customs officers were dismissed, convicted and imprisoned for 2 to 14 years. Both governments in August 2001 agreed to set up a working group to formulate a memorandum of understanding between their customs services. The memorandum is expected to cover controlling smuggling, simplifying procedures, exchange of information and human resource development. The RGC signed an memorandum of understanding (MOU) with Thai Customs in 1999. The parties agree to provide assistance when requested within the authority of their domestic laws. In particular the parties agree to assist in the research and evaluation of new procedures; train and exchange personnel; exchange information; co-operate to simplify and harmonize procedures and prevent and investigate offences.

As discussed above, a number of government agencies are involved with regulating foreign trade at Cambodia’s borders. Strengthening the ability of the CED to control border smuggling is not sufficient. All agencies should be committed to control smuggling and should co-ordinate their efforts.

Review of customs procedures and administration

IMF institutional strengthening of CED

Following a 1999 IMF review of CED administration after Cambodia joined ASEAN, a long term customs advisor began working with the CED in April 2001. A work plan has been agreed with CED management for the next two years that will seek to strengthen all aspects of CED's operations, including human resources, organisation structure, legislation, systems and procedures and infrastructure. Important elements of this review work involve transit control, control of exempt imports, cargo inspection, prepayment, advance rulings, and post clearance audit.

Draft Customs Law

The plan provides for the draft Customs Law to be reviewed against WTO requirements and revised as necessary over the next six months. The Government recognises the need to amend the draft law to comply with the WTO valuation agreement. The law was drafted in 1997 in French and Khmer; however, due to its length (339 articles) no English version yet exists. The draft law has remained with the Council of Ministers since 1998.

Overall, the draft law is a significant improvement upon the existing 7 page, 26 article Law on Import and Export Duties enacted in 1989, and provides sufficient powers of search and seizure and appropriate penalties. However, in its current form the draft does not meet the needs of a modern customs administration. There is an urgent need to enact suitable legislation clarifying the functions and powers of the CED.

The IMF advisor and a visiting consultant reviewed the draft law in August 2001. Initial concerns related to unnecessary repetition of text common to a number of articles and the detailed codification of administrative and judicial procedure. This detail is partly explained by the French legal structure of the draft and partly by the intention to reduce reliance on judicial review in Cambodia.

Another issue relates to what seems to be excessive powers provided to the CED. For example, the draft gives CED the power to seize any goods being transported without CED prior approval within 20 kilometres of the Thai border. Also, no provision is made for electronic commerce — the draft requires declarations to be in writing.

Until the new Customs Law is enacted no licensing rules exist to regulate the activities of customs brokers. Lack of common standards and a process to monitor and regulate brokers can raise CED administration costs. Or to put it another way, the establishment of a professional customs brokers service would efficiently deliver many of the public relations and education services is now likely to be inadequately provided by CED.

Business registration

Cambodian and foreign owned legal entities are free to import and export provided they first register with the Legal Department of the MOC at a cost of $68. Owners or their authorised representatives have to personally attest in the presence of Ministry officials the identity, location and legal form of their enterprise with copies of supporting documents. Every regular trader must also register for VAT at the Tax Department, regardless of their turnover.

The personal presence requirement adds to the cost of establishing a business for SMEs exporters and importers located in provincial centres and who have not already appointed a representative in Phnom Penh. Furthermore, the $68 fee is likely to be relatively high cost for SMEs while being trivial for large companies. A draft company law is being considered by the Council of Ministers — it could provide for a new fee scale reflecting the cost of registering and monitoring different forms of legal entity.

Licensing

Most import licences were removed in 1993. Import licences are now only required for pharmaceuticals and for imports of military equipment and gold and silver. Pharmaceutical importers first register the products to be imported with the Ministry of Health and then apply for an import licence for each product valid for six months.

The RGC does impose ad hoc limits on imports from time to time. Imports of live pigs and pork were banned last year for a period. Imports of used tires, shoes and handbags have recently been banned. Imports of any chemical that the Government considers may be used to manufacture narcotics must be approved by the MOH. The Public/Private Sector Consultative Working Group on export processing expressed a concern of the shoe industry that receiving approval for each chemical import from the MOH was expensive and cumbersome.

After the third public/private sector forum in February this year, the Council of Ministers agreed to permit investment enterprises to import chemical raw materials without MOH approval for individual imports, provided:

- MIME completes an initial technical evaluation for the chemical; and
- use of the chemical by the enterprise is monitored by a Committee comprising MOC, MOH, MIME, MEF, CDC and National Authority for Combating Drugs (Notification on 3rd Forum, 7 February 2001, 22 February 2001).

Simplified procedures for small volume traders

The VAT Law requires all importers and exporters to register for VAT. Importers comprise the largest group of businesses registered for VAT — 1 507 out of a total 2 747 VAT taxpayers by February 2001 (data provided by Tax Department to IMF). However, CED permits small irregular traders to import or export without registering for VAT, giving CED officials a discretionary power over traders. Furthermore, a simplified one-page form is used to apply for CED permission to import and export consignments valued at less than $300. This lowers the formal costs of trading for SMEs. There is a concern among freight forwarders that unless a good is regularly exported, CED and Camcontrol will delay clearing an uncommon export until they have consulted with all potentially interested government agencies. For example, a hotel waited three weeks before a consignment of fabric, in excess of its furnishing requirements, was cleared for export.

Transit control

Negligible trade transits through Cambodia en route to its neighbouring countries. Lao PDR trades through Thailand and Vietnam. For this reason, there has been little incentive to implement appropriate transit procedures along Cambodia's international frontier. Cambodia is subject to the ASEAN Framework Agreement on the Facilitation of Goods in Transit Agreement. Four of nine protocols have been signed by each member country (Types and Quantity of Road Vehicles, Technical Requirements of Vehicles, ASEAN Scheme of Compulsory Motor Vehicles Insurance, and Sanitary and Phytosanitary Measures). Countries have been considering the draft protocols dealing with designation of border posts and the customs transit system over the past year. At the ASEAN Customs meeting in Manila on 13–4 July 2001, Singapore encouraged members to reduce their list of prohibited and restricted goods annexed to the protocol in order to facilitate transit trade

Most transit cargo in Cambodia comprises goods transported in containers under seal from the port to be cleared at one of three dry ports in Phnom Penh. About half of all exports are consolidated into containers within the dry ports before proceeding to Sihanoukville Port. The dry ports are privately operated under a bond agreement between the operator and CED. The operators provide transport and storage facilities to owners of goods preparing goods for export or wanting to clear goods at the dry port rather than Sihanoukville port. Containers are transported under seal between the seaport and dry port.

Computer system

CED has a manual system of cargo reporting, declaration processing and revenue accounting. A small computer network has recently been upgraded to compile statistics from manually completed forms. A fully computerised system is urgently required to improve the efficiency of customs clearance, revenue accounting and data collection and analysis. In particular, all transactions would be processed in a consistent manner promoting equity and reducing the opportunity for corruption. Computerisation also enables more accurate systems of risk assessment, post-clearance auditing and duty drawback to be implemented.

A strategic plan for IT development and implementation was prepared in early 2001. SGS is providing limited IT technical assistance under its PSI contract with the Government. CED requires funding to purchase and implement an off-the-shelf system such as UNCTAD’s ASYCUDA or the French SOFIX system. The cost is likely to be in the range of $2.0 to $2.5 million.

The system adopted should be expandable to meet additional functions, as well as complying with international standards and local conditions, for example, supporting Khmer language applications. CED will require sufficient staff training and resources to be able to locally maintain and upgrade the system.

The IMF has recommended that system functions be implemented in the following order: i) manifest control; ii) tariff and documentation control; iii) basic import clearance; iv) revenue accounting; v) basic trade statistics; and vi) simplified valuation. Once the system is in place and is stable these functions can be strengthened in addition to adding export clearance, suspensive regimes and on-line links with users.

Pre-shipment inspection

During the planning and implementation phases of the comprehensive program to strengthen the enforcement capacity of CED, the RGC is relying upon Pre-Shipment Inspection to support the activities of CED and, in particular, to safeguard customs revenue. PSI is used to monitor imports, conduct physical verification of goods, and provide value and customs classification for revenue collection.

PSI was operating in Cambodia between September 1995 and July 1999. The RGC directly awarded the contract to SGS. However, due to contractual disputes the contract was suspended. An open tender for a new PSI service provider was held in 2000 and the tender awarded to SGS again. SGS has been operating under the new PSI contract since October 2000.

The new contract revises a number of features of the former contract, including the following:

- the exemption threshold is lowered from $5 000 to $4 000 in order to increase the coverage of PSI;
- SGS will reconcile all requests for imports (submitted by importers) and import clearances (issued by CED) against the reports of findings issued by SGS;
- the penalty for circumventing PSI is increased from 5 to 7 per cent of the value of the goods;
- SGS is providing training and a valuation database (Valuation Support Service (VSS) to improve the valuation capacity of CED staff members; and
- a working group of CED and SGS representatives meet every two weeks to discuss reconciliation results and other current issues.

Circumvention

Revenue is maximised if PSI inspects, classifies and values all assessable imports. However, for administrative ease, consignments with a value of less than $4 000 are exempt from PSI and may be declared directly to CED for admission. The RGC has also exempted duty-free imports by CDC registered exporters and certain dutiable goods from PSI, including cigarettes and government purchases.

Despite the reasonably broad PSI coverage of imports, industry observers suggest that importers are evading PSI on 60–70 per cent of their total dutiable imports. The Government is risking substantial revenue loss. Importers are choosing to clear dutiable goods through CED and pay the penalty, equal to 7 per cent of c.i.f. value, for not obtaining PSI from SGS. Importers are able to misrepresent to CED the quantity or value of their goods but are unable to interfere with the PSI assessment because inspection occurs in the exporting country.

Importers avoid post clearance audit on their under-valuation by classifying the goods as ‘other’. In 1999 SGS routinely reported that importers were undervaluing by 50 per cent or more the goods they requested SGS to inspect. The resulting payment of duties, taxes and the penalty is lower than the duties, taxes and 0.8 per cent fee that would be payable if assessed by SGS. Importers also attempt to avoid PSI by undervaluing and/or splitting consignments into loads worth less than $4 000.

In their latest monthly report to CED, SGS state that they have only assessed 63 per cent of the total revenue collected by CED this year. Adjusting total revenue for export taxes and taxes on goods exempt from PSI (of which the major class of goods is cigarettes representing about 10 per cent of total customs revenue) it still indicates that the 60–70 per cent of dutiable imports that are circumvented only contribute in the order of 30 per cent of total customs revenue. This represents significant foregone revenue for the Government.

Penalties for circumvention

Customs has been considering increasing the current penalty equal to 7 per cent of c.i.f. value for repeated PSI circumvention offences. SGS would like to see circumvention penalties strengthened even further. Goods could be seized and auctioned. The auction proceeds could be shared between the Government and Customs officers responsible for the seizure. The current customs law provides for CED to reward customs officials and other co-operating agencies from penalties imposed on customs offenders.

Reconciliation of ROF with duties collected

SGS is also concerned that CED is not returning the Report of Findings to SGS after the goods have been cleared for entry. For a PSI system to work properly the report of findings (ROF) needs to be endorsed with the duties and taxes actually collected by CED. Therefore, SGS has been unable to reconcile revenue collected by CED against revenue assessed by SGS. All border post customs officials are required to collect duties and taxes in line with the assessment made by SGS — without further approval from CED headquarters. CED has now agreed to provide SGS with the ROF endorsed with a breakdown of duty, VAT, excise and fees paid.

Unsealed containers

SGS is concerned that CED are opening and inspecting containers that have already been examined by SGS and carry the SGS seal. Customs says it inspects a small share of containers and that many SGS inspected containers are arriving without seals and have not been properly inspected before their departure. (One estimate puts the share of inspected containers arriving without seals at 43 per cent of the total.) SGS point out that some inspected containers may arrive unsealed, mainly because shipping lines reserve the right to containerize some time after inspection or a consolidator containerizes different inspected consignments.

In order to maximize trade facilitation, CED should only re-inspect containers sealed by SGS when there is a clear discrepancy. When practical, SGS could be present during such inspections to confirm the discrepancy and the findings of the second inspection.

CED suggests that SGS inspections are too slow and that valuations and tariff classification are often incorrect. Delays may encourage importers to avoid PSI. Freight forwarders estimate that a PSI consignment takes 2–3 days to be delivered compared to approximately two days if PSI is avoided — this is important for perishable goods. This is a significant problem for urgent containers arriving unsealed and triggering an inspection from CED and Camcontrol.

Both sides are working through their differences according to the terms of the contract in their biweekly working groups. The situation could be helped if RGC puts the role of SGS into perspective — as part of a capacity building program for customs administration. RGC, the CED and SGS could agree on a realistic time frame for the CED to take over the functions of SGS.

Valuation

In order to ease the task of valuing goods and limit under declaration of value by importers, the CED has established set prices for a range of goods to be used by its officials. (Set prices apply to 400 classes of goods, including petroleum, cigarettes, motor vehicles and motor cycles, used appliances, cement, cooking oil, used clothing, steel and iron, generators.) In general, CED sets determined prices at levels lower than market values in order to encourage their declaration and payment of taxes and duties. This is particularly the case for cigarettes and used electrical appliances, which are at risk of being smuggled into Vietnam.

In the past, CED requested SGS to use its determined values rather than the export country fair market values maintained by SGS's own database. Importers may have complained that SGS market prices are higher than the determined prices. At their meeting in August, CED and SGS agreed that SGS will use the higher of the two values. The only exception is petroleum which is valued according to the determined price.

CED uses the Valuation Support Service provided by SGS to value goods that do not have determined prices and are either exempt from PSI or have evaded PSI. VSS is in place at the airport and in Phnom Penh. Check points at other borders only have the authority to value goods up to $1 200, and must seek the approval of CED Head Quarters above this value.

The current PSI agreement does not comply with the WTO valuation agreement. RGC has informed WTO members that SGS will adopt compliant valuation method after Cambodia's accession. The New Zealand Customs Service has commenced providing WTO compliant valuation training to CED staff. Furthermore, the PSI fee (0.8 per cent of the fob value) charged by SGS is not WTO compliant. Circumvention may increase for low value shipments when SGS adopts a compliant pricing policy because a new fee structure would set a minimum and maximum fee per container inspected.

Under declaration of quantity

The recent SGS valuation training appears to have been effective at detecting under declarations of value. Concern has shifted to under declarations of quantity. Industry observers consider that only 25 per cent of the true volume of goods shipped to Cambodia are being declared to CED. Such under declaration of quantity raises two concerns:

- much of this under declaration of quantity is of duty-free imports used to produce garment exports. Exempt exporters may be smuggling dutiable imports in their containers of exempt imports; and
- other imports are evading PSI and being under-declared to CED.

CED could address under declaration of quantity by rigorously reconciling goods listed in cargo manifests against goods actually declared to CED.

Smuggling

Cambodia has a number of features that tend to encourage smuggling and result in revenue loss for the Government. Firstly, the country has long and remote land borders with three countries. Many rivers cross into Vietnam and many bays line the coastline. Secondly, import duties and taxes are relatively high on goods able to be smuggled — consumer goods and petroleum. Thirdly, as discussed in the first section of this chapter, CED officials are underpaid not well resourced and are poorly paid.

Fighting smuggling and increasing revenue collection involves a number of policy and administrative interventions. Lowering the returns to smuggling, that is, lowering customs duties on consumer goods, and raising the costs of smuggling, that is, increasing the chances of being caught and the level of penalties, can actually increase net revenue collection. Improving the chances of being caught involves not just increasing the anti smuggling capacity of the CED, but also raising salaries and co-operating closely with neighboring customs administrations.

The petroleum distribution companies, Nestle, Coca Cola and the Pepsi franchise holder are very concerned over the level of smuggling of competitor's products and smuggling of their own brands from Thailand into Cambodia. This lack of expected import protection is driving demands for tax incentives.

A study prepared for the Manufacturing and Distribution Working Group estimated that $35 million was foregone per year from the smuggling of beverages, petroleum and milk products into Cambodia (see the Minutes of the Working Group on Manufacturing and Distribution, 22 March 2001). These three goods were considered to be the most profitable to smuggle into the country due to their high rates of import tariff. The group considered that the recently enacted Product Quality and Safety Law should be rigorously enforced to ensure that domestically produced and legally imported food products are labelled in Khmer.

Armed threats reduce ability of customs to collect revenue from car imports. Only 10 Toyota Land Cruisers were assessed for duties and taxes in 2000, despite 149 410 cars being registered with the Ministry of Transport in 1999 (Tait, Benon and Simard 2001 and National Institute of Statistics Yearbook 2000).

RGC has acted to address these smuggling concerns. A mobile anti-smuggling task force comprising 100 officers work has been established by CED, with support from a military police unit, to operate on main roads leading from sea and road check-points. The task force determines if goods have circumvented the CED check point upon their entry into Cambodia. In the first quarter of 2001 the task force filed 300 cases of smuggling contributing CR0 0.7 billion. In 2000, 1066 cases of smuggling were filed. The task force also visits businesses suspected of possessing smuggled goods and patrols land and river borders.

Export procedures

The Government has lifted most export taxes and non-automatic licensing arrangements. The majority of exports only require an export declaration to be completed in triplicate accompanied by the invoice and packing list. However, export licences remain on certain goods in order to conserve the environment (wood products including furniture and plywood), food security (rice and fish) and protect to antiquities being removed from the country (handicrafts). The EU requires licences to demonstrate Cambodian origin for exports of shoes and garments.

Although the fixed quantity licences can be extended for a further 45 days, having to apply for four licences a year imposes unnecessary transaction costs on exporters. The law on commercial invoices for garments provides for six-month licences on garments exported to the EU, although such licences do not serve to limit exports of garments. Only inspection of the consignments will determine if the exporter is in breach of any quantitative restrictions imposed upon him.

In practice, at least one freight forwarder commented that unless a clear process was in place, customs officials were unwilling to approve uncommon exports. Only about a dozen categories of goods are exported from Cambodia and garments and shoes comprised 92 per cent of total exports in 2000. Informal payments and uncertain procedures discourage SMEs from exporting low-volume exports. MOC agreed to an issue raised by the public/private sector export processing working group that export licences fees were discouraging SMEs exporting handicrafts.

Small farmers have expressed concern over obtaining licences to export rice and fish (see fishing and garment sector chapters). A recent study estimates the costs of exporting one tonne of rice to comprise $5 of formal fees (for Camcontrol phytosanitary inspection and rice handling) and $9 of informal fees paid to each of the six agencies involved (CED, Camcontrol, phytosanitary inspector, economic police, border police, and handling workers). These costs represent 10–15 per cent reduction in the farmgate price on one tonne of exported paddy (Sik Boreak 2000)

Garment exports

In addition to the trade diversion costs, the quantitative restrictions placed on garment imports by many developed countries impose considerable administration and compliance costs in developing countries. The Cambodian authorities have entered into textile agreements with the US and EU to manage quota access to these markets for Cambodian garment producers. It is in the interest of both producers and the government to facilitate this trade. However, the government has to implement a system to ensure that garment makers comply with local content rules and to defend the country's quota access from third country producers disguising their garment exports as having a Cambodian origin.

Table 3.2 outlines the documentary steps required to export garments to a country requiring proof of origin. The following table summaries these requirements. The final column shows the total compliance costs per consignment, these may be highlighted as follows.

- Five different government agencies are involved in the process.
- At least three different inspections are undertaken with the option of a forth inspection.
- Visa fees paid per dozen pieces dominate formal costs. The example given is for a consignment to the EU which has the lowest visa fee of 10 cents per dozen. The most common garment export to the US in 2000 was 347/348, costing $1.28 per dozen pieces. Using these visa fees in the example would increase the formal cost to $728 or $6 758 for the consignments of 500 and 5000 dozen pieces respectively.
- Informal fees are modest but can exceed formal fees for low value consignments.
- 10 original and 22 copies of original documents are required.

UN ESCAP alignment of trade documents

In 1997–98 the UN Economic and Social Commission for Asia and the Pacific (ESCAP) funded a project to compare Cambodia's trade documents with the 1981 UN Layout Key for Trade Documents. The project team recommended a number of changes to Cambodia's trade documents.

- Eliminating application letters by requiring the trader to complete the form being requested and declaring on the form that the particulars are correct. MOC has so far resisted giving blank forms to traders to complete. Ministry officials are concerned that non-quota holders or foreign manufacturers will use the forms to gain fraudulent Cambodian Certificates of Origin.

- Using the same form when requiring the approval of different government agencies. The project team recommended that the licence forms for importing and exporting be combined and signed by all relevant agencies. Most import and export licences have been eliminated, and those that remain are specific to the relevant government agency. Import licences are now only required for military imports, pharmaceuticals, gold and silver. Export licences are limited to military exports, wood products and handicrafts, rice and certain garments and shoes. Therefore, there exists less need to modify the process.

However, the Certificate of Processing and Certificate of Quantity could be combined into a single site inspection form. Any inspections that take place could be recorded in different sections of the single form by the relevant agency. Furthermore, one general form could be used to replace the Temporary Export Authorization (TEA), Export License (EL), Certificate of Origin (CO) and Commercial Invoice (CI)– the current forms being used are virtually identical. A final stamp could indicate a change in the status of the document from being temporary to being a final proof of origin.

- Various additions and deletions of data fields and changes to field headings to conform to the UN Layout Key, including: 27 changes to the Customs Declaration form, 2 changes to the Certificate of Processing form, 6 changes to the TEA form. It appears that few if any of these recommended changes have been adopted.
- The RGC should accept copies of supporting documents rather than the original document. Although the government is concerned about fraudulent applications, in practice at least one agency, CED, accepts copies of supporting documents.

3.2 Process to obtain Certificate of Origin for garment export

	Certificate of processing	Temporary Export Authorization	Certificate of quantity	Export declaration	Export Licence	Certificate of Origin & commercial invoice	Total per consignment
Purpose	Verify production	Verify production	Verify loading Qty and price	Record exports	Market access to EU	CI for US, CO for other GSP	
Agency	MIME	TP Dept, MOC	Camcontrol/ Customs	Customs	FT Department, MOC	TP Department, MOC	3 Ministries 5 Departments
Inspection	Inspect factory	Inspect factory	Joint visit of factory	Joint review of seals at port	NA		Maximum of 4 inspections
Time to Issue (days)	3	1-2	3	2	2		Minimum of 2 weeks
Formal cost $ per consignment	20	Included in EL and CO/CI cost	0.1% FOB	4	4=EL, 30=CI/CO, 50=CO(formA) 0.10–1.28 per doz pieces EU/US		for example $138 or $858[1]
Informal cost $	20-30		?	?	10-14	90-120[2]	$110-150
No of Copies	1 original ? 3 copies ?	1 original 3 copies	1 original ? 3 copies ?	3 original	3 original 5 copies	1 original 8 copies	10 original 22 copies
Authorised	Minister of MIME	Director TPD	Director of Camcontrol	Royal Delegate	Under Secretary of State		
Supporting documents	Application letter Invoice Packing list Contract Pdn report	Application form Draft CO/I, EL CP Invoice Packing list Contract Receipt of fee	None	TEA or EL Invoice Packing list	TEA, Certificate of Quantity Bill of Lading Export Declaration Certificates of Origin of ASEAN sourced raw materials		6 main documents, 5 supporting documents. Application letter

1) Based on two consignments of 500 and 5 000 dozen pieces valued at $30 000 destined for the EU and subject to the minimum visa fee per dozen pieces of 10 cents. One of GMAC's questions to MOC states that 200 dozen pieces could be produced in one day. The other formal and informal fees for the $30 000 and the $300 000 consignments are equivalent to tariffs of 0.8% and 0.3% respectively.

2) Additional $100 if only 2 or 3 CI applications. These amounts are doubled for urgent cases. (Source GMAC Q&A December 2000)

Source: Prakas 1437 1999, ESCAP 1998, Conversation with CED, FTD and TPD officials, GMAC 2001UN ESCAP Alignment of Trade Documents

Garment Manufacturer's Association of Cambodia (GMAC) concerns

In preparation for the third public / private sector consultative forum held in February 2001, the Garment Manufacturers Association of Cambodia submitted a set of proposals and concerns to the MOC concerning garment export procedures. Some of the questions and the response of Ministry officials are outlined below.

- Discontinue the inspection by the Trade Preference Department (TPD) prior to issue of the TEA. The Certificate of Processing should be sufficient to demonstrate the garments will be produced at the factory. According to MOC both inspections are necessary to ensure proof of origin. However, Certificate of Processing is no longer a prerequisite for the TEA inspection.

- The TEA is unnecessary. MOC respond that the TEA helps eliminate data discrepancies.
- COs are no longer necessary for all export destinations, for example, Malaysia and Singapore, yet MOC requires investors to apply for Certificate of Origin.
- Garment manufacturers are required to 'run' all documents through different officials in different departments. MOC responds that it has set up a window with a 48 hour turnaround for Certificate of Origin and CI. A closed circuit camera has been installed to monitor 'running'.
- Officials delay responding to requests and seek higher informal payments when work is urgent. MOC responds that it has streamlined the process, fixed time limits for TEA and CO/CI approval, appointed proxies when the authorised signatory is not available and have made their staff available at night and on public holidays.
- Amendments to the TEA or Commercial Invoice require the exporter to undergo another factory inspection and retrieve the CO or CI from CED and Camcontrol, adding another week to the approval process. MOC responds that a repeat inspection is unnecessary and MOC shall inform CED and Camcontrol of the amended CO or CI without need to retrieve documents.
- Quota transfer fees are high, should be a nominal \$10–20. According to MOC the matter is under consideration.

Options for change

The Trade Preferences Department has commenced using electronic verification of garment exports to the US (ELVIS) and to the EU. This provides a chance for the RGC to revise the import and export documentation process.

Currently traders complete an application letter *and* a draft of the final form, repeating much of the same information. Data from the draft form is then transcribed on to the final form by TPD officials. Traders could prepare the forms electronically and email or deliver by diskette to the Ministry of Commerce. The trader could execute the declaration through an electronic signature or physical signature on the printed form. Such forms could be available on the website under construction by MOC.

The Ministry could keep track of a trader's application by generating a unique code to refer to the trader and communicating this code only with GSP authorities in the export markets. The Ministry currently uses a unique code to verify garments shipped to the US. This may simplify the process but it cannot convert the current paper documents into an electronic process. A file is still necessary to hold the supporting documents.

Monitoring tax and duty free imports

Currently investors registered with CDC exporting 80 per cent or more of their total output are exempt from customs duties on all imported inputs, other investors can only be exempted on their imports of construction material and capital equipment in their first year of operation. In order to ensure that exempt investors only import goods appropriate to their business activities exporters negotiate a list of goods and prescribed quantities that may be imported duty and tax-free. This Master List is negotiated between CDC and the investor each year and more frequently when the investor requests additional goods. CDC determines the quantities according to the production capacity of the firm and its previous inventory levels and seeks the approval of the Royal Delegate of CED.

Once the Master List is approved the processing of imports subject to the Master List is relatively straightforward. For each consignment, the broker/importer prepares and submits three copies of a letter seeking permission to import the goods duty free, noting the description and quantity of the goods, place of importation, invoice date and number. Copies of the invoice and bill of lading are attached. The Control Office checks off the volume of each consignment against the allowable quantity of the commodity in the Master List held by the Control Office.

Five Customs officers separately check and sign each document, including the Royal Delegate of Customs who signs every page of the applicant's file. Customs staff state that this process only takes one day if all officers are present. The Royal Delegate can delegate his authority to approve the application during his absence from the office.

Problems with Master List system

Despite recent improvements in the approval process – the approval of the Minister of Finance is no longer required — there are a number of problems with this system.

- Unscrupulous exempt investors face both incentive and opportunity to overstate the variety and volume of goods they require in order to operate their businesses. These surplus duty and tax-free goods are at risk of being sold in the domestic market. Alternatively excessive volumes of permitted exempt goods can be used to hide the volume of non-exempt goods being smuggled in the container. Customs can only become aware that import volumes may be excessive once the volume permitted by the Master List is exhausted — long after the goods have been admitted. Customs officers suggest that in practice CDC does not have the resources to accurately assess the input requirements of exempt exporters and so the Master List becomes a negotiated document. CDC has requested CED to investigate 65 entities currently registered with the CDC. These entities appear to be non-operational and may have sold duty free imports in the domestic market.

- The process is bureaucratic. CDC and each exempt investor must agree upon the Master List as frequently as each calendar quarter. CED must record the volume of each imported consignment against the Master List and the Royal Delegate must approve each exempt import. Due to the uncertainty of forecasting potential imports over a 12 month period investors include a wide range of goods at inflated quantities in the Master List. When these quantities of goods are not actually imported CDC regularly disallows 50 per cent of the quantity investors apply to import in the subsequent Master List negotiations (Garment Manufacturer's Association of Cambodia issue raised with MOC in February 2001).
- CED does not have the resources to properly audit exempt investors to determine if their exempt imports have been used appropriately and such audits are reported to be rare.

Potential revision

The exemption system could be rationalised to improve the linkage between the production requirements of the investor and exempt imports in order to help reduce the scope for abuse of the current system. A revised system could include one or more of the following elements:

- *Automatic Exemption of Key Inputs:* existing garment and shoe exporters could import a small range of production inputs commonly used by such industries free of taxes and duties using a simplified admission document. The Master List would no longer be used for such firms. Customs should reconcile exports from such firms with their imports of duty free inputs, and investigate any irregular trading. Such inputs could include fabric, cotton thread and garment accessories that have a low risk of being leaked into the domestic Cambodian market.
- *Modified Duty Suspension:* Production input coefficients for a range of goods for each industry could be determined and remain in force for a minimum period of time; that is, at least one year. Upon presentation of

proof of the quantity of their export orders exempt exporters would be permitted to import goods duty and tax free up to the volume and value provided by the input coefficient for each good.

- This system would link inputs to outputs more accurately than the current Master List. Customs would be alerted to requests for exempt import of volumes in excess of current export order requirements before the goods are cleared, not when Master List quota is exhausted. However, there would be a need to ensure such export orders were genuine and the system would have to account for changes in the price of inputs or outputs. Coefficients would change with changes in production technology.
- *Auditing:* Exempt investors willing to be audited by a suitably qualified and reputable auditor could be automatically exempt on all their eligible imports, without being subject to the production input coefficient.
- *Bank Guarantee:* Exporters without a proven track record of good compliance and exempt importers of goods that are at risk of being sold on to the domestic market, should provide Customs with a bank guarantee of the foregone duties and taxes on their expected imports for the subsequent 12 month period. Exempt goods would not be able to be imported in excess of the value of the guarantee. Customs should audit such firms to verify the intended use of the exempt imports.
- *Minimum Tariff:* Another option would be to abolishing the current duty and tax exemptions enjoyed by CDC registered investors but at the same time lowering the tariff rates that all importers face on production inputs. The setting of the tariff rate would have to carefully balance increasing the cost of doing business in Cambodia with the net revenue change and expected reduction of compliance and administration costs.

Table 3.3 shows that garment exporters enjoyed about 75 per cent of the total duty and tax exemptions over the past three years (based on first quarter records). Other CDC investors and exporters only made up 3 per cent of total exemptions by the first quarter of 2001. Therefore, automatically exempting only the key inputs of garment exporters would remove much of the current workload of monitoring exempt investors.

A risk to leakage of duty free imports into the domestic market is posed by imports associated with foreign grant aid, temporary imports and privileged persons. Temporary imports could be safeguarded by payment of a bond or arranging bank guarantee.

3.3 **Source of customs duty and tax exemptions**

	NGO	*Embassies*	*Garment firms*	*Other CDC investors*	*Exporters*	*Foreign grant aid*	*Temp. imports*	*Privileged persons*	*Total*
				million riel					
Qtr 1 1999	2 846	2 182	117 649	497	48	1 795	14 294	6 943	156 254
Qtr 1 2000	6 204	2 682	125 956	4 032	48	9 086	13 700	6 514	168 222
Qtr 1 2001	3 030	2 944	158 364	6 037	166	18 862	17 688	8 322	215 413
				%					
Qtr 1 1999	2	1	75	0	0	8	9	4	100
Qtr 1 2000	4	2	75	2	0	5	8	4	100
Qtr 1 2001	1	1	74	3	0	9	8	4	100

Sources: MOEF–CED 2001 and IMF third review under the PRGF.

Customs bonded manufacturing warehouse

Customs is developing proposals to replace the Master List with a Customs Bonded Manufacturing Warehouse to store tax and duty-free imports of exempt investors under these proposed arrangements. Customs would manage the movement of goods from the port to the warehouse and from the warehouse to the importer’s premises when required by the importer.

Such a scheme would impose an additional and significant layer of administration between the arrival of the goods at the port and their receipt by the importer. The ability of the importer to quickly access goods in storage would be at risk. Customs would have to invest significant levels of training and capital and work closely with the private sector to successfully operate such a bonded warehouse. The scheme would penalise all exempt importers even though a limited number are likely to be abusing their incentive entitlements.

Camcontrol

Cambodia is in the difficult position of establishing a system of industrial standards and conformity assessment. This is driven by a combination of factors, including: the need to recognise the conformity assessment of trading partners, for example within ASEAN; the need to comply with the Technical Barriers to Trade and Sanitary and Phytosanitary Agreements upon accession to the WTO; and the need to meet standards set by major trading partners, particularly with respect to agricultural exports. These requirements are additional to the rules of origin that RGC enforces to gain preferential market access.

MIME sets industrial standards and manages a certification programme for local manufacturers. The Ministry has drafted a sub-decree to establish a quality assurance system involving relevant government agencies.

Camcontrol's task is to enforce conformity assessment and when necessary, to take samples of imports and domestically produced goods for testing. Camcontrol has broad powers to search, seize and destroy goods and to close a factory permanently for non-compliance with the law. The recently enacted Law on the Management of Quality and Safety of Products and Services (21 June 2000) requires importers and manufacturers to provide proof of appropriate prior examination of their products upon request by Camcontrol. If any product is harmful to health or to fair trade or is of benefit to local production then the exporter, importer or manufacturer shall request Camcontrol to inspect and approve the product before it may enter into commerce. Camcontrol is receiving technical assistance for training and equipment with respect to sampling and testing. Camcontrol states that it relies on certificates of quality accompanying imports and only takes a sample for testing an export if a certificate is required by the importing country. About 5 per cent of food imports are sampled at the government chemical laboratory or the private microbiology laboratory.

Camcontrol about commercial and health services

The GSP compliance role of Camcontrol has been to certify that the category and quantity of garments in an export consignment is reflected in the documentation. Camcontrol sees its role as complementary to that of CED. CED investigates smuggling while Camcontrol provides commercial and health services to the public.

Regardless of its conformity assessment function in the wider economy, Camcontrol officials stop and inspect the visual condition of packaging, the labels and expiry dates of 100 per cent of imports and exports not subject to PSI. A fee of 0.1 per cent of the value of the consignment is charged for each inspection.

Inspecting every import and export is a significant waste of resources. Because of limited resources frequent inspections and testing tend to be poorly performed and, therefore, do not achieve their objectives. Food imports create the greatest risk to health, yet the Food and Agriculture Organization recommends that only five per cent of all food shipments should be subject to inspection and control when sufficient confidence exists that the food entries will meet the importing countries' requirements (Food and Nutrition Papers no. 14, Manual 15 – Food Quality Control: Imported Food Inspection). Despite sampling 100 per cent of food imports, Jordan only rejected 0.6–0.9per cent of food shipments during 1996–1998.

Although, Camcontrol admits that it does not have the resources to sample and test more than 5 per cent of food imports, its officials do undertake physical inspections of all non-PSI imports.

As discussed at the beginning of this chapter the number of agencies involved in clearing goods for import and export gives rise to competition and overlap. Instead of just dealing with CED, traders have to deal with Camcontrol and the Economic Police. Sub-decree 64 provides that CED shall collect revenue and enforce the customs law while Camcontrol shall inspect and certify quantity and quality of goods exported and imported. Camcontrol and CED must perform their inspection together and only once.

CED has 1 150 staff members working at nine provincial branch offices, the ports and airports and at head quarters. In 1999 Camcontrol had 448 staff at the same border check points performing similar inspection functions as CED staff. About 500 people were employed by Camcontrol in 2001. CED management is concerned that CED and Camcontrol operate under conflicting incentives. CED is trying to reduce the time and cost of inspection by adopting a risk based selection system.

Incentives for risk management

However, in order to maximise its revenue Camcontrol has an interest in inspecting every container. Camcontrol uses a relatively low cost factor, labour, to conduct visual inspections of imports and exports, without undertaking more thorough quality assessments. SGS is required to inspect and assess the quality of goods as well as to value and classify all goods being imported under PSI. SGS profiles the risk of misdescription or misclassification of a good submitted for PSI and will test laboratory results if necessary. Camcontrol is not required to inspect containers sealed by SGS, unless there is a discrepancy between the container and the report of finding. If the level of PSI circumvention is reduced then fewer goods will enter Cambodia requiring intervention from Camcontrol.

In general, quality control of the remaining goods should rest with the importer. Importers have a contractual responsibility to ensure that their products are fit for the purpose to which they are intended. Consumers bear the responsibility to check that desired industrial standards have been attained. In Cambodia, most of the imports that are exempt from PSI are garment inputs, for which Camcontrol has little quality control expertise.

Most governments do check the quality of imports that potentially affect health and safety, for example. food, pharmaceuticals, livestock, plants, some electrical and telecommunication equipment. However, governments try to rely upon certification in the country of export as much as possible. Also, risk based selection systems are used to inspect and test these imports, relieving importers of unnecessary delays and costs.

Thus to sum up:

- the compulsory inspection of all imports and exports is unnecessary. It is the role of CED to check quantity. Any necessary visual inspections can be conducted by CED staff;
- skilled teams could be trained to manage a risk based sample selection system for imports affecting health and safety. These teams may comprise MOH, MAFF or Camcontrol officials; and
- it is important that Cambodia puts in place a rigorous system to recognise foreign standards and evidence of conformity assessment. This will reassure the public and relieve the trading system of unnecessary administration and compliance costs.

Trade finance

Most of the trade in Cambodia is conducted by multinational enterprises. Parent companies provide all, or most, of their funding. They use local banks to deposit and transfer funds. Their local bank is often a branch of their parent company's bank. Furthermore, since most transactions in Cambodia are undertaken in US dollars, funds are simply telegraphically transferred between Cambodian and foreign entities.

Nineteen commercial banks currently operate in Cambodia, five of which have been re-licensed with a minimum capital of $13 million under the new bank licensing requirements. Banks are permitted to carry out the whole range of banking functions, but activities in practice tend to be limited by the small market and lack of enforceability of security. Many Cambodians resist depositing their savings in a bank after a number of banks closed over the past year following the introduction of the new licensing provisions. Some of these banks have yet to refund depositors their money.

The Foreign Exchange Law prohibits any restriction on foreign exchange operations, including transfers and all types of international settlement. However, these transactions must be performed through a local bank. Fees for telegraphic transfers are high, one bank charges 0.15 per cent of the amount transferred in addition to a fixed fee of up to $35.

Lending rates are high and averaged 17.78 per cent per annum for US dollar loans at the end of June 2001. Although these loans are secured by land or guarantee the high interest rate reflects the lack of any secured transaction legislation and it is reported that it can take 3 to years to discharge a mortgage. Despite relatively high interest rates total monthly commercial bank credit has almost doubled over the past four years, from $125 million in January 1997 to $238 million by March 2001. One quarter of these funds is lent to the wholesale and retail trade sector indicating that inventory financing, and hence financing of imports, is an important source of business to banks.

At least 50 micro finance organisations provide loans of between $100-$500 to SMEs and farmers at interest rates of 3–5 per cent per month. Few SMEs meet the lending criteria of commercial banks; which charge more attractive commercial interest rates (18–24 per cent per annum). At the fourth Public-Private Sector Forum in August 2001, the Prime Minister encouraged the working groups to find ways to lower the cost of credit to SMEs.

The FTB is one of two state owned banks and is the second largest bank in terms of deposits. It will provide a letter of credit to a Cambodian importer subject to a 20 per cent deposit, land or building collateral and a good credit history. Its minimum acceptance fee of 0.1 per cent is competitive in the region and about 25 per cent less than that charged by commercial banks in Cambodia. However, due to Cambodia's perceived country risk importers are usually required to pay a fee of about 0.2 per cent of the invoice value to a local branch of a foreign bank as a confirming bank fee.

In summary, the banking sector provides a wide range of banking services but at a relatively high cost to the consumer. Promptly enacting the necessary financial legislation requested by the private sector and implementing this legislation is essential to lower these costs.

The RGC provides no trade finance assistance to the private sector. There are no export credit insurance or export guarantee schemes. In order to assist SMEs and farmers to finance their exports the government could consider guaranteeing export credit provided by commercial banks to SMEs meeting certain criteria.

Trade facilitation will also be enhanced if banks work with CED to provide for improved means of payment of duties and taxes, for example, payment by credit card. Currently importers have to pay by cash or a cheque certified by their bank. This creates delay and increases compliance costs. In particular, a system permitting pre clearance payment of taxes and duties should be introduced. CED could also regularise post clearance payment of duties and taxes by qualifying importers.

Export processing zones

The RGC has been considering establishing one or more industrial zones in Cambodia and attracting domestic and foreign investment into the zones. Given the poor condition of much of the country's infrastructure, scarce infrastructure development resources could be focused initially inside the zones to bring them to an internationally competitive level. Zone enterprises may also be able to import raw materials and intermediate products exempt from duties and taxes for consumption within the zone.

In June 2000 the Prime Ministers of Thailand and Cambodia agreed to formulate an integrated plan for economic co-operation. A centrepiece of the plan is the development of industrial zones in Cambodia along the Thai border. This year Thailand graduated from receiving GSP market access for a number of labour intensive products. Thai manufacturers of these products are interested to relocate their production operations to Cambodia in order to enjoy Cambodia's continuing GSP market access. The zones would be located close to Thailand in order to take advantage of Thai infrastructure, in particular, road and rail links to Thai ports. Thai manufacturers would also benefit from Cambodian labour costs that are approximately half of the level of Thai labour costs in Zone 3. The Thai Board of Investment has divided Thailand into three areas or zones. Zone Three is farthest from Bangkok and offers the most attractive investment incentives.

A Thai developer has already commenced developing a 250 hectare zone at Koh Kong in anticipation of enactment of the draft Industrial Zone law currently being discussed by the Government. The site is two kilometres from the Thai border on Cambodia's coastline. A number of Thai manufacturers are interested to invest. The zone is three hours by road from Laem Chabang port.

Considerable progress has been made with the zone, the land has been purchased and roads have been built to the Thai border and into the nearby town including a bridge over the Prek Khao Pao River. Telephone and electricity services are being supplied from Thailand and a water reservoir is completed.

The developer is also assisting the RGC to improve the road to connecting Koh Kong with National Road 4 — connecting Phnom Penh with Sihanoukville.

Another site is being considered at Poipet on the Thai border. Poipet is close to Battambang (population 100 000) in Cambodia and has good road access to both Bangkok and Phnom Penh. Rail access requires upgrading. The development of this site depends upon the consolidation of a large number of small privately owned land holdings.

Conflicting interests of industrial estate parties

As with any commercial undertaking, successful operation of an industrial estate depends upon balancing the interests the three participating parties – the developer, the enterprise investor and the government. Box 3.4 below summarises these interests. The government sets the broad policies for the establishment and management of the zones in its legislation. Contractual arrangements further define relationships between the parties. Successful zones reflect a working partnership between the developer and the government, and recognise investors as clients.

3.4 Relative interests of industrial estate partners

Developer and Investor

- Retain full control over use of land and infrastructure
- Maximise financial returns from land and infrastructure investment
- Minimise risk of cost changes and government interference

Investor

- Obtain inputs exempt from duties and taxes (that is, at world prices)
- Obtain appropriately skilled work force in sufficient quantity
- Receive utility services at appropriate quantity, quality and competitive price
- Minimise transport costs to market and ports, that is, road access to Bangkok and Laem Chabang Port
- Minimise compliance costs with customs and administrative requirements

Government

- Maximise Government's share of the returns earned by Developer and Investors
- Maximise employment (Koh Kong has a small population of 20 000)
- Maximise use of domestic inputs
- Protect the natural environment (Koh Kong has seven national parks and a mountain wildlife sanctuary)
- Prevent smuggling into domestic territory and use of genuine Certificates of Origin

Discussion of draft law

Annex F sets out a summary of the draft law.

Relative authority of council and developer

The first issue relates to the balance between public and private control of the zones. Given Cambodia's scarcity of experienced managers and limited financial resources the Government is likely to rely upon a private developer to create and manage one or more of the zones. This already appears to be the case in Koh Kong. Such developers would prefer themselves to undertake many of the policy and management decision making authorities that the law gives to the Council and Secretariat.

Ideally, these statutory authorities could be contracted to the developer. In particular, the developer could register investors and set fees. If the developer is providing the majority of services to the investor, including leasing land and then fees cannot be regulated by a sub-decree. An extremely important feature of any zone is the simplicity and efficiency of its administration. Private sector developers can more often provide these efficiencies than the public sector. Public interests are still protected through the provisions of government's agreement with the developer and through legislation.

The Council and Secretariat would remain responsible for those one stop services that should be undertaken by an entity at arm's length from the developer and investor. In particular, customs services and tax collection should be performed by an unrelated party.

Council and Secretariat structure

The law envisages a very senior policy making body (Council) that delegates executive power to a mid-level executive body, that further appears to delegate management activities to representatives in each zone. This structure has the risk of blurring policy and management functions and becoming unnecessarily bureaucratic. Furthermore, accountability should be clarified. The Council should regularly report to Parliament. The Council appears to be represented by unnecessarily senior officials, that is, the Prime Minister.

However, the intended structure could function well if the Council acts as a policy making board of directors and the Secretariat as the executive management with line functions in each zone. Most public sector industrial estate development is undertaken by parastatals with adequate operational autonomy and their own board of directors to enable them to operate in a business like manner. The private sector is often represented on the board of directors reflecting the interests of enterprise investors and private sector developers.

Management of customs and tax revenue collection

The zone customs agency must demonstrate an ability to monitor imports and exports from the zone with minimum cost to the investor. Ideally, an entirely new agency could be established that is independent from the public sector — along the lines of a revenue authority discussed above. Or these functions could be contracted to the private sector.

Annex F 1 of the Kyoto Customs Convention sets out model provisions for the customs requirements of a duty free zone. The interesting customs feature of the proposed zones is the planned proximity of a duty free processing area with duty and tax paid accommodation and service areas. This suggests the following features could be appropriate:

- one customs office could clear all goods imported from Thailand entering the zone and all exports leaving the duty free area;
- imports destined for the service and accommodation areas would be duty paid before being cleared;
- goods entering and leaving the duty free area would be recorded in an inventory control system (ICS) maintained by customs;
- a simplified admission document could be used to enter imports and exit exported goods. Customs may even decide to rely only on the bill of lading;
- sales from the domestic territory to the duty free area would be recorded in the ICS. Sales from the duty free area to the domestic territory would be cleared through the customs office and have tax and duties paid;
- the ICS would monitor the movement of goods into and out of the duty free area and could be used to confirm that garments were made in the zone pursuant to any required Certificate of Origin;
- customs would undertake a risk based audit programme of investors to verify their inventories of duty and tax free goods;
- ideally all goods crossing the border check point into Thailand should be cleared by the customs office at the zone and transported under seal or escort to and from the border check point. This would avoid double handling and allow goods to move quickly over the border; and
- Article 37 appears to be unnecessary. All imports into the duty free area are duty and tax-free. If goods produced in the area are sold into the domestic market then they will incur duties and taxes at the time of such sale. It is not necessary to know in advance if an imported input is being used to produce an export or duty-paid sale to the domestic territory.

Investment incentives

Thai manufacturing enterprises relocating to the zones will enjoy:

- GSP access to 26 foreign markets
- labour costs at least 50 per cent of their current labour costs
- access to Thai electricity and telephone services
- use of Thai road, rail and port services
- duty and tax free imports of all imported inputs, including their current purchases of Thai inputs, and

- a likely credit against their Thai income tax liability for profit taxes paid to the RGC.

For these reasons the RGC should not offer a reduced rate of profit tax to attract Thai investors. Further work should be undertaken to compare the cost structures of Thai manufacturers in their current location compared to their likely cost structure in a Cambodian zone. The additional value of GSP benefits and the current tax treatment of the Thai manufactures should be factored into the model.

Table 3.5 compares the net profit for an exporter selling a product with a CIF cost of $100 into three different markets. The selling price at which the exporter has contracted with the importer is $120. If the importer is located in the EU then the good enjoys completely duty free access and the profit is $20 or 16.7 per cent of the contract price. The EU average MFN tariff is 7.4 per cent therefore, the exporter's profit rate falls to 10.5 per cent The profit spread on sales to the US and Japan are smaller than to the EU.

Table 3.5 shows that if production costs are conservatively assumed to be the same in Cambodian zone as they were in Thailand then if the exporter sells to the EU, they enjoy a gain equivalent to 7.4 per cent of their cost of sales. If their cost of sales is lower in Cambodia then their GSP gain would be greater than 7.4 per cent.

3.5 **Comparison of export profit under average GSP and MFN tariff rates**

	Unit	*EU GSP*	*EU MFN*	*US GSP*	*US MFN*	*Japan GSP*	*Japan MFN*
CIF cost	$	100	100	100	100	100	100
Duty rate	%	0.0	7.4	1.8	5.0	1.7	4.3
Contract rice	$	120	120	120	120	120	120
Profit price	%	16.7	10.5	15.2	12.5	15.3	13.1

Calculated using 1999 average tariffs across all goods provided by Table 8, *Market Access for Developing Countries' Exports*, WB and IMF, April 2001. Current GSP rate for LDCs used rather than 1999 average GSP rate.

The zone investment incentives should be aligned with the incentives offered by the Law on Investment. Consistent incentives will prevent investment locations within Cambodia competing with one another by offering lower rates of profit tax to foreign investors that have already chosen to locate in Cambodia. The current review of investment incentives should consider the tax treatment of Thai investors in the proposed zones.

Other issues

The RGC should clarify that the US and EU will continue to permit GSP access of goods made in duty free zones in Cambodia. The US generally does not permit duty and tax free entry of goods made in foreign EPZs.

The requirement for a master plan is important. The plan should set out a design concept for the zone and the process by which investors comply with the design concept. Developers should be given the opportunity to participate in the formulation of the plan. The plan should be approved by the Council. The draft law does not require developers or investors to conduct an environmental impact assessment (EIA). The Government should ensure that minimum environmental standards are met by developers and investors. An environmental monitoring office could be established in the zones to evaluate EIAs and monitor compliance. Certificates of Origin could be issued by the zone customs office using the ELVIS and SEGAL links with the US and EU.

4 *Assessing poverty impacts*

The linkages between trade policies and poverty have been addressed recently at length by several papers (World Bank 2001 and WTO 2001). There is a consensus that greater openness to trade can affect an economy in various ways, creating opportunities for the poor as well as risks: i) by affecting the prices of goods and services the poor consume and produce, changes in policy will benefit those who are net consumers of goods that become cheaper and those who can obtain higher prices for their products; ii) by affecting the demand for and returns to factors of production that the poor have to offer, such as unskilled labor; iii) it can affect government revenues and the resources available for antipoverty programs; iv) it can affect the potential for economic growth , which in turns affects poverty; v) due to likely transition costs and the possible increased volatility of growth coming from the opening up of markets, properly designed social protection mechanisms are recommended (G-8 Genoa Summit, July 2001). Following the scope of the document, this chapter will deal mostly with points i), ii), and iv), considering also scenarios where land is distributed to poor farmers and where transaction costs linked to the rice market are reduced. Besides the assessment of the impact of trade policy on poverty, this section intends to be a clearing house for the assessment of the expected impact of other, non-trade policy recommendation done in other parts of the study.

Lack of information for the Cambodian economy (for example, input-output table) forbids the use of any sophisticated economic model (for example, Computable General Equilibrium), and this poverty assessment is rather conducted in a partial equilibrium setting. It provides a proxy of the magnitude of the first order impact on poverty coming from changes in key prices and quantities. The setting of the model is flexible enough to capture impacts coming from:

- changes in tariffs of key goods consumed and/or produced by the poor;
- changes in prices and quantities in key markets (for example, rice markets, including segmentation of them into regional markets);
- a reduction in transaction costs (for example, reduction in unofficial taxes, and/or in transportation costs);

- some key technological improvements in production (for example, reduction in post harvested losses, increment in milling yield of paddy);
- cross-effects of some important linked markets (for example, impact of agricultural prices on agricultural wage income, impact of urban employment and wages on remittances); and
- shifts in labor demand (for example, increased demand for labor in garment industry, labor saving technology in rural areas).

This chapter presents in section 1 a summary of the poverty profile of Cambodia, highlighting some key issues related to the measurement of poverty in Cambodia. Section 2 identifies who the poor people are in term of consumption patterns and in term of sources of income. Section 3 presents the framework to be used in making the poverty assessment of different policies recommended in the other chapters of this document. Section 4 provides the results of the various simulations done, and Section 5 presents some conclusions.

Poverty and poverty measurement in Cambodia

Current measures of poverty in Cambodia are controversial. Changes in survey design and in interview practices make difficult to compare estimates of poverty rates from the 1999 Cambodia Socioeconomic Survey (CSES) with estimates from previous surveys. The 1999 CSES was done in two rounds of interviews, one in January–March and the other in June-August, with the intention of capturing the effect of seasonality in consumption and income. The detailed analysis of the data done by Gibson (1999) shows that there are important discrepancies in consumption, inequality and poverty estimates for the two round of the 1999 CSES that are not consistent with previous evidence of seasonality in Cambodia. For instance, the estimated headcount poverty rate for Cambodia in 1999 is 51 per cent if both rounds of interview data from the 1999 CSES are used, but it is 64.4 per cent if the first round is used and 35.9 per cent if the second round is used. Because of these discrepancies, it is difficult to see whether poverty increased since the previous survey in 1997. From Gibson's report, (1999, page iii) we have:

> If the data from Round 1 of the 1999 survey are used then poverty appears to have increased, regardless of the methods and adjustments used to ensure comparability with the 1997 data. If the data from Round 2 of 1999 are used, poverty appears to have decreased. If the discrepancies between survey rounds are ignored and all data from the 1999 survey are used poverty either increased or decreased since 1999 depending on the method used to ensure

comparability with the 1997 data. A straight comparison of the poverty estimates from the *unadjusted* 1997 survey data with the combined-rounds 1999 survey data shows a small rise in the headcount index from 47.8 per cent to 51.1 per cent, with large proportionate increases in the depth and severity of poverty. An alternative comparison, which avoid using revised estimates for the headcount poverty rate in 1997, based on a consumption aggregate which exclude rent and medical expenses (the items adjusted in 1997) and used a lower poverty line. Under this comparison, and using the combined rounds data from 1999, there is a small reduction in the headcount index (from 36.1 to 35.4 per cent) but increases in the depth and severity of poverty. However, even this comparison does not remove the basic ambiguity caused by the variation across survey rounds in 1999; with this restricted consumption aggregate and lowered poverty line, there are significant increases in poverty recorded for all poverty measures and all regions from 1997 to Round 1 of 1999 and falls in poverty from 1997 to Round 2 of 1999.

Results for 1997 that have been incorporated into public policy in Cambodia (particularly into the poverty profile) are based on consumption data that were adjusted to correct for possible under-estimation of certain types of consumption, such as health, house rental values, and education. The adjustments made to the data had a big impact in raising the value of mean consumption by almost one-fifth (Gibson, 1999, p. 14).

In spite of its problems, the CSES survey done in 1999 was the first attempt to collect detailed information on household incomes in Cambodia. Households' sources of income were collected with a detailed questionnaire, and 1999 data is the only available data that allow an assessment on the relative importance of each source of households' income. Thus it is necessary to rely on the 1999 data to make the type of simulations this chapter on Poverty intends to make. As measures of poverty levels using the 1999 data are subject to controversies and this chapter tries to avoid making references to a particular measurement of poverty, and presents the information by deciles of the per capita adult equivalent expenditure instead. Following Deaton (1997), the deciles were formed by computing the per capita adult equivalent household consumption for each sample household as: total hh consumption / (0.5*# of children + # of adults). The reader should infer that improvements in the consumption level in the first five deciles as a result of any of the policies suggested by the IF analysis, has a pro-poor effect. To follow what seems to be the official data set for poverty analysis in Cambodia (see for instance, the Second Five Year Socioeconomic Development Plan 2001-2005), we present in this chapter results coming from using the second round from the CSES 1999 survey. All the computations were also done using the first round and the complete data set for 1999 and are available from the author upon request. Although to easy exposition those results are not shown in the text, an explanatory footnote indicates whenever these results differ qualitatively from those coming from the second round. The 1993–94 and 1997 poverty profiles identified many of the characteristics of the poor:

- Poverty rates are highest in rural areas and amongst people living in households headed by farmers.
- Poorer households tend to be larger, younger and have more children and are more likely to be headed by a male.
- The poor are more likely to live in households where the head is illiterate and has few years of schooling

In turn, and although some of the cross-sectional poverty patterns are not robust across the two 1999 survey rounds, the 1999 poverty profile indicates that some of them are robust and in general corroborate the findings of previous poverty profiles. Amongst the latter:

- poverty is lowest in Phnom Penh;
- poverty has a non linear relationship with the age of the household head, tending to be highest for those whose household is middle aged;
- poverty rises with the household size and the number of children;
- poverty is lower for those whose household head has a secondary or advanced education; and
- poverty is highest for those whose household head is engaged in agriculture.

Locating the poor

Knowledge of how the poor obtain and spend their income is crucial in assessing the impact of economic policies on poor people. For the case of trade policies, it is expected that the impact on the sources of income of the poor will be more important that the impact on their consumption bundle. The reason is that trade reform will affect many relative prices, some of which will move in offsetting directions creating scope for adjustment of the consumption bundle. In contrast, as the poor people generally have limited assets, the most important of which is low skilled labor and/or small quantity of low quality agricultural land that do not allow for cushioning the effect of big changes, the impact on the sources of income (World Bank 2001). The approach used in this chapter — described below in section 3 — relies heavily in locating the poor people in terms of patterns of expenditures and of sources of income. The rest of this section presents first a description of what are the main expenditures of Cambodia’s people, ordered by deciles of adult equivalent per capita expenditures, and then a description of their main sources of income.

Consumption patterns

Table 4.1 shows by per capita adult equivalent consumption deciles the share of some key consumption aggregates in total expenditure (see annex G for more detail). In Cambodia, expenditures on food take about ¾ of total expenditures of the first five deciles, and are lower than 70 per cent only in the highest two deciles. As expected, expenditures on rice (all varieties) are by far the most important single item of all expenditures for the poorest deciles: this share is 28.4 in the poorest decile, about 23 per cent in the second and third deciles, and still above 20 per cent for the fourth and fifth deciles. Thus, any policy that has a high impact on rice prices is expected to have a high impact in poor households' consumption. A simple exercise can show that, keeping the other prices and the sources of income constant, a reduction, say, of 10 per cent in the price of rice would imply an extra 3 per cent of disposable income for people in the poorest decile 10 per cent of 28.7 per cent) and 0.6 per cent for people in the richest decile (10 per cent of 5.7 per cent). Second in importance among food items is 'Fish and fish products' that involves between 9.2 and 11.1 per cent of total household expenditures in deciles 1 to 9 and only 5 per cent in the tenth decile. Regarding non-food expenditures, the mayor differences between deciles seem to be concentrated in 'Housing, fuel and transportation': this category of expenditure captures 46.7 per cent of the total expenditures in the richest decile and only 15.7 per cent in the poorest one.

4.1 **Expenditure shares, by decile of per capita consumption, in per cent**

	Decile										
Consumption item	***1***	***2***	***3***	***4***	***5***	***6***	***7***	***8***	***9***	***10***	***avg***
Food Total	75.7	76.3	76.0	73.7	73.7	72.6	72.0	70.3	64.4	38.6	63.5
▪ Rice, all varieties	28.4	23.3	22.7	20.7	20.6	18.9	17.5	15.1	12.5	5.8	15.6
▪ Fish & fish products	9.9	11.1	10.6	10.5	10.9	10.8	10.0	10.0	9.2	5.0	8.9
▪ All other consumption items	37.4	41.9	42.7	42.5	42.2	43.0	44.5	45.2	42.7	27.8	39.0
Non Food Total	24.4	23.8	24.1	26.4	26.3	27.5	28.0	29.7	35.6	61.4	36.5
▪ Housing, fuel and transportation [a]	15.7	15.5	15.2	17.1	17.3	17.4	17.5	19.4	24.1	46.7	25.5
▪ Clothing [b]	2.9	2.8	3.0	3.0	2.8	3.4	3.4	3.2	2.9	2.3	2.9
▪ Other expenditures [c]	5.8	5.4	5.9	6.2	6.1	6.6	7.1	7.1	8.6	12.4	8.2

[a] Includes house rent (rental value of subsidized housing, rental value of owner-occupied housing, hotel charges), house maintenance and repair, water and fuel, medical care, transportation and communication, and personal care

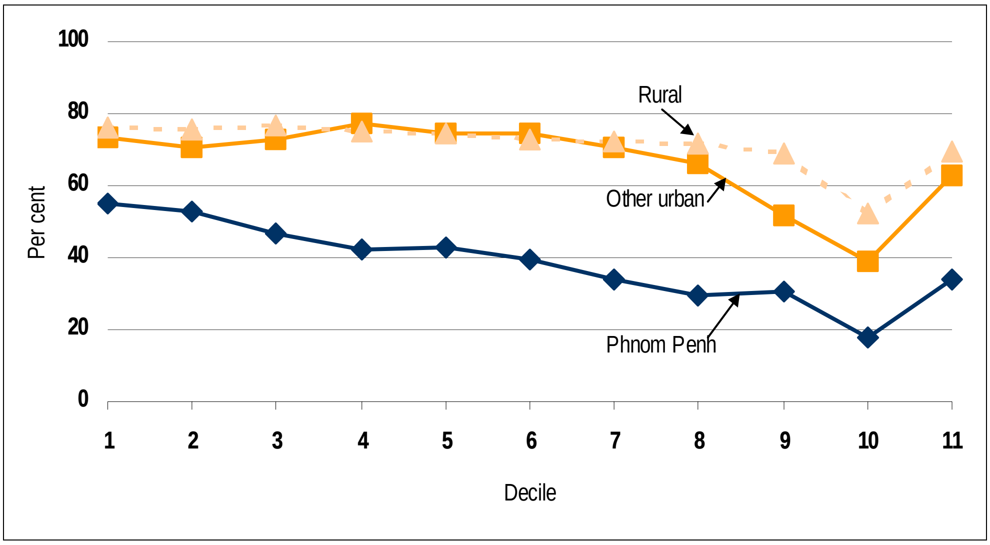
[b] Clothing and footwear (tailored clothes, ready-made clothes, shoes, etc.)

[c] Includes furniture and household equipment and operation, expenditures in recreation, education , personal effects and miscellaneous items.

Source: CSES Survey 2001.

Chart 4.2 shows the share of food expenditures in total expenditures by per capita consumption decile for households in Phnom Penh, in other urban areas and in rural areas. In rural as well as in other urban areas the share of food in total expenditures is higher than 70 per cent for the first 8 deciles, while in Phnom Penh this share is below 55 per cent for all deciles, and as low as 18 per cent for the 10th decile. These different patterns are just another way of observing the prevalence of relatively higher poverty levels — which are in general associated with a higher share of expenditures on food — in the rural areas of Cambodia. Any policy that affects food prices, everything else constant, will have a greater impact on households' welfare in rural and in other urban areas, and a smaller impact — albeit still important for people in the poorest deciles — on households in Phnom Penh.

4.2 **Share of food expenditures in total expenditures: rural and urban areas, in per cent by consumption decile**



Data source: Cambodian authorities and team estimates.

Sources of income

Table 4.3 shows by per capita adult equivalent consumption decile the contribution to total income made by different sources . Earnings from self employment are on average equal to 60.9 per cent of total income, 2/3 of which are coming from activities related to cultivation (22.4 per cent of total income), most of which is coming from rice cultivation (16.3 per cent), livestock (9.4 per cent), fish growing (5.6 per cent) and forestry and hunting (5.7 per cent). Income from wage employment was on average only 20.5 per cent, slightly higher than the 16.5 per cent coming from sources as rental income, interest received and imputed value of houses. Income from remittances represents on average only about 2.1 per cent of total income.

4.3 **Contributions to income from different sources**

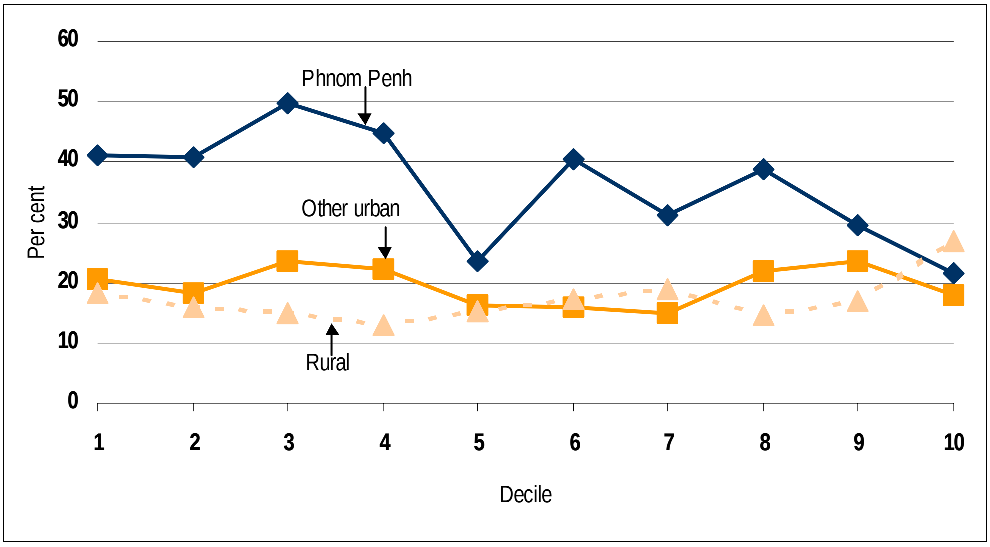
Source of Income:	*1*	*2*	*3*	*4*	*5*	*6*	*7*	*8*	*9*	*10*	*avg*
						Decile					
Self employment	67.8	71.4	71.7	70.3	73.6	68.5	71.2	70.7	63.3	36.3	60.9
▪ from cultivation	27.8	29.7	31.1	30.3	31.9	32.1	30.6	32.3	19.8	3.2	22.4
▪ from rice cultivation	21.4	24.3	25.3	23.6	25.7	25.0	22.7	20.4	9.7	2.1	16.3
▪ from other crops	6.4	5.4	5.8	6.7	6.2	7.1	7.9	11.9	10.1	1.1	6.1
▪ from livestock	16.6	14.3	14.2	13.0	12.4	11.9	11.6	12.0	8.3	1.5	9.4
▪ from fish growing, etc	6.1	7.1	5.5	8.7	6.9	6.8	8.7	7.1	5.2	2.1	5.6
▪ from forestry and hunting	8.3	10.2	9.7	7.3	7.7	7.9	8.1	6.1	4.9	0.6	5.7
▪ from non farming activities	8.9	10.0	11.2	10.9	14.7	9.8	12.2	13.2	25.1	29.0	17.7
Other sources	32.2	28.6	28.3	29.7	26.4	31.5	28.8	29.3	36.8	63.9	39.1
▪ from wages	19.0	15.0	15.9	14.5	14.3	18.5	17.6	16.5	21.0	30.2	20.5
▪ from remittances	1.2	1.9	1.6	2.8	1.3	2.4	1.6	1.7	2.3	2.6	2.1
▪ other (rents, dividends, etc)	12.1	11.7	10.9	12.4	10.8	10.6	9.6	11.1	13.4	31.0	16.5
Total	100	100	100	100	100	100	100	100	100	100	100

Source: CSES Survey 2001

The table shows also that by decile of per capita adult equivalent consumption, a similar pattern to that of consumption emerges: the composition of income by sources is similar for deciles 1 to 8, and only for the ninth and tenth deciles the shares are different. The latter show a higher importance of non-farming activities in self employment sources of income (above 25 per cent), a higher importance of wage income, and, for the tenth decile, a higher proportion of income coming from other sources as rental income, interest received and imputed value of houses, as a reflect of a higher capital stock ownership.

Chart 4.4 shows the relative importance of wages as a source of income in different regions of the country: for deciles 1 to 8, wages are about 40 per cent of total income in Phnom Penh and about 20 per cent in the rest of the country.

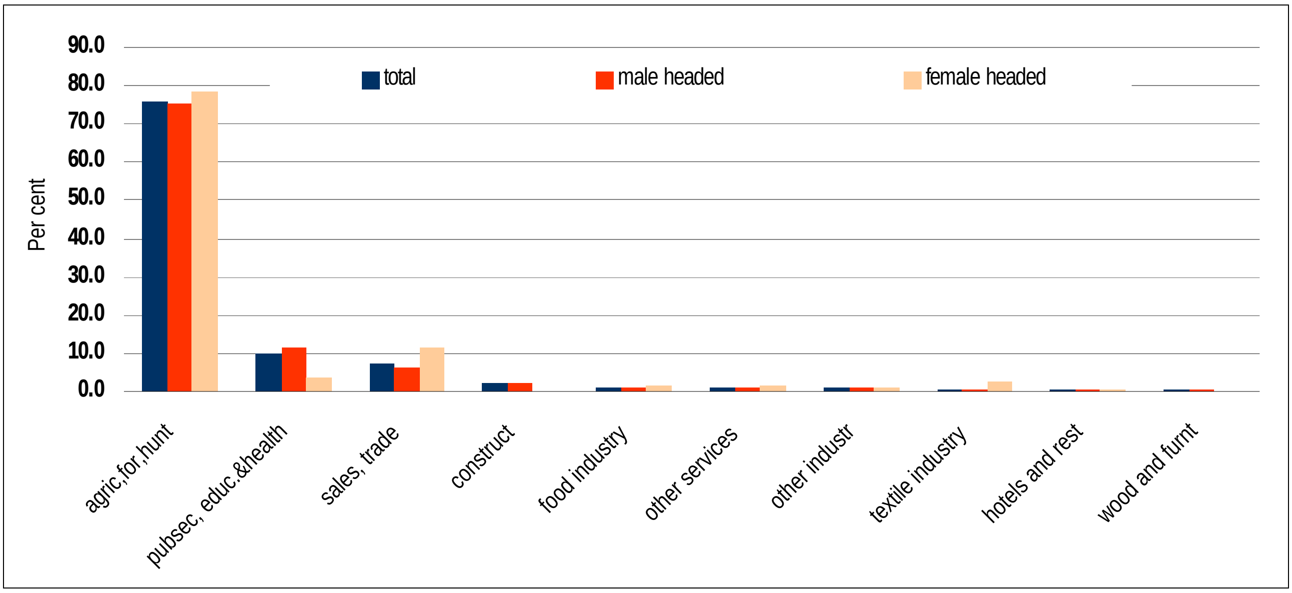
4.4 **Share of wage income in total income: Rural and Urban areas, in per cent by decile**



Data source: Cambodian authorities and team estimates.

Chart 4.5 shows the distribution of employment of the household head by industry and gender. 75 per cent of Cambodian household heads have ‘agriculture, hunting, and forestry’ as their main occupation, with a slightly higher proportion for female headed households (78 per cent). Employment in the public, education and health sectors is next in importance as a source of main income (9 per cent average for the whole country, 11 per cent for males head of households and 3.5 per cent for females) followed by employment in the wholesale and retail trade sectors (7.3 per cent average for the whole country). The ‘textile’ industry as well as the ‘hotel and restaurant’ industry is the main source of income for only 0.8 of Cambodia’s head of households.

4.5 **Employment, by industry group and gender**



Source: Cambodian authorities and team estimates.

Framework for the impact on poverty analysis of different policies

It is assumed a model where the household is the unit of analysis. Total net household income (savings) is defined as the sum of total income minus the sum of total expenditures. Each household has different endowments (for example, land of different qualities, number of skilled and unskilled laborers) that generate income (for example, from agriculture, from labor) and different expenditures patterns (for example, allocation of expenditures to food and non food items). The general formulation is;

$$
\begin{aligned}
NetIncome = & \sum_m X_m^{SRice} P_m^{Rice}(1-t_m^{SRice}) + \sum_i X_i^{SO} P_i^{O}(1-t_i^{O}) - \sum_j X_j^{I} P_j^{I}(1+t_j^{I}) \\
& + \sum_k L_k^{Skilled} W_k^{Skilled}(1-t_k^{Skilled}) + \sum_l L_l^{UnSkilled} W_l^{UnShilled}(1-t_l^{UnSkilled}) \\
& - \sum_m X_m^{DRice} P_m^{Rice}(1+t_m^{DRice}) - \sum_n X_n^{Oth.Food} P_n^{Oth.Food}(1+t_n^{Oth.Food}) \\
& - \sum_o X_o^{NonFood} P_o^{NonFood}(1+t_n^{NonFood}) \\
& + \sum_p \sum_q T_p^q \qquad (Eq.1)
\end{aligned}
$$

where

X_m^{SRice} =Amount of rice of quality *m* produced by the household

P_m^{Rice} = Selling price of rice of quality *m* produced by the household (gross price). For internationally tradable varieties, this price is the border price.

t_z^w = *ad valorem* tax on good *z* of the *w* sector. Alternatively, t_z^w = is the tax equivalent of a distortion that affects good *z* of sector *w*.

X_i^{SO} = Output *i* (other that rice) produced by the household (for example cattle, handicrafts, services)
P_i^O = Selling price of output *i* produced by the household (gross price). For an internationally tradable output, this price is the border price.

X_j^I = Amount of input *j* used by the household to produce goods *o* (for example, fertilizers, land rented, hired labor, hired animals).
P_i^O = Before tax (or before a tax equivalent domestic distortion) price of input *j* used by the household to produce goods *o*.

$L_k^{Skilled}$ = Amount of skilled labor sold by the k^{th} member of the household
$W_k^{Skilled}$ = Before tax (or before a tax equivalent transaction cost or domestic distortion) wage of skilled labor supplied by the household.

$L_l^{UnSkilled}$ = Amount of un-skilled labor sold by the l^{th} member of the household
$W_l^{UnSkilled}$ = Before tax (or before a tax equivalent transaction cost or domestic distortion) wage of unskilled labor supplied by the household.

X_m^{DRice} = Amount of rice of quality *m* demanded by the household (including rice produced by the household and not sold in the market)
P_m^{Rice} = Buying price of rice of quality *m* demanded by the household (gross price)
t_m^{Drice} = Import tariff on rice imports
$X_n^{Oth.Food}$ = Amount of non-rice food *n* demanded by the household
$P_n^{OthFood}$ = Buying price of non-rice food *n* demanded by the household (gross price)
$t_n^{OthFood}$ = Import tariff on non-rice food n
$X_o^{NonFood}$ = Amount of non-food good *o* demanded by the household
$P_o^{NonFood}$ = Buying price of non-food good *o* demanded by the household (gross price)
$t_o^{NonFood}$ = Import tariff on non-food good *o*
T_p^q = Transfer received by household member *p* from source *q* (*q* could be public or private).

In addition, the value of paddy rice output can be expressed as a function of the value of milled rice, as:

$$\begin{aligned} Value\,of\ Rice\,Output &= Q_m^{PaddyRice}(1-phl_m^{PaddyRice})(1-t_m^{Rice})P_m^{PaddyRice} \\ &= Q_m^{PaddyRice}(1-phl_m^{PaddyRice})(1-t_m^{Rice})(1-\alpha)\lambda P_m^{Rice} \end{aligned} \qquad (Eq.2)$$

where, $phl_m^{PaddyRice}$ denotes the per cent of post-harvested losses due to improper handling, lack of storage facilities, rodents, etc., assumed to be currently about 10 per cent; α denotes milling transformation costs; and λ is the milling yield of paddy-to-rice, assumed to be 0.62 on average (with some regional variation), by the MAFF.

We can consider all quantities in Eq.1 as fixed in the short run and simulate what the impact of a change in prices, taxes and/or transaction cost may be. The formulation would be:

$$\begin{aligned} \Delta NetIncome \big/ \overline{all\ q} = &\sum_m P_m^{Rice}(1-t_m^{SRice})X_m^{SRice}\frac{\Delta[P_m^{Rice}(1-t_m^{SRice})]}{P_m^{Rice}(1-t_m^{SRice})} \\ &+\sum_i P_i^{O}(1-t_i^{O})X_i^{SO}\frac{\Delta[P_i^{O}(1-t_i^{O})]}{P_i^{O}(1-t_i^{O})} \\ &-\sum_j P_j^{I}(1+t_j^{I})X_j^{I}\frac{\Delta[P_j^{I}(1+t_j^{I})]}{P_j^{I}(1+t_j^{I})} \\ &+\sum_k W_k^{Shilled}(1-t_k^{Skilled})L_k^{Skilled}\frac{\Delta[W_k^{Shilled}(1-t_k^{Skilled})]}{W_k^{Shilled}(1-t_k^{Skilled})} \\ &+\sum_l W_l^{UnShilled}L_l^{UnSkilled})\frac{\Delta[W_l^{UnShilled}(1-t_l^{UnShilled})]}{W_l^{UnShilled}(1-t_l^{UnShilled})} \\ &-\sum_m P_m^{Rice}(1+t_m^{DRice})X_m^{DRice}\frac{\Delta[P_m^{Rice}(1+t_m^{DRice})]}{P_m^{Rice}(1+t_m^{DRice})} \\ &-\sum_n P_n^{Oth.Food}(1+t_n^{Oth.Food})X_n^{Oth.Food}\frac{\Delta[P_n^{Oth.Food}(1+t_n^{Oth.Food})]}{P_n^{Oth.Food}(1+t_n^{Oth.Food})} \\ &-\sum_o P_o^{NonFood}(1+t_o^{NonFood})X_o^{NonFood}\frac{\Delta[P_o^{NonFood}(1+t_o^{NonFood})]}{P_o^{NonFood}(1+t_o^{NonFood})} \\ &+\sum_p\sum_q \Delta T_p^q \qquad (Eq.3) \end{aligned}$$

In reality, after changes in prices, producers would switch production to the more valuable crops, consumers would in general switch to cheaper goods and away from the now relatively more expensive ones, and the household would adjust its labor supply to changes in wages. Because *Eq. 3* keeps quantities fixed, this formulation provides a lower bound for any estimated gain and an upper bound for any estimated loss.

Results from the simulations

The following simulations, by adopting strong assumptions on quantities demanded and consumed, and on the way prices are determined, capture only partial and extremely simplified aspects of the plausible impact of reforms on households. Nonetheless, the dimension of the impacts simulated as well as the distribution across consumption deciles allow to have a first approximation for the potential positive or negative effect of different economic policy scenarios on poor people in Cambodia. The specification of Eq.1 and Eq.2 above are flexible enough to capture key avenues identified elsewhere for the improvement in the livelihood of poor households (for example, see chapter on Agriculture where transaction costs and post harvested losses are described for the rice market, and also the chapter on Trade Policy, where it is shown the potential pro-poor effect of some modifications to the current tariffs structure). For instance, the specification can properly capture the impact of a variation in the price of rice that is different for net sellers and net buyers or rice. Moreover, by introducing tax equivalent parameters for different types of transaction costs, and parameters for milling yield of paddy rice, post harvested losses, and milling costs, the specification allows to simulate several different impacts that seem appropriate for today’s Cambodia.

Following common practices in the literature on poverty, we anchor the analysis on households’ expenditures, and express all results as per cent of households’ expenditures, ordered by decile of per capita adult equivalent total household consumption. That is, the absolute change in net income of household *i* that is expected to come from a policy change is divided by total household *i* expenditures. The interpretation in terms of poverty is straightforward: a simulation identifies a pro-poor strategy if the latter provides extra money for the first five deciles. The size of the impact is measure as per cent of household expenditures.

The rice sector

As stated in the Sector Case Study on Rice, in Cambodia, most efficiency gains are to be realized from reforming the domestic production, processing and trade systems rather than from reforms at the border. This section presents results coming from two simulations in the rice sector. The first simulation makes an assessment of the poverty impact of reforms in domestic production coming from the introduction of better varieties of seeds that improves the paddy-to-rice yield, from reduction in post-harvesting losses, and from reduction in transaction costs. The second simulation assesses the impact on poverty of reforms that take place mainly in rural areas. It assumes the presence of market segmentation, where low quality rice is produced and consumed in rural areas and high quality milled rice is imported. Finally, the third simulation calculates the poverty impact of a rise in the price of rice.

Simulation 1: improving key elements in the rice market

This simulation implies a reduction in post-harvested losses, improvement in paddy-to-rice milling yields, and a reduction in broadly defined transaction costs. The two first elements are key technical components of the rice production system and are often indicated as the avenues for improving households' revenues (IRRI 1997 and JICA 2001). Broadly defined transaction costs were also identified as impediments for a development of the rice sector (see sector study on rice). To make an assessment of the impact of a change in these three components, a useful decomposition of the value of the *m* quality of paddy rice output is:

$$Value\, of\ Rice\, Output = Q_m^{PaddyRice}(1-phl_m^{PaddyRice})(1-t_m^{Rice})P_m^{PaddyRice}$$
$$= Q_m^{PaddyRice}(1-phl_m^{PaddyRice})(1-t_m^{Rice})(1-\alpha)\lambda P_m^{Rice}$$

where, $phl_m^{PaddyRice}$ denotes the per cent of post-harvested losses due to improper handling, lack of storage facilities, rodents, etc., assumed to be currently about 10 per cent; α denotes milling transformation costs, assumed fixed; and λ is the milling yield of paddy-to-rice, assumed to be 0.62 on average with some regional variation, by the MAFF. The term t_m^{Rice} adopts here the form of a tax equivalent transaction cost, assumed to be 10 per cent.

This simulation assess the impact of a plausible change in: a) $phl_m^{PaddyRice}$ from its current level of 10 per cent to 5 per cent, due, for instance, to an improvement in handling and packaging; b) in λ from its current level of 0.62 to 0.64, due, for instance, to a plausible and attainable improvement in rice variety; and c) in t_m^{Rice} from its current 10 per cent to 5 per cent, due to, for instance, to an improvement in infrastructure or to a diminishing in other transaction costs.
The impact on total household income would be:

$$\Delta Value\, of\ Rice\, Output = Q_m^{PaddyRice}(1-\alpha)P_m^{Rice}[\lambda_2(1-phl_{m,2}^{PaddyRice})(1-t_{m,2}^{Rice})-\lambda_1(1-phl_{m,1}^{PaddyRice})(1-t_{m,1}^{Rice})]$$

were the subscripts *1* and *2* denote the current value and the simulated new values, respectively.

$$\Delta Value\ \ of\ \ Rice\ \ Output\ = P_0\, Q_0 * [0.64 * (1-0.05)(1-.05) - 0.62\,(1-0.10)(1-010)]$$
$$= P_0\, Q_0 * [0.5776 - 0.5022]$$
$$= P_0\, Q_0 * 0.0754$$

In words, the combined simulated effect of a 5 percentage points improvement in post-harvested management, a 2 percentage points improvement in milling yield of paddy, and a 5 percentage points reduction in (broadly defined) transaction costs produced an increment in total value of production of 15 per cent (=0.5776/0.5022). The gains are directly linked to the amount of rice produced. As there is no effect on the equilibrium price of rice, all households gain, and net seller households gain more.

To calculate the impact at the household level by decile, the change in the value of rice output was divided by total household expenditures. The average gain in this simulation is 4.5 per cent (see table 4.6), with net sellers gaining 8.1 per cent and net buyers 1.4 per cent on average. The average gain for the first five deciles ranges from 4.7 to 5.8 per cent.

4.6 **Effect of a 5 per cent reduction in transaction costs, +3 per cent increase in milling yield, and +5 per cent reduction in post harvested losses, by decile, as per cent of total household expenditures**

	Decile (*)										
	1	***2***	***3***	***4***	***5***	***6***	***7***	***8***	***9***	***10***	***Total***
Urban											
Net Sellers	7.9	9.3	10.7	10.2	10.0	7.6	5.8	6.4	5.5	15.2	7.7
Net Buyers	2.4	1.7	0.8	1.1	1.0	0.8	0.9	0.7	0.4	0.0	0.4
Total Urban	3.7	5.3	3.5	3.3	3.1	2.8	2.8	3.3	1.9	0.8	2.0
Rural											
Net Sellers	9.2	8.8	8.5	8.3	9.0	8.7	7.6	7.0	5.5	5.3	8.1
Net Buyers	2.4	2.1	2.7	1.9	2.1	1.5	1.2	1.3	0.9	0.2	1.7
Total Rural	4.8	5.2	5.7	5.4	5.9	5.5	5.0	4.9	2.6	0.6	4.9
Net Sellers	9.1	8.9	8.6	8.3	9.0	8.6	7.5	6.9	5.5	10.1	8.1
Net Buyers	2.4	2.0	2.6	1.9	2.0	1.5	1.2	1.2	0.7	0.1	1.4
Total	4.7	5.2	5.7	5.3	5.8	5.4	4.8	4.7	2.4	0.7	4.5

(*) Deciles by per capita total equivalent consumption.

Source: Model results

Simulation 2: decreasing transaction costs in rural areas

As seen in the Sector Study on Rice, there are some localized areas that currently has no opportunities to access other domestic and international markets. Under this assumption of rice market segmentation (due for instance to different rice qualities that are trade only locally), this simulation assesses the impact on poverty of a decrease of 2.5 percentage points in transaction costs (or equivalently, in producer and consumer taxes) faced by producers and consumers *in rural areas*. This simulation provides a measure by decile of the payoff of any measure that increases the effective price received by the producer and that reduces the effective price paid by consumers in rural areas (see table 4.7). The average impact is 1.6 per cent, higher for net-sellers (2.4 per cent).

4.7 **Effect of a 2.5 per cent reduction in transport cost for consumption and production in rural areas, by deciles, as per cent of total household expenditures**

	Decile (*)										
	1	***2***	***3***	***4***	***5***	***6***	***7***	***8***	***9***	***10***	***TOTAL***
Urban											
Net Sellers	0	0	0	0	0	0	0	0	0	0	0
Net Buyers	0	0	0	0	0	0	0	0	0	0	0
Total Urban	0	0	0	0	0	0	0	0	0	0	0
Rural											
Net Sellers	2.9	2.7	2.6	2.6	2.7	2.6	2.4	2.3	2.0	3.0	2.6
Net Buyers	1.5	1.2	1.4	1.2	1.2	1.0	0.9	0.9	0.8	0.6	1.1
Total Rural	2.0	1.9	2.0	1.9	2.1	1.9	1.8	1.8	1.3	0.8	1.8
Net Sellers	2.8	2.6	2.5	2.5	2.7	2.6	2.3	2.0	1.4	1.5	2.4
Net Buyers	1.4	1.2	1.3	1.1	1.1	1.0	0.8	0.7	0.5	0.2	0.9
Total	1.9	1.8	1.9	1.8	1.9	1.9	1.7	1.5	0.8	0.3	1.6

(*) Deciles by per capita total equivalent consumption. (segmented markets assumption: this effects has an impact only in rural areas)
Source: Model results

For net consumers, the impact is given by:

$$\Delta NetIncome = P_m^{Rice}(1+t_m^{Deice})(X_m^{DRice} - X_m^{SRice}) * [\frac{-\Delta(1+t_m^{DRice})}{(1+t_m^{DRice})}]$$

with $\Delta t_m^{DRice} < 0$

For net producers, the impact is given by:

$$\Delta NetIncome = P_m^{Rice}(1-t_m^{SRice})(X_m^{SRice} - X_m^{DRice}) * [\frac{(1+\Delta t_m^{SRice})}{(1-t_m^{SRice})}]$$

with $\Delta t_m^{SRice} > 0$

Simulation 3: changes in the price of rice

As pointed out in the Sector Study on Rice, if the quality of rice produced locally is improved, this could reduce the need to import high quality rice and, if transports costs are also reduced, this could result in lower prices of high quality rice in urban areas, which is the principal market for the upper quality rice. In the absence of other efficiency gains, the increased domestic production of high quality rice could result in reduced supply and increased prices of lower quality rice, affecting low income consumers. This simulation provides a assessment of the distribution by per capita consumption decile of the impact of an increase in the price of rice. To keep the simulation simple, it is assumed that the rise in the price of rice of quality m is *under no tax and no distortions in the rice market* scenario (that is $t_m^w = 0$, for *w=Srice and Drice).* The change in net income is given by:

$$\Delta NetIncome = P_m^{Rice}(X_m^{SRice} - X_m^{DRice})\frac{\Delta[P_m^{Rice}]}{P_m^{Rice}}$$

The sign of the impact on a particular household will be given by sign of $(X_m^{SRice} - X_m^{DRice})$. For net rice seller households, the impact will positive, and negative for net rice buyer households. For a poverty analysis, it is important to identify where the negatively affected households are located in terms of per capita consumption. Are all of them poor?

4.8 **Effect of a 10 per cent increase in the price of rice, by decile, as per cent of total household expenditures, Cambodia**

	Decile (*)										
	1	***2***	***3***	***4***	***5***	***6***	***7***	***8***	***9***	***10***	***TOTAL***
Urban											
Net Sellers	1.9	2.8	3.2	3.5	2.9	2.9	1.7	2.2	1.8	5.7	2.5
Net Buyers	-2.2	-1.5	-1.7	-1.5	-1.5	-1.3	-1.2	-1.2	-1.0	-0.6	-1
Total Urban	-1.3	0.5	-0.4	-0.3	-0.5	-0.1	-0.1	0.3	-0.2	-0.3	-0.2
Rural											
Net Sellers	2.2	2.6	2.4	2.4	2.9	2.8	2.4	2.3	1.4	1.9	2.4
Net Buyers	-1.9	-1.4	-1.1	-1.2	-1.2	-1.2	-1.2	-1.2	-1.0	-0.7	-1.3
Total Rural	-0.4	0.5	0.7	0.8	1.1	1.0	0.9	1.0	-0.1	-0.5	0.6
Net Sellers	2.2	2.6	2.4	2.5	2.9	2.8	2.4	2.3	1.5	3.8	2.5
Net Buyers	-1.9	-1.4	-1.1	-1.2	-1.2	-1.2	-1.2	-1.2	-1.0	-0.7	-1.2
Total	-0.5	0.5	0.7	0.7	1.0	1.0	0.8	0.9	-0.1	-0.4	0.5

(*) Deciles by per capita total consumption

Source: Model results

This simulation indicates (see table 4.8) that, everything else constant (including the amount of rice consumed by each household), a rise of 10 per cent in the price of rice would increase the income of households that live in the urban area, belong to the first decile and are net sellers of rice, by an average amount equivalent to 1.9 per cent of their total household expenditures. By the same token, for households that live in the urban area, belong to the first decile and are net buyers of rice, the higher price of rice implies a loss of an average amount equivalent to 2.2 per cent of their total household expenditures. The last row of the table indicates that, considering the whole population, those belonging to the first, ninth and tenth deciles are losing due to the price increase (-0.5, -0.1 and –0.4 per cent of total expenditures, respectively), while people in all the other deciles on average win an equivalence to 0.5 and 1 per cent of their total expenditures. On average, as percentage of total expenditures, net sellers gain 2.5 per cent and net buyers lose 1.2 per cent respectively. For the whole country, there is a gain of 0.5 per cent.

Trade policy

As pointed out in the chapter on trade policy, the tariff structure has important implications for the government's export led economic development and poverty alleviation strategy. Due to high tariffs on semi processed and consumer goods, Cambodians are required to pay above international prices for basic needs, unless smuggling of imported goods circumvents these high prices. Table 4.9 shows the current tariff structure for the main categories for which detailed information on household consumption is available. Although for rice (the main single consumption item in households' budget) the tariff is only 7 per cent, for the different types of meat, for dairy products and for prepared and preserved vegetables, the tariff is above 30 per cent. Regarding non-food items, the average un-weighted tariff for clothing and footwear is 28 per cent. For fish the tariff is 18 per cent, which rises the domestic price above international level, but at the same time there is an export tax of 10 per cent that plays in the opposite direction. Since there is no detailed information on consumption of different types of fish, for this exercise it was assumed that there is no change in the tariff rate for fish and fish products.

This section makes an assessment of the impact of a reform that sets all tariffs to 7 per cent (see the chapter on trade policy for the rationale of such an uniform and low tariff level). Following above equation 3, households' change in net income after the tariff change is given by:

$$\Delta NetIncome \Big/ all\ \overline{q} = \sum_m P_m^{Rice}(1+t_m^{DRice})(X_m^{DRice} - X_m^{SRice})\frac{[P_m^{Rice}(t_{m1}^{DRice} - t_{m0}^{DRice})]}{P_m^{Rice}(1+t_m^{DRice})}$$
$$+\sum_n P_n^{Oth.Food}(1+t_n^{Oth.Food})(X_n^{D.Oth.Food} - X_n^{S.Oth.Food})\frac{[P_n^{Oth.Food}(t_{n1}^{Oth.Food} - t_{n0}^{Oth.Food})]}{P_n^{Oth.Food}(1+t_n^{Oth.Food})}$$
$$+\sum_o P_o^{NonFood}(1+t_o^{NonFood})X_o^{NonFood}\frac{\Delta[P_o^{NonFood}(t_{o1}^{NonFood} - t_{o0}^{NonFood})]}{P_o^{NonFood}(1+t_o^{NonFood})}$$

where, t_{ij}^{z} is the tariff level *i* of good *z (*rice, other food, and non-food consumption items), in moment *j* (0= before tariff reform, 1=after tariff reform). Since this simulation does not imply a change in the tariff of rice – it is already at 7 per cent — the first term of the right hand side is zero. The second term of the right hand side captures the fact that although most of the household are net consumer of the good and benefit from the lowering of tariff, some households could be net producers of the good and lose from the change in tariff. As indicated for the simulation of a change in the price of rice, by keeping quantities consumed and produced constant, the calculated change in net income table 4.9 underestimates gains — because demand would increase for those goods that are now relatively cheaper--

and overestimates loses — because production is expected to diminish after the change in price. That is to say, by applying the framework described in equation 3, we are obtaining a lower bound of favorable changes that may affect poor people, and an upper bound for the negative changes.

4.9 **Tariff rates for main consumer items**

Consumption item	*Share in total consumption, average for Cambodia*	*Current tariff level*
	%	
Rice (all varieties)	15.6	7
Other cereals and preparations (bread, maize, other grains, rice/wheat flour, noodles, biscuits, etc.)	2.6	19
Fish (fresh fish, shrimp, crab, fermented, salted and dried fish, canned fish, etc)	8.9	18(*)
Meat (pork, beef, buffalo, mutton, dried meat, innards)	5.0	35
Poultry (chicken, duck, and other fresh bird meat)	3.2	35
Eggs (duck egg, chicken egg, quail egg, fermented/salted egg, etc)	1.4	33
Dairy products (condensed milk, powdered milk, fresh milk, ice cream, cheese, other dairy products, etc.)	0.9	33
Oil and fats (vegetable oil, pork fat, rice bran oil, butter, margarine, coconut/frying oil. Etc)	1.3	7
Fresh vegetables (trakun, cabbage, eggplant, cucumber, tomato, green gourd, beans, onion, shallot, chili, etc.)	4.3	7
Tuber (cassava, sweet potato, potato, traov, jampada, etc.)	1.4	7
Pulses and legumes (green gram, dhall, cowpea, bean sprout, other seeds, etc.)	1.0	7
Prepared and preserved vegetables (cucumber pickles, other pickles, tomato paste, etc.)	0.8	34
Fruit (banana, mango, orange, pineapple, lemon, watermelon, papaya, durian, grape, apple, canned and dried fruit, etc.)	2.8	7
Other fruits and seeds (coconut, cashew nut, lotus seed, peanut, gourd seed, other nuts)	1.2	12
Sugar, salt (sugar, jaggery, sugar products, including candy, and salt, etc.)	1.4	11

(Continued on next page)

4.9 **Tariff rates for main consumer items** (Continued)

Consumption item	*Share in total consumption, average for Cambodia)*	*Current tariff level*
	%	
Spices and seasoning (fish sauce, soy sauce, vinegar, garlic, ginger, coriander, red pepper, monosodium glutamate, etc.)	1.7	16
Tea, coffee, cocoa	0.8	24.5
Non alcoholic beverages (drinking water, sugar cane juice, syrup with ice, bottled soft drink, fruit juice, etc.)	0.8	35
Alcoholic beverages (rice wine, other wine, beer, whisky, palm juice, etc.)	1.6	35
Tobacco products (cigarettes, mild tobacco, strong tobacco, etc)	2.2	26
Other food products (fried insects, peanut preparation, flavored ice, ice, other food products)	1.0	22
Food taken away from home (meals at work, school, restaurants, snacks, coffee, soft-drinks purchases outside home)	2.9	(**)
Prepared meals bough outside and eaten at home	0.8	(**)
Total food	64.0	
Textiles and footwear	2.9	28

(*) There is also an export tax of 10 per cent on fish.

(**) The effect is going to be indirect, through the tradable contents of these mostly non-tradable final goods.

Source: MOC 2001

Table 4.10 presents the results for this simulation. The lower prices due to tariff reduction imply and improvement of 4 percentage points in average household purchasing power. Most of this impact is coming from reduced prices in food items (3.5 per cent of per capita household expenditures) and a smaller part from reduced prices on clothing and footwear (0.5 per cent of per capita household expenditures).

4.10 **Effect of reducing Food and Clothing and Footwear tariffs to 7 per cent**

	Decile (*)										
	1	***2***	***3***	***4***	***5***	***6***	***7***	***8***	***9***	***10***	***avg***
Urban areas											
Effect from Food	2.7	2.9	3.7	3.5	3.6	4.1	4.5	4.8	4.6	3.6	3.9
Effect from Clothing & Footwear	0.2	0.4	0.4	0.5	0.4	0.3	0.4	0.4	0.4	0.4	0.4
Total Urban	2.9	3.3	4.1	4.0	4.0	4.4	4.9	5.2	5.1	4.0	4.3
Rural areas											
Effect from Food	2.8	3.2	3.4	3.4	3.4	3.6	3.8	3.7	3.9	3.8	3.5
Effect from Clothing & Footwear	0.5	0.4	0.5	0.5	0.5	0.5	0.6	0.5	0.5	0.4	0.5
Total Rural	3.3	3.7	3.9	3.9	3.9	4.1	4.3	4.2	4.3	4.2	4.0
Total Cambodia											
Effect from Food	2.8	3.2	3.4	3.4	3.4	3.6	3.8	3.9	4.1	3.7	3.5
Effect from Clothing & Footwear	0.4	0.4	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.4	0.5
Total Rural and Urban	3.2	3.7	3.9	3.9	3.9	4.1	4.4	4.4	4.6	4.1	4.0

(*) Deciles of per capita adult equivalent consumption.

Source: Model results

Land distribution

Land is the only important productive asset and store of wealth for about 85 per cent of Cambodia people, whose main income is derived from agricultural activities for subsistence and marketing (Sik Boreak 2000). Hence, access to land is one key issue in poverty reduction and rural development (Figueiredo and Walraven 2001). This simulation make an assessment of the poverty impact of land distribution. We simulated that 0.5 has of land is given free of charge to all households engaged in farming and with an operated land size of less or equal to 0.5 has. About 265000 households are each receiving 0.5 has of land.

The impact on income of 1 extra hectare of land is calculated as the *village* average net income per hectare from cultivation activities. Thus, the net impact on household *ij* income of 0.5 additional hectares of land was imputed as:

$$\Delta NetIncome_{ij} = 0.5 * NYCha_j$$

where $\Delta NetIncome_{ij}$ is the increase in Net Income of household *i* that belongs to village *j*, and $NYCha_j$ is the Average Net Income per hectare from cultivation activities in village *j*.

Average $NYCha_j$ by region is presented in the table 4.11. In general, it can be said that the higher the consumption decile, the higher the impact due most probably to a higher use of capital and modern inputs in production. The average net income per hectare is 1126 thousands of 1999 riels (equivalent to U$S 295).

This average seems a bit high if the household is only planting rice. According to the IRRI study ('Rice production in Cambodia', H.J. Nesbitt Editor, 1997), the net return to family the household factor is about 80 per cent of total revenue for the case of rice. This means that, if all land is devoted to rice production, the gross average income per hectare is about 1407000 riels (=1126000/0.8). Considering an average of 1.9 tons of paddy rice/ha, this implies a gate price for paddy rice of about 740000 riels per ton, which is higher to the paddy prices that prevailed in 1999 (about 500 000 riels per ton). The figure of 1126000 riels per hectare is more plausible if one consider that on average only 73 per cent of the income from cultivation is coming from rice, the other 27 per cent is coming from other crops, including vegetables and tubers that have a higher income of riel per hectare.

4.11 **Average net income per hectare, by region, in thousands of riels of 1999(*)**

	Decile										
Region	*1*	*2*	*3*	*4*	*5*	*6*	*7*	*8*	*9*	*10*	*avg*
Phnom Penh, Rural	751	640	812	705	780	765	761	1464	1821	1425	1192
Plain, Urban	1072	866	996	866	992	687	1411	1340	1508	1360	1363
Plain, Rural	944	880	1125	1252	1366	1490	1521	1598	1651	1811	1295
T.Sap Urban	889	780	564	519	772	1226	635	1067	1207	865	958
T.Sap Rural	835	888	961	938	1035	965	867	880	845	734	918
Coastal, Urban	1063	1137	999	1137	1053	958	989	1013	943	969	1005
Coastal, Rural	678	728	763	688	725	783	930	716	643	525	747
Plateau, Urban	640	1063	1091	1111	1814	2399	1318	2545	1603	1453	1648
Plateau, Rural	593	1119	857	1047	1035	996	1181	1164	902	946	1010
Total	875	878	1017	1067	1155	1248	1274	1343	1281	1331	1126

(*) Average net income of farming households with operating farm size between 0.5 and 1.5 has

(**) Deciles by per capita total equivalent consumption.

Source: Model results

(Agricultural Statistics 1999-2000, Statistics Office, Department of Planning and International Cooperation, Ministry of Agriculture, Forestry and Fisheries). Table 4.12 presents the number of households and the number of people affected by the land distribution. The number of hectares distributed is 132600 hectares (=number of households * 0.5). Table 4.13 presents the impact of this simulation as a percentage of total household ij consumption, by decile. Table 4.14 presents the impact of this simulation only on those households that received the 0.5 hectares of land.

4.12 **Number of families and number of people beneficiated by the land distribution (0.5 has of agricultural land is given to farming households with less that 0.5 ha), in 000**

Number of families and number of people beneficiated by the land distribution (0.5 has of agricultural land is given to farming households with less that 0.5 ha), in 000

	Decile										
	1	***2***	***3***	***4***	***5***	***6***	***7***	***8***	***9***	***10***	***TOTAL***
Number of families affected Urban	1.2	0.8	1	1.7	1.5	0.9	1.6	2.7	6	4.7	22.2
Number of families affected Rural	32.0	27.1	31.2	30.7	36.1	17.1	25.0	20.8	16.9	6.0	243.0
Total number of families affected Urban + Rural	33.2	27.9	32.2	32.5	37.7	18.1	26.6	23.5	22.9	10.7	265.2
Total number of people affected	176.8	150.7	141.7	152.4	184.5	84.8	126.3	100.7	96.1	52.2	1266.2

Source: Model results

4.13 **Effect of a land distribution: 0.5 has of agricultural land is given to farming households with less that 0.5 ha In per cent of per capita household consumption**

	Decile										
	1	***2***	***3***	***4***	***5***	***6***	***7***	***8***	***9***	***10***	***avg***
Urban	1.5	2.0	2.1	4.0	2.5	2.3	1.4	1.3	1.6	1.6	1.7
Rural	3.5	1.5	2.0	2.3	2.4	1.3	1.9	2.2	1.3	0.9	2.1
Female headed household	6.2	2.5	3.2	5.4	4.7	4.3	1.4	4.1	3.7	0.6	3.9
Male headed household	2.8	1.4	1.8	1.5	2.0	0.9	1.9	1.6	1.1	1.2	1.7
Total	3.4	1.6	2.0	2.3	2.4	1.3	1.8	2.1	1.4	1.1	2.0

(*) Deciles by per capita total equivalent consumption. 0.5 has of land is given to all households engaged in farming and with an operated land size of less or equal to 0.5 has. The impact on income is then calculated as ½ of the village average net income per hectare from cultivation activities

Source: Model results

This simulation indicates that, everything else constant a land distribution of 0.5 has to farmers that currently operate less than 0.5 has of land, rises households' income by an average amount equivalent to 2 per cent of total household expenditures. The highest impact is observed in those female headed household in the first decile (6.2 per cent).

Table 4.14 shows the impact on those households that actually received land. The average impact is equivalent to 16.4 per cent of household expenditures, and is bigger for rural areas (16.8 per cent).

4.14 **Effect on per capita consumption in those households that received land**

	Decile										
	1	***2***	***3***	***4***	***5***	***6***	***7***	***8***	***9***	***10***	***Total***
Urban	20.7	17.5	8.6	14.9	11.6	14.2	12.1	14.3	12.3	9.0	12.5
Rural	21.5	12.4	16.9	18.3	14.4	15.8	17.9	22.2	12.9	7.0	16.8
Total	21.5	12.5	16.4	18.1	14.3	15.8	17.5	20.9	12.7	7.9	16.4

Source: Model results

What have we learned

There are several avenues by which poverty can be reduced (that is, the income of the lowest decile increased) in Cambodia. This chapter provided an assessment of the likely impact of some of them. The assumptions involved in each scenario are, to say the least, strong, but still results provide a sense of the direction of the likely impact. Among all the simulations done, the improvement in two key elements of rice production technology (paddy-to-rice yield and post-harvested losses) in addition to the lowering of transaction costs is expected to provide a strong improvement in the livelihoods of poor Cambodians, and can be identified clearly as a pro-poor strategy . Tariff reform (that is setting all tariffs to 7 per cent) would have a direct effect on consumption of about the same magnitude as the previous simulation, but, there are going to be income effects that were not accounted for that may cushion the short term impact of such a reform. Finally, the scenario of land distribution to about 265 000 Cambodian small farmers produced a high impact on those households directly benefited by the reform.

Annexes

A Cambodia: medium term macroeconomic framework

Baseline scenario

Background

Cambodia's macroeconomic framework presented here is consistent with the framework for the Third Review Under the PRGF approved by the IMF Board of Directors on 18 July 2001 (IMF 2001). However, its update is underway in the context of the Fourth Review under the PRGF. The updated framework would take into account recently revised national account series and the short term impact of the deterioration in the world economic outlook since September 2001. It would also reflect the government's medium term fiscal stance and reform agenda on military demobilization and administrative reform, and the expected normalization of relations with bilateral creditors.

The baseline scenario is based on the government's outward looking development strategy, combining public and private investment aimed at improving infrastructure for service delivery and broadening the export base of agricultural and manufacturing products. The main assumptions underlying the baseline are: i) maintenance of a stable political and security situation; ii) sustained implementation of financial policies aimed at a establishing a sound macroeconomic environment; and iii) timely implementation of a structural reform agenda aimed at fostering resource efficiency. Key quantitative assumptions are specified in table A.1.

Growth and inflation

Economic growth is assumed to remain sustained at an annual rate of 6 per cent through 2003 and increase to 6.5 per cent thereafter, when the implementation of crucial structural reforms, especially in the fiscal and banking areas, is well advanced. *Inflation* is expected to remain below 5 per cent, owing to appropriately restrained fiscal and monetary policies.

Fiscal sustainability

Medium term fiscal sustainability critically hinges upon raising revenue in relation to GDP and reallocating expenditure from military and security spending toward social expenditure. Under the baseline scenario, revenue would increase from 11.8 to 14.0 per cent of GDP by 2006, a level still much lower than countries with comparable income. Revenue collection efforts in the period ahead are expected to focus mainly on a broadening of the tax base, and improved tax administration, while reduced trade-related taxes in context of trade liberalization would be offset by increased excises. In parallel, in-depth administrative reform and military demobilization together with enhanced expenditure management are expected to play a crucial role toward maintaining sustainable fiscal balances and reorienting expenditure toward the social sectors.

The external environment

Trade — Exports

Total exports are expected to decline slightly from 44 per cent of GDP in 2000 to about 38 per cent of GDP in 2006. Re-exports, accounting for 21 per cent of total export in 2000, are assumed to decline gradually in relation to GDP throughout the medium term. The share of traditional exports (for example, forestry products, rubber and rice) in total exports is assumed to increase gradually in the medium term, as exports of forestry products are expected to recover as a result of the ongoing forestry reform. Nontraditional exports are anticipated to grow rapidly, mostly on account of garments. Unrecorded exports are believed to be large; however, the only estimates for unrecorded exports considered in the baseline scenario are those for unrecorded log and timber products, and rubber products.

Following a sharp increase since 1998 in the range of 50-80 per cent annually, garment exports are projected to grow by 5-7 per cent annually, reflecting the global economic slowdown and tougher competition from neighboring countries. Forestry product exports declined drastically in 2000, largely owing to government’s efforts to strengthen monitoring of illegal logging activities. For the medium term it is assumed that log and sawn timber exports will converge to a sustainable level of production. Rubber exports and rice surplus exports are projected to remain marginal.

Trade — Imports

Retained imports (that is, excluding imports for re-export) account for about 83 per cent of total imports in 2000; they are expected to decrease from 45 per cent of GDP in 2000 to 39 per cent in 2006, reflecting, inter alia, the declining oil price path. The composition of retained imports would change gradually, with increased imports of investment goods in line with projected foreign direct investment flows.

Services and transfers

Under the baseline scenario a conservative growth of tourism receipts has been assumed, due to bottlenecks to tourism expansion (for example, airport and hotel capacity constraints). Accordingly, *tourism receipts* are assumed to grow by 5 per cent from 2004 onward after some dramatic increases of 10-20 per cent per annum in 2002-03. *Net private transfers* are assumed to remain broadly stable in the medium term, while continued large inflows of official transfers would be still required.

External balances

The *current account deficit* (excluding official transfers) is expected to decline gradually from about 10 per cent of GDP in 2000 to 8 per cent in 2006. *External financing requirements* are assumed to be covered through a mix of concessional multilateral and bilateral loans together with rescheduling of existing debt on favorable terms. FDI would also cover a significant portion of Cambodia's financing requirement, assuming that efforts to attract foreign investment are successful. Based on traditional debt indicators as of end 2000 (debt service ratio of 5 per cent of exports of goods (excluding re-exports) and services, debt stock of 66 per cent of GDP). Cambodia does not meet the qualifying criteria for debt relief arrangements under the Heavily Indebted Poor Countries (HIPC). However, taking into account Cambodia's limited payment capacity, the medium term scenario assumes the completion of rescheduling agreements for outstanding debt on concessional terms within the context of the Paris Club. Gross official reserves would increase gradually from the equivalent of 2.8 months of imports of goods and services in 2000 to 3.6 months in 2006.

Sensitivity analysis

The sensitivity of the baseline scenario selected changes in key trade assumptions is highlighted below. Three alternative trade related scenarios have been considered. However, the downside risks stemming from the deterioration of security and political situation and policy implementation slippages that could thwart the medium term outlook are not addressed in this exercise.

Alternative scenario I: higher growth rate of garment exports

One percentage point increase over the baseline would lead to an improvement of the current account deficit by 0.5 percentage points to 7.6 per cent of GDP in 2006. Another possible way of improving the garment sector's contribution toward strengthening the external balance would be to increase the domestic content of garment production through developing domestic inputs to garment factories. Since the import content of the garment industry is currently estimated at 65 per cent, a 5 per cent reduction in the import content would reduce the current account deficit by 1.5 percentage points, to 6.6 per cent of GDP in 2006.

Alternative scenario II: higher growth rate of traditional exports

Traditional exports accounted for only 6.1 per cent of total exports in 2000. Accordingly, a rapid growth of traditional exports would not affect drastically the balance of payments medium term prospects. For example, a doubling of the annual growth of rubber exports would only improve the current account deficit by 0.7 per cent of GDP in 2006.

Alternative scenario III: faster increase in tourism receipts

Addressing the airport and hotel capacity constraints would allow for significant increases in tourism receipts over the medium term. Assuming a 20 per cent growth of tourist arrivals over 2001–06, tourism receipts would reach about $500 million by 2006, thus improving the current account deficit (excluding grants) compared with baseline by about 3.7 percentage points of GDP.

Summary

The above scenarios are summarized below:

A.1 **Current account deficit (excluding official transfers)**

Scenarios	***2000***	***2001***	***2002***	***2003***	***2004***	***2005***	2006
				% of GDP			
Baseline [a]							
Scenario I[b]							
Scenario I[c]							
Scenario II[d]							
Scenario III[e]							

a As presented in the Third Review Under the Poverty Reduction and Growth Facility (PRGF) (IMF 2001)

b Assuming a one percent point increase in the growth rates of garment exports over the baseline scenario.

c Assuming a 5 per cent reduction over the medium term in the import content of garment exports, compared to the baseline scenario.

d Assuming a doubling of the growth rate of rubber exports compared to the baseline.

e Assuming a faster increase in tourism receipts compared to the baseline scenarios (that is, a 20 per cent annual growth of tourist arrivals over 2001–06 as against 10–20 per cent up to 2003, and 5 per cent thereafter in the baseline scenario)

Source: IMF staff estimates

B Cambodian excise taxes

B.1 Excise taxes imposed in Cambodia (2000 and 2001)

Product	*Import tariff rate*	*Excise tax rate*	*Import tariff rate*	*Excise tax rate*
Mineral water with sugar added	35	10	35	10
Distilled spirits (brandy, whisky etc)	50	10	35	33.3
Fermented spirits				
Beer	35	10	35	10
Wine	50	10	35	33.3
Cider	35	10	35	10
Medicated samsu	50	10	35	10
Bitters	50	10	35	10
Cigar, cigarillos, cigarettes from tobacco and substitutes	50	10	35	25
Beedies etc	7	10	7	10
Perfume	50	0	35	10
Gasoline	50	20	35	33.3
Diesel	20	0	15	4.35
Petroleum spirits	20	20	5	4
Solvents	20	0	15	5
Lubricating oils	20	20	15	25
Motor vehicles				
Transport more than 10 persons	15	10	15	10
Passenger vehicles:				
1000-1500cc	30	20	35	15
1500-3000cc	40	20	35	45
3000-4000cc	90	30	35	80
>4000cc	120	30	35	110
Transport for goods	15	110	15	10
Motorcycles				
<50cc	20	0	15	5
50-125cc	20	0	15	45
125-800cc	20	10	15	45

C Effective tariff rates

C.1 **Average effective tariff rate on imports, 2 digit HS headings**

Code	*Description*	*Unweighted average nominal tariff rate*	*Import weighted average tariff rate*	*Effective tariff rate*	*Share of total customs revenue*	*Share of total imports*
22	Beverages, spirits and vinegar	45	35	35	2.3	0.4
46	Manufactures of straw, or of other plaiting materials;	35	35	35	0.1	0.0
02	Meat and edible meat offal	35	35	35	0.0	0.0
27	Mineral fuels, mineral oils and products of their distillation	13	23	23	43.8	12.7
95	Toys, games and sports requisites; parts and accessories	14	30	29	0.5	0.1
20	Preparations of vegetables, fruit ,nuts or other parts of plants	34	26	26	0.3	0.1
87	Vehicles and other than railway or tramway rolling-stock, and parts and accessories thereof	28	27	19	14.5	5.1
18	Cocoa and cocoa preparations	33	19	19	0.0	0.0
57	Carpets and other textile floor coverings	35	28	19	0.1	0.0
21	Miscellaneous edible preparations	22	19	18	0.3	0.1
33	Essential oils and resins; perfumery, cosmetics, soap, washing preparations, etc	28	17	17	0.4	0.2
11	Products of the milling industry; malt; starches; wheat gluten	32	17	16	0.5	0.2
03	Fish and crustaceans, molluscs and other aquatic invertebrates	18	15	15	0.0	0.0
24	Tobacco and manufactured tobacco substitutes	34	8	7	5.4	5.4

(Continued on next page)

C.1 Average effective tariff rate on imports, 2 digit HS headings (Continued)

Code	*Description*	*Unweighted average nominal tariff rate*	*Import weighted average tariff rate*	*Effective tariff rate*	*Share of total customs revenue*	*Share of total imports*
14	Vegetable plaiting materials; vegetable products not elsewhere specified or included	15	15	15	0.0	0.0
04	Dairy produce; birds' eggs; natural honey; edible products of animal origin, not elsewhere specified or included	33	17	15	0.5	0.2
13	Lac; gums, resins and other vegetable saps and extracts	25	15	14	0.0	0.0
61	Articles of apparel and clothing accessories, knitted or crocheted	30	34	18	0.2	0.1
81	Other base metals	7	13	13	0.0	0.0
12	Oil seeds and oleaginous fruits; etc	13	13	13	0.1	0.1
25	Salt; sulphur; earths and stone; plastering materials, lime and cement	13	15	13	4.4	2.2
37	Photographic or cinematographic goods	15	14	12	0.1	0.1
36	Explosives; pyrotechnic products; matches; pyrophoric alloys; certain combustible preparations	24	10	10	0.0	0.0
09	Coffee, tea, maté and spices	16	12	9	0.0	0.0
19	Preparations of cereals, flour, starch or milk; etc	12	9	8	0.8	0.7
06	Live trees and other plants; bulbs, roots and the like; cut flowers and ornamental foliage	15	15	10	0.0	0.0
70	Glass and glassware	17	8	8	0.3	0.2
07	Edible vegetables and certain roots and tubers	7	7	7	0.1	0.0
08	Edible fruit and nuts; peel of citrus fruit or melons	7	7	7	0.2	0.2
63	Other made up textile articles; sets; worn clothing and worn textile articles; rags	25	7	7	3.5	3.3
82	Tools, implements, cutlery, of base metal	13	12	9	0.1	0.1

(Continued on next page)

C.1 Average effective tariff rate on imports, 2 digit HS headings (Continued)

Code	*Description*	*Unweighted average nominal tariff rate*	*Import weighted average tariff rate*	*Effective tariff rate*	*Share of total customs revenue*	*Share of total imports*
68	Articles of stone, plaster, cement, asbestos, mica or similar materials	18	8	7	0.2	0.2
69	Ceramic products	8	7	7	0.8	0.7
17	Sugars and sugar confectionery	11	7	7	0.8	0.9
29	Organic chemicals	11	7	7	1.7	1.7
44	Wood and articles of wood; wood charcoal	31	34	9	0.0	0.0
74	Copper and articles thereof	13	9	7	0.0	0.0
79	Zinc and articles thereof	7	8	6	0.1	0.1
76	Aluminium and articles thereof	9	7	6	0.7	0.8
91	Clocks and watches and parts thereof	18	14	9	0.0	0.0
93	Arms and ammunition; parts and accessories thereof	38	17	7	0.0	0.0
78	Lead and articles thereof	10	8	5	0.0	0.0
40	Rubber and articles thereof	18	23	9	0.9	0.7
15	Animal or vegetable fats and oils and their cleavage products; prepared edible fats; animal or vegetable waxes	7	7	6	0.4	0.5
51	Wool, fine or coarse animal hair; horsehair yarn and woven fabric	7	7	6	0.0	0.0
85	Electrical machinery and equipment, electronics etc	23	16	7	4.0	3.8
32	Tanning or dyeing extracts; tannins and their derivatives; dyes, pigments and other colouring matter; paints and varnishes; putty and other mastics; inks	21	16	8	0.2	0.1
94	Furniture; bedding, mattresses, mattress supports, cushions and similar stuffed furnishings; lamps and lighting fittings, not elsewhere specified or included; illuminated signs, illuminated name-plates and the like; prefabricated buildings	27	24	8	0.5	0.4

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C.1 Average effective tariff rate on imports, 2 digit HS headings (Continued)

Code	*Description*	*Unweighted average nominal tariff rate*	*Import weighted average tariff rate*	*Effective tariff rate*	*Share of total customs revenue*	*Share of total imports*
45	Cork and articles of cork	27	13	2	0.0	0.0
80	Tin and articles thereof	11	28	0	0.0	0.0
72	Iron and steel	7	7	5	1.2	1.7
38	Miscellaneous chemical products	8	7	4	0.2	0.2
28	Inorganic chemicals; organic or inorganic compounds of precious metals, of rare-earth metals, of radioactive elements or of isotopes	7	7	4	0.1	0.1
85	Electrical machinery and equipment, electronics etc	23	16	7	4.0	3.8
32	Tanning or dyeing extracts; tannins and their derivatives; dyes, pigments and other colouring matter; paints and varnishes; putty and other mastics; inks	21	16	8	0.2	0.1
94	Furniture; bedding, mattresses, mattress supports, cushions and similar stuffed furnishings; lamps and lighting fittings, not elsewhere specified or included; illuminated signs, illuminated name-plates and the like; prefabricated buildings	27	24	8	0.5	0.4
45	Cork and articles of cork	27	13	2	0.0	0.0
73	Articles of iron or steel	15	11	4	0.6	1.0
34	Soap, organic surface-active agents, washing preparations, lubricating preparations, artificial waxes, prepared waxes, polishing or scouring preparations, candles and similar articles, modelling pastes, 'dental waxes and dental preparations with a basis	15	8	5	0.3	0.4
42	Articles of leather; saddlery and harness; travel goods, handbags and similar containers; articles of animal gut (other than silk-worm gut)	32	29	7	0.1	0.1

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C.1 Average effective tariff rate on imports, 2 digit HS headings (Continued)

Code	*Description*	*Unweighted average nominal tariff rate*	*Import weighted average tariff rate*	*Effective tariff rate*	*Share of total customs revenue*	*Share of total imports*
92	Musical instruments; parts and accessories of such articles	7	7	4	0.0	0.0
84	Nuclear reactors, boilers, machinery and mechanical appliances; parts thereof	15	15	4	4.8	7.3
31	Fertilisers	0	0	0	0.0	0.2
30	Pharmaceutical products	0	0	0	0.0	2.8
39	Plastics and articles thereof	10	17	4	1.0	1.8
48	Paper and paperboard; articles of paper pulp, of paper or of paperboard	7	7	3	1.0	2.6
82	Miscellaneous articles of base metal	19	24	3	0.1	0.2
23	Residues and waste from the food industries; prepared animal fodder	9	7	3	0.0	0.1
43	Furskins and artificial fur; manufactures thereof	25	30	4	0.0	0.0
90	Optical, photographic, cinematographic, measuring, checking, precision, medical or surgical instruments and apparatus; parts and accessories thereof	17	8	3	0.3	0.8
67	Prepared feathers and down and articles made of feathers or of down; artificial flowers; articles of human hair	35	35	4	0.0	0.0
16	Preparations of meat, of fish or of crustaceans, molluscs or other aquatic invertebrates	32	7	3	0.1	0.2
35	Albuminoidal substances; modified starches; glues; enzymes	29	16	1	0.0	0.2
54	Man-made filaments	7	7	2	0.3	1.2
89	Ships, boats and floating structures	20	20	3	0.0	0.1
64	Footwear, gaiters and the like; parts of such articles	21	8	2	0.2	0.6

(Continued on next page)

C.1 Average effective tariff rate on imports, 2 digit HS headings (Continued)

Code	*Description*	*Unweighted average nominal tariff rate*	*Import weighted average tariff rate*	*Effective tariff rate*	*Share of total customs revenue*	*Share of total imports*
65	Headgear and parts thereof	35	35	3	0.0	0.0
05	Products of animal origin,not elsewhere specified or included	14	15	1	0.0	0.0
88	Aircraft, spacecraft, and parts thereof	8	9	1	0.0	0.0
49	Printed books, newspapers, pictures and other products of the printing industry; manuscripts, typescripts and plans	6	1	1	0.1	0.8
10	Cereals	10	9	0	0.0	0.8
96	Miscellaneous manufactured articles	15	7	0	0.1	1.7
56	Wadding, felt and nonwovens; special yarns; twine, cordage, ropes and cables and articles thereof	34	34	0	0.1	0.9
62	Articles of apparel and clothing accessories, not knitted or crocheted	30	35	1	0.1	1.5
59	Impregnated, coated, covered or laminated textile fabrics; textile articles of a kind suitable for industrial use	22	20	0	0.0	0.1
86	Railway or tramway locomotives, rolling-stock and parts thereof; railway or tramway track fixtures and fittings etc	15	15	0	0.0	0.0
01	Live animals	7	2	0	0.0	0.0
58	Special woven fabrics; tufted textile fabrics; lace; tapestries; trimmings; embroidery	35	35	0	0.1	1.3
50	Silk	7	7	0	0.0	0.0
71	Natural or cultured pearls, precious or semi-precious stones, precious metals, metals clad with precious metal, and articles thereof; imitation jewelry; coin	42	0	0	0.1	2.4
52	Cotton	7	7	0	0.0	1.4
97	Works of art, collectors' pieces and antiques	0	0	0	0.0	0.0

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C.1 Average effective tariff rate on imports, 2 digit HS headings (Continued)

Code	*Description*	*Unweighted average nominal tariff rate*	*Import weighted average tariff rate*	*Effective tariff rate*	*Share of total customs revenue*	*Share of total imports*
55	Man-made staple fibres	7	7	0	0.1	15.9
60	Knitted or crocheted fabrics	18	35	0	0.1	9.1
41	Raw hides and skins (other than furskins) and leather	29	35	0	0.0	0.8
53	Other vegetable textile fibres; paper yarn and woven fabrics of paper yarn	7	12	0	0.0	0.0

[a] Effective tariff rate is the ration of customs revenue to value of imports

D Investment restrictions

D.1 Sectors with investment restrictions

Industries closed to both foreign and national investors	*Rationale*	*Conditions*
Manufacture/processing of cultural items		Subject to ministerial approval
Sawn timber, veneer, plywood, wood based products utilising local logs as raw materials	Forestry conservation	
Toxic chemicals	Public health, international treaty	
Manufacture of psychotropic substances	Public health	
Manufacture and processing of narcotic drugs	Public health	
Manufacture of weapons and ammunitions	National security	
Manufacturing of firecrackers and fireworks	Public security	
Manufacturing related to defence and security	National security	
Plantation of medicinal and traditional herbs	Reserved for farmer	
Native chicken, cattle, buffalo and duck	SME policy	
Endangered fresh water fish	Endangered species	
Mining of radioactive minerals	National security	
Industries closed to foreign investment		
Genetic resources (biodiversity)	Environment protection	
Fresh water fishing	Reserved for small scale enterprises	
Small scale mining	Reserved for local people	
Industries open with restrictions to foreign investment		
Manufacture of cigarettes	Industry protection	Only for 100% export
Alcohol	Industry protection	Subject to ministerial approval

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D.1 **Sectors with investment restrictions** (Continued)

Industries closed to both foreign and national investors	***Rationale***	***Conditions***
Movie production		Subject to ministerial approval
Exploitation of gemstones		Local equity participation
Bricks made of clay and tiles		Local equity participation
Rice mill		Local equity participation
Manufacture of wood and stone carving		Local equity participation
Silk weaving		Local equity participation
All types of food, fruit crops, industrial crops and processing industries		Partnership with local farmers association
Chicken farms - boiler and layer		Partnership with local farmers association
Livestock farms		Partnership with local farmers association
Manufacturing related services		
Publishing including newspaper, journals, periodicals and recorded media		Subject to discussions with Ministry of Information and Ministry of Culture and Fine Arts
Printing		Foreign equity restricted to maximum of 49%
Service activities related to printing		
Radio and television activities		

Source: Royal Government of Cambodia.

E Cambodia's CEPT schedule

E.1 Cambodia's CEPT schedule 2001

Base rate	*0*	7	15	35	Total	Total tariff lines
	%	%	%	%	%	%
Inclusion List						
Tariff lines in NT	139	590	1017	257	2003	29.4%
Tariff lines in FT	97	767	63	185	1112	16.3%
Total	236	1357	1080	442	3115	45.7%
Temporary Exclusion List						
Tariff Lines	44	1377	828	1275	3524	51.7%
Sensitive List						
Tariff Lines	0	23	15	12	50	0.7%
General Exclusion List						
Tariff Lines	17	1	13	103	134	2.0%

NT refers to normal track; FT refers to fast track. See text for details.

RCG intends to commence transferring goods from the Temporary List to the Inclusion List beginning January 2005.

Source: Ministry of Economy and Finance.

E.2 Cambodia's tariff reduction schedule for AFTA

Base rate	*Track*	*Year*							
		2001	*2002*	*2003*	*2004*	*2005*	*2006*	*2007*	*2010*
%		%	%	%	%	%	%	%	%
7	F	7		6		0–5			
	N	7		6			0–5		
15	F	15		10		0–5			
	N	15		10		7		0–5	
35	F	20	15		10		7	0–5	
	N	20		15			10		0–5

Source: Ministry of Economy and Finance.

F Documentation processes

Documentation process for garment exports to country requiring proof of Cambodian origin

Preliminary Step — *Registration with the Trade Preference Department of MOC.* Every 12 months each garment exporter must register with the TPD. Twelve different documents must be filed with the TPD in addition to details of individual machine output and a description of garments produced. Required documents include photographs of the goods to be produced, copy of registration with CDC, and a copy of membership certificate of the Garment Association. Each month registered garment exporters must provide TPD with details of their inventory and imports of raw materials together with bills of lading.

Step One – For each export consignment the Cambodian manufacturer must apply in writing to MIME for a Certificate of Processing. Ministry officials will inspect the factory to confirm that the consignment garments are capable of being manufactured in the factory.

Step Two – Within four weeks prior to shipping the garment manufacturer applies to the Trade Preferences Department of the Ministry of Commerce for the necessary document evidencing proof of Cambodian origin. Based on the garment manufacturer's history of good compliance, Department officials shall decide whether to visit the factory to assess if the goods intended to be exported have been, or are about to be, manufactured at the factory. The TPD provides a TEA in the same form as the final proof of origin document. The TEA permits the manufacturer to export the garments described therein to the stated export destination. If details of the eventual consignment change then a new TEA must be issued.

Garment manufacturers require an Export License (valid for six months) and Certificate of Origin if exporting to the EU. The same application form and supporting documents are used by both the Foreign Trade Department to issue the Licence and the TPD to issue the Certificate of Origin at the same time. Garment exports under quota to the US require a Commercial Invoice. Garment exports enjoying GSP access to other destinations require a Certificate of Origin.

If raw materials are sourced in ASEAN or the EU then garment exporters to the EU only require the Licence and certificates from the countries of origin of the raw materials. In practice, the TPD continues to issue a Certificate of Origin for the EU in addition to an Export Licence in order to strengthen its defence of Cambodian origin, even though this is no longer required by the EU under the 1999 textile agreement with RGC.

Step Three – Before the garments leave the factory premises the garment manufacturer has to request CED and Camcontrol to inspect the loading of the consignment into their containers and the sealing of the containers. Camcontrol issues a *Certificate of Quantity* verifying the contents of the consignment. Camcontrol charges 0.1 per cent of the FOB value of the consignment.

Step Four – The garment manufacturer prepares the customs export declaration and transports the containers to Sihanoukville Port. CED and Camcontrol check the sealed containers against the export declaration to permit loading of the vessel.

Step Five – After shipping, the manufacturer must submit the TEA, Bill of Lading, export declaration and Certificate of Quantity to the TPD in order to receive the Certificate of Origin, Commercial Invoice and/or Export Licence.

Summary of Draft Law on Industrial Zone — July 2001

The following is a summary of an oral translation of the Khmer text of the draft law. The translation was dictated by a Ministry of Commerce staff member.

- The law establishes a Council of Industrial Zones that is responsible for the development and management of zones and for operating a one-stop service for investors. The Prime Minister is the Chairman and the Minister of Industry is the Deputy Chairman. Other relevant ministries shall be represented, including the Secretary of State for Commerce. (Articles 6, 8 and 9.)
- A Secretariat shall be established in Phnom Penh managed by a Secretary General and reporting to the Council. The Council may delegate its executive functions to the Secretariat. (Articles 10 and 11.)
- Zone branches of the Council shall coordinate one-stop services as delegated by the Secretary General. (Article 12.)
- The functions of the one-stop service centre shall be: (Article 7)
  - providing incentives

  - issuing work permits, visas, and other permits
  - registering land sales and leases
  - collecting revenue
  - permitting entry and exit of goods.
- There are two types of zone – a general industrial zone and an export processing zone. Each zone shall have a free trade area (fenced duty and tax free area for packaging, warehousing and assembly), commercial area (support services) and accommodation area for employees. (Articles 4 and 5.)
- Each zone shall be separately defined by sub-decree. (Article 16.)
- The ownership structure of a zone shall be either public, private or a joint venture. (Article 17.)
- A zone developer shall apply to the Council for approval to develop a zone in compliance with criteria established by the Council. (Articles 21 and 22.)
- Every building shall comply with the Master Plan.
- The Council shall register all investors in the zone, except financial services subject to their own legislation. (Article 23.)
- Zone enterprises may trade with the domestic market subject to customs duties and taxes. (Article 24.)
- An inspection centre will be established in each zone to inspect imports and exports as necessary. (Article 26.)
- Developers and enterprises shall pay a fee according to a sub-decree for this purpose. (Article 29.)
- Enterprises may select their own workers domestic or foreign. Workers are subject to the Labour Law and immigration legislation. (Articles 30 and 38.)
- Officials authorised by the Council may impose fines (to be determined in the law) and initiate court proceedings. (Article 32.)
- Land may be leased to developer for 99 years. No land transfer or lease tax. Vehicles used only to carry construction materials into the zone may be duty-free. (Articles 33-35.)
- The general rate of profit tax for zone enterprises is 9 per cent, with 8 year tax holiday, 5 year loss carry-forward and exempt profits if reinvested or distributed. (Article 36.)
- Construction material and raw materials are duty free in first year. (Article 41.)

- Capital equipment is duty free. Raw materials duty free to extent that output is exported. (Article 37.)
- All imports into an EPZ are duty free without time limit. (Article 42.)
- The rate of profit tax on enterprises in an EPZ is 15per cent. (Article 43.)
- Natural water purified in the Zone and consumed or exported is free. (Article 39.)
- Council officials and relevant ministry staff can inspect enterprise premises, people and goods after working hours. All inspections subject to 24 hours notice in writing unless urgent. (Articles 44 and 45.)
- Persons may be arrested without a warrant. (Article 46.)
- Investor disputes can be heard firstly by the Council then referred to the courts or international arbitration. (Article 47.)
- Investors already receiving Law on Investment incentives may continue to receive such incentives if relocating to a zone. (Article 48.)

G Household expenditures

G.1 **Household expenditures, in per cent of total expenditures, by decile**

	Decile										
	1	***2***	***3***	***4***	***5***	***6***	***7***	***8***	***9***	***10***	***Avg***
Rice	28.4	23.3	22.7	20.7	20.6	18.9	17.5	15.1	12.5	5.8	15.6
Othercer	2.6	2.7	2.8	2.6	2.7	2.9	2.6	2.9	2.9	2.3	2.6
fish	9.9	11.1	10.6	10.5	10.9	10.8	10.0	10.0	9.2	5.0	8.9
meat	4.5	4.6	5.2	5.4	5.2	5.3	5.0	5.6	5.6	4.4	5.0
poultry	2.9	3.9	3.8	3.6	3.6	3.2	3.7	4.0	3.4	2.2	3.2
eggs	1.5	1.7	1.7	1.8	1.6	1.6	1.9	1.6	1.3	0.8	1.4
dairy	0.4	0.7	0.7	0.7	0.7	1.0	1.1	1.2	1.2	0.8	0.9
oil	1.4	1.5	1.5	1.4	1.5	1.3	1.4	1.5	1.3	0.8	1.3
freshveg	5.8	5.2	5.3	5.2	5.2	4.8	4.9	5.1	4.4	2.1	4.3
tuber	1.4	1.9	2.0	1.9	1.9	1.7	1.8	1.7	1.3	0.5	1.4
pulses	0.7	1.2	1.2	1.3	1.1	1.4	1.4	1.3	1.1	0.5	1.0
prepvegt	0.7	0.8	0.7	1.0	0.8	1.1	1.0	1.1	0.9	0.4	0.8
fruit	3.2	3.0	3.1	3.1	3.0	2.9	2.9	2.9	3.3	2.1	2.8
othrfruit	1.1	1.7	1.5	1.7	1.4	1.7	1.4	1.4	1.2	0.5	1.2
sugar etc	1.8	1.8	1.9	1.7	1.7	1.7	1.7	1.6	1.4	0.6	1.4
spices	2.1	2.2	2.2	2.1	2.1	2.1	2.1	1.9	1.8	0.8	1.7
tea etc	0.4	0.7	0.7	0.6	0.6	0.8	0.8	0.9	1.0	0.7	0.8
non-alco	0.2	0.6	0.5	0.6	0.6	0.6	0.9	1.0	0.9	0.9	0.8
alcoh	1.2	1.3	1.4	1.3	1.7	1.5	1.6	1.6	1.8	1.6	1.6
tobacc	3.0	2.6	2.3	2.6	2.3	2.4	2.6	2.3	2.3	1.4	2.2
othefood	0.4	0.7	1.0	0.8	1.1	1.2	1.3	1.2	1.1	0.7	1.0
away home	1.8	2.4	2.4	2.6	2.8	3.1	3.5	3.6	3.4	2.6	2.9
Prepmeal	0.3	0.7	0.4	0.5	0.5	0.6	0.8	1.0	1.1	1.0	0.8
Total food	75.7	76.3	76.0	73.7	73.7	72.6	72.0	70.3	64.4	38.6	63.5
Total Housing, fuel and transp.	15.7	15.5	15.2	17.1	17.3	17.4	17.5	19.4	24.1	46.7	25.5
Total Clothing	2.9	2.8	3.0	3.0	2.8	3.4	3.4	3.2	2.9	2.3	2.9
Total Other expenditures	5.8	5.4	5.9	6.2	6.1	6.6	7.1	7.1	8.6	12.4	8.2
TOTAL EXPENDITURES	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source:

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