

Section 2. Industrial Development and Improvement of Industrial Environment

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Cambodia is basically an agricultural country. Agricultural development, therefore, must be given the highest priority from the medium to long-term point of view, in which the achievement of both sustainable economic growth and alleviation of poverty are necessary. However, industries other than agriculture are also important and must be promoted in the short term, especially current leading sectors such as garments and tourism. In the medium-to-long term, it is necessary to foster new industries. From this point of view, Cambodia's economic and industrial (manufacturing in particular) development and the improvement of its environment are discussed in this section.

1. The present state of affairs

1-1 Changes up to the present

Cambodia's economy, in the past, revolved around traditional agriculture, forestry, and handicraft manufacturing. In less than ten years after the transition to a market economy from a centrally planned economy, however, Cambodia went through dynamic structural change. In the first half of the 1990s, Cambodia's economy was highly dependent on the assistance given by international aid agencies, and in the latter half, an increase in foreign investments in labor-intensive industries (such as garments) facilitated the economic growth. In the latter half of the 1990s, Cambodia obtained membership in ASEAN, which accelerated its transition to a market economy by prompting the globalization of the economy and quickening its integration into the regional economy.

Cambodia came to acquire an economic structure of its own as a result of being tossed about through such rapid economic change. The economic structure is characterized by (1) a two-tier system in which traditional industries are run by the indigenous people and modern industries are run mainly by ethnic Chinese, (2) a heavy weighting of garment industry, which is Cambodia's leading export-oriented labor-intensive industry, and (3) dependence on assistance from international aid agencies.

The economic state of Cambodia is fairly stable in

the sense that it got out of political unrest and the fall-out of the Asian financial crisis, both of which occurred in 1997. The real growth rate was 4.3% in 1999 and is expected to reach 5.5% in 2000. The inflation rate dropped in 1999 to 5.2%, and the exchange rate remains stable at around 1 US dollar=3,800 riels. All in all, macro-economic stability has been restored in Cambodia.

Cambodia's per capita GDP, however, has remained low, at about US\$300, and many more objectives must be attained in order for Cambodia to realize both sustainable economic growth and alleviation of poverty. The Royal Government of Cambodia needs to achieve the economic restructuring in line with agriculture-related reforms. Economy-wise, it is indispensable for Cambodia to accelerate industrial development by undertaking the following tasks: i) establishment of legal institutions for economic activities, ii) fiscal reforms, iii) monetary reforms, iv) improvement in the investment climate, v) formulation of industrial policies, vi) regional development, and vii) fostering of young talent.

1-2 Attempts of the royal government of Cambodia

The Royal Government has, up to today, taken various measures in an attempt to alleviate poverty and to accelerate its transition to market economy and to achieve sustainable economic growth, the outline of which is summed up below.

- (i) Formulating economic plans such as the Socioeconomic Development Plans (SEDP), Policy Framework Papers, and the macro-economic management plans
- (ii) Establishment of legal institutions for economic systems, including the Law Bearing upon Commercial Regulations and the Commercial Register, the Law on the Investment of the Kingdom of Cambodia, the Labor Law, the Law on the Organization and Functioning of the National Bank of Cambodia, and the Law on Taxation
- (iii) Improvement of investment environment through the Cambodia Investment Board and the *Law on the Investment of the Kingdom of Cambodia*

- (iv) Privatization of the state owned enterprises through property disposal by sale and lease
- (v) Fiscal reform through reduction of the government work force and tax system reform
- (vi) Monetary institution reform through reorganization of the banking institutions, such as the establishment of the Rural Development Bank

In terms of the implementation of the above measures, some are making progress, but they are on the whole lagging behind schedule because Cambodia's rapid economic structural changes are obstructing their progress. The Royal Government, therefore, must come to grips with the problem in order to improve its investment environment and therewith hasten its economic development for the years to come.

1-2-1 Economic planning

It is evident from Cambodia's past economic planning that, up until the year 1990, the Royal Government had regularly worked out socioeconomic development programs presupposing a planned economy. Between 1991 and 1995, the Socioeconomic Development Plan was formulated corresponding to the transition from planned economy to market economy. From the year 1995 on, Socioeconomic Development Plans have been drawn up presupposing a market economy. The National Program to Rehabilitate and Develop Cambodia (NPRD) worked out in 1994, to take a single instance, aimed to double the national income by 2004 through the development of agriculture, manufacturing and tourism.

The First Socioeconomic Development Plan (SEDP), for 1996 to 2000, gave highest priority to poverty alleviation and rural development. As to the economic targets, the Plan first aimed at the attainment of macro-economic stability through necessary economic structures, methods and policies. Secondly, the Plan endeavored to foster young talent who would be invaluable assets to the market economy. Thirdly, it intended to create more employment by promoting labor-intensive export-oriented industries, small and medium-sized enterprises, and the tourism. Lastly, it aimed at globalization of the Cambodian economy. The Plan also set macro-economic goals of achieving 7.5% GDP growth and containing inflation at around 4~5%. The Plan, at the same time, provided measures such as the following in order to hit the macro-economic targets: i) Monetary

reform by suspending central bank lending, increasing check transactions, expanding national savings and investments, promoting "de-dollarization," establishing development financial institutions, and strengthening the functions of the central bank; ii) Fiscal policies such as reducing the external dependency of national revenue, cutting down national expenditure, strengthening the tax collection systems, securing more budget for public investments, decreasing the military budget while increasing infrastructure development spending; and iii) Globalization by adopting free trade policy and liberalizing investments and exchange rates, obtaining both ASEAN membership and General State of Preference duties, and accepting IMF guidance.

Development strategies for each industrial field were also worked out in the First Socioeconomic Development Plan. As for the primary industries as a whole, annual GDP growth was targeted at 5.2%, 6% for the production of rice. Annual GDP growth for secondary industries as a whole was aimed at more than 9.8%-for manufacturing alone, the Plan targeted 10% growth through emphasis on i) privatization, ii) foreign investment inducements, iii) development of export industries, iv) development of the labor-intensive industries, v) utilization of the domestic resources, vi) development of import substituting industries, vii) development of the rural industries, viii) employment in urban informal sectors, ix) development of downstream chemical industries, and x) fostering of small and medium-sized enterprises as well as large-scale enterprises. As for the tertiary industries as a whole, an annual GDP growth rate of about 9% was targeted. For tourism in particular, the Plan set a goal of attracting one million tourists per year by the year 2000 through i) improvement of infrastructure, ii) development of hotels, iii) development of human resources, and iv) socio-culture preservation and natural environment conservation. As for the transportation and telecommunications industries, annual GDP growth was targeted at 10%.

The Royal Government of Cambodia came to an agreement with the IMF concerning the Policy Framework Paper, which was prerequisite for resuming the Enhanced Structural Adjustment Facility (ESAF) frozen by the IMF in October 1999. According to the Paper, the top priority is given to sustainable development and the alleviation of poverty. Various targets in the Paper were targeted for completion between 1999 and 2002, such as i) GDP growth at 6%, ii) inflation below 4%, iii)

the external current account deficit at around 12~13% of GDP, iv) gross official reserves equivalent to four months of import coverage, and v) increases in the national revenue to GDP ratio by 4% annually.

According to *Macro-Economic Management 1994-2002*, prepared by the Ministry of Economy and Finance for the consultative group (CG) meeting held in May 2000, the Royal Government aims to achieve the GDP growth rates of 5.5%, 6.3% and 6.3% in 2000, 2001 and 2002 respectively. Industrial breakdowns of the GDP growth rate indicate that the average growth rates between the years 2000 and 2002 for the primary, secondary and tertiary industries are expected to reach 2.8%, 9.1%, and 7.6% respectively. In particular, growth rates of the two leading industries, namely garments and tourism, are expected to reach 8.3% and 10.5% respectively. Estimates show private investment increasing by 9.5% annually between 2000 and 2002. The macro-economic indicators are expected to be stable all through the three-year period, with the inflation rate remaining at around 4% and the exchange rates at around 1 US dollar=3,800 riels.

1-2-2 Establishment of legal institutions for economic systems

The legal system in Cambodia has been prepared on an assumption that Cambodia's economy is already fully transformed into the market economy. Major laws (considered insufficient) concerning current economic activities are listed below.

- (i) The Law Bearing upon Commercial Regulations and the Commercial Register (enforced as of October 3, 1995)
- (ii) The Law on the Chamber of Commerce (May 20, 1994)
- (iii) The Law on the Investment of the Kingdom of Cambodia (August 4, 1994)
- (iv) The Labor Law (May 13, 1997)
- (v) The Law on the Organization and Functioning of the National Bank of Cambodia (January 26, 1996)
- (vi) The Law on Taxation (February 24, 1997)

The first two laws in the list above are enforced to regulate the commercial activities in Cambodia. The *Law Bearing upon Commercial Regulations and the Commercial Register* obligates private persons to register their commercial activities (except in cases where a

tax exemption privilege is granted). The *Law* requires all private persons engaging in the commercial activities to keep accounts, etc. according to the general accounting principles. The *Law on the Chamber of Commerce* prescribes the ways in which the Chamber of Commerce is established and its detailed functions. The Chamber of Commerce is to promote, with the support from the Ministry of Commerce, the development of Cambodia's industries such as commerce, manufacturing, agriculture and services. Immediately after the enforcement of the *Law*, the Phnom Penh Chamber of Commerce was, in fact, established.

Since these are the only two laws that regulate Cambodia's commercial activities, the current state of legal institutions is far from complete. Commercial disputes, as a consequence, are generally settled through the good offices of an influential person rather than at the court. Even at court trials, cases are often decided based on customary law rather than official laws due to Cambodia's incomplete legal system.

In order to establish a complete system of commercial laws, the Royal Government is currently revising the existing two commercial laws and preparing eleven new legislative bills (see the list below).

- (i) The Law on Commercial Enterprise
- (ii) The Commercial Contracts Law
- (iii) The Commercial Arbitration Law
- (iv) The Bankruptcy Law
- (v) The Law on Product Liability
- (vi) The Trademark Law
- (vii) The Law on Advertising
- (viii) The Law on Unfair Competition
- (ix) The Law on Secured Transactions
- (x) The Law Concerning the Leases of Personal Property
- (xi) The Law on Agency

The drafts of the bills are already made out and waiting to be proposed in the Congress. The Royal Government of Cambodia attempted to standardize the above laws with those of the major trading partners in ASEAN and the West, and also gave careful consideration to relation with the World Trade Organization (WTO) and the World Intellectual Property Organization (WIPO).

Additional laws concerning economic activities are the Civil Code and the *Land Law*, both of which are currently in preparation.

1-2-3 Improvements in the investment environment in Cambodia

(1) Cambodian Investment Board

The Royal Government of Cambodia, in its attempt to facilitate investment and to create new investment opportunities in the country, established the Cambodia Investment Board (CIB), an operational arm of the Council for the Development of Cambodia (CDC). CIB serves as a one-stop-service investment center, allowing local and overseas investors to deal with just one government body. *Anukret* (Council of Ministers Decree) *on the Organization and Functioning of the Council for the Development of Cambodia*, promulgated in June 1995, provides that CIB shall receive, approve and monitor all the investment applications. Those who plan to make investments in Cambodia must submit the investment applications to CIB. Once those investment projects are approved, favorable treatment is granted to the investors. Investors are to receive a response from CIB within forty-five days of the application.

(2) The law on investment

In August 1994, the Royal Government of Cambodia began enforcing the *Law on Investment*, which lays down rules on all the investment projects made by Cambodian companies (including those overseas) and foreign companies within the Kingdom of Cambodia, and which defines the details of favorable treatment granted to these companies. The government also provided the detailed rules of the *Law on Investment* by promulgating *Anukret* (Council of Ministers Sub-Decree) *on the Implementation of the Law on Investment in the Kingdom of Cambodia* in December 1997.

Cambodia's *Law on Investment*, with certain distinguishing features listed below, aims to attract foreign investments that would help Cambodia create new jobs and earn foreign exchange. (The Royal Government of Cambodia intends to present foreign investors with incentives that are more attractive than those of other ASEAN countries.)

- (i) The *Law on Investment* is made in reference to similar laws in other ASEAN countries.
- (ii) The treatment provided by the *Law* is more favorable than that provided by other ASEAN countries, such as a longer period of tax exemptions.

- (iii) The *Law* treats all investors, Cambodian or foreign, in a non-discriminatory manner, except for matters regarding ownership of land.
- (iv) The *Law* encourages investments in labor-intensive industries by providing favorable treatment.
- (v) More incentives are given for investments in export-oriented industries.

The *Law on Investment* guarantees to all investors that i) the Royal Government shall not nationalize private properties (article 9), ii) shall not impose price controls on goods and services (article 10), and iii) shall not restrict investors from remitting foreign currencies abroad (article 11).

Incentives in the *Law*, available for investors that meet specific conditions, shall consist of the following (article 14):

- (i) Reductions in corporate tax rates (from 20% down to 9%)
- (ii) Corporate tax exemptions (up to a maximum of 8 years)
- (iii) Carrying forward of losses (up to 5 years)
- (iv) Non-taxation on the distribution of investment dividends
- (v) 100% exemption from import duties

It is obvious that CIB approvals of foreign investment increased remarkably beginning in 1995 as the *Law on Investment* came into force. Industry breakdowns of these investments show that Cambodia in fact succeeded in attracting foreign investments in sectors such as garments, tourism and hotels. Major investing countries are the United States and France among the developed countries and Malaysia, Singapore, Taiwan, China and Korea among the Asian countries.

1-2-4 Reforms of the State Owned Enterprises

State Owned Enterprises (SOEs) played the central role in Cambodia's planned economy. In the decade since 1989, the Royal Government has made steady progress in privatizing the SOEs under the following schedule.

- | | |
|-----------|--|
| June 1989 | Leasing of SOEs' fixed assets (e.g., land and buildings) to the private sector started |
| July 1991 | Dissolution of SOEs (by sale to the private sector) started |

- Jan. 1995 Details of how to sell off SOEs provided (under the *1995 Law of Finance*)
- June 1995 Inter-ministerial Committee in charge of Privatization established (chaired by the Minister of the Economy and Finance), the functions of which are listed below:
- Overall planning of the privatization
 - Supervising the asset evaluation of the SOEs
 - Supervising the dissolution of the SOEs (by public tender, etc.)
- May 1996 The *Legal Framework for the State Owned Enterprises* adopted, the outline of which is as follows:
- Government ministries must pull out from all commercial activities.
 - SOE activities are limited to natural resource development, social infrastructure improvement, and public undertakings.
- Jan. 1998 The *1998 Law of Finance* enforced, requiring that money earned through the privatization of SOEs be spent for the promotion of further privatization

Many of Cambodia's factories have been closed down due to civil war, et al. Transfer of SOEs to private entrepreneurs, therefore, has been implemented (sale or leasing of SOE properties such as land and buildings to the private sector).

Out of the 187 SOEs that were present in 1989, 143 companies are already privatized, and out of the remaining forty-four SOEs, seventeen companies will be privatized and fifteen companies will be closed down as scheduled. Although the remaining twelve companies are expected to continue as SOEs, most of them would be neither profitable nor viable as private commercial enterprises. In particular, six state-owned rubber plantations, which together employ 15,657 workers, pose problems.

Among the already privatized 143 SOEs, twenty-two, many of which were manufacturing factories, were sold off to the private sector at an amount equivalent to about US\$18 million in total. For 116 SOEs, fixed assets such as land and buildings were leased to private entrepreneurs (at about US\$4.5 million annually in total). As for the remaining five SOEs, four were privatized through joint ventures and one was shutdown.

According to the government, all but three SOEs under the jurisdiction of the Ministry of Mining and Energy have already been privatized through disposal by sale or lease to the private sector. In addition, one of the remaining three, a textile factory SOE in Battambang, was recently leased out to the private sector. This leaves only two SOEs: Mechanical Factory No.1, which is a dormant large-scale machine factory located 10 km north of Phnom Penh along Route 5; and the Printing House, which is a Phnom Penh factory specializes in the printing of envelopes, etc. Among the SOEs that were leased out to the private sector, some are closed down for the time being-for example, Sang Yeah Rubber Products, a rubber factory located in Kandal Province, and Cambodia Ever Sky, a factory that produces cottons for medical uses.

As for SOEs under the supervision of the Ministry of Commerce, the three that were not privatized were merged to form the Green Trade Company at the end of 1998. This SOE purchases rice directly from farmers in Battambang, Prey Veng, et al. and from brokers in Phnom Penh and resells cleaned rice at the market in Phnom Penh. Its function and its terms of trade are basically the same as those of the rice cleaning mills in the private sector. The company has 220 workers and handles about 6,000 tons of rice per year.

1-2-5 Fiscal reforms

Cambodia's recent budgets have constantly been in the red, but the Royal Government is determined to reduce the deficit to zero through revenue mobilization and strict expenditure control.

(1) Mobilization of domestic revenue

In February 1997, in an attempt to increase domestic revenues, the Royal Government enacted the *Law on Taxation*, which prescribes the basics of a modern tax collection system. The tax base has also been widened by the introduction of new provisions to the *Law of Finance*, which is revised every year. The *1998 Law of Finance*, for instance, introduced value added tax (VAT), and the *1999 Law of Finance* introduced special purpose tax (SPT).

The kinds of tax collected in Cambodia include the following: i) corporate income tax; ii) a minimum tax; iii) personal income tax; iv) special tax; v) import ex-

port duties; vi) VAT; and vii) SPT. The corporate income tax rate, in principle, is 20%, but it varies among different industries. Some companies are exempted from taxation for up to a maximum of eight years or are granted the preferential tax rate (9%) according to the provisions of the *Law on the Investment of the Kingdom of Cambodia*. The minimum tax rate is fixed at 1% of total sales, regardless of the company's financial state or eligibility for preferential treatment. Personal income is categorized into four brackets and taxed progressively (5,10,15 and 20%). The special tax is imposed on tobaccos, beverages, motorcycles, bicycles, etc. As for the duties, export duty is imposed on some selected items, and import duty is imposed on all but a limited number of select items. Import duties are categorized and set in ranges-some items taxed less, as a means of investment incentive. The 10% VAT, which was introduced in January 1999, is imposed on goods and services supplied within Cambodia. SPT includes gasoline tax, the revenue of which is to be invested for the purpose of road betterment, and the 3% local tax on tobaccos and alcoholic beverages.

The Royal Government aims to increase the ratio of domestic revenues from 9% of GDP to 13% by 2002, and for this purpose the following measures were laid out in the Policy Framework Paper: i) complete enforcement of the *Law on Taxation*; ii) improvement in tax collection methods; and iii) expansion of the revenue base. More concretely, i) revision of the preferential treatments granted under laws such as the *Law on Investment*, ii) extension of VAT coverage, iii) incorporation of the non-tax revenue into the budget, and other measures are to be implemented.

(2) Expenditure control

In order to reduce military expenditure, which accounts for nearly 40% of public expenditure, the Royal Government is currently working out the Cambodia Veterans Assistance Program (CVAP), taking into consideration the fact that about 70% of military expenditure is for the salaries of career officers. The Royal Government plans to reduce the number of servicemen from around 140,000 as of June 1999 to between 80,000 and 100,000 within the coming five years. A register of all servicemen was completed by 1999, and a reduction in their numbers was implemented in January 2000. As a consequence, military expenditure will be reduced, from

2.9% of GDP in 1998 to 2% in 2002.

Under consideration at the same time is a reduction in the number of civil servants. Their numbers have been growing in recent years, with the expansion of the scope of public social services. The Royal Government, nevertheless, is determined to rationalize in this area-for example, by computerizing personnel management such as the calculation of salaries and by eliminating redundancy-and thus contain expenditures on civil service salaries at no more than 1.7% of GDP by 2002. As outlined in the Policy Framework Paper, the Royal Government aims to shift its priority to social development and infrastructure improvements. In *Macro-Economic Management 1994-2002*, it emphasizes promotion of education, health insurance coverage, and rural development.

1-2-6 Monetary system reforms

(1) Monetary system reforms

Both in the *Law on the Organization and Functioning of the National Bank of Cambodia* that came into force in January 1996 and in the First Socioeconomic Development Plan, the Royal Government of Cambodia expressed its intentions to improve Cambodia's monetary system by strengthening the central bank functions, which is also emphasized in the Policy Framework Paper. With regard to the Foreign Trade Bank of Cambodia (FTBC), it is scheduled to privatize by December 2001.

As for the private commercial banks, the *Financial Institution Law* (enforced in November 1999) obligates each commercial bank currently offering banking services within the boundary of Cambodia to re-obtain a bank license in order to strengthen the foundation of commercial banks in Cambodia. The license applications ought to be completed by the end of May 2000. After the bank inspections, which take half a year, the license will be renewed in November for those banks that pass; this implies the possibility that some banks will not obtain license, if they do not pass the scrutiny.

(2) Rural development finance

At the Council of Ministers of the Kingdom of Cambodia held in December 1998, rural development finance, especially for the alleviation of poverty in the rural farming villages, was given the highest priority.

For the development of the rural farming villages, the Rural Development Bank (RDB) was established in January 1998 under the leadership of the National Bank of Cambodia with the support from the Ministry of Economy and Finance. With initial capital of US\$250 million, the RDB started providing loans in June—the same year that non-government and other organizations began providing micro-finance. The rural development finance is regarded as a matter of great importance in *Macro-Economic Management 1994-2002* as well.

As for the lending conditions of the RDB, the annual interest rate is set within the ranges between 10 and 15 percent in US dollars and between 15 and 20 percent in Cambodia riels, taking into consideration the capital costs, business expenses, inflation rates, percentage of credit losses, etc. The RDB also gets a commission of 0.5% of the amount of loans. The lending period, in principle, is two years or less, and interest on loans should be paid in advance. The RDB also requires collateral in the form of fixed assets, bonds, and personal guarantees.

With regard to the micro-finance institutions that obtain loans from the RDB, the non-governmental organizations are now being transformed into the micro-finance institutions and will be placed under the jurisdiction of the central bank. In Cambodia, especially in the rural farming villages, micro-finance is provided by about 80 domestic and foreign NGOs in an attempt to complement private commercial banking. The micro-finance activity by the NGOs has not been limited to financing alone but has also contributed to the development of communities within farming villages and thus has played a part in the alleviation of poverty¹.

1-3 The Poverty Reduction Strategy Paper (PRSP)

Prime Minister Hun Sen, at the International Workshop held in May 2000, expressed his determination in

alleviating the poverty in Cambodia, for the purpose of which he also set the following goals: i) sustainable economic growth (e.g., annual GDP growth rate of 6~7%); ii) fair distribution (between haves and have-nots, between urban cities and rural farming villages, and between men and women); and iii) conservation of sustainable natural environment.

The Interim Poverty Reduction Strategy Paper (PRSP) was drawn up in August 2000 in accordance with the above-mentioned goals. The poverty reduction strategy presented in the PRSP consists of eight policy categories, each of which is accompanied by key policy measures.

As for the economic strategy, there are five policy categories offered in the report. With regard to the fiscal reforms (under the policy category of Economic Stabilization: see table 2-1), in particular, concrete policy measures such as the following are raised: extending the VAT coverage, etc.; removing such preferential treatments as tax exemptions and tax reductions; improving tax collection ability; containing public investments at a reasonable level; and rationalizing public expenditures.

From the economic point of view, the PRSP stands on the assumption that the tax revenue will increase according to the given growth rate of 6~7%. The Royal Government, in addition, aims to increase the tax revenue by imposing higher tax burdens, especially on the foreign owned private companies (by removing investment incentives such as tax deductions, and by extending the VAT coverage). It is assumed that foreign direct investment will increase, despite the increasing tax burden, as Cambodia restores its economic stability and improves its legal institutions.

With regard to the budget distribution, the Royal Government put more emphasis on the local finance. The external assistance from donor countries, therefore, is tacitly applied more to the provinces. The national budget has an assumption that money collected in urban areas will be distributed to provinces; thus, it is impor-

¹ The largest micro-finance institution in Cambodia is the ACLEDA, the present staff of which is 330. The ACLEDA, with support from international aid agencies, has been providing loans, which amounted to US\$10 million in total, to about 60,000 poverty-stricken farmers, 88% of which are women. The farmers often use the loans of a few hundred dollars each as capital and start their businesses such as vegetable cultivation, peddling, street vending, dining, and repair. As a consequence of the increased incomes, the living standards of the farming villages are gradually improving. The percentage of credit losses remains as low as about 3%. The SEILANITI, another micro-finance institution similar to the ACLEDA, provides loans not only to poverty-stricken farming populations, but also to war sufferers and women householders living under poverty in the metropolitan area of Phnom Penh. The activity of such micro-finance institutions is not limited to financing alone, but it contributes also in the alleviation of poverty through such activities as village development. For instance, CADET engages in a wide range of activities such as those of the Rice Bank and the Cattle Bank, and for health care for villagers, and childbirth and child-rearing education.

Table 2-1 The Outline of the PRSP

Policy Categories		Poverty Reduction Strategy: Policy Measures
1	Social stability	Improvement of legal institutions, human rights protection, democratization
2	Fiscal reform	Expanding public revenue, reducing public expenditure (esp. defense costs), strengthening the bank foundations (through the mobilization of savings)
3	Investment promotion	Increase in external assistance, promote foreign direct investments
4	Farming sector-oriented development	Investments in farm village infrastructures, strengthening micro-finance
5	Improvement in institution capacity	Good governance, greater transparency, reporting obligations, preventing corruption
6	Globalization of the economy	higher productivity, gaining comparative advantages through international competition
7	Development of human	Education resources
8	Closer cooperation with aid agencies	Building stronger ties with the donor countries and the NGOs

Policy Categories		Economic Strategies: Policy Measures
1	Economic stabilization	Acceleration of the transition to the market economy, strengthening the economic power of the provinces, globalization, fiscal reforms, taxation system reforms, international payments deficit and foreign debt management, stabilization of prices, maintaining the present monetary, trade and exchange rate policies, monetary system reforms, etc.
2	Promotion of private enterprises	Establishment of the legal system
3	Infrastructure development	Roads, electricity, water supplies and irrigation facilities
4	Rural development	Decentralization of power, land system reform
5	Micro-finance	The Rural Development Bank

Source: The table is compiled by the author based on information from the Royal Government of Cambodia in 2000.

tant for urban areas to achieve high economic growth and to increase tax revenue in order to assist the expansion of local finance.

Therefore, in order to accomplish the kind of budget distribution stated in the PRSP that would both alleviate poverty and realize rural-oriented development, it is indispensable to consider how to increase foreign direct investments in the urban areas.

1-4 External support

External support for the purpose of improving Cambodia's economic environment has been provided mainly through multilateral international aid, examples of which are the IMF loans, and technical cooperation and loans provided by the World Bank and Asian Development Bank. As for bilateral support to Cambodia, on the other hand, Japan is the largest donor, followed by support from France (through AFD) to the Rural Development Bank of Cambodia, and support from Sweden (through SIDA) to the Cambodia Development Research Institute (CDRI). The following is a list of the types of support provided to Cambodia.

- (i) Loans (provided by the IMF, WB, ADB, and Government of Japan)

- (ii) Drawing up of Cambodia's Economic Development Plan (by the WB, ADB, and Government of Japan)
- (iii) Establishment of legal institutions (by the WB, ADB, and Government of Japan)
- (iv) Improvement in the monetary system (by the ADB, AFD, and Government of Japan)
- (v) Dispatch of experts (by the IMF, WB, ADB, UNDP, USAID, Government of Japan, et al.)

1-4-1 The International Monetary Fund

Cambodia became a member of the International Monetary Fund (IMF) in December 1969 and obtained IMF loans in the first half of the 1970s. In the early 1990s, Cambodia was given the Enhanced Structural Adjustment Facility (ESAF), but the IMF decided to suspend the loans for the period between 1995 and 1997 due to Cambodia's inability to meet the IMF conditionality (see table 2-2).

The IMF decided to resume the ESAF in October 1999 taking into account the political stability being restored in Cambodia. A loan of about US\$81.6 millions is expected for the 1999-2002 period, which is supposed to contribute to poverty alleviation and the achievement

Table 2-2 IMF Loans

as of the end of June 2000

(Unit: SDRs)

Year	Loan Amount	Amount of Payment
1971	6,250,000	0
1972	6,250,000	0
1973	6,250,000	0
1978	0	6,426
1992	0	7,917,673
1993	6,250,000	10,825,865
1994	14,000,000	0
1995	28,000,000	0
1998	0	1,041,666
1999	8,357,000	2,441,666
2000	0	1,920,833

Source: Compiled based on IMF documents.

of sustainable economic growth. Prior to the implementation of the ESAF, the IMF and the Royal Government of Cambodia came to an agreement with the *Medium-Term Economic and Financial Policy Framework Paper, 1999-2002*, in which the IMF's conditionality was presented as a prerequisite for obtaining the loan. The Royal Government, for instance, is asked to undertake fiscal reforms, forest management, administrative reforms, private sector development, public enterprises reforms, monetary reforms, social development, etc.

The IMF, at the same time, is extending technical assistance to the Ministry of Economy and Finance, the National Bank of Cambodia, et al.

1-4-2 The World Bank

The World Bank has financed eight projects, listed in table 2-3, as of the end of June 1999, which includes three project loans in the field of infrastructure development such as an electric power facility in Phnom Penh, water supply facilities in both Phnom Penh and Sihanoukville, and repair work of Route 6. Five other projects were program loans, which the WB financed for such objectives as the improvement in agricultural productivity; medical and insurance systems, village development, and social development. The WB loans are also available in order to cover the expenses of technical assistance to the government institutions. Approved amount of the World Bank loans accumulates to about US\$240 million. In addition to this, three projects in the fields of education, environment, and water supply are scheduled in the future, the total amount of which is US\$21 million.

Table 2-3 World Bank Loans

as of the end of June 1999

(Unit: thousand US dollars)

Project Details	Loan Amount	Approved Date
Technical assistance	17,000	Jun-94
Social Fund	20,000	Jun-95
Restoration of power supplies in Phnom Penh	40,000	Sep-95
Insurance and medical care	30,400	Dec-96
Improvement in agricultural productivity	27,000	Feb-97
Urban water supplies	30,960	Feb-98
Social Fund II	25,000	Mar-99
Road restoration	45,310	Mar-99
Development of the villages of the north east	5,000	May-99
Total	240,670	
Education (plan)	5,000	
Environment (plan)	5,000	
Water supply (plan)	11,000	

Source: Compiled by the author based on WB documents.

The WB extends technical assistance to its Cambodian partners such as the Council of Ministers, the Council of Development, the Ministry of Economy and Finance, and the Ministry of Justice. As technical assistance, the WB hires consultants, provides training, and purchases computer apparatus in order to support public investment management, public expenditure management, foreign debt management, employment management, and development of legal institutions.

The WB held a meeting with the Royal Government of Cambodia at the end of February 2000 with regard to the Country Assistance Plan (CAS) for Cambodia. At the meeting, the WB brought up a US\$270 million financing plan provided by the International Development Association (IDA) of the WB group, the target period of which is from 1999 to 2003. The fund is to be spent mostly for rural development, rural infrastructure development, health care, education, and public sector reform, but partly for fiscal reform, legal system improvement, and capacity development among politicians and institution players.

1-4-3 Asian Development Bank

The Asian Development Bank (ADB), as shown in table 2-4, had financed thirteen projects in Cambodia as of the end of December 1999. In detail, the ADB provided eight project loans in fields related to infrastruc-

Table 2-4 The Asian Development Bank Loans

as of the end of December 1999

(Unit: thousand US dollars)

Project Details	Amount of Loans	Approved Date
Transformer in Phnom Penh	1,670	Apr-70
Support for special restorations	67,700	Nov-92
Restoration of electric power	28,200	Dec-94
Education	20,000	Aug-95
Irrigation facility	25,100	Sep-95
Agricultural sector	30,000	Jun-96
Textbooks for education	20,000	Jun-96
Insurance and medical care	20,000	Jun-96
Waterworks and sewer system in Phnom Penh	20,000	Sep-96
The Siem Reap Airport	15,000	Dec-96
Roads between Phnom Penh and Ho Chi Minh	40,000	Dec-98
Roads	68,000	Sep-99
Water supply	20,000	Dec-99
Total	375,670	—

Source: Compiled by the author based on ADB documents.

ture facilities, such as the development of an irrigation facility, construction of a high voltage transformer in Phnom Penh, restoration of a power facility, improvement of water supply facilities in Phnom Penh as well as in the provincial capitals, maintenance of the Siem Reap Airport, and repair of roads. The ADB, at the same time, provided Cambodia with five program loans, which were targeted at certain fields, such as agriculture, education, and public health. The total amount of loans approved by the ADB accumulated to about US\$380 million.

The ADB, up to today, has given sixty-five instances of technical assistance to Cambodia's macro-economy, finance, rural development, and infrastructure improvement, the total amount of which is about US\$49 millions.

One of the remarkable examples of ADB technical assistance is the traineeship provided at the in-service training center of the National Bank of Cambodia (NBC), which is designed for personnel in banking businesses and others. Every year, ninety people enroll in the training program: seventy-six NBC staff and fourteen from other institutions. The trainees are to complete the two-year bank-training program that is divided into five stages. The training program covers various subjects such as economics, law, accounting, information technology, and languages.

1-4-4 International Finance Corporation

The International Finance Corporation (IFC) set up the Mekong Project Development Facility (MPDF) in 1997 with the objective of fostering small- to medium-sized enterprises in the three countries at the Mekong delta, namely Cambodia, Viet Nam and Laos. The MPDF has been active in Viet Nam for some time, but its activity in Cambodia has just started.

The MPDF mainly provides business support for the small- to medium-sized enterprises. In Cambodia, its activity is still limited to extending technical assistance to the ACLEDA, the largest micro-finance institution in Cambodia. The MPDF, at the same time, is planning to back up Cambodia's medium-sized private enterprises in the future. In the years to come, the IFC as well plans to provide loans to such enterprises.

2. Direction of development

Thinking of Cambodia's future development, both the alleviation of poverty and the achievement of sustainable economic growth should be set as the goals. In order to achieve these aims, it is indispensable to attain macro-economic stability and to improve the foundation of the economic environment. It is of utmost importance, at the same time, for the Royal Government to carry out administrative reform, fiscal reform, monetary reform, legal institution building, and development of human resources.

Some of the above-mentioned economic reforms are, in a sense, double-edged swords. Especially in relation to fiscal reform, both the VAT, introduced in order to increase public revenue, and the removal of preferential tax rates, provided for investment incentives, are, at the same time, hindering the development of Cambodia's private enterprises. As another example, the public expenditure cuts, in order to reduce the number of both career officers and civil servants, are also leaving a problem of rising unemployment.

In a sense, the current success of one of the leading industries, garment industry, can be attributed to preferential tax exemptions from developed countries such as the United States. Without the preferential status, Cambodia by no means has comparative advantages in labor cost (as seen in labor productivity), production costs (such as electric power), and distribution costs (including transportation costs). Furthermore, the advantage

that Cambodia expects to obtain from becoming a member of the AFTA does not necessarily exceed the disadvantage of diminishing tariff revenues, which currently account for about forty percent of Cambodia's public revenues.

Therefore, in the years to come, it is not sufficient for Cambodia to pursue macro-economic stability and economic reforms alone; it also must aim to achieve a comparative advantage in the industrial sector. To do so the Royal Government needs to proceed with the following policy measures: improvement of the investment environment (in terms of legal institutions, economic infrastructure, and administrative ability); development of strategic industries (such as garment, industries with high factor-endowment ratios, and tourism); promotion of small-scale businesses (such as urban-area small-scale enterprises, local industries, and micro-finance); and realization of an information-oriented society (through the development of human resources, and the improvement of both information infrastructure and information content).

2-1 Macro-economic stability and economic reform

It is a matter of great importance for Cambodia to maintain its macro-economic stability and to carry on with its economic reform. With regard to the administrative reform, it is indispensable for the Royal Government to reduce the number of civil servants through rationalization of public works and to lay off career officers. Fiscal reform should consist of public expenditure cuts through reductions in both civil servants and career officers, and public revenue increases through tax reforms such as the introduction of VAT and the expansion of the tax base. As for monetary reform, both the development of the money market and the mobilization of savings are necessary (through building up bank systems, etc.). With regard to legal institutions, the enactment of land law, mercantile law and civil law is urgently needed. The establishment of an accounting system is also of great importance. It is also essential for the Royal Government to pay special attention to attaining stability in prices and exchange rates and to improving its balance of payments.

2-2 Improvement in the investment environment

2-2-1 Improvement in legal institutions

Cambodia's economy since the early 1990s has been changing from a planned economy to a market economy, and is still in the middle of the process due to the delay in establishing the necessary legal institutions.

With regard to the legal institutions necessary for economic activities, it is of utmost importance for Cambodia to equip itself with the basic components of the market economy, namely i) land law, ii) mercantile law, and iii) a civil code. For this very purpose, international aid agencies are currently providing Cambodia with necessary support. In addition to this, in the industrial development point of view, it is important to i) carry out a review on the existing Law on Investment and ii) enact law on the development of the small- to medium-sized enterprises and iii) on the export processing zones (see "Good Governance" in chapter 2, section 1, part 2 for the more complete study on Cambodia's legal institutions).

With regard to overall improvement in the capacity of its legal institutions, it is a matter of great importance for the Royal Government to build up the capacity of Cambodia's Ministry of Justice and to educate lawyers, for which technical assistance is necessary.

2-2-2 Improvements in economic infrastructure

Cambodia's infrastructure such as roads, harbors, airports, railroads, electric power and telecommunications are, in general, underdeveloped. In the rural areas as well, it is necessary to improve infrastructure, such as farm roads and small-scale irrigation facilities (see "Improvement in Social Overhead Capital" in chapter 2, section 3 of part II for more complete study on infrastructure).

As for the economic infrastructure, it is important to apportion the limited funds only to the essentials. The highest priority should be given to the development of infrastructure such as the Sihanoukville harbor, the city of Phnom Penh, and the areas along Route 4 connecting Sihanoukville and Phnom Penh, all of which make up the main artery of Cambodia's economy (in terms of industry, trade, and distribution). The selective develop-

ment of such is, at the same time, reasonable in terms of efficiency. In this sense, it is also requested that the Royal Government incorporate development both of the export processing zones and of the surrounding regions into the development projects of the Sihanoukville harbor, electric power plant, etc.

On the other hand, it is necessary to selectively improve the infrastructure of Siem Reap, which is known for its Angkor temple complex, Phnom Penh, and the regions connecting the two cities. As a matter of fact, in Siem Reap, which is expected to flourish as a tourist city, expansion of the airport and the development of Route 6 are currently in progress. Because Siem Reap is highly regarded as a source of foreign exchange, it is important for the Royal Government to proceed further with the development of its infrastructure.

It is also indispensable, at the same time, to promote the development of infrastructure on borders with Viet Nam (such as Svay Rieng and Bavet along Route 1) and Thailand (such as Battambang, Sisophon and Poipet along Route 5).

2-2-3 Improvements in the institutional capacity of Cambodia's administrations

In order to improve Cambodia's investment environment, it is indispensable for the Royal Government to expand the institutional capacity of its administration, in addition to its development of its legal institutions and economic infrastructure. For the institutional capacity building, extensive training should be provided to civil servants at each ministry and agency in order to foster the necessary talent, examples of which are listed below.

- (i) The Cambodia Investment Board needs personnel with the ability to comprehend and judge the private sector investment plans.
- (ii) The Ministry of Planning requires personnel capable of compiling various kinds of economic statistics, analyzing statistical data, putting them to practical use, and drawing up Socioeconomic Development Plans. It is also important for the Ministry to improve the staff's project planning abilities.
- (iii) The Ministry of Mining and Energy needs personnel capable of planning the development schemes for small- to medium-sized enterprises, for which in-service training should be provided.
- (iv) The Ministry of Economy and Finance requires

personnel highly capable of collecting taxes, knowledgeable about public finance, and able to relate with the real business world.

- (v) The National Bank of Cambodia needs personnel knowledgeable about finance and able to relate with the real business world.

2-3 Development of strategic industries

2-3-1 Garment industries

The construction of garment factories in Cambodia, especially by overseas Chinese, has been increasing since 1994, which was encouraged by the enforcement of the Law on Investment in the same year. The number of shoe factories, at the same time, has been increasing and is expected to continue doing so for the years to come.

With regard to garment industry, continuance of growth depends solely on whether or not Cambodia's garment products for export to the United States can continue to enjoy preferential tax rates. In the hope of further promoting garment industries, abolition of the GSP ceiling on garment products, etc. by the US is anticipated. Meanwhile, it is necessary for the garment industries to do the following: i) foster persons of talent, especially a stronger management class; ii) expand the export volume (by extending the market, etc.); iii) diversify products so as to create a new demand for products that are not subject to GSP ceilings; iv) make inroads to the upstream industries; and v) develop small- to medium-sized enterprises.

In order to accelerate the growth in garment industries, the Royal Government, from the point of view of employment generation, should focus on the promotion of labor-intensive industries by giving favorable treatment. It is true that garment industry is currently Cambodia's leading industry. The actual import business, however, is carried out by companies of surrounding countries (such as Taiwan, Korea, and China), from which Cambodia imports necessary facilities, raw materials, etc.; and the actual export business is by companies of the Western countries to which Cambodia exports its products. One should note that this is an aspect of territorial economy, which is similar to plantations during the colonial era. It is important, therefore, to promote companies of Cambodian origin to engage both in the upstream and downstream businesses of the gar-

ment industry. It is imperative for Cambodia to expand the range of garment industries by increasing commitments to the related businesses of the indigenous people.

2-3-2 Industries of high domestic factor endowment

Cambodia, although it traditionally has been an agricultural country, has no comparative advantage in food processing industries, due to the fact that the degree of self-sufficiency in domesticated crops is low. Not many Cambodian companies, as a matter of fact, engage in food processing related businesses, due to low competitiveness. In addition, packing materials for processed foods are also imported fully, which does not allow enough scope for import substitution in this field. The Royal Government, therefore, is expected to draw up a plan to promote and assist the Cambodian companies in food processing industries. For instance, canned food businesses (for processed fish and fruits) have high potential.

For Cambodia, which is rich in forest resources, timber export is the most important source of its foreign currency acquisition. In recent years, however, the Royal Government has had to restrict its annual volume of felling and, at the same time, engage in afforestation projects and manage strictly the timber resources, due to criticism of multilateral donors and NGOs concerning environment protection. Cambodia's timber processing industry should achieve higher productivity through cost cutting and the production of higher value added goods such as furniture and flooring.

2-3-3 Tourist industries

Cambodia's tourism, in which the Angkor temple complex plays a central role, is one of Cambodia's industries that can acquire foreign exchange for certain. The number of tourists heading to Siem Reap, where the Angkor temple complex is located, is currently in a rapid increase. A direct flight from Bangkok, Thailand has been opened and extension work of the Siem Reap airport has been completed. Direct flights from other Asian countries will certainly increase in the years to come. It is important for the Royal Government to recognize Siem Reap as a major tourist city with which to further promote Cambodia's tourism. It is also expected

to have a considerable ripple effect on tourism related businesses and to generate new employment.

2-3-4 Assembly and processing industries

Following the experience of the leading ASEAN countries, Cambodia should regard assembly and processing industries such as electrical product manufacturing as important and promote them as Cambodia's strategic industries for the years to come. It is thus expected to invite foreign capitalized companies to set up their plants in Cambodia.

2-4 Small-scale enterprises

2-4-1 Fostering the small-scale enterprises

The most distinguishing feature of Cambodia's economic structure is its duality. It consists of a rural economy centering around the self-sufficient traditional agricultures on one side, and an urban economy shaped by foreign direct investments, especially in garment industries, on the other side.

Under such economic circumstances, Cambodia's success in attaining sustainable economic growth and poverty alleviation depends on the promotion of small-scale businesses in the urban cities such as Phnom Penh and on the development of local industries in the rural farm villages.

In order to foster small-scale businesses, expansion of micro-finance activities should be an effective measure. The Royal Government has currently just started providing the necessary support by establishing the Rural Development Bank, but it does not go far enough.

2-4-2 Urban small-scale businesses

In Cambodia's urban areas, such as Phnom Penh, the economy revolves around garment industries run by foreign companies. It is important to develop new small-scale enterprises run by the indigenous people in fields such as manufacturing, trade and services. The following are the actual examples of businesses that are in demand: i) the upstream and downstream businesses of garment industries; ii) businesses that are extended from the activities of the international aid agencies; iii) retail; iv) tourism related businesses; and v) handicrafts, all of which must be encouraged by the Royal Government.

2-4-3 Local industries in the provinces

In order to alleviate poverty, resolve the income disparities between the cities and rural villages, and stop the population movement from farm villages to cities, it is important for Cambodia to develop local industries in the provinces. However, putting this idea into practice is very difficult due to many constraints.

In Cambodia's *Law on Investment*, greater tax incentives for investment are given for investment in the provinces than in urban areas. However, the difference is not enough to entice companies away from cities, because disadvantages in underdeveloped rural infrastructure (such as roads and electric power) currently exceed by far the advantages of the investment incentives.

Historically, regions with no specific basic skills or markets have had little chance of developing new industries, which is also evident in Japan's experience. Therefore, realistic measures must extend the existing local traditional industries in the region and aim at producing higher value added goods in those industries. It is also important, at the same time, to partly utilize the traditional techniques that have been used in the manufacturing processes of the local industries by applying them to modern industries.

Cambodia's local industries that are expected to develop in the future are i) earthenware (and relevant techniques) of Kompong Chhnang, et al., ii) silk cloth (and relevant weaving techniques) of Takeo, et al., iii) furniture (and relevant carpentry techniques) of Kratie, et al., and iv) stone products (and relevant stone cutting techniques) of Pursat, et al. In order to promote industrial development in the provinces, it is effective for the Royal Government to foster such local industries by providing them with specific incentives and necessary assistance.

2-5 Promotion of the diffusion of information technology

2-5-1 The current state of the diffusion of information technology

It is well known that the evolution of information technology, scale of economy and economic growth rate correlate closely with each other. Promotion of information technology, therefore, is an essential factor for Cambodia's economic development. First of all, the

Table 2-5 Diffusion of Information Related Apparatuses

Information Apparatus	Numbers in Use	Percentage of Households Owning
Household Telephones	19,000	0.18
Portable Telephones	34,000	0.32
Fax Machines	3,000	0.03
Televisions	1,298,000	12.3
Radios	1,300,000	12.7

Source: The New ITU Association of Japan (2000)

current diffusion of information apparatus in Cambodia (see table 2-5) is very low.

Most of Cambodia's telephone facilities were established before 1970. Telecommunications service in Phnom Penh, for instance, is still low in quality and short in supply, despite the fact that those telecommunications facilities were once improved through grants from Japan. The current state of communications in the provincial capitals, in particular, requires improvement. Portable telephones, on the other hand, came into wide use recently in urban areas, which is one of the distinctive features of Cambodia.

Diffusion of personal computers is expected to grow in the years to come. Internet service providers include Camnet (a joint venture established in May 1997 involving Cambodia's Ministry of Posts and Telecommunications), Canadian International Development Center and The Telstra Bigpond run by an Australian company.

2-5-2 Diffusion of information technology and how to cope with various constraints

Cambodia must get over the following obstacles in order to promote the diffusion of information technology: i) lack of talented persons, ii) slow diffusion of information technology within the government agencies, and iii) delays in taking appropriate measures (such as hardware and software development).

- (i) Lack of talented persons is not necessarily the problem peculiar to the diffusion of information technologies. Technical experts, nevertheless, are required, and for this purpose the University of Phnom Penh, the National Institute of Management, and the Institute of Technology of Cambodia are all currently providing training in personal computer related skills.
- (ii) As for the diffusion of information technology

within the government agencies, the percentage of persons owning personal computers is as low as around 10%. Office networks are not established, much less home pages (those ministries that have home page are the Ministry of Commerce, the Ministry of Tourism, and the Ministry of Justice). With regard to the information-dispatching function of the government agencies, it is necessary to provide data on Cambodia's market as well as its investment environment. It is also important, with regard to the information gathering function of the government agencies, to obtain data of the developed countries, surrounding ASEAN countries, et al.

- (iii) Strengthening the hardware, such as by the establishment of a communications network, is of great immediate importance (see "Improvement of the Social Overhead Capital" for the details of hardware development of telecommunications infrastructure). As for the software, problems such as the following must be solved: underdeveloped information content; limited information circulation; and the lack of an information input system in the Khmer writing.

2-5-3 The Course of information technology diffusions

The most realistic course Cambodia must choose for future information technology diffusion is as follows, taking into consideration its initial conditions such as its economic strength, underdeveloped infrastructure, and lack of necessary manpower.

- (i) Solve the problem of "digital divide" existing between Cambodia and other ASEAN countries.
- (ii) Promote the evolution of information technology from a "point" (within Phnom Penh) to a "line" (connecting Phnom Penh and the provincial capitals), and from a "line" to a "surface" (extending from the provincial capitals to the rural farm villages).
- (iii) Prioritize the diffusion of information technology from the center to the periphery (from city dwellers, people with high academic background, and the rich to farm village dwellers and the poor).

There is currently a concern that the "digital divide" existing between the developed and developing countries might expand due to the IT revolution in progress

in the developed countries, including Japan. In order for Cambodia to further globalize its economy, therefore, it needs to catch up urgently with the ASEAN countries, with which Cambodia has to compete and cooperate at the same time. The Royal Government must make an attempt to lessen the information disparity existing between Cambodia and other ASEAN countries. Following the ASEAN examples, for instance, the Royal Government needs to draw up a plan regarding the diffusion of information technology in the country, and to establish the relevant legal system.

The IT revolution, at the same time, is a perfect opportunity for Cambodia to gain the latecomers advantage. This possibility has been proven, in a way, by the rapid diffusion of portable telephones in Cambodia. As a matter of fact, high-performance and easy-to-operate personal computers and the Internet have been available in Cambodia since the very beginning of its economic restoration. Although this does not immediately enable e-businesses, the Royal Government, at least, can benefit from increased efficiency in public works, accelerated business formation through improved information and reduced transaction costs, accelerated reform in education, etc.

The diffusion of information technology from Phnom Penh and the provincial capitals to the rural farm villages is inadequate, and it is undesirable that diffusion of information technology has been mainly to city dwellers and the rich while ignoring rural citizens and the poor. However, prerequisite to carrying out personal computer education in rural farm villages is the existence of computer experts and teachers equipped with computer skills, increased percentages of households owning personal computers, and a communications network being installed.

2-5-4 Information technology diffusion measures

In order to accelerate the diffusion of information technology in Cambodia, the following measures should be emphasized: i) fostering of talented persons; ii) development of information infrastructure; and iii) improvement of information content.

- (i) Fostering of talented persons requires more complete education. In Cambodia, the number of private-owned computer schools and English language schools is currently showing a rapid in-

crease. Public schools, at the same time, play a key role in fostering talented persons. High level education provided by universities should be especially emphasized, followed in the future by primary and secondary education.

- (ii) As for the development of information infrastructure, it is necessary to establish an optical fiber telecommunications network and wireless stations, etc. Increased personal computer use in government agencies, the establishment of office networks, and the diffusion of computer technology are also required.
- (iii) Improvement in information content includes organization of written information and statistical data, and the establishment of a home page for each ministry so as to provide Cambodia's basic information.

3. Direction of Japan's assistance

3-1 Basic concept

Japan, up to today, has been providing Cambodia with needed resources through multilateral and bilateral aid agencies. Still more assistance, however, is required for Cambodia, which is still in the process of rehabilitation from the aftermath of the civil war that lasted for a quarter of a century. Further external assistance is especially needed for accelerating Cambodia's transition to the market economy.

In the economic sphere, macro-economic stability, favorable economic environment, development of human resources, etc. are necessary in order to achieve sustainable economic growth, alleviation of poverty, and fair distribution, all of which are already mentioned in the PRSP. In addition to this, it is considered important, in order for Cambodia to gain comparative advantage in the industrial sphere, that the Royal Government take measures such as those for investment environment improvement, strategic industry development, small-scale business support, and information technology diffusion, and obtain more external assistance for these purposes.

In particular, it is regarded as important that foreign assistance be given selectively for the following purposes: i) achievement of both economic growth and national income growth; ii) fostering of talented persons (e.g., competent administrative officials in charge of the economic related activities); and iii) creation of new

employment and new sources of income other than agriculture in the agricultural districts.

3-2 Expected results of the foreign assistance

In the economic sphere, realization of sustainable economic growth and alleviation of poverty are the ultimate objectives-which cannot be accomplished by Japanese assistance alone. The expected result of the foreign assistance that is set up for each of the individual projects, therefore, becomes important. In practice, before the implementation of a project, one must determine the following: i) to what extent the foreign assistance will contribute to the economic growth; ii) a quantitative objective and trial calculations, in addition to the qualitative objective of alleviating poverty; and iii) development of human resources (It is easy to set up the total number of people as an objective. However, qualitative objective such as the significance of the assistance must be emphasized here over the quantitative objectives.).

Japan can obtain, in the economic sphere, the following results from its aid to Cambodia policy: i) increased number of pro-Japanese Cambodian administrative officials in charge of economic related activities; ii) greater numbers of Japanese companies investing in Cambodia; and iii) increased number of Japanese tourists visiting Cambodia.

3-3 Strategy for achieving the expected results

In the years to come, Japan anticipates facing a big increase in its workload involving its aid to Cambodia, the causes of which are listed below.

- (i) Increase in the entire volume of aid activity
- (ii) Contents of aid shifting from hardware improvement to software support, which is a greater workload
- (iii) Increasing number of project type assistance in which more effort is required in ironing out the differences of opinions among the interested parties, and the increased number of projects that poor people participate.
- (iv) Required coordination with international aid agencies

Therefore, efforts should be made to monitor

Cambodia's situation on a regular basis in addition to increasing the number of both the experts dispatched to the country and the local training programs sponsored by Japan. It is necessary to cope with the situation from within the country, as well as from Japan, and this will require increases in the number of JICA and JBIC staff.

It is also necessary for all the government agencies that engage in ODA to work in closer cooperation with each other and to share information, while building a closer connection with the NGOs. Ideas such as to organize Cambodians who have studied in Japan and returned should also be considered along with other means.

3-4 The contents of external assistance

3-4-1 Macro-economic stability and economic reform

With regard to the macro-economic stability and economic reform, international aid agencies such as the IMF, WB and ADB have already been supporting Cambodia's administrative reform, fiscal reform, monetary reform, etc.

Additionally, Japan has been providing training on financial and related matters, and is expected to extend its activities in the years to come. In concrete, intellectual support provided to Viet Nam, Mongolia, et al. by JICA on the issue of transition to a market-oriented economy (including topics on fiscal and monetary matters, tax collection, promotion of private enterprises) can also be applied to Cambodia.

The number of experts dispatched to Cambodia should be increased in the economics related fields. As well, it is necessary to increase the number of local staffers who are in the economics field.

3-4-2 Improvement of the investment environment

Concerning the establishment of Cambodia's legal system, Japan has been assisting Cambodia with its drafting of the Civil Code. It is expected to take about three more years to complete the draft. It is an important project that requires Japan to continue and strengthen its support to Cambodia. There also is a possibility that Japan might engage in the review work of the existing *Law on Investment*, and provide support to

the enactment of the *Law on the Development of the Small- to Medium-Sized Enterprises* and the *Law on the Export Processing Zones*. From the point of view of improving institutional capacity of the legal system, it is necessary to provide intellectual support (in the form of dispatching experts and providing training), in order to strengthen the Ministry of Justice, and to foster lawyer development (see "Good Governance" for the more complete study of external support provided for the improvement of Cambodia's legal institutions.)

For the improvement of economic infrastructure, Japan has been continuously extending assistance to Cambodia. At present, repair work of part of Route 6 and the Kompong Cham bridge building are in progress, and yen credit is also granted to the repair work of Sihanoukville harbor. These kinds of assistance for the improvement of economic infrastructure should constantly be extended to Cambodia, now and in the future. While other issues such as poverty alleviation are currently occupying the greater attention of the international aid agencies, Cambodia may expect more from Japan in terms of assisting in its economic infrastructure improvement, which will form the foundation of industrial development (see "Improvement of Social Overhead Capital" for the more complete study of infrastructure improvements).

With regard to improvement of the institutional capacity in administration, Japan has been dispatching experts to the Committee for the Rehabilitation and Development of Cambodia and the Ministry of Commerce. The contributions and achievements of such experts in the area of human resource development have been well regarded, and other economic related ministries are also requesting such experts. In response, Japan must consider expanding such assistance to Cambodia in the future.

In addition to this, the major ministries in charge of Cambodia's economic development and industrial promotion, namely the Cambodia Investment Board (CIB), the Ministry of Planning, the Ministry of Commerce, the Ministry of Mining and Energy, the Ministry of Economy and Finance, and the National Bank of Cambodia are asking Japan for intellectual support and other necessary assistance. For instance, the CIB has requested that the JETRO Investment Seminar make an appeal to Japanese companies, persuading them to set up their plants in Cambodia. According to our analysis, it is obvious that the CIB is currently short of talented

persons, especially those who can understand and judge the investment plan of private companies. In order to assist Cambodia in developing such faculties, Japan must focus its support on training (locally and in Japan) and on dispatching experts, which, are also in great demand. This also contributes enormously to the smooth increase in investment by the private companies, including Japanese.

With regard to the assistance to the Ministry of Planning, Japan used to dispatch experts in the past. In recent years, however, Japan has been focusing on holding a statistics related training, which has been accepted with gratitude by the Royal Government. At present, accumulation of economic related statistical data and drafting of Cambodia's Socioeconomic Development Plans are carried out with assistance from many international aid agencies. The Ministry of Planning, however, neither analyzes these statistical data nor puts them to practical use, which implies the necessity to foster talented persons who can draw up plans. In this sense, training (held within Japan and in Cambodia) and the dispatch of experts are considered most useful as assistance.

As to the Ministry of Commerce, the JICA experts and JETRO advisers have already been dispatched, and the Royal Government thinks highly of their contributions. Japan, at the same time, is expected to continue its assistance in the introduction of computers and office networks.

The Ministry of Mining and Energy needs to foster talented persons who can draw up a plan for promoting small- to medium-sized enterprises, the support to which is in great need but not coming much from the international aid agencies. Especially in terms of industrial development, both the management guidance to private companies and the market information are greatly in need.

For the Ministry of Economy and Finance, the Development Bank of Japan (DBJ), the Japan Center for International Finance (JCIF), et al. are currently providing local training on finance and corporate analysis. Such training is expected to continue for the years to come.

The NBC has been obtaining the support from Japan in the form of training similar to that for the Ministry of Economy and Finance. Cambodia, at present, is in the process of drastic monetary system reform, through which it aims to complete re-licensing of all the banks by November 2000. Because the NBC lacks the talent

for carrying out bank inspections that are required in the licensing, the Royal Government called on Japan to dispatch the necessary experts. As for the number of personal computers, the percentage of staff that own personal computers is still very low. An office network has not been established, and the NBC's information dispatching function is yet to be developed. These are the areas in which the Royal Government currently seeks support from Japan.

3-4-3 Development of the strategic industry

(1) Garment industry

The Cambodia Garment Training Center has been established under the leadership of the Japanese Ministry of Economy, Trade and Industry (the former Ministry of International Trade and Industry). At the Center, training is provided focusing on the education of garment factory workers, specifically for those at managerial positions. The training project is progressing favorably and has won local recognition; and as a result, the number of participants has been increasing. Expansion of the Center function so as to include the training for shoe manufacturing is also in demand. Garment industries are currently aware of the necessity to expand their businesses through such measures as expansion of the market, diversification of their products, and making inroads into the upper stream industries, all of which requires expert knowledge. In regard to this, it is considered effective to present a comprehensive program that includes the dispatch of garment and shoe experts (such as factory engineers, and wholesale and retail dealers), training, research on the states of the two industries, etc. It is also expected that the Senior Volunteer will participate actively in such a program. External support in the form of public loans by the International Cooperation Bank is also necessary in order to lure Japanese clothing companies to set up their plants in Cambodia.

(2) Industries of high domestic factor endowment

With regard to the Japanese support extended to Cambodia's food related industries, it is currently at the stage of technical cooperation for rice distribution system reform. Cambodia's agricultural products and pro-

cessed goods have greater export potential in the future. For the next stage of assistance, Japan should come up with down-to-earth plans, such as contributing in market information by reporting on the state of the canning industries in Japan.

As for the timber related industries, such support as sending engineers for setting the teeth of saws seems practical. At the same time, Japan should present down-to-earth plans such as organizing a research group of Japanese furniture experts and providing Cambodia with reports on Japan's market, such as the state of industries in Japan. It is expected that Japanese companies who will be setting up plants in Cambodia will be able to obtain Japanese public loans. Concerning possible assistance to tree planting business, both the dispatch of scholars and the provision of public loans for the tree planting expenses are expected to come forward.

(3) Tourist industries

It is important to carry out comprehensive research on Cambodia's tourist development. In addition to the development of infrastructures such as roads and airports, a great deal of effort should be made in order to make tourist spots more attractive and to persuade tourists to stay longer through the opening of museums for historical materials, etc. And for those Japanese companies that intend to build tourist related facilities in Cambodia, Japanese public loans should also be available.

(4) Assembly and processing industries

Increasing the foreign direct investment is a matter of great importance to Cambodia's assembly and processing industries. It is important, therefore, for Japan to carry out development research investigating the reason foreign assembly and processing companies (such as those of electrical products) have not yet set up plants in Cambodia. As a part of Japan's support to Cambodia in the years to come, Japan intends to carry out research projects such as the Comprehensive Development Plan of the Growth Corridor of Cambodia: the Metropolitan Area and Sihanoukville, and the Development Plan for the Border of Thailand and Cambodia. It is possible to include, as well, primary research on assembly and processing industries.

3-4-4 Developments of small-scale businesses

(1) One village one product campaign

In order to promote Cambodia's industrial development in provincial capitals as well as rural farm villages, and therewith alleviate poverty, it is indispensable to focus on the promotion of local industries such as handicrafts. Recently, Japan has been extending assistance to Cambodia in the form of intellectual support under the leadership of the Ministry of Economy, Trade and Industry (the former Ministry of International Trade and Industry), in which it promotes a One Village One Product Campaign. In concrete, through cooperation of JETRO, the Association For Overseas Technical Scholarship (AOTS), and Ohita prefecture of Japan, Japan has so far carried out the following technical support: a seminar in Cambodia; a training program held in Japan for the staff of the Chamber of Commerce and Industry of Phnom Penh, an exhibition, etc., all highly appreciated. These activities are expected to continue for the years to come.

The skills and the know-how of Cambodia's traditional handicraft products used to be handed down from generation to generation. Under the influence of the civil war, however, Cambodia's human resources, infrastructure, and distribution networks were severely damaged. The One Village One Product Campaign is a way to overcome the crisis through self-help with support from the administration. The campaign aims to improve technological standards of the provinces and promote their adaptation to a market economy by fostering local industries that produce well-known local products and therefore have a comparative advantage. One aspect of the One Village One Product Campaign is its aim to contribute to the improvement of the social standing of the weak such as disabled persons and women. Moreover, it demands direct benefit to the poor. The One Village One Product Campaign is also counted on as a measure to cope with the problem of increased unemployment resulting from the steady reduction in the number of career officers and civil servants that will continue for some years ahead.

In order to support Cambodia's One Village One Product Campaign hereafter, Japan is expected to continue, and expand, its intellectual support by holding training programs (both in Japan and in Cambodia) and

seminars, and opening exhibitions. Through these activities, Japan is also expected to transfer technologies, improve information distribution, and develop human resources, and therewith contribute to the development of local industries. The idea of announcing the success of the One Village One Product Campaign to encourage its use throughout the country is worth considering. First, a specific rural district as a model case of the Campaign is appointed, and its promising products are supported exceptionally to become a success case, and finally the model case is used for the promotion of the One Village One Product Campaign all over the country.

(2) Handicrafts

Cambodia's handicraft business faces various problems such as the following: i) low quality; ii) high production costs that renders the sales price high; iii) continuation of the business depends solely on the assistance given by the international aid agencies etc; iv) increasing numbers of substitutes for daily products; and v) less demand for souvenirs.

In order to cope with problems such as low quality and low productivity, technical guidance is necessary. Since Japan's standard in such traditional handicrafts is fairly high, especially for earthenware and silk cloths, it is considered effective for Japan to transfer the technology to Cambodia by dispatching its experts and holding training programs, which will also contribute to quality improvements and production cost cuts.

With regard to the issue of enlarging the market for handicraft products, strengthening of the marketing is indispensable. It is especially important for both the producers and the retailers of the handicrafts to have easy access to market information, and such environment should be developed. From this point of view, it is possible to organize groups of handicraftsmen and other persons concerned so as to enable a smooth distribution of information and to reduce the business costs.

In order to support the One Village One Product Campaign as well as the handicraft businesses, active participation of the Senior Volunteer and the Japan Overseas Cooperation Volunteer (JOCV), and the Japanese NGOs is necessary.

(3) Micro-finance

For the development of the small-scale enterprises, it is effective to expand the volume of micro-finance. The Royal Government of Cambodia, in fact, has established the Rural Development Bank (RDB) in order to promote the micro-finance, the foundation of which is still very weak but getting started along the right lines. Micro-finance is an area in which Cambodia fervently seeks Japanese assistance. As a matter of fact, the current state of the RDB requires the intellectual support through training programs. In addition, support for business planning and capital contribution is also being requested.

3-4-5 Promotion of the diffusion of information technology

With regard to the promotion of information technology diffusions in Cambodia, it is important to i) foster talented persons; ii) develop information infrastructures; and iii) improve information contents. Japan as well intends to consider its assistance to Cambodia along the same line (see "Improvement of Social Overhead Capital" for the details of the hardware aspects of the information infrastructure).

- (i) As a support measure for fostering talented persons, it is possible to send computer specialists to universities. As well, it is effective to hold a computer-training program for primary and secondary school teachers. Grassroots support will be considered in order to directly benefit the poor. To say the least, the supply of computer apparatus is indispensable.
- (ii) Regarding information infrastructure improvements, the establishment of an optical fiber telecommunications network between Phnom Penh and the provincial capitals should be supported. And between the provincial capitals and the rural farm villages, a wireless communications network should be established by setting up relay stations. As for the diffusion of portable telephones, it is considered appropriate to leave that to the private commercial enterprises. With regard to the improvement of the information infrastructure of the government agencies, both the supply of computer apparatus and the training of the staff are required. Many requests, as a matter of fact, have already

been received from the ministries and the departments. In response to such demands, the Center of International Cooperation for Computerization (CICC) of Japan has recently provided Cambodia's Ministry of Commerce with the necessary computers, etc. This kind of assistance, including support for establishing office networks, should continue for the years to come.

- (iii) As a measure to assist the improvement of information content, it is necessary for Japan to extend support to the creation of a home page for each ministry and to organize statistical data, and thereby enable the ministries to provide basic information. In addition, from the point of view of information distribution, Japan is expected to contribute in the form of dispatching Japanese missions to Cambodia, receiving Cambodian missions to Japan, holding seminars, and promoting the distribution of Cambodia related information within Japan.

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