



MINISTRY OF COMMERCE,
CAMBODIA

Integration and competitiveness study —Part A

Overview

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

26 November 2001

Contents

Preface	iv
Glossary	v
Main points	vii
Technical assistance matrix from overview	xiv
1 Building a pro-poor trade sector strategy	1
2 Macroeconomic developments	6
3 Developments in trade policy	11
Domestically imposed trade barriers	11
External trade barriers	13
ASEAN membership	15
Poverty impacts of the tariff	16
Further tariff reform	16
WTO accession	17
4 Trade facilitation	20
5 Sector studies	29
Rice	29
Marketing and production	30
Diversified agriculture and agro-processing	33
Handicrafts	35
Freshwater fisheries	36
Garments	40
Tourism	47
Labour services	50
References	53

Boxes, charts and tables

1	Technical assistance matrix	xiv
1.1	Events leading up to this Cambodian Trade Policy Diagnostic Study	3
1.2	Building a Pro-Poor Trade Sector Strategy: technical assistance activities and needs	4
1.3	Integrated framework approach	5
2.1	Macroeconomic developments: TA activities and needs	10
3.1	Trade policy: technical assistance needs and activities	19
4.1	Trade facilitation: technical assistance needs and activities	28
5.1	Rice sector study: technical assistance needs and activities	33
5.2	Diversified agriculture sector study: technical assistance needs and activities	35
5.3	Handicrafts sector study: technical assistance needs and activities	36
5.4	Fish exports through Poipet	38
5.5	Fisheries sector studies: technical assistance needs and activities	39
5.6	Garments sector study: technical assistance needs and activities	47
5.7	Tourism sector study: technical assistance needs and activities	50
5.8	Labour services sector studies: technical assistance needs and activities	52
5.9	Sector study, selected cross cutting issues: technical assistance needs and activities	52

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, Sapanha 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
ASEAN	Association of South East Asian Nations
CARDI	Cambodia Agricultural Research and Development Institute
CDRI	Cambodia Development Resource Institute
CED	Customs and Excise Department
CEPT	Common Effective Preferential Tariff
CSES	Cambodia Socio-economic Survey
EU	European Union
FMV	Fair market value
GDP	Gross domestic product
GSP	Generalized System of Preference
GTC	Green Trade Company
GTZ	German Technical Cooperation
IF	Integrated Framework
IMF	International Monetary Fund
IPRS	Interim Poverty Reduction Strategy
IPRSP	Interim Poverty Reduction Strategy Paper
ITC	International Trade Centre
JICA	Japanese International Cooperation Agency

LDC	Least developed country/ies
LOI	Law on Investment
MFN	Most Favoured Nation
MOC	Ministry of Commerce
MSWLVA	Ministry of Social Welfare, Labour and Veteran Affairs
PRSP	Poverty Reduction Strategy Paper
PSI	Pre-shipment Inspection
RGC	Royal Government of Cambodia
SEDPII	Socio-economic Development Plan
SMEs	small and medium enterprises
TA	Technical Assistance
TOR	Terms of Reference
UNDP	United Nations Development Program
WB	World Bank
WTO	World Trade Organization

Main points

Following presentation of its Pro-poor Trade Strategy at the July 2001 donor meeting in Tokyo, the Royal Government of Cambodia (RGC) and donors agreed to conduct a Diagnostic Study of Cambodia's integration into the international trading system. With support from the Integrated Framework for Trade-Related Technical Assistance, and based on terms of reference developed under the guidance of the RGC, international and local consultants worked with Ministry of Commerce officials during August 2001 to prepare draft reports addressing the terms of reference. These draft reports were discussed at a two day workshop in Phnom Penh on 19 and 20 November 2001 and were revised on the basis of feedback from the workshop. This overview and accompanying reports identify obstacles and institutional development needs to address the demands of increased engagement in the international economy facing Cambodian households and firms. A program of technical assistance to address identified constraints and strengthen the capacity of government agencies and private sector support mechanisms was proposed at the workshop and revised thereafter.

Over the last several years the RGC has embarked on a comprehensive program of economic and trade policy reforms. Key areas include fiscal reform, banking sector restructuring, civil service reform and improved governance. Much has been accomplished but much more remains to be done. On the trade side, all quantitative restrictions on trade were eliminated in 1994. More recently, the tariff regime has been significantly simplified with the number of rates falling from 12 to 4 in April 2001 and the top rate reduced to 35 per cent. The currency is convertible with dollarization pervasive. Thus in many respects the trade regime is relatively open.

The economy has responded well to this opening of trade. Growth rates of 5 per cent are good compared with those achieved in Cambodia's recent past. However they fall short of the performance achieved by neighboring countries. Vietnam for example has grown by 8-9 per cent per annum over the past ten years. Moreover, these growth rates are insufficient to make a dent in the incidence of poverty, estimates of which range between 36 to 61 per cent using the headcount approach.

In setting out to build a Pro-poor Trade Strategy knowledge of the nature and incidence of poverty is essential. The following characteristics of the poor are consistent across Cambodian poverty surveys:

- poverty is lowest in Phnom Penh;
- poverty rises with household size and the number of children;
- poverty is exponentially higher for households with older household heads;
- poverty is lower in households where the family head has a secondary or advanced education; and
- poverty is highest for those whose household head is involved in agriculture.

These characteristics point to the importance of breaking down barriers to trade for rural household production in areas such as diversified agriculture, handicrafts and labor services. They also point to the importance of human development which equips people to engage in trade and exchange. The government has prepared its Interim Poverty Reduction Strategy and the Poverty Reduction Strategy Paper is due in mid 2002.

Notwithstanding the opening of trade many significant barriers remain, as identified in case studies of key sectors. The dispersion of tariff rates (standard deviation of 11.9 per cent) against a top rate of 35 per cent has the potential to create pockets of high protection. The tariff is a tax on consumption and analysis of moving to a uniform 7 per cent duty implies an improvement of 4 percentage points in average household purchasing power from reduced food and clothing prices. Incomes of people in lower deciles improve by between 3.2 and 3.9 percentage points. Income effects would depend on industry structure — for example the income effects of tariff reductions for capital intensive industries would be different from the effects for labor intensive industries. Other non tariff barriers to trade involve various bureaucratic costs (often unofficial) and the need to comply with international labor standards as a condition of international market access.

Accession to the WTO is well advanced. But complying with WTO requirements is very demanding for a small developing country and technical assistance will be useful in several areas (legislative framework, valuation procedures, trade policy evaluation and reporting, assessing the impact of trade protection). As part of the Diagnostic Study, a legal expert from the team worked directly with Ministry of Commerce officials to

develop a WTO-consistent legislation program. Support for WTO accession or associated institutional capacity building is desirable but the fact that a policy meets WTO requirements does not necessarily mean it is the highest priority for Cambodia. Assistance on WTO accession needs to be complemented with technical assistance that builds domestic capacity to assess and develop policy on its merits.

Customs administration has significantly improved in recent years but establishing a low cost formal trade facilitation system faces many difficulties. To begin with, the administrative task is onerous given the porous borders with three neighbours and a long coastline with many rivers and bays. Second, various trade arrangements (rules of origin requirements, preferential trading arrangements in ASEAN) complicate this task. Third, the institutional framework for border control is opaque, with unclear mandates among different agencies. Fourth, limited resources constrain the capacity of the customs department to carry out its functions. Civil service salaries are low, physical support facilities are inadequate, and management information systems are poor. These difficulties are reflected in high unofficial payments, widespread smuggling, unreliable clearance and processing times, and tariff collection that is significantly lower than is implied by the official tariff. Customs and trade controls are rated as the biggest barrier to exports by almost all the firms that were interviewed. Expansion of the existing TA programs in customs include faster computerization along with restructuring of both the export control systems and duplication is necessary.

Apart from the difficulties associated with ‘external’ trade facilitation, ‘behind the border’ constraints (for example, transport, market intelligence) are also significant deterrents to exporting. Shipping charges in Cambodia are the highest in the region and four times the cost for shipments of comparable size in Thailand. Survey respondents overwhelmingly rated transport costs as a significant barrier to trade – a reflection of the unofficial charges and the poor quality of many roads. Carefully monitored user charges or toll operations to fund road maintenance and construction would be ways of addressing this problem. So would fuel taxes. TA is needed to examine the implications of such options for fund raising and road fund sharing at local levels.

Rice is an important source of food for most rural households. An evolution is occurring from rice as a source of food security to rice as a source of trade and income. Rice trade both within the country and across the border is currently constrained by poor transport infrastructure — reflecting in part road funding policy, checkpoint charges and inadequate access to funds for road building and repair. In addition, export procedures

pose a significant tax on rice exports. ‘Facilitation fees’ are required to obtain export licenses and are about \$14/ton. According to some estimates, unofficial costs are nearly double the official costs. Simulation of impacts on poverty indicate that improving two major elements in rice production technology (paddy to rice yield and post harvest losses) would reduce transaction costs and improve the livelihood of poor Cambodians. A detailed exposure of these unofficial charges is needed to reduce constraints on current and potential exporters of rice.

Diversification of agriculture away from rice is increasingly common. The key obstacles to developing non-rice agriculture are similar to those for rice. They include poor transport infrastructure, high energy costs, weak information systems, inherited distrust among buyers and sellers, inadequate access to credit and limited business development skills. Cambodia could potentially benefit from the increasing demand for niche agricultural products, such as spices, herbs, specialty tropical fruits, sesame seeds and essential oils. To do so, action is needed on several fronts. First, the institutional capacity of the Ministry of Commerce needs to be strengthened. Second, technical assistance is needed to help small farmers with their informational needs. This could include the facilitation of establishing associations interested in marketing, technology and purchasing inputs. The authorities could build on the extensive ITC sector analytical studies in this respect.

Handicraft production has been hampered by years of civil strife and war which broke the chain of traditional transfer of skill and design. Craftspeople lack critical information on market demand, quality standards and trends. As with diversified agriculture, technical assistance is needed to identify barriers to and sources of market information and to support building associations of people with similar interests in marketing, technology and the sourcing of inputs.

Fisheries sector development is hindered by intervention of government agencies in almost every aspect of market transactions. Fisheries marketing is dominated by the Kampuchea Fish Import and Export Company (KAMFIMEX), a state-owned enterprise which has the sole authority to control fish exports. According to the law, all fish destined for export should be sold through this agency, which in turn licenses five export traders to take physical delivery of the fish and transport them across the Thai border to the Arranyaphatet fish market. Building a competitive and market responsive fisheries sector will require a change in the corporate culture in the sector to nurture market-based transactions. Regulation of management regimes to control overfishing is required. Technical assistance is needed in two main areas: fisheries marketing and

distribution and fisheries management. In the former, the impact of the export tax and existing restrictions on who can export fish identified in the study merit detailed investigation. In management, TA is needed to examine the incentives for short-term exploitation, unregulated common property fisheries and establishing transparency in the allocation of fisheries access. In addition, TA can help with developing a regulatory system for exports to the US and the EU and enabling the private and public sectors to collectively develop a long-term strategic vision for the fisheries sector.

Garment sector export growth has been spectacular over the past several years. Some 160 000 people are reported to work in the sector. This growth reflects a combination of limited access to the currently highly restricted US and EU markets (set to expire in 2005), a hospitable policy environment and competitive production costs. In the case of the US, preferential access means that Cambodia has some access to a tightly restricted market. While Cambodia has US market access for a large number of duty items and quota under GSP, for the items it does export-garments, MFN rates apply and for those garments where Cambodia has shown itself to be especially competitive quotas now apply. For the EU, preferential arrangements are such that Cambodia can export without duty and quantitative limits so long as rules of origin requirements are met. These requirements are in most cases not met given the limited development of Cambodia's textile sector. However substantial production from Cambodia is sufficiently competitive to be able to sell on the UK market without the concession.

Because the US and EU markets are protected by tariff and quotas, prices on these markets are high and those sales that can be made through access arrangements are typically very profitable. But this access to these restricted markets comes at a cost. Satisfying rules of origin, requirements, including the bureaucratic machinery to enforce them, is one such cost. Furthermore, the increasing costs of transactions associated with customs, duty exemption systems and multiple export controls are slowly eroding the competitive edge created by preferential access. This coupled with better access given to African countries under A to A can slow down this dynamic sector. For investors another cost is the need to purchase quota and about 10 per cent of quota is sold by auction. But at least this cost has a positive side in that revenue goes to the government. Other quota is allocated on a historical performance basis. This too has a cost if it means that manufacturers engage in activities in order to secure quota rather than to make profits. Above market wages bought about by the need to comply with labor standards in order to secure quota is also a cost. While employed labor benefits from the higher wage, people who would be

prepared to work for lower wages lose out. Restrictions on double shift benefit hardly anybody. In the medium to long-term, reduction of trade barriers by the major developed countries is more important than this limited access, which messes up cost structures. Key areas for technical assistance revolve around the following set of issues: how to reduce the transaction costs caused by duty exemption system and customs, the capacity of Cambodian producers to compete after 2005 when preferential access expires, the impact of existing preferential arrangements on Cambodia's cost structure and how to achieve a more efficient and equitable distribution of quota rents.

Tourism is growing at over 30 per cent annually. The challenge for this industry is to find the appropriate roles and tasks for government industry, private operators with respect to such things as industry statistics, promotion, training, certification and charging for 'unique' attractions such as the temples of Angkor Wat. Core technical assistance needs are: TA to collect tourism related data and to analyze it; a careful evaluation of the net benefits of tourism to Cambodia and its long-term potential; developing a tourism development strategy, involving all major stakeholders, building on successful private-public partnerships such as the Tourism Working Group; in conjunction with the tourism development strategy, identifying those investments necessary to encourage greater regional and domestic tourism as well as eco-tourism – all of which would help the poor; and establishing the appropriate role of the government in regulating, 'charge'-setting, setting standards and collecting industry statistics.

Labor export has been an important option for reducing poverty in several of Cambodia's Asian neighbours, such as the Philippines, Sri Lanka, Thailand and Vietnam. RGC policy is to encourage official labour exports to increase welfare, enhance skills, reduce unemployment and increase state revenues. Constraints to increased exports of workers include, low education and limited foreign language skills, an increasingly competitive market for export labour, complex regulatory and administrative requirements. Developing appropriate government policies and regulations and bilateral arrangements, which do not prohibitively raise costs yet adequately protects the interests of export workers poses a challenge. Technical assistance is needed in these areas and should draw on the considerable regional experience in developing labour markets and regulations.

Information Technology has much to offer in enabling all these sectors to move to more productive systems. Already some of Cambodia's many

young people are embracing IT based activities. In some cases IT systems are being used to convey market information and expedite transactions of handicrafts produced in villages far from urban centres. In other cases Cambodians are processing data from other countries and thereby effectively exporting data processing services.

Technical assistance implied by these findings is foreshadowed in the following table. This table is a living document. A preliminary version was discussed at the workshop in Phnom Penh on 19 and 20 November 2001. The following revised version reflects contributions from breakout group discussions at that workshop.

Technical assistance matrix from overview

1 Technical assistance matrix

<i>Observations</i>	<i>Type of action</i>	<i>Agencies responsible/external support</i>	<i>Time frame</i>
<i>Policy actions to enhance competitiveness</i>			
<i>Macroeconomic policy</i>			
<ul style="list-style-type: none"> ▪ Improve budgetary performance through revenue mobilization. ▪ Increase access to credit and lower its cost. 	<ul style="list-style-type: none"> ▪ Strengthen macroeconomic management capabilities. ▪ Develop sound banking and payments systems. ▪ Establish a financial market relying on government securities and other riel denominated assets. 	<ul style="list-style-type: none"> ▪ Ministry of Economy and Finance ▪ National Bank of Cambodia ▪ World Bank ▪ IMF ▪ UNDP ▪ ADB and several donors 	
<i>Trade policy</i>			
<ul style="list-style-type: none"> ▪ Support WTO accession. ▪ Build institutional capacity. 	<ul style="list-style-type: none"> ▪ Continue ongoing assistance with Cambodia's legislative reform under WTO accession. ▪ Establish WTO consistent valuation procedures. ▪ Strengthen and institutionalize trade protection measurement and trade policy review (see below). ▪ Advise on techniques for measuring levels and impacts of trade protection and taxation. ▪ Advice and training for trade policy evaluation and reporting. ▪ Assist specific reviews (for example, the cascading tariff), export controls and taxes, implications of binding at different levels. ▪ Review export marketing arrangements for relevant sector studies. ▪ Strengthen the IF Steering Committee. 	<ul style="list-style-type: none"> ▪ Ministry of Commerce ▪ Japan, Canada, Singapore ▪ ESCAP ▪ German Technical Cooperation (GTZ) ▪ Ministry of Commerce ▪ Ministry of Economy and Finance ▪ Affected sector Ministries ▪ IF Steering Committee ▪ Affected sector Ministries 	

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1 Technical assistance matrix (continued)

Observations	Type of action	Agencies responsible/external support	Time frame
<i>Policy actions to enhance competitiveness (continued)</i>			
<i>Trade facilitation: customs</i>			
<ul style="list-style-type: none"> ▪ Reduce the degree of unofficial interventions and increase transparency, to enhance customs efficiency. ▪ Reduce institutional duplication. ▪ Introduce equitable enforcement of the law. ▪ Strengthen capacity in customs administration and improve incentives for staff. 	<ul style="list-style-type: none"> ▪ Simplify the tariff and associated arrangements including trade preferences and duty exemptions. ▪ Support computerization and automation of procedures and information systems. ▪ Clarify the roles and responsibilities of the several overlapping agencies involved in border inspection. ▪ Support the establishment of an independent appeals office on custom matters. ▪ Support professionalization of officials with appropriate rewards, accountability and recruitment of young computer literate people. ▪ Support computerisation in related agencies. 	<ul style="list-style-type: none"> ▪ IMF ▪ JICA ▪ ADB ▪ ESCAP 	
<i>Trade facilitation: transport</i>			
<ul style="list-style-type: none"> ▪ Reduce the cost of transport by improving quality and reducing unofficial fees and charges 	<ul style="list-style-type: none"> ▪ Examine options for road use charges (i.e. examine the implications of fund raising and fund sharing at local levels of road funds raised by way of fuel taxes, property taxes and concessions for toll road operations). ▪ Review models of port management. ▪ Determine how unofficial fees and charges are used. Do they go to private use or are they used for semi public activities? What services, if any, flow from these charges? Does the incidence vary across regions and provinces? Do such facilitation fees support provincial government activities? ▪ Assess how customs services should be designed and delivered in a zone situation. ▪ Identify the management model to be followed, pricing for land and access to the zone, who should supply power, telecommunications etc and pricing for these services, and investment incentives. 	<ul style="list-style-type: none"> ▪ JICA ▪ ADB ▪ IMF ▪ JICA 	

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1 Technical assistance matrix (continued)

<i>Observations</i>	<i>Type of action</i>	<i>Agencies responsible/external support</i>	<i>Time frame</i>
<i>Policy actions to enhance competitiveness (continued)</i>			
<i>Diversified agriculture and agro-processing</i>			
<ul style="list-style-type: none"> ▪ Young computer literate Cambodians are already breaking into international IT and data processing ▪ Maximize opportunities to break into new 'niche' products. ▪ Weak information base ▪ Strengthen infrastructure ▪ Strengthen markets for key assets: credit and land. ▪ Bedding in of new land law is crucial. ▪ Rice has been the focus of R&D and extension. 	<ul style="list-style-type: none"> ▪ Establish 'incubators' which nurture cooperation on production, markets, technology and information. ▪ Identify 'success' models and build on them. ▪ Explore other sources of building information bases. ▪ Assess comparative advantage in new crops such as spices and processed vegetables. ▪ Identify specific infrastructural needs that are likely to have high pay-offs in transport, energy and telecommunications. ▪ Increase access to credit. What specifically should be done in the land market? ▪ Broaden R&D to include new and small crops. ▪ Clarify barriers to trade in rice and other goods as a basis for their eventual dismantling. 		
<i>Handicrafts</i>			
<ul style="list-style-type: none"> ▪ Lack of 'critical masses' capable of acquiring and using information at low unit costs. ▪ Weak links between crafts people and markets because of poor information base. 	<ul style="list-style-type: none"> ▪ Facilitate the building of relationships and systems that enable people to work out of small production units and households to produce products to a specification and identified demand. ▪ Identify obstacles to the use of IT in production and marketing. ▪ Develop synergies between tourism and handicrafts. 		

(Continued on next page)

1 Technical assistance matrix (continued)

Observations	Type of action	Agencies responsible/external support	Time frame
<i>Policy actions to enhance competitiveness (continued)</i>			
<i>Freshwater fisheries</i>			
<ul style="list-style-type: none"> ▪ Sub-optimal fisheries marketing and distribution due to current single exporter arrangement. ▪ Poor information base. ▪ Various jurisdictions are involved in the determining the collection and allocation of the fisheries resource. ▪ Yields are well down. ▪ Market recognition and development is poor. 	<ul style="list-style-type: none"> ▪ Build on emerging IT data management capacity to develop information systems into households on markets and production. ▪ Evaluate of the 10 per cent export tax, the 4 per cent distribution tax and the fishing export licensing fee, production and marketing decisions in fish exports and the impact of having a sole exporter. Assess effect on formal versus informal activities and implications for government revenue and exporting. ▪ Assess the impact on incentives for short-term exploitation of extending lease periods to four years. ▪ TA is needed to facilitate linkage between fisheries industry participants and markets - buyers and processors - local and foreign. ▪ Investigate the extent and impacts of the allocation of fisheries access by non-transparent methods. ▪ Clarify the role of different agencies in fisheries. ▪ Build private sector capacity for meeting health and quarantine standards for fish exports into developed country markets. ▪ Identify mechanisms to assemble statistics - for marketing and for management. ▪ Facilitate development of private sector organizations and support education and development of industry networks. ▪ Support clarification of roles of different ministries and agencies in the sector. 	<ul style="list-style-type: none"> ▪ Ministry of Fisheries ▪ ADB ▪ ESCAP 	

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1 **Technical assistance matrix** (continued)

Observations	Type of action	Agencies responsible/external support	Time frame
<i>Policy actions to enhance competitiveness (continued)</i>			
<i>Garments</i>			
<ul style="list-style-type: none"> ▪ Increase understanding of the true competitive advantage of garments. ▪ Overcome existing tariff and quota restrictions (e.g. on local content requirements and product standards). ▪ Achieve a more efficient and equitable distribution of quota rents. ▪ Increase labor market flexibility in garments sector. 	<ul style="list-style-type: none"> ▪ Determine the capacity of Cambodian producers to compete post 2005, compare costs and quotas facing main competitors and assess prospects for productivity gains. ▪ Assess the impacts of existing preferential arrangements on Cambodia's cost structure. ▪ Increase capacity to analyze impact of market access restrictions and to negotiate better. ▪ Determine the distribution of benefits/rents arising from the existing system and develop alternative options. ▪ Explore alternative profit-sharing system such as flexible year-end bonuses instead of minimum wage. ▪ Examine role of small and medium firms. ▪ Examine options for promotions of Cambodian product. ▪ Conduct analysis of EBA initiative and GSP access. ▪ Provide assistance with quality and standards. ▪ Examine options for saving on wastage in production. 	<ul style="list-style-type: none"> ▪ Ministry of Commerce ▪ Ministry of Social Welfare, Labor and Veteran Affairs ▪ Council for the Development of Cambodia. ▪ IMF Resident Customs Adviser. 	

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1 Technical assistance matrix (continued)

<i>Observations</i>	<i>Type of action</i>	<i>Agencies responsible/external support</i>	<i>Time frame</i>	
<i>Policy actions to enhance competitiveness (continued)</i>				
<i>Tourism</i>				
<ul style="list-style-type: none"> ▪ Develop a strategic vision based on empirical data and which takes into account the fact that many inputs into tourism are sourced from foreign supplies 	<ul style="list-style-type: none"> ▪ Support the collection of basic industry statistics and their analysis. 	<ul style="list-style-type: none"> ▪ Ministry of Tourism ▪ Ministry of Interior 		
	<ul style="list-style-type: none"> ▪ Examine of the net benefits of tourism to Cambodia? 	<ul style="list-style-type: none"> ▪ Ministry of Health ▪ Ministry of Public Work 		
	<ul style="list-style-type: none"> ▪ Assess of tourism's potential and development of a tourism strategy. 	<ul style="list-style-type: none"> ▪ ADB 		
	<ul style="list-style-type: none"> ▪ Evaluate of the appropriate role of government in regulating, setting charge and standards. 			
	<ul style="list-style-type: none"> ▪ Develop inter-ministerial working groups to raise the profile of tourism and to ensure that cross-sectoral constraining issues (health, transport, safety) are addressed. 			
	<ul style="list-style-type: none"> ▪ Take advantage of cultural and ecological attractions to broaden tourism focus. 			
	<ul style="list-style-type: none"> ▪ Develop synergies between handicrafts and tourism. 			
<i>Labor services</i>				
<ul style="list-style-type: none"> ▪ Improve the regulatory framework for export of labour services. 	<ul style="list-style-type: none"> ▪ Examine the relative weight of different factors in the explaining the weak performance of export of labour services. 	<ul style="list-style-type: none"> ▪ Ministry of Social Welfare, Labor and Veteran Affairs (MSWLVA) ▪ Ministry of Interior 		
	<ul style="list-style-type: none"> ▪ Review how other countries in the region have regulated labour exports. 	<ul style="list-style-type: none"> ▪ Ministry of Foreign Affairs and International Cooperation. 		
	<ul style="list-style-type: none"> ▪ Streamline passport application procedures 			

1

Building a pro-poor trade sector strategy

Trade activity is recovering fast

THIS DIAGNOSTIC STUDY of Cambodia's trade policy priorities and implied technical assistance needs draws on analysis and surveys covering macroeconomic circumstances, trade policy, trade facilitation and poverty impacts. Seven sector case studies provide practical grounding, for ideas and actions. The sector studies confirm that considerable international and domestic trade now occurs in Cambodia. The burgeoning trade in garment and tourism exports and the import of modern inputs to support these activities are contemporary examples. But there is also considerable and long standing trade across borders in traditional products — fish is one example, labour is another.

Transaction costs are high...

All this trade happens at various levels of complexity. In some cases, it is small scale and based on barter. Other trade is formal and passes through official channels, typically with the need to pay official taxes and duties. Various unofficial fees and charges are also levied on goods as they move through the country and across borders. Compared with circumstances where there was barely any trade, most people are better off and the Royal Government of Cambodia (RGC) has proposed a pro-poor trade strategy to make opportunities to trade accessible to all citizens. The evidence from experiences of other countries is that trade delivers growth and growth delivers poverty reduction (Dollar and Kray 2000).

...but growth is occurring

Institutional arrangements to reduce costs of trade transaction so people at all income levels can join in

The RGC has taken the view that trade policy reform — including the building of institutions to support open trade, which enables all Cambodians — urban and rural, poor and not so poor — to enter into domestic and international trade with transaction costs that are not forbidding is an essential ingredient of improved economic performance and poverty reduction. In July 2001, the RGC presented its Pro-poor Trade Sector Strategy at Cambodia's Third Consultative Group meeting in Tokyo (The Tokyo Road Map). This strategy set out a plan for identifying and overcoming the obstacles and costs facing Cambodians as they engage in trade, whether that trade be simple local transactions or sophisticated international trade.

<i>Draw on expertise of other countries through technical assistance</i>	An important feature of this strategy involves drawing on the technical support provided by the Integrated Framework (IF) Program for assisting least developed countries to integrate into the global trading system (see box 1.1 for a description of the Integrated Framework Program and events leading up to the design, initiation and conduct of this Diagnostic Study). Following the July 2001 Tokyo meeting, the Ministry of Commerce (MOC), which was assigned responsibility for the IF, worked with the World Bank (WB) as IF task manager to put together a team and terms of reference to conduct the Diagnostic Study.
<i>Take other policies being used to tackle poverty</i>	The approach taken is set out in chart 1.3. It begins with Cambodia's past economic and export performance and its macroeconomic policies. It recognizes that a pro-poor trade policy must also consider other measures being used to tackle poverty. These include direct activities targeting health and education and policies developed under the Interim Poverty Reduction Strategy (IPRS), the Socio-economic Development Plan (SEDPII) and the emerging Poverty Reduction Strategy Paper (PRSP).
<i>Add Cambodia's own trade policies and other countries</i>	The next point involves analysis of Cambodia's current trade and investment policies — including institutional arrangements for developing and administering these policies and trade facilitation procedures. Moreover, while the policies of other countries, particularly with respect to market access are not under control of Cambodia, they do matter. Seven sector case studies were conducted. Based on this material the study draws implications for trade policy and supportive technical assistance. The study reports on tests of the impacts of relevant recommended policies on poor people. Box 1.2 canvasses follow up TA work foreshadowed in the Pro-Poor Trade Sector Strategy and started in the Diagnostic Study.
<i>Draw implications for TA</i>	

1.1 Events leading up to this Cambodian Trade Policy Diagnostic Study

- The Integrated Framework (IF) Program commenced in 1997 to promote the integration of least developed countries into the global economy. Participating agencies are the World Trade Organization (WTO), the International Monetary Fund (IMF), the International Trade Centre (ITC), United Nations Development Program (UNDP), United Nations Conference for Trade and Development (UNCTAD) and the WB.
- In 2000, a Trust Fund was established to increase the benefits that least developed countries derive from trade related Technical Assistance (TA). As of September 2001 pledges to the Trust Fund had been made by the following partners: Canada, United Kingdom, Japan, Switzerland, Norway, Denmark, Sweden, Ireland, United States, the Netherlands, Finland, UNDP, the European Commission, France and the World Bank. Three pilot countries (Cambodia, Madagascar and Mauritania) were identified for a program of work starting with a diagnostic trade integration study covering competitiveness and the impact of increased integration in the world economy on poverty and implied technical assistance needs flowing from these findings.
- Cambodia provided its initial trade policy needs assessment to the IF program in September 1998.
- An IF Interministerial Committee chaired by Ministry of Commerce (MOC), was appointed in March 2001 to manage the process. This Committee was subsequently expanded to include high level policy makers and representatives from the private sector. The State Secretary for MOC was appointed as focal point.
- With local UNDP support the MOC prepared its Pro-poor Trade Sector Strategy, which was presented by the Minister for Commerce H. E. Cham Prasidh at the Cambodia's Third Consultative Group meeting in Tokyo, June 2001.
- By end August, MOC working with the WB as task manager had finalized IF terms of reference (TOR), recruited consultants, established a MOC team and completed field work.
- IF activities complement other poverty reduction strategy development activities including:
 - completed IPRS
 - completed second draft of Second Five Year Socioeconomic Development Plan (SEDPII) (April 2000)
 - initiated work to complete SEDPII by end 2001
 - Poverty Reduction Strategy Paper (PRSP) due mid 2002.
- In July the government appointed its senior economic advisor to the post of Ambassador to the permanent mission of Cambodia to the WTO.
- In August the Prime Minister appointed a large think tank comprising senior officials to assist in matters related to Cambodia's accession to the WTO.
- On 20 October 2001, draft reports on the various components plus an overview were circulated among government and the private sector in Cambodia and to donor groups.
- On 19 and 20 November 2001, a workshop involving Government, private sector and donors was held in Phnom Penh.
- Based on feedback and contributions from this workshop the draft reports were revised and finalized on 30 November.

1.2 Building a Pro-Poor Trade Sector Strategy: technical assistance activities and needs

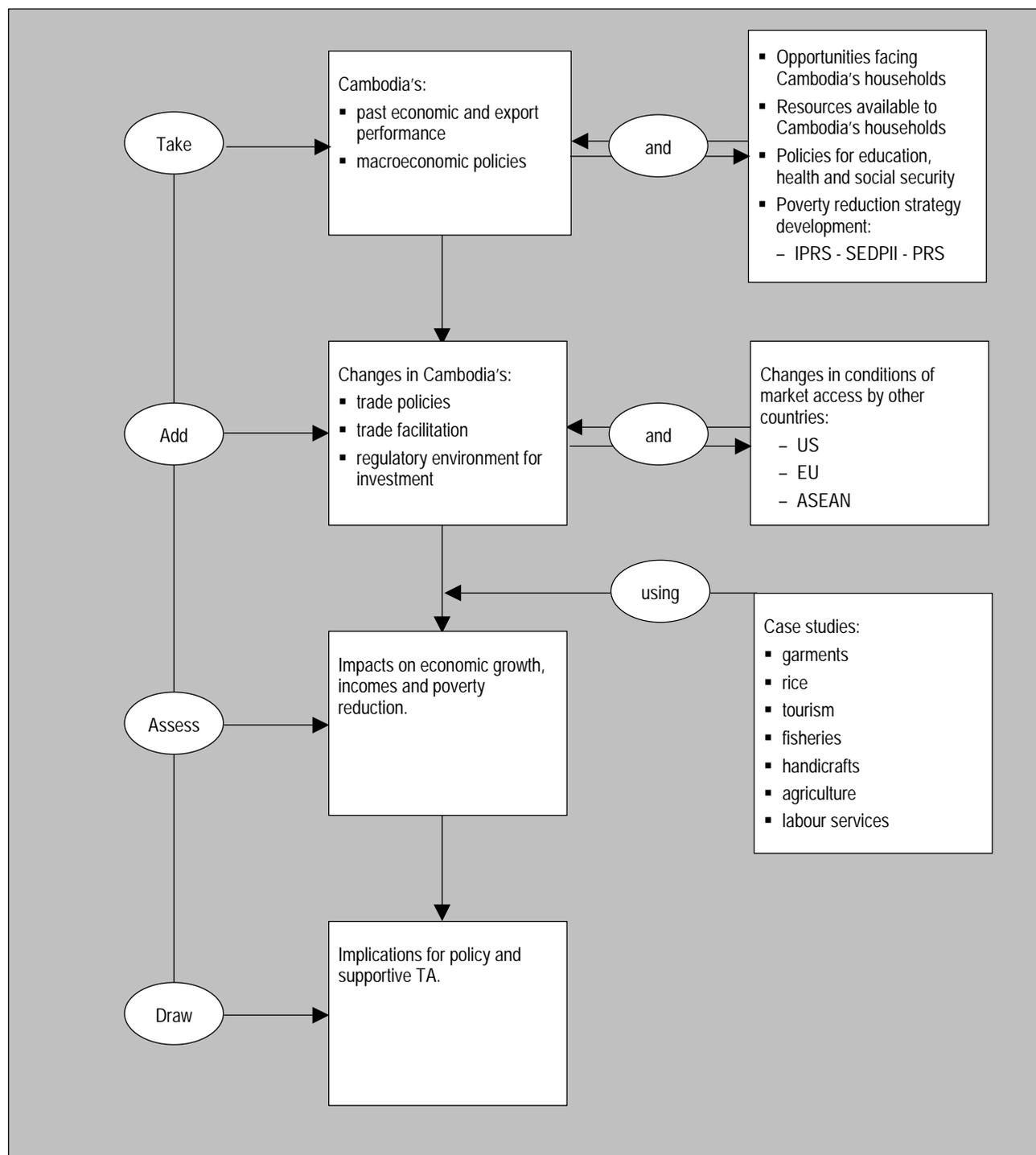
The Government's Pro-poor Trade Strategy as spelled out in the Tokyo Road Map envisages detailed fact finding at the firm and household level.

This diagnostic study has done some detailed fieldwork with interviews of garment workers, farmer associations, rice cooperatives and a survey of the obstacles confronting 100 exporting firms. Time and resource precluded participatory trade policy assessment directly involving poor communities. The activities that were conducted have yielded valuable insights into the obstacles confronting households and firms as they produce and trade.

Further technical assistance is needed to support the design and conduct of fieldwork aimed at identifying and measuring other unnecessary restrictions on trading activities as they exist in various regions across the country. These investigations should focus on particular activities in regions and track the trading chain from producer to consumer in a 'gate to plate' manner. They should also involve participatory pro-poor trade policy assessment working directly with poor communities. Such work was foreshadowed in the Tokyo Road Map.

Donors such as DFID, JICA, ADB and UNDP are already engaged in household level studies. The survey and measurement should also test restrictions on entry to economic activity and security of ownership and exchange of goods.

1.3 Integrated framework approach



2

Macroeconomic developments

Early days of economic reform

In the early 1990s, Cambodia attempted to reconstruct the economy, supported by a United Nations sponsored peace agreement and large inflows of international assistance. Reflecting a period of macroeconomic instability in the late 1980s and the large inflow of foreign aid, the economy became almost completely dollarized. But after an initial period of growth, ongoing civil strife and political instability interrupted reform efforts. It was not until the late 1990s that reconstruction efforts were renewed, when the country firmly unified under one administration. The coalition government formed in 1998 committed itself to pursuing increased transparency within an open political and economic environment. Important measures policy measures have been initiated, notably revenue enhancing actions, improvements in forestry management, and banking reform. Cambodia's reform effort chiefly aims to ensure macroeconomic stability, accelerate economic reconstruction, improve governance, and reduce poverty.

Growth has recovered but at 5 per cent is not high and relies on three sectors: garments, tourism and agriculture

The establishment of peace and these reforms have seen a rebound of growth in the economy. Tourism has bounced back with rising demand met by strong investment in the sector and supportive policies. Agriculture has responded well, supported by efforts from government and from private sector firms to improve quality, yield and processing. Garments and footwear exports have surged driven by a combination of improved market access, supportive policies and low inflation and competitive cost structures. However, the ensuring growth rates of around 5 per cent, while good by recent Cambodian standards, especially considering the floods of 1999, are not high relative to the performance of some neighbors. For example, Vietnam has grown at around 8 and 9 per cent per annum over the past 10 years. Moreover, the ingredients of growth are fragile. Tourism is concentrated around Siam Reap and Phnom Penh and linkages with the rest of the economy are weak. The same applies to the garments sector which is also vulnerable to changes in market access arrangements.

Reforms and performance since 1999

Revenue effort a priority

Given an extremely low ratio of taxation revenue to gross domestic product (GDP) and a pressing need to rebuild infrastructure and increase social outlays, measures are being taken to substantially improve revenue raising effort. This increased effort in conjunction with other measures such as demobilization of the military will enable greater expenditures on health, education, and rural development. Overall fiscal performance has improved since 1999, increasing revenue by about 3 percentage points of GDP, reflecting, in part, the introduction of a value added tax in 1999. Military expenditure has been reduced in tandem with increased social expenditure relative to GDP. The government has initiated fiscal restructuring while maintaining macroeconomic stability, as current budget surpluses have remained at about 1.5 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.

Inflation under control

The government has 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. 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), due to the strong performance of garment exports. While there are significant barriers to both domestic and international trade, compared with many developed countries, Cambodia's trade regime is relatively open following reforms in 2001. The country's exchange system is free from restrictions on payments and transfers for current international transactions.

Government pursuing better governance...

Reform efforts have also aimed at improving governance and combating corruption includes the following.

...audit

- A new National Audit Committee was established and a governance action plan approved in early 2001.

...forestry

- Steps have been taken to improve governance in the forestry sector through the initiation of measures to establish a Forest Crime Monitoring Unit.
- A new forestry law was sent to Parliament in mid 2001.

- ...banking*
 - The banking system is being restructured following passage of the Financial Institutions Law in mid 1999.
- ...demobilization and*
 - A pilot military demobilization program in 2001 led the WB and other donors to endorse a \$42 million comprehensive demobilization program in August 2001.
- ...civil service reform*
 - Civil service reform is being tackled including a census of civil servants in mid 1999 and a subsequently computerized civil service reform strategy for 2000–06 aims to provide better incentives and merit based classification.

Challenges ahead

Transparency not well established but embraced as an objective

But much remains to be done. Governance and transparency issues remain at the forefront of the reform agenda. A Governance Action Plan sets out actions and a timetable for tackling these matters. Central to improving governance will be the establishment of a modern legal and judiciary system that can provide for a clear rule of law and modern commercial laws and regulations. In addition, effective operation of the National Audit Authority will need to be achieved. Fiscal transparency should benefit from the ongoing strengthening of budget management procedures. The establishment of a reliable, timely, and comprehensive statistical framework is still required.

Need to broaden the tax base...

The essential macroeconomic challenge is to further improve budgetary performance through revenue mobilization and increased spending for the social sectors. However, options for further increasing tax revenue are constrained to a few economically challenging and politically difficult measures, given the limited direct tax potential at Cambodia's current level of development. In this context, efforts to increase tax revenue will need to focus on broadening the tax base and improving tax administration, while strictly limiting exemptions. The ability to raise government salaries in the future, as the civil service reform strategy calls for, is directly tied to achieving annual targets for revenue performance and military demobilization.

...and repair the banking system

Timely implementation of the bank restructuring process and payments system reform will be crucial in broadening financial intermediation. Challenges with bank restructuring include smooth liquidation of nonviable banks, monitoring of bank asset quality, and modernization and privatization of the Foreign Trade Bank. With respect to external policies, Cambodia still needs to refrain from contracting non concessional foreign borrowing and to resolve outstanding debt rescheduling with major bilateral creditors.

<i>Ambitious targets for poverty reduction consistent with this growth strategy</i>	Cambodia's medium term strategy is to support a rate and a pattern of economic growth consistent with ambitious reductions in poverty as set out in its IPRSP and the forthcoming SEDPII for 2001–05, developed in conjunction with the UNDP, the IMF, the WB, and the Asian Development Bank (ADB). A further elaboration of the strategy is expected in 2002, when Cambodia completes a full PRSP exercise.
<i>Poverty assessment complicated</i>	Cambodia's per capita income was estimated at \$238 in 2000, the lowest in Southeast Asia. While changes in survey design and interview practices make it difficult to assess the evolution in the incidence of poverty over time, the most recent data (1999 household survey rounds) suggest that the poverty headcount rate lies between 35.9 to 64 per cent. Earlier surveys in 1993–94 and 1997 identified key characteristics of the poor and these findings were largely supported by the most recent survey in 1999. The poor were more likely to live in rural areas, to live in households headed by farmers, or where the head was illiterate and had few years of schooling. Poorer households also tended to be larger, younger and have more children.
<i>Food prices a key determinant</i>	For the poor, expenditures on rice are the single most important item of all expenditures. On the income side, earnings from self employment account for over 67 per cent of total income of the poorest decile, with two-thirds coming from activities related to cultivation. Thus policies that affect food prices, especially rice, have important implications for the welfare of households. The government's Interim Poverty Reduction Strategy notes that people are poor because of inadequate human and physical resources, or the opportunity to generate income and accumulate resources. The poor are generally disadvantaged by a plethora of factors: inadequate food supplies, poor health, physical disabilities, lack of access to land, insecure land titles, lack of skills, inadequate information, and poor access to input and product markets.
<i>Dollar and riel co-exist.</i>	In large parts of Cambodia the US dollar and the local currency — the riel — co-exist smoothly. In Phnom Penh either currency is widely accepted for everyday transactions. Large commercial transactions and asset building are invariably conducted in US dollars. In the countryside everyday transactions are more likely to be in riel. In border areas the Thai baht is also widely used. The dollarization of the economy is a direct result of the destruction of economic and financial institutions after 1975, economic mismanagement in the 1980s and large inflows of US dollars in the 1990s. There is an active foreign exchange market managed by licensed money changers and there are no restrictions on international transactions.
<i>Dollar used to trade and save.</i>	

Dollarization has served Cambodia well but limits government's management and reserve options

The readiness to accept the dollar as a currency has yielded many benefits. It supported early reconstruction, it helped Cambodia cope with the Asian crisis and it helps protect producers and traders from exchange rate risk. However relying on another currency means that the ability to use monetary policy as an adjustment instrument is constrained, as is the capacity of the government to earn revenue from seignorage, or the right to issue a foreign currency. The continuation of dollarization raises important issues of export competitiveness especially in the context of minimum wage regulation. See subsequent discussion of the garment section where minimum wages are well above market clearing wages.

De-dollarization not on at this time

De-dollarization as an option would yield seignorage revenue. But given the extent of dollarization changing perceptions would be difficult. Basic requirements for de-dollarization include overall economic stability, an effectively restructured banking system including a nationwide network and a government securities market. A currency board arrangement involving pegging the reil to the US dollar would be difficult to sustain with the banking system still unreformed and the fiscal position still fragile.

Box 2.1 sets out main TA activities and emerging TA needs.

2.1 Macroeconomic developments: TA activities and needs

Key issues for technical assistance include: strengthening macroeconomic management capabilities, developing sound banking and payment systems and establishing a financial market relying on government securities and other reil denominated assets.

Broad technical assistance support aimed at strengthening capacity-building within the Ministry of Economy and Finance and the National Bank of Cambodia is already being provided by foreign development partners. The Ministry of Economy and Finance will soon work with resident advisors on budget management and customs and tax administration jointly sponsored by IMF, UNDP, ADB and several donors. The World Bank is also supporting administrative reform through an Economic Capacity Building Operation and a PHRD grant. The IMF is assigning a resident statistical advisor to the Ministry of Planning. The ADB has been working with the Government on statistical system development. Discussions are also underway with the ADB to develop the financial markets over the medium term through a financial sector program loan.

3

Developments in trade policy

Cambodia is returning to the open economy of the 1960s

During the 1960s, Cambodia exported agricultural products (mainly rice, rubber and corn). As the regional conflict spilled over into the country 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. Tariffs and trade taxes played little or no role other than as a means to collect revenue. 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. From 1993, restrictions limiting the ability of firms and individuals to engage in international trade were largely removed.

Domestically imposed trade barriers

Tariffs reduced and simplified in 2001

The tariff regime was again reformed in April 2001. High rates were reduced from 120 per cent to 35 per cent. And the system was simplified with the number of bands being reduced from 12 down to 4. At the same time excise taxes were raised on excisable products. This meant that revenues could be maintained without inadvertently providing high protection to these products. Compared with the countries Cambodia exports to, its trade regime is relatively open. Moreover the tariff regime has not evolved in response to protectionist demands from local industry. Unlike many countries the challenge is not primarily one of dismantling protection and managing industry adjustment.

But tariffs still cascade and so offer scope for very high effective protection for some activities

However there is still a cascading tariff structure, with the highest rates applying to processed goods and lowest rates on raw materials. Because producers are influenced by duties on inputs as well as on outputs, this kind of tariff structure can provide high effective protection even with a tariff ceiling of 35 per cent. Importantly, it can also lead to big variations between commodities in the levels of effective protection that each enjoys. Variation in effective protection across sectors can lead to costly resource misallocation by inducing scarce resources away from productive activities to less productive ones.

<i>Tariffs on inputs are taxes on exports</i>	While tariffs are low compared with past levels and tariffs in some other countries they nonetheless involve taxes on people and firms consuming and using these goods. For firms producing for the domestic market a duty of 35 per cent on output combined with a duty of say 10 per cent on input can still leave a comfortable margin. But for exporters there is no output protection on international markets so even small input duties cannot be passed on. This is especially a problem where the export activity involves importing a lot of material for processing such as is the case for garments.
<i>Exporters need access at duty free prices</i>	
<i>Such schemes are always complicated and ...</i>	Schemes involving duty rebate, duty drawback, duty deferral, bonded warehouse and so on are to be found in many countries. Just as these schemes are common so are problems with them. Cambodia is no different in this regard. The Law on Investment (LOI) provides for exporters to have exemptions on the import of goods for export production. Like most devices for getting duty free access of materials to exporters, this system has deficiencies. In order to constrain exempted imported inputs to goods actually used in export production, exporters are required to complete a Master List of planned imports. The ensuring system is reported to be unwieldy and to involve high bureaucratic costs for exporters.
<i>...so is Cambodia's Master List and exemption system</i>	
<i>It is a tough question. A new system would also have administrative problems.</i>	There is no easy way around this problem so long as tariffs remain. Given Cambodia's still evolving administrative system switching to other methods of delivering duty free access such as duty rebating or duty referral would also incur difficulties. Declaring a zero tariff on the goods most frequently used would be an option in that at least the system would be transparent and administration would be simpler. Risk based audit systems are another option. In the longer run moving to lower duties on all goods would gradually diminish the problem. Whatever the case ways need to be found to give exporters access to inputs at world prices in a low cost way and evidence points to the importance of this access in attracting export oriented investment.
<i>Valuation an outstanding issue</i>	The actual amount of duty paid by importers is also affected by valuation procedures. For many goods, the Pre-Shipment Inspection (PSI) company proposes a value for duty based on fair market value (FMV). But in other cases the Ministry of Economy and Finance sets minimum or fixed values for duties and other taxes. Minimum prices are a practical way of coping with under-invoicing and a weak customs system but offer scope for very high protection. This protection is not transparent and can be determined by administrative decisions about the level of minimum price.
<i>Quantitative restrictions going but a few bans still exist</i>	Most quantitative restrictions and licensing of imports were eliminated in 1994. A few goods remain under some form of control including pharmaceutical products, gold and silver, ornaments, ammunition and

various cultural and medical materials. Imports of some goods are banned— for example, pigmeat, used motorbikes tyres, right hand drive motor vehicles and used footwear. A few state trading companies continue to operate but they appear to compete with private companies in the same markets.

Controls apply to some exports

Controls of various kinds apply to exports in the following circumstances.

- Controls in place for health and security reasons.
- Quotas and inspection procedures applied to meet requirements of trading partners to satisfy quota limits or rules of origin.
- Controls apply to exports of processed wood products.
- Rice is a controlled export for food security objectives.
- Military, pharmaceutical and medical goods are also controlled for security purposes.

Export taxes not a good way of encouraging processors

Export taxes apply to several classes of goods. These include live animals and fish and raw hides and skins. Controls on fish and rice are discussed under sector study headings in chapter 5. While there are sometimes perceptions that encouraging further processing in this way is a good way to encourage value adding and employment generation, in practice this is seldom the case.

- Such taxes involve ‘hurting’ one activity and ‘helping’ another so that the basis for presuming an output gain is weak.
- Illegal exports are encouraged.
- Reducing returns to animal producers from hides and skins discourages them from delivering high class product; yet such product is needed by processors seeking to compete in international company.

External trade barriers

Taking Cambodia’s top 50 export commodities, the main products are apparel (74 per cent), footwear (5 per cent), wood products (4 per cent) and rubber products (3 per cent). The main markets for apparel are the US and the EU. In 2000 the US imported 76 per cent of garment exports and the EU 23 per cent. Most footwear is exported to the EU (60 per cent) and Japan (35 per cent).

<p>Survey of 100 plus firms confirmed barriers:</p> <ul style="list-style-type: none"> —quotas —tariffs —labor standards —bureaucratic costs 	<p>The Diagnostic Study team designed and commissioned a survey of some 100 exporting firms. These firms covered garments, footwear, wholesale and retail trade, wood processing, fisheries, agro-processing and logging. Garment firms identified quotas, tariffs and labour standard requirements as the main obstacles to the US market. Opinions about the EU market were similar indicating that local content requirements mean a substantial amount of goods are not eligible for duty free access and must enter at MFN rates. Footwear firms have been established primarily through Taiwanese investment. Most footwear exports are to the EU and Canada. Hardly any goes to the US. There are virtually no local inputs and the 40 per cent local content requirement bites hard on producers. Tariffs do not appear as a major obstacle for exporters and firms exporting to Japan rated tariffs there as relatively unimportant. Labour standards into the EU were cited as a problem. Cambodian ownership and management of firms exporting in other product areas is much greater. The survey results from these firms did not indicate the same degree of consensus about market barriers.</p>
<p>Despite Cambodia's LDC status there is not much actual duty free access</p>	<p>While Cambodia has duty free access for some 6 000 tariff items under the US GSP, the items where Cambodia can compete effectively with respect to cost and quality, apparel products, are regarded as 'sensitive' and are excluded from GSP access. Most favored nation (MFN) rates apply and 12 categories of garments are subject to restrictive quotas. Thus despite the fact that Cambodia is a least developed country (LDC) the average duty into the US is 17 per cent. In the EU Cambodia faces no quota restrictions and has duty free access subject to rules of origin requirements under the Everything-but-arms Initiative (EBA). Cambodia does not have a well developed textile sector and these rules of origin requirements are forbidding. So much so that the average rate of duty for exports to the EU is 8.8 per cent. The implications of these restrictions are developed in the garment sector study - Part C and in chapter 5 of this overview</p>
<p>Quotas might seem valuable but they:</p> <ul style="list-style-type: none"> – complicate facilitation – raise issues of labour productivity – will not be around forever 	<p>Preferential access may seem to be a valuable consideration but it has costs.</p> <ul style="list-style-type: none"> ▪ Some of the bureaucratic obstacles identified as domestic restrictions are caused by access requirements. For example, administration at the border is further complicated by the need to enforce various rules of origin requirements. ▪ While labor market requirements are driven by the Cambodian Labor Law the regulations for garment labor conditions are linked to requirements of the US and the European Union (EU). The US quota expansion is directly linked to substantial compliance with labor standards and EU Generalized System of Preference (GSP) status also has labor and environmental links.

- Minimum wages are a transfer to existing workers. That is a positive for them but a negative for people who would like to get work but cannot.
- Mandatory double time for night shift work appear to help nobody, raising costs of producing in Cambodia and removing work opportunities for people who would like to work.

When quotas go it would be a pity if they left a high cost environment behind

Given the level of productivity in Cambodia costs are considered to be high relative to some competitor countries. Other competing countries such as Vietnam are also being granted MFN status. Quota restrictions on imports from other countries into the US and EU are scheduled for removal in 2005 under the Agreement on Textiles and Clothing. When this happens Cambodia will need to compete on costs and chasing preferences can put the capacity to do that at risk.

The African Growth and Opportunity Act (AGOA) grants GSP benefits to eligible countries in sub-Saharan Africa. It also allows selected eligible sub-Saharan African countries duty free and quota free access to US apparel markets subject to the origin of the fabric. Whether competition from these preferential sources will be appear to be significant is an important question. While the preferential conditions appear generous, the experience is that the administrative requirements to meet them are costly — demonstrating rules of origin for example — and as Cambodia's own experience has shown, rapid increases in market share are likely to be met by tariff and quota.

ASEAN membership

When Cambodia became a member of ASEAN in April 1999, it committed to a gradual reduction in most tariff rates by 2010 for trade with other ASEAN members. Currently the decision making process with respect to AFTA mainly hinges on the timing at which different classes of goods will hit the 0–5 per cent target.

However assuming that the Common Effective Preferential Tariff (CEPT) target of 0–5 per cent is reached, the question arises as to whether rates applying to other countries should match this rate. Interestingly, some ASEAN member countries have done this. Indonesia for example has reduced MFN rates largely in tandem with CEPT. The reasons for taking such an approach include the following.

But differences between a rate with ASEAN and the rest of the world would mean:

- **administrative problems**
- **firms buy from high cost sources**
- **not necessarily more revenue**

- Large differences in rates on the same goods from different sources feed administrative problems including the scope for taking unofficial payments.
- If MFN and AFTA rates differ, firms might be encouraged to source from ASEAN countries even if the pre duty value of goods from other sources was lower. That is trade would be 'diverted' rather than 'created'.
- Low uniform duties would facilitate valuation and take some of the administrative pressures off the exemption system. Revenue is an issue but with official duties at lower levels, the opportunity to shift official revenues into unofficial charges would be less.
- High duties on consumer goods means Cambodians pay above world prices for their basic needs. For example, the duty on flour is 35 per cent. This duty protects the local flour miller and means bakers, food processors and home based industries pay more — and charge more. In most countries food makes up a large proportion of poor people's expenditure and such duties hit them hardest. But in Cambodia importable food products do not appear to be significant expenditure items for poorest people.

Poverty impacts of the tariff

Poverty analysis shows tariff reforms would raise household purchasing power

Household survey data were used to model the impact of tariff reductions to a uniform 7 per cent. These results are reported in part B. Although the duty on rice is only 7 per cent, for different kinds of meat, dairy products and for prepared and preserved vegetables duties are above 30 per cent. The unweighted duty for clothing and footwear is 28 per cent. Household expenditure data was used to assess the extent of poverty reduction arising from a tariff reduction to 7 per cent. This calculation took into account the shares of different items in consumption of each income class. The lower prices arising from this tariff reduction resulted in an improvement of 4 percentage points in average household purchasing power and an improvement from 3.2 to 3.9 percentage points for poorer groups.

Further tariff reform

Tariff reform already started.

In some ways Cambodia is well placed to tackle further tariff reform. Tariffs have already been significantly reduced with no adverse adjustment consequences. Revenue is a concern but even there a low uniform rate would make for much more simplicity and deliver similar revenue. Nonetheless the issues are complex and review would need to be done with due process and involve informed stakeholder participation. The impli-

Further reform needs to be based on domestic consideration and processes

cations of these options would need to be assessed from the point of view of employment, poverty reduction, government revenue, regional income effects and so forth. An economy-wide model would be needed to assess the full effects of tariff changes on consumption and in income. An outcome of such a review might be advice regarding the pace and nature of tariff reductions and the need for and kind of complementary policy measures. The review would need to be supported by the information and analytical techniques need to evaluate the impacts of the tariff change. The Steering Committee established by the Government for purposes of managing the Integrated Framework Program could oversee such a tariff review.

WTO accession

RGC and National Assembly building a legal framework

As Cambodia accedes to the WTO, one of the many obligations entailed by WTO membership will be for Cambodia to participate in a regular trade policy review process through the WTO Trade Policy Review mechanism. A regular process of domestic review would facilitate this process.

IF study advising on WTO implications

Another set of issues relating to WTO membership is appreciation of Cambodia's program of legislative reform. As part of the Diagnostic Study, a legal expert from the team worked directly with Ministry of Commerce officials to develop the legislation program in language that would address WTO requirements. The RCG and the National Assembly of the Kingdom of Cambodia have been working in close collaboration in recent years to adopt and implement a coherent, complete and comprehensive legal framework in Cambodia. The Council of ministers has adopted a draft Legislation Action Plan that sets the legislative agenda for 2000 through to 2004. In preparing, drafting, assessing and adopting these new laws and regulations the RGC has determined that all ministries will see to it that there is compliance with WTO Agreements. Various technical assistance projects are either underway or are in preparation to support government officials for the drafting and preparation. The assistance provided in the pilot study involved preparing for each law or regulation, a description of its content and scope, planned approval dates and processes and the WTO Agreements implicated.

Priorities need to be set for legislation reform put to the WTO

Whether for domestic imperatives or WTO accession requirements, trade policy reform is as much about building institutions and processes as it is about setting particular policies. Much needs to be done. It cannot all be done at once so the order of doing things is crucial. Some laws and institutions could be set further back in the queue of things to be done. For example, a competition law would require a separate agency with highly trained lawyers and technical experts. Whether such resources would be

better devoted to developing contracts and secure transactions law is a question that warrants addressing. As the economy becomes more open to international trade, the need for a competition law would be less.

Low rates reduce incentives to under invoice

As Cambodia makes ‘offers’ in the accession process, there is the question of the maximum rates it should seek to negotiate. These negotiated rates would bind Cambodia from making subsequent increases. One view is that at this stage Cambodia should seek to negotiate the highest permissible levels. This would give Cambodia more freedom to make decisions about tariff levels. However, setting binding rates relatively low, say equal to or very close to current applied rates also has advantages. Low binding tariff rates provide stability and credibility in the country’s trade policy framework. The important thing is for Cambodia to establish the processes and information to be able to judge what is a good tariff structure for Cambodia.

Need domestic processes to assess tariffs on the basis of what would be best for Cambodia

Understanding what is WTO allowable is not as important as understanding what is good policy for Cambodia

Basic GATT principles may be varied in some respects for developing and least developed member countries. Thus, developed countries may not expect reciprocity for commitments to reduce tariffs and under the ‘enabling clause’ may offer more favorable treatment than MFN rates. Special and different provisions for developed and developing countries allow member countries to maintain assistance measures over longer periods. There is also an option of introducing quantitative controls for balance of payment reasons. The contributions of such provisions to policies of LDCs is problematic. Rather than being guidelines for ‘good’ policy they are more realistically viewed as escape clauses for bad policy.

While WTO accession and membership can be a way of ‘locking in’ desirable reform merely conforming with WTO rules will not guarantee ‘best possible policy outcomes for Cambodia. WTO provisions for example allow antidumping and countervailing duty actions. Such provisions have frequently been ‘back doors’ to protection for many developed countries and an increasing number of developing ones. The assistance Cambodia is receiving with WTO accession needs to be complemented with assistance for building capacity in the application of techniques and principles for assessing policy on its merits.

Box 3.1 sets out ongoing technical assistance activities and needs.

3.1 Trade policy: technical assistance needs and activities

Proposals for trade policy technical assistance cover issues such as investigating and making transparent those obstacles which inhibit households from building wealth, through to work on the trading restrictions and regulatory procedures identified in the Sector Studies. The trade policy issues identified in this chapter fall under the following headings: i) WTO accession ii) trade policy measurement and review iii) export marketing arrangements and iv) systems for providing imported inputs to exporters free of duty.

WTO accession

Some of the core issues emerging in the next rounds of WTO accession activities include:

- ongoing assistance with Cambodia's legislative reform program which addresses WTO technical requirements and review priorities recognizing that the legislative reform program cannot all happen at once;
- establishment of WTO consistent valuation procedures; and
- assessment of the implications of binding at 'high' or 'low' rates and policies for 'special and differential treatment'.

The government has an extensive program of WTO related assistance activities under way or in process. Thus donors such as Japan have committed to support work in the area of TBT, France in the area of IPR protection, Canada has committed to support the WTO accession process and Singapore will support in trade related capacity building. Valuable work in Trade Facilitation has been undertaken at the regional level by ESCAP and at the recent ASEAN Economic Minister's Meeting the Australian Trade Minister announced a A\$3.5 million SPS capacity building program for ASEAN countries intended to build the internal capacities of regional countries to manage animal and plant pests and diseases within their own borders and to operate effective quarantine services at their own borders to protect them against incursion.

Trade policy measurement and review

Important as WTO disciplines are, for good policy to be developed and accepted there also needs to be a capacity and institutional processes which facilitate the development of trade policy in terms of widespread understanding of the impacts of such policy on the Cambodian economy and not just in terms of whether those policies are WTO consistent. Such processes need to be independent, transparent, technically sound, and be capable of explaining the benefits and costs of different policies and the distribution of these benefits and costs on people in Cambodia. Institutionalization of such a mechanism would help deliver on many requirements of the WTO and would in particular be the basis for reporting to WTO Trade Policy Reviews that will be a requirement of WTO accession.

Technical assistance to support such institution and capacity building could involve:

- advice on techniques for measuring levels and impacts of trade protection and taxation;
- advice and training procedures for trade policy evaluation and reporting; and
- assistance with a specific reviews — for example, the cascading tariff — export controls and taxes and the implications of binding at different levels.

Technical assistance to review export marketing arrangements is proposed for relevant sector studies.

The government is already managing technical assistance in these areas. German Technical Cooperation (GTZ) has an agricultural trade project, which has the objective of elaborating a national foreign trade strategy for selected countries. Projects include the promotion of bio-pesticides and agricultural quality improvement. JICA is providing support for human resource development for advancing identification and formation of industries with comparative advantage.

4

Trade facilitation

The trade facilitation task

Low transaction costs requires efficient trade facilitation

Reducing transaction costs by efficient trade facilitation is an increasingly important issue in international trade. The volume of trade is expanding. The range of sophistication of goods is increasing. Consumer demands for safety, environmental standards and the like are rising. Expanding use of bilateral and preferential trade agreements has raised the need to enforce rules of origin requirements. Variations in streams of technological developments have given rise to differences in technical specification and standards, which might warrant border control on safety and consumer protection grounds. These pressures and the costs of trade facilitation are sometimes aggravated by domestic demands to use standards and other specification issues as protective barriers.

Scope for keeping transaction costs low enhanced by:

- information technology***
- risk management***
- harmonization of procedures***
- evolution of service culture***

But there have also been developments that have contained the costs of ‘doing business’ both within and between nations. Information technology and statistical techniques have assisted with the development of customs risk assessment techniques so that inspection of each and every shipment is no longer necessary. Automation of data management and processing, which has helped with risk management has also facilitated processing of consignments by traders and their agents and by customs and other border control agencies. Harmonisation of procedures and standards between countries has reduced the pressure on border inspection. Processes to encourage a service culture of professionalism in facilitation are changing practices, which were once obstructionist, to processes which are facilitative.

Cambodia is tackling these issues but the task is complicated by...

Most countries are grappling with these issues unilaterally and in a range of co-operative fora including ASEAN and APEC. While trade facilitation in Cambodia is in its early days much has been done including the appointment of a PSI service provider, co-ordination of agencies at border checkpoints and the streamlining of procedures for certifying rules of origin. That said, much remains to be done to build a modern, low transaction cost, trade facilitation process.

-
- porous borders with three neighbours**
- The physical task is large with sparsely populated border areas with three countries and a long coastline with many rivers and bays.
 - The administrative task is complicated by:
 - a cascading tariff
 - many exemptions and the need to allow exporters access to inputs at world prices
 - rules of origin requirements imposed by trading partners, and
 - preferential trading arrangements with ASEAN.
- a complicated tariff**
- limited resources**
- low salaries**
- no automation**
- unclear lines of responsibility**
- duplication**
- civil service salaries are low and officials in the Customs and Excise Department (CED) deal with large sums of money;
 - the service is not automated and other physical support facilities are poor;
 - regulation and accountability is not well defined between PSI and professional shipping agents or brokers;
 - CED works alongside a number of other agencies at the border where there is overlap and confusion of responsibility; and
 - the capacity to move to a risk management inspection system is hampered by poor information and data management systems and the incentives to move to risk management are muted by the opportunities to supplement very low salaries afforded by inspection of each consignment.
- As a result there are unofficial payments, smuggling and unreliable processing**
- These circumstances have given rise to concerns with trade facilitation. Unofficial payments are reported to be high and the government’s revenue collection is much lower than that implied by the official tariff. Smuggling is reported to be widespread and clearance and processing times are sporadic.
- Trade facilitation needs to address domestic trade and...**
- Trade facilitation does not just happen at the border. International trade also depends on free movement of goods within a country. Thus in Cambodia trade facilitation needs to address impediments to the movement of goods in the form of poor infrastructure and barriers, which might arise in the form of transit charges and local marketing monopolies.
- ...regulation of investment.**
- Trade facilitation is also linked to the regulation of investment. Over 50 per cent of international trade is done by multinational corporations and a large part is between units of multinational corporations. Thus trade facilitation and investment facilitation are two sides of the same coin. Cambodia has recognized this linkage. However, regulation which treats

foreign investors differently from domestic investors will have implications for the treatment of goods as they enter into trade.

The task is also complicated by a cascading tariff...

Although the tariff has been simplified it still cascades from 0 to 35 per cent. Such differences raise issues of classification and valuation and create scope for customs officials to 'charge' for decisions that can mean substantial reductions in duty payments due. Rules of origin and exemption further complicate the administrative task.

...easy movement across long borders and...

Border markets with Thailand local residents trade surplus household production for foreign consumer goods. One-day border passes and duty free entry of non commercial quantities facilitates this trade. There are more than thirty land and river crossing border checkpoints with Thailand, Vietnam and Laos. Exports to neighbouring countries are a small share of total exports. However, Cambodia imports almost one third of its total reported imports from Thailand.

...many border points

Customs capacity building

Salaries are low and while goods get cleared...

With the existing low civil service salary structure customs clearance tends to happen on a 'user pay' basis with unofficial payments going directly to officials. Some customs posts are bought and sold on the understanding that they provide access to charging for clearing services. At least with this system goods are cleared and charges are reported to be predictable and not unreasonable for large consignments. However, they tend to be prohibitive for small traders. Moreover, this kind of customs clearance has relatively high costs. Customs officials have an incentive to inspect, or threaten to inspect, each consignment rather than apply risk assessment techniques. While 'unofficial' payments might cover the 'wage' costs of the delivery of customs clearance, revenue collection by the government has suffered.

...traders pay 'import fees' but often not to the national revenue

Incentives are created to cut out PSI

The co-operation of the CED with the PSI provider is at risk because of a conflict of interest. As a means of covering for Cambodia's currently limited customs resources PSI is being used to monitor imports, conduct physical verification of goods, and provide value and customs classification for revenue collection. However some 60–70 per cent of dutiable imports are reported to be circumventing PSI, leading to substantial foregone revenue. Traders are choosing to under-declare the value and quantity of their imports to CED and pay a 7 per cent penalty. Industry participants contend 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. CED and the PSI contractor, SGS are building working arrangements in biweekly working group meetings. The role of SGS needs to be seen in the

<i>PSI should be part of capacity building</i>	perspective of a capacity building program for customs administration and the parties need to agree on a realistic time frame for the CED to take over the functions of SGS.
<i>Computerization is necessary...</i>	The system has limited computer support and greater use of computers would improve the efficiency of customs clearance, revenue accounting and data collection and analysis. It would also facilitate the development of professionalism of customs officials. Transactions could be processed in a consistent manner promoting equity and reducing the opportunity for corruption. Increased computerisation would also assist more accurate systems of risk assessment, post clearance auditing and provision of duty free inputs to exporters. Nevertheless, greater computerization system alone would not be sufficient. There also needs to be institution building, clarification of responsibilities and simplification of tasks. The draft customs law does not meet the needs of a modern customs administration in its current form. There is a need to enact suitable legislation clarifying the functions and powers of the CED. A revision of the customs law is underway with completion expected by mid 2002.
<i>...but not sufficient</i>	
<i>Also needed are...</i>	Further computerization of procedures is unlikely to be successfully implemented if it is seen just as a means of enforcing duty collection. Instead, it needs to be understood that in combination with training, regulation, salaries and clear lines of responsibility, as part of building a better and more professional customs service. Customs officials need to be convinced of the advantages of a modern customs service offering salaries that reflect training and responsibility, career structures reflecting promotion by merit, and a rapidly growing economy helped along by rapidly growing trade and falling transaction costs. Customs officers would benefit from such arrangements compared with a system where they are rewarded by unofficial payments, which are subject to some risk and where there are insufficient resources to provide a career structure. Part of the job of bringing about change is to convince them of that. Importers and exporters would be better off by paying official charges and having their goods cleared quickly and having a government with sufficient resources to deliver essential services. And the government would be better off as a result of having a broader tax base.
<i>–training</i>	
<i>–salaries</i>	
<i>–career structures</i>	
<i>Question whether capacity building should proceed with civil service reform</i>	Customs officials' salaries are tied to civil service conditions. However, the civil service reform strategy provides for a special status for customs staff to address remuneration issues. Another approach would be to establish customs as a separate authority. Transparent fees could be levied to cover the costs of the authority with the shares of duty going to the state being made explicit. Enhancing the capacity of CED to achieve trade facilitation objectives would require commitment at senior levels of government to

universal enforcement of customs laws. There would need to be a demonstrated belief in fairness and a common respect for the rule of law, which would encourage voluntary compliance by traders and CED staff. All regulatory regimes rely on voluntary compliance.

Widespread smuggling is a costly way of doing business but formal legal systems have to be efficient to attract trade

According to the Private Sector Working Group on Manufacturing and Distribution some \$35 million is foregone per year from the smuggling of beverages, petroleum and milk products into Cambodia. Smuggling of goods into Cambodia that are produced domestically and pay local taxes discourages investment. It is also suggested that as much as 80 per cent of the cigarettes imported into Cambodia are smuggled into Vietnam. The CED has established a mobile anti smuggling task force, which collected CR 0.7 billion in the first quarter of 2001. The fact that smuggling with its risks and costs is so prevalent is a reflection of the high level of transaction costs applying in the formal sector. The challenge is to get these costs down so that it will not be worthwhile bothering with smuggling. With efficient trade facilitation and reasonable rates of duty people trading by way of smuggling would be encouraged to move through efficient low cost channels.

Duplication of agencies is a problem

Duplication and confusion at clearance adds to processing time and costs. Thus the Ministry of Agriculture administers SPS controls. The Frontier Defence Department is responsible for checkpoint security and prevention of smuggling. The Economic Police assist with the suppression of fraud. Camcontrol, an agency established by the MOC is responsible for monitoring the quality of imports and exports. In addition at the 28 land and river border checkpoints, the 'chief' of border operations is a representative of either the provincial governor or the administration of the nearest provincial city. Measures to rationalise the presence of government agencies at border checkpoints were introduced in mid 2001 (sub-decree number 64). But uncertainty about roles and responsibilities is still exists.

Import and export procedures

Simplified forms help small traders

Simplified declaration forms and an exemption from registering for value added tax facilitates trading low value and infrequent consignments by farmers and small and medium enterprises (SMEs). However, licensing requirements for rice, fish and handicrafts significantly raise the costs of exporting these products. There also appears to be uncertainty among officials as to the export process for non-traditional exports, causing delays and additional costs to exporters.

Garment exporting could be simplified

Garment exporters incur significant trade facilitation costs. Five different government agencies are involved in the process undertaking at least three

different inspections. Fixed informal costs of up to \$150 per consignment are modest compared to formal fees paid to RGC to obtain certificates of origin. Options for simplifying garment exporting procedures include the following:

- eliminating application letters and providing traders with forms to complete themselves;
- providing a system to accept applications on electronic media;
- combining application forms and inspections; and
- taking advantage of new communication protocols with US and EU authorities to simplify the application process.

Verification of quantity and quality is cumbersome

Camcontrol has a dual role — to verify both the quantity and quality of goods being exported and imported. This verification could be based on risk assessment and need not involve physical inspection of every consignment. Instead, officials stop and inspect 100 per cent of exports and imports not subject to PSI charging a fee of 0.1 per cent of the value of the consignment for each inspection. Low salaries provide an incentive to undertake unnecessary inspection.

Inspection of all goods unnecessary

- The compulsory inspection of all imports and exports is unnecessary. It is the role of CED to check quantity. CED staff could conduct any necessary visual inspections.
- Teams need to be trained to manage a risk based sample selection system for imports affecting health and safety. These teams could comprise Ministry of Health, Ministry of Agriculture, Fisheries and Forestry or Camcontrol officials.

Regular processes for user and services providers interaction

One source of frustration for people dealing with trade facilitation procedures is the lack of regularized and transparent process for appeal. Some developing customs services have tackled this issue by establishing an independent appeals unit. In Cambodia the regular private sector forum has provided a useful vehicle for complaints and suggestions to be aired in public. However, some traders say that ‘standing up’ in such fora has also led to penalties applied by being made to wait or ‘losing’ goods.

Transport and border markets

Port charges are relatively high

Shipping operators contend that port charges at the government owned Sihanoukville port are the highest in the region and four times higher than a comparably sized feeder port such as Songkhla in Thailand. The port had a pre-tax profit equal to 50 per cent of its total revenue in 2000. However, port equipment is unutilised because of high charges. High port charges

could discourage shipping operators opening new services to Cambodia and providing traders more flexibility and choice. Experience in other countries with private investment and management in port facilities has shown that with carefully specified contractual relationships private investment and management can deliver an improved range of services at lower prices.

Regulations for competitive provision of customs agency services needed

Another government owned organisation, the Kampuchea Shipping Agent and Broker, earns substantial profits from its authority to handle shipping agent and customs brokerage functions within Sihanoukville and Phnom Penh ports — CR 4 billion (\$1 million) pre tax profit in 2000 — representing 68 per cent of its total revenue.

Road transportation appears to be highly competitive

Inland road transportation has increased significantly and is now almost double the volume carried by sea and rail. The industry is characterised by a large number of registered and unregistered operators providing competitively priced services. Fuel costs are not high and diesel is on a par with US prices and much cheaper than in Europe. Road freight rates vary considerably with the physical condition of the road. Fees collected by illegal police checkpoints are between 11 and 17 per cent of the formal freight rate for a container being trucked from Phnom Penh to Sihanoukville.

Most (90 per cent) survey respondents rate transport costs as a significant barrier to trade

Despite the significant competition among operators and relatively low fuel prices, respondents to the survey overwhelmingly rated transport costs as a significant barrier to domestic and international trade (90 per cent). Unofficial fees and charges are one reason for this. Other reasons might include the poor quality of roads and the lack of user charges — applied by way of registration or fuel taxes — to fund road maintenance and construction. Fuel pricing and taxation is complicated by the need to consider policies of neighbouring countries where fuel taxes are also low. Another option for road charging would be to establish toll operations. While this could provide funding and incentives for road maintenance, careful specification of contractual arrangements and transparent bidding processes would be required to ensure improvements in the quality and price of road transport services found their way to users.

Industrial zone policy

The RGC has been considering establishing one or more industrial zones in Cambodia and attracting domestic and foreign investment into the zones. Reasons for this approach include:

- focusing scarce infrastructure development resources initially inside the zones to bring them to an internationally competitive level;
- lowering the costs of administering complete duty and tax free exemptions on imports within the physically defined area of the zone;
- attracting Thai manufacturers to relocate their production operations to zones in Cambodia situated along the Thai border. Benefits to Thai investors include:
 - continuing GSP market access (Thailand has graduated from GSP);
 - access to Thai infrastructure, in particular, road and rail links to Thai ports; and
 - access to labour costs that are approximately half of the level of Thai labour costs in zone three.

A draft industrial zone law envisages private management

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.

Need to have clear distinctions between policy and management

The draft 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. The intended structure could function well if the Council were to act as a policy making board of directors and the Secretariat as the executive management with line functions in each zone. The zone customs agency would need to 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 or these functions could be contracted to the private sector.

Zone incentives need to match those generally available

Zone investment incentives should be aligned with the incentives offered by the LOI. Consistent incentives will prevent investment locations within Cambodia competing with one another. Apart from the possibility of disadvantaging some regions with respect to others another set of incentives could raise administrative costs and hurt revenues. The current review of investment incentives should consider the tax treatment of Thai investors in the proposed zones.

A core issue is how the long term gains flowing from the industrial zones can be shared. This will involve looking carefully at the method of transferring the control of public land to private developers perhaps by

leasing public land (with lease payments based on current improved value) to private developers rather than selling it, or by imposing a property tax based in property value. Box 4.1 sets out ongoing technical activities and needs.

4.1 Trade facilitation: technical assistance needs and activities

Achieving a modern customs clearance and goods inspection system with low transaction costs begins with some of the TA activities specified for trade policy. A first step is to simplify the tariff and associated arrangements including trade preferences and duty exemptions.

A second step is to clarify the roles and responsibilities of the several overlapping agencies involved in border inspection. Such technical assistance could draw on procedures followed in other countries and lessons learned there. It would require a detailed review of operations, overlap and unnecessary duplication of agencies including Customs, Camcontrol, the Department of Agriculture, the Economic Police and various local authorities.

This stream of technical assistance should complement and be designed in sympathy with support for computerization and automation of procedures and information systems to support risk assessment. Technical assistance should be designed to support professionalization of officials with appropriate rewards and accountability. The technical assistance could also cover the specification of an independent appeal office on custom matters.

Survey results show road transport to be a major issue. In this regard, a study of options for road user charges would be timely. Such options might include fuel taxes, regulation fees and toll charging.

The movement towards economic cooperation between Cambodia and Thailand including industrial zones at border areas raise a large number of technical questions. One is about the provision of customs services. Technical assistance to assess how such customs services should be designed and delivered in a zone situation would be useful. Should there be dedicated customs officials or should zones draw on the Customs Department generally?

Other core issues warranting technical assistance in the context of technical cooperation and industrial zones include:

- what management model should be followed?
- how should prices for land and access to the zone be struck?
- who should supply power, telecommunications etc and at what price and conditions?
- what investment incentives should be struck?

The RGC has already mobilized considerable technical assistance in these areas. The civil service reform program is relevant from the point of view of building a professional customs service. The IMF is supporting a long term resident customs specialist who is working in the Customs Department. JICA is supporting border controls aimed at drug and crime. The ADB and ESCAP have been extensively involved with the Greater Mekong Subregion on trade facilitation in the region. A trade facilitation working group has been established and is supported by ADB. ESCAP has provided assistance to the GMS countries covering such matters as: simplification, standardization and harmonization of trade related documents and procedures and the development of national institutional arrangements for trade facilitation. Other relevant projects include the development of a framework for customs cooperation.

5

Sector studies

Sector studies to identify opportunities and constraints

The Tokyo Road Map stressed the importance of encouraging and attracting investment and entrepreneurship into rural based sectors. That is where the people, especially the poor people are, and it is also where vast and largely under-utilized resources are. To this end, seven sector case studies were conducted with a view to identifying opportunities available, or which might be made available, to households, and constraints limiting their capacity to take advantage of these opportunities. The seven sector studies are rice, agriculture and agro-processing, fisheries, garments, tourism, labour service and handicrafts.

Most people especially most poor people in rural areas

Agricultural crops account for around 50 per cent of agricultural sector value added. Rice dominates agricultural crops though the total area planted to rice is only 80 per cent of that planted in the 1970s. Economic returns to labour from rice production are much lower (less than half) than rates generated from production of vegetables, soy beans, mung beans, cassava, sweet potato, tobacco and cotton. About 1.2 million hectares of agricultural land is currently unused. Other agriculture options include plantation or industrial crops such as coffee, caskeus, palm oil, coconuts, sugar cane and horticulture. Livestock production accounts for around 17 per cent of value added with potential for expansion in eggs, poor poultry and pig meat. Many farm households use livestock as a form of insurance. Thus, programs covering animal nutrition, and disease control would help provide security and improved livestock marketing and trading opportunities would enhance people's wealth and reduce the incidence of poverty.

Rice

Shift from a food security (quantity) to a trade (quantity and quality) mindset

Most rural households are engaged in some form of paddy production mainly for home use with the balance for trade. Cambodia has moved from being a net rice importer to a net rice exporter over the last decade. Food shortages are reported to exist in some areas. As food security concerns are becoming resolved, attention is shifting to seed selection and post harvest practices to increase productivity and deliver more consistent quality for storage and processing.

Marketing and production

Rice millers starting to build commercial trading relationships with farmers...

...including advisory services on a commercial basis

Marketing and processing is typically done by mills, which range from small family affairs to larger mills with their own wholesale and retail outlets. A Federation of Rice Millers has recently been established with a view to building relationships with farmers to provide them with the information, capacity and incentives to deliver more consistent quality rice. Farmer training and incentives are reported to have reduced the rejection rate for grain grown under contract from 80 per cent to less than 15 per cent in just a year. Farmer extension services provided by the state are rudimentary and there is an important policy question regarding the best way of getting information to farmers. Many countries have subsidized extension services but leverage is relatively low and advisory services are being increasingly privately sourced. The balance of private/public extension is a key question.

Clarity of land ownership is a key issue

On the input side, land use is a key issue — for rice and for agriculture generally. Land in Cambodia can be classified in four classes:

- large areas of unused land in the hands of the State
- land which though reasonably securely held is not amendable for use as collateral for borrowing
- land which is unusable because of the existence of mines, and
- land which is securely held and well enough titled for use as collateral.

New Land Law a first step but a big step

A new land law was legislated in 2001 to clarify title, resolve disputes and build the foundations for efficient land markets and for using land as collateral in financial transactions. Much needs to be done to bed this law into everyday practice. It needs to be disseminated throughout the country and understood and supported by individuals and local administrators.

Transport costs high partly because roads are poor, but also because of checkpoint charges and road funding policy

One explanation why some areas are food exporters while others are reported to be in food deficit could be transport costs. Transport costs are high partly because of the nature of the terrain and the quality of roads where the solutions lie in planning and building transport infrastructure. The informal fees and charges reported to be collected at checkpoints reflect policy with respect to security salaries and arrangements between local and central government. In addition as noted earlier fuel pricing and taxation policies and the fact that many vehicles are not registered limits funds for road building and maintenance. A program is underway to decentralize decision making, improve governance and achieve more sustainable and cost effective development of community infrastructure projects.

<i>Finance is seldom available</i>	Few rural businesses including farmers have access to formal sources of finance. Branch banking is expensive, incomes are low and collateral is not well specified. Farmer processor contracting is emerging as a basis for credit security.
<i>Rice marketing largely deregulated but still substantial army purchases and 'facilitation fees' apply for export</i>	Extensive interventions in rice procurement, pricing and marketing were largely disbanded during the 1980s. Fertilizer subsidies were abolished in 1997 and now most inputs are supplied by the private sector. The government remains involved in food aid distribution and the army purchases domestic and imported milled rice for soldiers. A state enterprise, Green Trade Company (GTC) is responsible for purchasing rice on behalf of the state including the purchase and storage of rice for food security purposes. GTC also competes with private traders. While no formal quotas or taxes apply to rice exports, exporters are required to obtain a permit. No official charges apply to these licenses but 'facilitation fees' are apparently required. Such 'irregularities' are reported to be a major constraint on exporting rice from Cambodia. The total cost of export procedures, add about US\$14 per ton to the cost of exporting rice. The total cost of these unofficial charges is estimated to be equivalent to total government expenditures on agriculture.
<i>Substantial research and development over the years</i>	There has been extensive research and development in rice through a government research institute — Cambodia Agricultural Research and Development Institute (CARDI). While many varieties have been produced, dissemination throughout the country has been limited. The research emphasis is now switching from yield to quality and to post harvest management.

Impacts of rice market changes on poverty

Efforts to estimate the extent of changes in poverty over time in Cambodia have faced significant statistical and measurement problems. These problems flow from efforts to refine the Cambodia Socio-economic Survey (CSES) to consider seasonality factors. Nonetheless whatever measure is used and at least 36 per cent of people are in poverty. While comparisons over time will remain difficult until measurement methods become consistent, several findings about the nature of poverty are robust across surveys and time.

- Poverty rates are highest in rural areas and amongst people living in households headed by farmers.
- Poorer households tend to be larger and 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 or has few years schooling.
- Poverty is lowest in Phnom Penh.

According to the CSES data, expenditure on food takes about 75 per cent of total expenditures for the first five deciles in rural areas. Only people in the top 20 per cent of consumption groups spend less than 70 per cent on food. Rice is the biggest single item of expenditure and is about 30 per cent for the poorest people. In urban areas, food (and rice) do not dominate expenditure to the same extent. On the income side earnings from cultivation are important and rice cultivation is most important in rural areas. In Phnom Penh wage income is more important.

This information on the level distribution and composition of income and expenditure provides the basis for calculating the impacts of various policy changes and consequent changes in the price of rice. One scenario tested involved reductions in post harvest losses, improvements in paddy to rice milling yields and a reduction in transport costs. The average gain under this scenario is equivalent to 4.5 per cent of total household expenditures, and although all households would gain, the gains for households selling rice is about 8 per cent. This is about five times the gains of those households that need or which are not self sufficient in rice.

A second scenario involves decreasing transaction costs for rice in rural areas which raised the net price received by producers and reduced the net price paid by consumers. On average people are better off by an equivalent of total household expenditures 1.6 per cent and net sellers are better off by an equivalent of 2.4 per cent. A third scenario involved an increase in the price of rice perhaps because of increased export demand. Although it is obvious that in this scenario net rice seller households would benefit and net rice buyer households would lose out the simulation indicates that only very poor and very rich people would lose. People benefit overall.

5.1 Rice sector study: technical assistance needs and activities

Crosscutting issues which are relevant not just to rice but to most social and economic activities such as cooperative activity through associations, regulatory processes and road fees are discussed under a separate heading.

Core streams of work for rice include case studies of evolving marketing and production systems and unofficial barriers to trade in rice. While most legislated restrictions on marketing have apparently been removed some restrictions — official and unofficial — remain. Technical assistance to examine the nature and extent of any such restrictions and their impacts is suggested.

There is also potential value in following up on the case study work reported here whereby rice millers have cooperated to form long term contracts with farmers. How effective are such contracts? What other modalities might operate? In addition what barriers if any exist to the extension of such activities?

On past and ongoing assistance activities, JICA has supported a major rice study and this work will be expanded in the forthcoming ADB Agricultural Sector Technical Assistance Loan.

Diversified agriculture and agro-processing

Trade expands people's opportunities

The role of trade policy in making it feasible for people to overcome poverty is to expand opportunities and enhance their resources. Thus, it is necessary to identify opportunities realistically confronting rural household and holders of small areas of land. In the past harsh and immediate concerns about food security have caused both private and official emphasis to center on rice production. While production of rice for subsistence might be a recipe for survival, it is not a recipe for alleviating poverty and rice processors and rice growers are now increasingly focussing on commercial opportunities for trade in rice as a means of raising incomes.

The broader these commercial opportunities are the better and there are good reasons for pushing them beyond rice. First, rice has been the focus of policy for many years. Production levels are still below those of 30 years ago but whether commercially driven rice output stays the same, increases steadily or explodes along the lines of the Vietnamese rice export experience is yet to play out. It needs to do this in a policy environment that seeks neither to further promote rice nor to discourage it. Second, returns from growing rice are relatively low compared with returns from other specialty crops. Third, there are many such specialty crops well suited to Cambodia, which offer the potential for high margin returns

given appropriate physical and social infrastructure and trading conditions.

Expanded opportunities might involve both small and large holdings. But allocation of unused land needs to be transparent and fair.

Whether this diversification away from rice will involve a move towards larger plantation style holdings, only time will tell. In many Asian countries, large scale agriculture coexists harmoniously beside smallholder agriculture without adverse environmental or social consequences. A core issue involves how the large amount of land that remains in government hands is allocated to private users and the security of title once land is in private hands. In Cambodia, large scale concessions are reported to have been granted without 'due process' and consequently large scale agriculture has come to be associated with favoritism and environmental irresponsibility. Such practices are both unfair and inefficient but this does not mean that large scale agriculture is necessarily an inferior way of bringing about improvements in people's lives. The new land law, which came into force in 2001, is expected to provide the basis for the secure land transactions which might involve both the consolidation of small holdings and the breaking up of large ones.

New Land Law is a starting point so is small holder agriculture

However in the short run small holder agriculture is the starting point. The RGC's priorities as laid out in SEDPII include: i) improving food security; ii) adding value to crop and livestock production; iii) increasing income opportunities for rural households; iv) strengthening participatory processes; v) ensuring sustainable production, and vi) increasing the availability of rural financial services.

Most processing is household based

Cambodian markets display a broad range of locally processed agricultural products such as milled rice; smoked, dried, fermented or salted fish; fermented cabbage and pickled vegetables. Much of this processing currently happens at the household or micro enterprise level but a few larger processing firms do exist. The main obstacles to specialization and exchange as a way of overcoming poverty are partly about infrastructure — transport, energy, telecommunications — partly about social and institutional arrangements and partly about markets for credit and land. Most market transactions require a degree of trust. When parties trust one another, transactions proceed at low cost with less need to verify quantities, qualities, methods of delivery and so forth. Such trusting relationships and the reputations which reinforce them, are an important if underrated institution underpinning most market economies. In rural Cambodia, these aspects of an efficient market took a terrible battering for many years and are only slowly recovering. Farmers operate in very competitive markets yet for the most part they do not compete with each other for individual customers. Thus, there is ample scope for them to share information about technology and markets. In many countries — developed and developing

Market transactions are oiled by trust

Trusting relationships need to be nurtured

Farmers can cooperate because in many ways they do not compete with each other.

Cooperation habits need to be rebuilt

— farmers do this by way of clubs, associations, breed societies and the like. Such activities are not well developed in Cambodia. The RGC is actively supporting activities to rebuild them.

International markets looking for 'different' niche products

Just as Cambodian agriculture is evolving from a food security target, international markets are increasingly calling for niche products which are 'interesting', 'different', tasty, clean and green. While individual transactions might be small, the market is huge. Cambodia has many such products already in place. They include spices, herbs, certain fine flavored fruits, sesame seeds essential oils — tea tree and lemongrass for example — certain rice varieties.

Role for incubator projects to nurture co-operation about production and markets

These opportunities need to be tested and demonstrated. This is happening already but at a slow pace because of the physical and social barriers mentioned. One way of supporting development would be through incubator projects which worked with groups of producers, processors and marketers to identify markets, analyze capabilities and costs developed options for commercial and support relationships and put together proposals for raising finance. These incentives would need to be designed so that where they were not working they would be allowed to full and where were working well, they would be allowed to grow and become commercial entities.

5.2 Diversified agriculture sector study: technical assistance needs and activities

The identified 'blocks' between the untapped resource of a varied diversified agriculture and a large international market for new, 'niche', green products are largely to do with information.

Technical assistance is proposed which enables small farmers to efficiently tap into the needed information at low cost. This includes assistance with the development of modalities for setting associations with a common interest in marketing, technology and purchasing inputs. One approach to this would be by way of establishment of 'incubators', which nurture cooperation about production and markets.

Handicrafts

Handicrafts suited to household production and can fit in with seasonal demands

Handicrafts offer considerable potential in the context of a pro-poor trade strategy. Handicraft production can be organized through household units to fit around the timing of seasonally driven activities such as rice planting and harvesting. The rich tradition of handicraft production in Cambodia has yet to be brought to the attention of international buyers. However many obstacles stand in the way of this happening. Years of war and civil

strife broke the chain of traditional transfer of skill and design. These capacities are slowly reassembling but linkages between craftspeople and markets. The capacity and keenness of Cambodia's young people to tap into the opportunities offered by information technology is being utilized in some marketing of handicrafts. This approach offers considerable promise.

Demand prospects promising

The demand for a greater variety of reasonably priced quality handicrafts for the burgeoning tourist trade is one clear market for further development. Many of the crafts being sold in the primary tourist markets for foreigners in Siem Reap and Phnom Penh are imported from neighboring countries.

But mobilizing many small units to produce for international markets requires extensive information network

Local tourism is also expanding as Cambodians feel more secure traveling within their own country. Until very recently Cambodians have tended to stay close to home out of fear of security risks in the countryside. Opportunities also exist in export markets as these markets are exposed to the unique design characteristics of Khmer arts and crafts. Small amounts of handicrafts are already being exported to Europe, Taiwan, Japan and the US. However exporters continue to be confronted by obstacles in meeting the quantity quality and cost demands of these markets. For producers to be able to take advantage of new economic opportunities and capture new markets they need assistance to expand their production capacity, upgrade the quality of their products to the standards demanded by buyers, and, overcome the many obstacles noted above.

5.3 Handicrafts sector study: technical assistance needs and activities

As with diversified agriculture the missing ingredients for the development of handicraft trade is information and the establishment of 'critical masses' capable of acquiring and using information at low unit costs.

The challenge for technical assistance here is to facilitate the building of relationships and systems which enable people to work out of small production units and households to produce products to a specification and identified demand.

Freshwater fisheries

***Fisheries a vital, but delicate resource ...
... under pressure ...***

Fisheries provide around 70 per cent of the animal protein intake. Cambodia's abundant capacity to produce freshwater fish arises from complex and delicate interactions involving vast bodies of water (Ton Le Sap lake and the Mekong and Ton Le Sap rivers), topography and nature. The wet and dry seasons bring about regular and significant changes in the area (from 3 000 km² to 75 000 km²), depth, flows and nutrient composition. Traditionally, these interactions have replenished fish food stocks and

provided a hospitable environment for fish to breed and grow. Now this vast but delicate resource is under pressure from many sources.

...from users in several countries...

...logging...

...agriculture and poor fisheries management

Not all these pressures originate in Cambodia. People in China, Laos, Thailand and Vietnam all depend on the Mekong for multitude of needs — food, water for irrigation, power, recreation and waste disposal to name a few. The economic planning and regional cooperation needed to deliver sustainable and harmonious use and care of this great system is a core challenge being addressed in regional fora including ASEAN. Cambodian fisheries stocks are also under pressure from the haphazard use of fertilizers and chemicals in agriculture production, forest logging, population growth and marketing and fisheries management arrangements.

Poor statistics for planning and management

The statistics on fisheries production, consumption and trade are rudimentary and complicated by the large amount of informal trade. That said, it seems to be widely accepted that about 25 per cent of the total fish catch is exported. About half that is exported through illegal channels. Seventy five per cent of exports are delivered to Thailand as fresh, sea fish and seafood. The bulk of the balance goes to Vietnam. On the production side the problem is one of resource stock depletion. On the marketing side, key issues are the large share of unofficial trade and the focus on border markets where prices are low and losses through spoiling are high.

Research fishing lots disbanded

But community fisheries management also require fishing limits

Management regimes involving research fishing lots that were allocated to special groups through non transparent processes have been disbanded. Large scale fisheries with relatively sophisticated production and processing methods now purchase fishing lots in competitive bidding systems. While these processes are open and the revenues substantial, the short-lived nature of the access purchased encourages over fishing. In early 2001 a large component of fishing areas under fishing management were released for community use. The establishment of incentives for sustainable management of the fisheries resource is an urgent issue. The establishment of community based management regimes is a difficult task on technical and cultural grounds and there are risks of continuing resource depletion through the treatment of fisheries as a common property resource.

Sole export agency takes the tax

On the marketing side, unofficial local trade with consequent low prices appears to reflect an export tax of 10 per cent and allocation of a sole authority to control fish exports. The state owned enterprise, KAMFIMEX, does not take physical delivery of fish but instead, for a fee, licenses five traders to purchase and transport fish across the Thai border. These traders work through markets located across the border in Thailand. The 'fee' is apparently prohibitively high at \$1 per kilogram. Prices in Thailand appear to be low and handling appears to be unnecessarily repetitious and returns

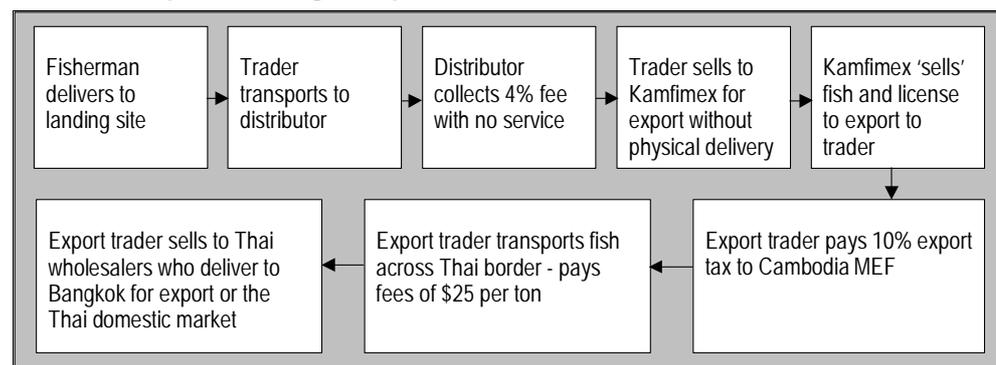
to resource poor. While unofficial systems appear to work more efficiently, benefits appear to be skimmed off by way of unofficial charges.

Just why Cambodia's freshwater fish markets are often located in Thailand is not clear. Because Thailand does not allow Cambodian transport trucks to deliver the fish to the market, fish are unloaded from trucks, re-iced and placed in push carts that hold about 3 tons. Fish are pushed across the border to the fish market and sold to Thai fish traders.

Selling fresh fish at 5 in the afternoon bound to deliver low returns

According to reviewed reports, the average price for these exported fish is about 35 cents per kilo, which is about one fifth the retail price for the same fish in Phnom Penh. In addition to the cumbersome procedures involved in crossing the border, export traders must also pay official and unofficial fees totalling about \$75 for each push cart of fish to Cambodian and Thai authorities on either side of the border. Chart 5.4 below illustrates the export trade system used for exporting fish to Thailand through Poipet.

5.4 Fish exports through Poipet



Data source: Report of Preliminary Field Assessment and Observations of Commercial Freshwater Fishery Operations Around Tonle Sap Lake, A Survey Conducted for UNESCAP, Enterprise Development Cambodia, July 2001.

Especially with export taxes and other charges

Exports of fish to the EU have ceased pending the establishment of a regulatory structure to ensure safe hygiene in production. One exporter is reported to have US Federal Drug Administration approval.

Thus on both the marketing and production side sustainable fisheries management can be enhanced by appropriate regulatory regimes. An abiding feature of Cambodia's fisheries is the depth of interventions. Yet, many of these interventions appear to be counterproductive. The fees, taxes and other charges actually appear to discourage investment in modern sustainable management and marketing systems and instead bring about management and production systems which are both unsustainable and costly. They also encourage a clandestine and unnecessarily circuitous system of trade.

Government departments depend on fisheries to survive

These outcomes appear to be a direct result of government agencies intent on survival and supporting themselves through direct market interventions, invasive regulations designed and enforced with a view to securing departmental revenue rather than sustainable fisheries operators. Activities to turn this state of affairs around could include reviewing the need to have a sole marketing agency enforcing, reviewing the export tax, supporting the development of private sector and community organizations, supporting private–public sector partnerships to improve technical and business management capacity and developing an effective demand and price information system.

5.5 Fisheries sector studies: technical assistance needs and activities

The main identified technical assistance issues for fisheries relate to:

- fisheries marketing and distribution, and
- management regimes

Overlaying both these streams of potential technical assistance activities are themes relating to the poor information base, the various jurisdictions affecting the fisheries resource and the tendency for government departments to place additional demands on the fisheries resource.

Marketing systems

The effects of the export tax and restrictions on who can export fish identified in the sector study warrant further work. Technical assistance in this context would need to address such questions as to:

- what is the extent of the export tax on fish exports?
- what are the effects of the export tax on production and marketing decisions?
- what are the impacts of the sole exporter requirement?
- do efforts to export fish out of the formal — taxed and sole trader — system lead to reduced export values? How big are any such losses?

Technical assistance to establish regulatory systems to meet international market requirements would also be timely.

Management regimes

The case for regulation of fisheries as a common property resource is well established. Concerns about management regimes in Cambodia arise on several fronts. There include:

- the incentives for short term exploitation given by awarding of leases for short periods,
- the large number of unregulated common property fisheries
- the allocation of fisheries access by non transparent methods.

Technical assistance is needed to address these three sets of issues. Such technical assistance should be participatory and support ongoing developments of commercial management systems. The ADB and ESCAP have supported extensive research into the management and marketing of fisheries and ESCAP is continuing to participate in the development of market information systems.

Garments

A remarkable growth story

Garment sector growth over the past five years has been remarkable especially considering that in two of those years there was significant political instability. Almost all garment production is exported. From 35 factories in 1996 there are now around 220 factories employing some 160 000 people. That such growth could take place in a country that is widely regarded as having weak if not corrupt administration and poor infrastructure suggests that the sources of this growth must be rather special. What are those sources? What benefits flow from this growth and how are these benefits distributed? What are the policy settings for continued sustainable, efficient and pro-poor growth?

Sources of garment sector growth

Growth because of:...

- *concessional access ...*
- *investment incentives ...*
- *comparative advantage ...*

The typically proposed sources of the garment success story (so far) are as follows.

- Agreements with the US and the EU providing MFN status and access under the GSP.
- Incentives made available through the LOI to foreign investors.
- Cambodia's comparative advantage at this stage of its development in labour intensive manufacturing.

and despite:...

- *weak administration...*
- *poor infrastructure...*
- *high bureaucratic costs.*

There are also frequently mentioned obstacles — factors that inhibit even faster growth of the garment sector. Besides a weak bureaucracy, and poor infrastructure these obstacles include; location off main shipping routes, a poorly educated labour force and institutions fractured by many years of war. How high these obstacles are is hard to judge. One view is that given the spectacular growth in garments and tourism, these weakness in the business environment are overstated and, with democratization proceeding, these obstacles are on the way to removal. Another view is that the attractiveness of investment in garment exports has been so high that it has been sufficient to overwhelm these very large obstacles.

Access to the US and EU

Some commentators consider preferential access to be the sole explanation for the garment sector growth story.

'The development of the garment industry in Cambodia at the present time is the result of trade concessions granted by developed nations'(CDRI 2001).

'Concessions' mean Cambodia as an LDC faces fewer restrictions than others

When MFN access is a 'concession' the market must be restricted indeed

But even Cambodia now faces quota restrictions on some products and quota expansion depends on 'substantial compliance' with labor standards

The US and Europe are the two most important destinations for Cambodian garments. For the US, 'concessions' meant that in 1997 Cambodia was 'granted' MFN status. That is American consumers could purchase imported garments after paying the relevant duty. How is it that such access is regarded as a 'concession'? There seem to be two reasons. First Cambodia, as a non member of the WTO, is not 'entitled' to MFN status in the normal course of events and must be accorded that status through a special 'Normalized Trade Relationship' agreement. Second, when it comes to the US garment market, access after paying MFN duty is a 'concession' in the sense that other countries with well developed garment industries operating at large scale and low costs face restrictive quotas when selling these 'sensitive' products to the US market.

Indeed so 'sensitive' is the market in these areas that even a relatively small newcomer like Cambodia exported sufficient quantities in some product areas — mainly woven trousers and knitted shorts — to trigger the US government to impose restrictions on 12 categories of Cambodian exports in 1999 on the grounds that this level of exports was 'disrupting' the US garment market. This quota agreement was initially for three years and is due to end in December 2001. The agreement provided for an easing of the restrictions by at least 6 per cent per year with an additional 14 per cent easing to be negotiated depending on the extent to which the US assessed Cambodia 'substantially complies with labour standards'.

The status of Cambodia's current access to the US market is as follows.

- Over half of Cambodia's garment exports are not restricted by quota but pay MFN duty of an average rate of 17 per cent.
- Quota restrictions were expanded by the agreed 6 per cent plus an additional 9 per cent in 2000 reflecting US assessment about the extent of 'substantial compliance' with labour standards.
- The agreement expires in 2001 with potential options including:
 - quota restrictions no longer apply
 - the agreement is rolled over in current form
 - a new agreement is reached involving no restrictions and preferential duties along the lines embodied in the African Growth and Opportunity Act which provides unrestricted duty free access to certain sub Saharan African countries.

Some African countries face fewer restrictions than Cambodia

EU access involves no quota and no duty

The second largest market for Cambodian garments is the EU. Under a three year agreement, which came into force in April 1999, Cambodian garments enter the EU without duty and without quantitative restrictions. Special incentive arrangements covering labour and environmental

protection also applied. In March 2001 the 'Everything but Arms' amendment provided for unrestricted duty free access to all products originating in least developed countries excluding arms, subject to satisfying rules of origin requirements. As noted these requirements mean that most of Cambodia's garment exports do not have GSP status.

Cambodia also competes without concession and in 2005 quotas are due to be phased out

Other countries are getting MFN access

In the US, the value of market access to Cambodia flows from the restrictions applied to efficient large competitors. But preferential access the only or main source of Cambodia's garment export success? Most of Cambodia's exports to the US and to the EU pay MFN duty. Partly in response to the imposition of quota restrictions on 12 major categories, producers have begun to supply the US market with garments not yet covered by quota but which incur MFN rates. This may indicate that Cambodian producers are still competitive for other reasons beyond preferences. However some potential competitors do not have MFN access and others face quotas. This is an important question because the capacity of these major markets to discriminate among providers is expected to diminish. The longstanding restrictions applying to garment trade are to be phased out in 2005 and the number of competitor countries with MFN access is increasing. For example normalized trade relations between the US and Vietnam came close to reality with US Senate approval in October 2001. Thus, to the extent that preferential access is a source of success, it is not a reliable one and in the long term Cambodian garment exporters will need to be able to compete with all suppliers.

Incentives to invest in Cambodia

Investment incentives might explain some garment growth

Under the LOI, foreign investors in garment production have benefited from various kinds of tax relief. Tax holidays apply to a certain extent, and exporters do not pay duty on imported production inputs. To the extent that the LOI is a source of garment industry growth, it would reflect the following considerations.

- Duty exemptions allow exporters to the opportunity to source inputs at almost world prices.
- The tax holidays provide foreign investors with an attractive environment.
- Proposed revisions to the LOI were the cause of strong protest by investors in 2001 suggesting investors do value the concessions.

The matter of greatest concern to existing garment exporters was the prospect of losing access to imported inputs at world prices. As noted exporters cannot easily pass on such charges and most countries seek to

But investment incentives are muted by high bureaucratic costs and other government charges

deliver duty free access to inputs. However, other considerations point to these provisions having only a modest impact on new investment decisions.

- While the LOI allows for a maximum 8 year tax holiday in practice such long periods are not granted. Tax holidays of up to four years (the maximum to date) have been granted to less than 50 firms.
- The LOI is subject to complex administrative processes that constrain the use of potential incentives and the administration of these incentives is reported to involve delays and 'bureaucratic costs'.
- Other charges have been introduced to raise revenues and these affect investors returns.

Comparative advantage

Cambodia's stage of development suits it to labour intensive garment production

Garment production is labour intensive. Low wage countries are suited to garment production and typically, garment exports have figured prominently in the early stages of development of several neighboring countries. Cambodia has a traditional garment and textile sector supplying the local market which in 2000 is estimated to employ 40 000 people so that there is an existing skill base (CDRI 2001). As development proceeds, skills increase and wage levels rise, Cambodia's comparative advantage in simple labour intensive garment production is likely to diminish. That would be a positive thing to happen as it would mean Cambodians had found more rewarding things to do in response to increased productivity and growth in demand for labour from other sectors. But there is also a concern among some manufacturers that despite large numbers of unemployed people, Cambodia's competitiveness *vis a vis* other countries is diminishing. Cambodia wage rates are lower than Malaysia, China, Philippines and Thailand but higher than Indonesia, Bangladesh, Vietnam and India (CDRI 2001). In addition other restrictions apply which also raise costs such as the requirement to pay double wages for a second shift. A looming question is whether the most viable long term source of export success — the capacity to be able to compete at a price — is at risk because of requirements linked to market access and the investment law — the most commonly regarded sources of garment industry success.

But need to keep costs low

–market access

–LOI

raise costs

Benefits and their distribution

How big are the benefits and who gets them?

In the context of a pro-poor trade strategy, the following features of garment sector growth warrant addressing:

- the size of the benefits of the garment sector to the economy; and

- the distribution of these benefits
- the creation of 'high cost' methods for distributing rents that threaten future competitiveness of the garment industry and other export sectors not yet exploited. .

Size of benefits

On the matter of the size of the benefits, three concerns are raised in policy discussion.

- The import content is very high and this means that not all of the benefits flow to Cambodia.
- Garment production is built on low wage activity and Cambodian policy should be looking for activities that deliver higher wages.
- Garment production is fine as far as it goes as a source of industrial activity and development but there needs to be diversification into other activities.

High import content does not signify low benefits

For every \$100 of garments exported around \$63 is spent on imported raw materials (CDRI 2001). In comparison with other garment producing countries an import content of 63 per cent is quite low and this probably reflects the rules of origin conditions major importing countries impose as a part of according concessional access. The survey of exporting firms conducted in the course of the Diagnostic Study indicated that 60 per cent of material inputs are imported from Hong Kong and China, 10 per cent from ASEAN countries and 25 per cent from various other countries mainly Taiwan. Thus the modified local content requirement which allows Cambodia to cumulate origin from ASEAN countries does not help ease content restrictions greatly. Nearly 80 per cent of the firms surveyed considered EU local content requirements to be a significant market access barrier. In principle there is nothing special about the extent of import content in an export product. What really matters is whether that import content is subsidized in some way by other sectors. In Cambodia's case, garment producers have a system of exemptions that enable them to access inputs at duty free prices. While there are concerns about what inputs can be accessed under these provisions and the costs of administering them, provisions with this intent are necessary for successful export performance and are common throughout the world.

Legislating increased wages does not help people without jobs and in the long run does not help people with jobs

In international terms garment production in Cambodia is a low wage activity although compared with wages that garment workers might be earning in other activities their wages are quite high. Should the government push for higher wage activities? One way that is attempted now is through minimum wage laws, which have raised the wages of existing garment workers. Investors contend that these minimum wages are discouraging further investment and further employment expansion. The evidence from other developing countries is that high minimum wages reduce employment opportunities in modern manufacturing and service sectors and crowd workers into low paying low productivity jobs in the urban and rural informal sectors. These workers are those most vulnerable to poverty — the young unskilled and single women heads of households.

Garment sector growth largely reflects investor assessments of risks and rewards

What about concerns that there is a risk in having excessive dependence on garment production? Whether there is a risk and one that the government should actively address depends on several considerations. Specialization does bring economies of size. Such economies might flow from the capacity to fill containers and ships, or the sharing of information about production methods. Perhaps more importantly, it is the individual investors who have assessed the opportunities and risks and who are currently bearing them. For government to deliberately encourage activities that have not yet emerged on the grounds of diversification would require that it knew better and was prepared to bear the risk. Encouragement of sectors by way of reduced impediments to all investors does not entail such risks.

Government initiated diversification would have risks of its own

Distribution of benefits

The benefits from garment sector activity may be classified as follows.

- The returns to labour and capital as wages and profits.
- Spillover benefits, such as training, demonstration of Cambodian capacity and the like.
- ‘Rents’ or extra returns arising from the fact that Cambodia does not face as many restrictions on access to the markets of developed countries as many other exporters.

Initial benefits of market access are substantial

Of these potential sources of benefits the last mentioned is the most interesting. Positive spillovers such as those mentioned apply in most activities and in any event need to be assessed against negative spillovers. Whether prevailing wages and profits are appropriate returns to capital and labour is not easy to establish whereas it seems clear that the value of market access is both substantial and affected by policy.

Rent is shared among...

This value is sometimes called a rent. For purposes of illustration this rent is calculated on the basis of quota restricted goods and is the value of the prices received for goods sold under quota less the value they would have received, multiplied by the size of the quota. Two important questions arise. First, how is this rent shared? Second do rent sharing systems adversely affect costs of production?

—government...

On the first question, the parties that share the rent are assumed to be the government, manufacturers, workers and various others. The government gets part of its share by selling approximately 10 per cent of the quota. Three different taxes — a visa fee, a minimum turnover tax, or pre paid profit tax and a Camcontrol inspection fee also apply but to some extent these taxes are also fees for services rendered. There are also bureaucratic costs. Some estimates say bureaucratic costs are around 7 per cent of total revenues or about \$70 million (CDRI 2001). A more conservative estimate based on reported costs per container would have bureaucratic costs much lower and in the order of \$5.0 million. Some ‘rent collection’ in the form of bureaucratic costs could also be a ‘sharing’ of benefits afforded under the LOI.

—workers...

Workers also get some of the rent. One way they do this is through wage increases obtained by way of minimum wage laws. Depending on the number of workers this transfer could be in the order of \$20 million. However some of this transfer does not reach garment workers and is instead paid as a ‘fee’ to brokers such as security staff for finding them a job. Other people sharing in the rent would include people enforcing labour standards and people enforcing the rules of origin, which are part of most concessional access requirements.

—and job brokers.

Officials and inspectors also get a share

Sharing rents has costs — important that these costs do not stay after the rents have gone.

As noted the concessional access to developed country markets can be a ‘valuable consideration’ and there are good arguments for the government insisting on a large share. In some countries, a large part of the quota allocation is sold at auction, which implies that the lion’s share of available rent goes to government. This approach has several advantages. First, it is transparent. Second rent allocation by auction is relatively simple compared with coping with bureaucratic demands from a range of sources. Third, the revenue obtained enables governments to deliver better standards of service. Fourth, rent appropriation by way of auction need not become embedded in industry costs as when the quota rents go the auction price would be zero. In principle, there is no reason why labour should not benefit from a share in the rent. Where problems might arise however is when rent sharing methods or institutional arrangements become embedded into costs not only in the garment sector, but other export sectors not given ‘preferential’ access to foreign markets. Finally, firms

might make long term commitments with a longer horizon of assured markets that is not subsequently borne out. This has happened in many countries that have relied on preferential arrangements and it is an emerging issue for Cambodia.

5.6 Garments sector study: technical assistance needs and activities

The core questions for technical assistance emerging from the diagnostic study of garments are:

- How to lower the transaction costs arising from exemption, rules of origin and multiple export control agencies?
- What is the capacity of Cambodian producers to compete post 2005?
 - compare costs and quotas facing main competitors
 - assess prospects for productivity gains
- what are the impacts of existing preferential arrangements on Cambodia's cost structure?
- what is the distribution of benefits/rents arising from the existing system?
- how might quota rents be more efficiently and fairly shared — perhaps by selling a greater share by auction?

Tourism

Tourism growing at 30 per cent per annum...

...400 000 visitors and expect 1 million by 2005.

During the 1950s and 1960s, Cambodia was a popular year-round tourist destination. In the 1990s, after 20 years of conflict, tourism quickly took off in an open and stable Cambodia. After being set back in 1997 and 1998 tourist numbers hit 400 000 by 2001 with growth rates of 30 per cent per year. While there is a tendency sometimes to conclude that Cambodia's legal, regulatory and infrastructure environment is relatively weak, in this case (and with garments also) it has been sound enough to facilitate an impressive supply response. Hotels have been built, tour operators have emerged and policies such as the 'open skies' airline policies have facilitated effective response to demand growth.

Questions:	Although the scale is still small in terms of rates of export growth, tourism matches garments and similar issues are commonly raised.
–does Cambodia benefit?	<ul style="list-style-type: none"> ▪ Many inputs into tourism are sourced from foreign supplies and there are questions as how to encourage greater domestic supply.
–could it benefit more?	<ul style="list-style-type: none"> ▪ The tourism growth story is also linked to a ‘scarce’ factor — in this case the magnificent temples of Angkor Wat.
The tourists come to Cambodia but where do the profits go?	<ul style="list-style-type: none"> ▪ As is the case with garments, there are concerns about sustainability and concentration.
The tourists come to Cambodia but where do the profits go?	It is estimated that a significant portion of tourist dollar is returned to Thailand or Vietnam to import fresh vegetables, fruit, flowers, handicrafts and furniture. This is both a problem and an opportunity. Already local enterprises are looking for ways of establishing handicrafts villages and packaging and presenting Cambodian handicrafts to consistent standards.
They fly in and they fly out...	The focus of most tourist activity is the Angkor Wat temple complex and now four foreign airlines fly directly to Siam Reap and only about 10 per cent of visitors going initially to Siam Reap go on to Phnom Penh. Compared to tourists going to other Asian countries visitors to Phnom Penh spend relatively little and most of that is for accommodation. Is it the case then that overseas service providers are the ones that are making the money out of Cambodia’s unique antiquities? And if it is, are there policies which Cambodia should follow to ensure that more of the returns from having this ‘scarce’ factor — ‘magnificent temples’. Just as garment quotas have a value or rent which belongs to Cambodia so also do the temple complexes have a special value, which belongs to Cambodia.
Trouble is clawing back rent usually raises costs	Some countries endeavour to increase their take from tourists visiting their ‘unique’ venues by operating a national airline. But these ventures often turn out to be costly, inefficient and highly inequitable ways of gathering in extra returns. Another approach would be to insist that tour guides be locally licensed and accredited. On the one hand, accreditation can be a way of providing information about service competence and quality, but on the other hand if accreditation is used to restrict supply it can lead to higher costs and less service.
Take care as other countries also have ‘unique’ tourism attractions	Charging for visitors at individual sites is also an option. Setting charge levels is a matter of trial and error. Levels that are excessive would drive tourists away, low levels would probably not be worth the administrative costs. In determining any fees to be levied on tourists, it is important to remember that wonderful and ‘unique’ as Cambodia’s temples are, tourist destinations in other countries also have their own wonderful and unique places. International tourists do have a choice and in the long run the

opportunities to ‘charge for scarcity’ need to be carefully assessed. This is especially the case when, as appears to be the case with garments, appropriating rent runs the risk of raising costs of production.

Open skies has been good so far, explore other regulation with care

The Cambodian open skies policy and relatively lightly regulated tour operators have serviced a growing market very well so far. Important questions involve the extent to which charges could be imposed at specific points, the role of government in zoning regulation and promotion of certain marketing activities such as tourist villages and accreditation and licensing of tourism service providers.

Is tourism a fickle source of exports?

As is the case with garments, some people are concerned about whether past rates of growth can be maintained. Demand is reported to be falling sharply because of the terrorist bombings in the US in September. However in the past world tourism has grown steadily each year despite conflicts and upheaval. On the supply side while the airline seats and hotel rooms might be available, some commentators consider that the supply of sufficiently well trained people is limited and there is a risk that service levels might drop off.

Opportunities to spread the benefits of tourism

Another issue is whether tourism activity could be expanded beyond Phnom Penh and Siam Reap. There are also beautiful temples in northern provinces that are currently inaccessible. Improved access combined with handicraft production and performing arts could spread the benefits of tourism more widely.

No but Cambodia needs to have a reliable product

In this context industry level activities involving staff training, accreditation, industry data and promotion are important issues. How should training be delivered? What role should the government play in delivery of training, accreditation of training providers and facilitation of joint industry activities in these areas? In many countries, tourism is promoted at an industry or national level on the grounds that no single operator has an incentive to promote national tourism where many suppliers would stand to benefit. At what level should tourism be promoted? Should it be promoted at all? After all, it has grown very rapidly without much promotion. Should the Ministry of Tourism organize national promotion, or a specialist agency or a tourism industry body perhaps assisted by a compulsory levy? All these matters warrant further analysis.

Resolve training, accreditation and promotion at individual industry and government level

5.7 Tourism sector study: technical assistance needs and activities

The core areas for technical assistance for tourism are:

- given that many 'tourism inputs' are sourced from other countries — planes, food, etc., how can the local content be increased without higher costs?
- how reliable is tourism as a source of economic activity?
- what is the appropriate role of government in:
 - regulating the quality and reliability of supply
 - setting 'charges' for the right to see 'unique' attractions
 - setting standards for training and facilitation of promotion
 - collection of industry statistics.

Labour services

Remittances big in some countries

Remittances from citizens working in other countries are an important source of export income in many developing countries including for example, the Philippines, Sri Lanka, Thailand and Vietnam. There are costs in terms of family dislocation and risks in terms of limited sanctions for poor treatment or deficient or non payment, but there are also potential long term non income benefits in the form of developing skills, training and business networks and market information. In some countries for example, India developments in information technology have enabled the 'export' of labour services without requiring the provider to leave the country.

Many Cambodians work in Thailand on informal basis

While formal labour exports are not well developed, more than 100 000 Cambodian workers are reported to work in Thailand on unofficial basis. The RGC intends is now encouraging official labour exports. Small numbers of people have gone to Malaysia as construction workers and maids and contracts have been signed so that 1 200 construction workers can work in Greece.

Slow going with formal markets perhaps because:

The Ministry of Social Welfare, Labour and Veteran Affairs (MSWLVA) is responsible for the regulation of labour exports. The regulations appear to presume that workers will arrange their assignment with a labour export company and require conditions for workers to be specified in the contract and to meet MSWLVA specifications. Workers need to provide copies of a security clearance, medical certificates, qualifications and passport. Each worker is required to hold a labour license. A deposit of \$100 000 is required and labour exporters are required to cover the costs of MSWLVA staff to inspect working conditions in the country of work. Only two companies have been licensed to operate so far and the number of workers involved is small.

Possible reasons why the numbers are so small include the following.

–lack of skills and language

- Compared with people from other Asian countries Cambodian foreign language and workplace skills are not well developed.

–fall in demand

- Demand for export labour in some Asian countries — for example, Malaysia is falling and supply from other Asian countries is increasing because of the Asian economic crisis.

–heavy regulation

- Regulatory compliance costs are high, reflecting the size of the deposit, the mandatory testing requirements and the limited number of licensed firms. These high costs may have cooled the interest of foreign buyers on the one hand and Cambodian workers on the other.

Need to test regulatory barriers

Understanding the relative significance of these possible reasons is a core issue for the government. Most other countries have decided that some regulation of this market is necessary to provide an option in the event of ill treatment and non delivery by the employer and poor performance by the labourers and the labour here company. Nevertheless other countries seem to have established relatively low cost regulatory arrangements.

While the unregulated export of labour services is reported to involve incidents of non payment and other firms of poor treatment, studies report that on balance most people have positive outcomes. The main impact appears to be the levying of unofficial charges for border crossing. The policy imperative in this area appears to be to test regularity procedures and ensure that there is unrestricted entry into the business of providing services, which match Cambodians wishing to work overseas with people wishing to hire.

5.8 Labour services sector studies: technical assistance needs and activities

In many other developing countries remittances from the export of labour services has been an important source of export income. While over 100 000 Cambodians are reported to work in Thailand through unofficial channels, efforts to promote labour exports through formal channels — involving training, inspection and monitoring have had little impact. Technical assistance is needed to tackle questions identified but unresolved in the diagnostic study. Why have the efforts to promote a regulated delivery of labour services met with so little success?

- Falling demand after Asian crisis.
- Lack of language skills.
- Lack of interest by Cambodians.
- High costs of agency fees for inspection and training.
- Limited number of approved export agencies.

Cambodia faces a dilemma in regulating labour exports. On the one hand a completely unregulated market could bring about exploitation of workers and a damaged reputation for Cambodia if dishonest or unreliable workers go abroad. On the other hand, excessive regulation and lack of competition among agencies could make Cambodian workers uncompetitive whereby the price to foreign employers is too high and the returns to the Cambodian worker is too low. Technical assistance which enabled policy makers to learn how other countries — say Philippines and Sri Lanka — have managed this balance would be a way of tackling this problem.

5.9 Sector study, selected cross cutting issues: technical assistance needs and activities

Three cross cutting issues which emerged in most of the sector studies were regulation, transport infrastructure and unofficial charges and taxes.

Regulation and regulatory processes

A cross cutting issue through the sector studies is the tendency for regulation to be impulsive not transparent and often counterproductive. This problem of finding and keeping the 'right' level and form of regulation is being tackled in many countries.

Technical assistance which supported a program of regulatory review and testing is suggested by these findings. Such technical assistance would involve advice on techniques for evaluation of regulation and exposure to regulatory review systems followed by other countries.

Road user charges

An improved road system will require investment and maintenance. To this end technical assistance which supported examination of options for road use charges might be considered. Such a study could examine the implications of fund raising and fund sharing at local levels of road funds raised by way of fuel taxes, property taxes and concessions for toll road operations.

Unofficial fees and charges

While the incidence of unofficial fees and charges is widely referred to little is known about how those funds are used. Do they go to private use or are they used for semi public activities? What services, if any, flow from these charges? Does the incidence vary across regions and provinces? Do such charges support provincial government activities?

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