

PART I: IMMEDIATE ACTIONS FOR SPECIAL PROMOTION ZONE

1. Conclusions and Recommendations for Special Promotion Zone¹

1.01 Role of Growth Corridor Area for Economic Development

The Growth Corridor area is where the strength of economic development is highest in Cambodia. The area should accommodate new industries in Cambodia to diversify the export commodities and accumulate new technologies. Particularly, the Municipality of Sihanoukville in the hinterland of the Port of Sihanoukville, the only deep seaport of Cambodia, will be a strategically important area for the future of Cambodia, in parallel with the western suburbs of Phnom Penh around the international airport. Specific development strategies and projects discussed in this Study need to be contemplated as a basis for regional development planning of Growth Corridor area.

1.02 Strong Measures Necessary to Diversify Growth Base

To prepare for the probable removal of national export quotas and increasing advocacy of regional free trade, Cambodia must diversify its export commodities and export markets. Cambodia needs to diversify the export industries primarily by Foreign Direct Investment (FDI) with necessary technologies and capital, and enhance domestic industries that could provide interactions. Better utilization of local resources other than labor will have to be promoted to increase the value of the resources. Nonetheless, the climate of investment environment of Cambodia is not bright, with unstable domestic conditions and severe international competition, particularly after the accession of China to World Trade Organization (WTO). Cambodia needs to device strong and effective measures to attract FDI by establishing legal base and pilot area with good infrastructure with competitive prices.

1.03 Special Promotion Zone as a Key Tool for FDI Promotion

Cambodia needs to implement a special promotion zone (SPZ)—a specific and clearly delineated area where different and entirely innovative investment and administrative procedures and principles would be applied. The basic objective of the SPZ is to promote investment, primarily by foreign direct investment (FDI), for export-oriented manufacturing and service industries, introduce new technologies, and consequently create new jobs.

The SPZ will be comprised of two zones with active interactions between them:

Free Zone (FZ)

The core of the SPZ will be the Free Zone (FZ), which will be a fenced-off bonded area directly connected to an international port or airport. As long as goods and materials stay within the FZ, import/export duty would not be incurred. The FZ will accommodate primarily FDI new export oriented firms for both manufacturing and services that are not in operation in Cambodia presently.

¹ For full description, please refer to Chapter 8 of the Main Report.

Promotion Zone (PZ)

The Promotional Zone (PZ) is essentially a mechanism to enhance the so-called backward linkage between economic activities in the FZ and the economy of Cambodia. PZ denotes the area surrounding FZ, where location of various manufacturing and service enterprises, both foreign and domestic, are promoted. These firms in PZ will provide the firms in the FZ with various economic interactions such as related manufacturing on a sub-contract basis, providing appurtenant services including logistics, supplies and maintenance, skills training and education and commercial services such as banking, telecommunication, lodging and tourism. These firms in the PZ will be the receptors of trickle down effects of FZ development, and the economic activities thus created in the PZ will deliver the development benefits to Cambodia.

1.04 Advantage of Sihanoukville for SPZ Development

The Municipality of Sihanoukville is a focal point of regional and economic development of Cambodia. The city has the only deep seaport of Cambodia, serving as the gateway to foreign nations. It is a fast growing city with plenty of room for future expansion. On top of this, Sihanoukville is located on a new development axis of Cambodia towards the coastal area. The first SPZ is thus proposed in Sihanoukville, as the showcase for the future development of industrial estates, including the western suburbs of Phnom Penh and in border areas such as Kaoh Kong.

1.05 Required Innovative Institutional and Legal Arrangement

An Independent and Autonomous SPZ Authority

For the operation and governing of the SPZ, a separate independent and autonomous organization in the form of a public corporation will be required under the guidance of a high authority within the Royal Government of Cambodia (RGC). Should the authority be created as an ordinary department structure within an existing organization, it would require enormous labor to rectify the existing administrative impediments for securing independence, and would be difficult to obtain investor confidence. The authority, tentatively called the Cambodian Special Economic Zones Authority (CAPZA), will offer such functions as the One-Stop Shop where all the necessary applications and permits for business operation, import / export and investment are handled altogether, customs clearance, tax collection, labor relations and small and micro enterprises (SME²) promotion, in collaboration with the relevant authorities in Cambodia.

Fiscal Incentives for the SPZ Showing the Commitment of RGC

Among neighboring nations, Thailand has devised Industrial Estates for 30 years, and Vietnam has implemented Export Processing Zones for 10 years, both with a variety of fiscal and non-fiscal incentives and good performance in attracting FDI. To be competitive, the

² Ordinarily, SME denotes “small and medium enterprises”, but in this study, SME denotes “small and micro enterprises” following the widely accepted definition in Cambodia.

SPZ in Cambodia must provide with a set of preferential fiscal and non-fiscal incentives competitive with those in these neighboring nations. This will convey to potential investors the strong commitment of RGC in attracting FDI.

For fiscal incentives, the Amended Law on Investment (ALIZ) provides a uniform corporate tax rate of 20% for the nation and *either* a tax holiday for a certain period *or* a special depreciation. In consideration of the weak international competitiveness and little accumulation of industries and shortage of qualified human resources, Cambodia needs to device strong enough incentives to attract FDI in the SPZ. The proposed fiscal incentives for the SPZ in Sihanoukville will include a reduction of the corporate tax rate to 15% in the PZ and 10% in the FZ, both for 3 years after the tax holiday stipulated in ALIZ, and *concurrent* application of a tax holiday *and* special depreciation. If such fiscal incentives were not provided, comparable measures would need to be taken to offset the absence.

A SPZ Law as Firm Legal Basis

It is imperative that the SPZ be properly positioned in the policy framework of the RGC and given an appropriate legal basis. In order to implement the SPZ successfully and sustainably, a new law that defines the SPZ as having a separate customs territory in the FZ and creates an independent organization for its operation is indispensable. A sample Law on SPZ³ was drafted by the Study Team, as per attachment to this Main Report, for consideration by the RGC.

1.06 Urgent Construction of a FZ in Sihanoukville

Urgent actions are necessary to materialize the proposed FZ as the core of the SPZ in Sihanoukville. An extensive questionnaire survey given to 8,700 export oriented firms in Asia confirmed substantial potential demand for locating manufacturing facilities in Sihanoukville if good and reliable systems and measures for investment promotion are substantiated. Accordingly, a 43 ha parcel of land directly behind the Port of Sihanoukville was selected as the site for the FZ. According to a feasibility study conducted for the present study, the cost of development was estimated at US\$ 17.2 million, including the costs for necessary infrastructure development. The project has high economic viability with an EIRR⁴ of 21.6%. On the financial side, assuming that a small part of the project cost pertaining to environmental protection, US\$ 3.5 million, be borne separately as grant aid, the FIRR⁵ of the project will be 10.6% and the project is judged to be financially sound. Without the grant, the FIRR will drop to 6.1%, and a concessional fund such as an international soft loan would be desirable.

³ Upon the request of the RGC, the Study Team combined the Draft Law on Industrial Zones and the sample Law on SPZ, to make the Draft Law on Special Economic Zones, which is attached to the Main Report.

⁴ EIRR stands for Economic Internal Rate of Return, and indicates the economic viability of the project.

⁵ FIRR stands for Financial Internal Rate of Return, and indicates the financial soundness of the project.

1.07 Policy Position Needed for SPZ in RGC

Due to the unfortunate history of the previous regime, Cambodia is laden with a number of issues and shortfalls hindering export promotion and industrial development. In order to enhance the competitiveness of Cambodia in the export capacity, the SPZ must be positioned properly within the national development goal. It will be imperative to promote the development of SPZ under a strong policy coherence within RGC encompassing various sectors, highlighting on essential issues such as human resources development, proper land use planning, environmental management, contribution to social development in rural areas, and reliable and economical provision of necessary infrastructure. The present Study provides a wide range of policy proposals in the relevant fields of national and regional administration.

1.08 Recommendations

This study recommends that the RGC, international donors, and private sector stakeholders consider and adopt a number of urgent actions for the materialization of the proposed SPZ, as given below:

The Royal Government of Cambodia

The RGC is recommended to take the following actions, based on the proposals and recommendations of this Study.

- Make a formal decision within the RGC to adopt the Sihanoukville SPZ as an official instrument for promoting export and facilitating industrial development in Cambodia;
- Enact a law tentatively titled the Law on Special Promotion Zones, as per attached to this report, to define the authorities, functions and systems of operation of SPZs and coordinate its effects with the relevant laws and regulations, including the Amended Law on Investment;
- Establish a new independent and autonomous organization as tentatively called CAPZA, the Cambodian Special Promotion Zones Authority, for the management and operation of the SPZ based on the proposals and recommendations of this Study and with full commitment of the RGC to the governance thereof and elimination of opportunity for corruption;
- Take immediate actions to materialize the proposed FZ in Sihanoukville, including preparing financing, making arrangements for implementation and providing a sustainable solution to the resettlement issue;
- Commence investment promotion for new industries to Cambodia, primarily based on the questionnaire survey results for this Study, and promoting investment seminars in selected nations;
- Initiate coherent economic development policies to enhance the competitiveness of Cambodia, increase the value-added of local products, introduce agro-processing, promote tourism and extend sustainable micro-finance to domestic to the small and

micro (handicraft) enterprises (SME);

- Initiate positive social development policies to secure sustainability of development, facilitate spatial balance of urban development, mitigate negative impacts of development, particularly on the poor, ensure protection of the environment, and ensure that the fruits of development be shared by the people in need in Cambodia;
- Undertake positive initiatives for planning and implementing effective and economical infrastructure development for transportation, water, power and telecommunication; and
- Advocate imperative development projects with possible external assistance, focusing primarily on the proposed priority projects in this Study (See Paragraphs 8.02 – 8.04).

International Donors:

International donors acting as development partners to Cambodia are recommended to take the following actions.

- Coordinate and facilitate partnership for the successful and sustainable implementation of the proposed SPZ by continuing dialog at the Policy Round Table⁶ on this topic;
- Extend guidance as necessary for establishing an enabling legal framework and facilitate marketing for the SPZ;
- Extend assistance to investment promotion for new type of export industries to invest in Cambodia;
- Provide development assistance to Cambodia in consideration of the priority projects selected in this study (See Paragraphs 8.02 – 8.04);
- Provide additional funding and technical assistance to SME development, focusing on domestic or foreign/domestic joint-venture type of entrepreneurship particularly in the proposed SPZ in Sihanoukville; and
- Assist the RGC by facilitating the necessary funding for the development of the SPZ in Sihanoukville, particularly the urgent FZ development, by extending either a soft loan for the project or providing grant aid for the appurtenant environmental protection measures.

Private Sector:

- Utilize the facilities and opportunities to be materialized in the SPZ to diversify export commodities and target markets, and promote better use of locally available natural and agro-fishery resources;
- Take active part in the human resources development in Cambodia by providing various training programs, on and off the job, and broadening employment opportunities for Cambodian nationals, not only in unskilled work but also in middle managerial and technical jobs; and

⁶ The Policy Round Table for Special Economic Zone was co-organized by JICA and WB-IFC to facilitate dialog among stakeholders to successfully and sustainably implement the proposed zone. Two separate sessions took place in early 2003. The initiative of this dialog was shifted to RGC to ensure continuation of dialog.

- Take an active and continuous role in the sustainable development of Cambodia through expanding economic activities, and even more positively cooperate to the enforcement of the laws and regulations of Cambodia.

PART II: INTRODUCTION AND OVERVIEWS

2. Introduction⁷

2.01 Objectives of this Study

The Study on Regional Development of Phnom Penh – Sihanoukville Growth Corridor is a technical assistance under a grant aid program of the Government of Japan to the Kingdom of Cambodia. The objectives of this Study are:

- (1) To formulate a regional development master plan for the Growth Corridor with a target year of 2015;
- (2) To conduct a feasibility study for the Sihanoukville Special Promotion Zone (SPZ); and
- (3) To provide technology transfer.

2.02 Growth Corridor Area

This Study focuses on the “Growth Corridor Area”, which encompasses the municipalities of Phnom Penh and Sihanoukville and the five surrounding provinces⁸. The population of the Growth Corridor Area is 4.8 million people over a total area of 31,000 km². The Growth Corridor Area contains three distinctive sub-areas with different characteristics: the Greater Capital Area (Phnom Penh and the surrounding Kandal Province), where the nation’s administrative and economic functions concentrate; the Sihanoukville Area where the nation’s only deep seaport is located, and the remaining “Intermediate Area”, which is predominantly rural.

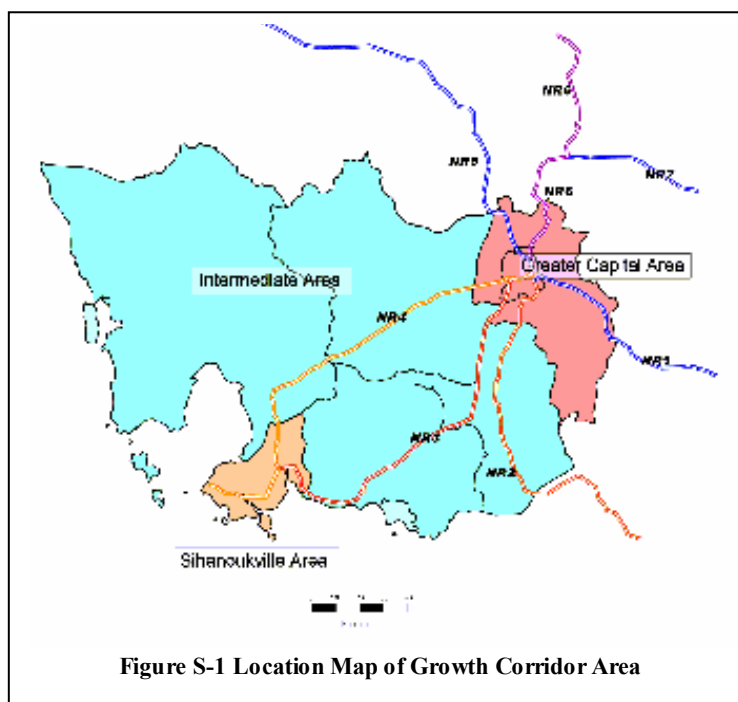


Figure S-1 Location Map of Growth Corridor Area

2.03 Target Years of the Master Plan

As the planning targets, the mid-term and long-term target years of the Master Plan were set at 2008 and 2015 respectively, with specific reference to the given timeframe of the AFTA⁹ agreement. It is agreed that tariff rates will be reduced to less than 5% in 2008, and then

⁷ Please refer to Chapter 1 of Main Report for full description.

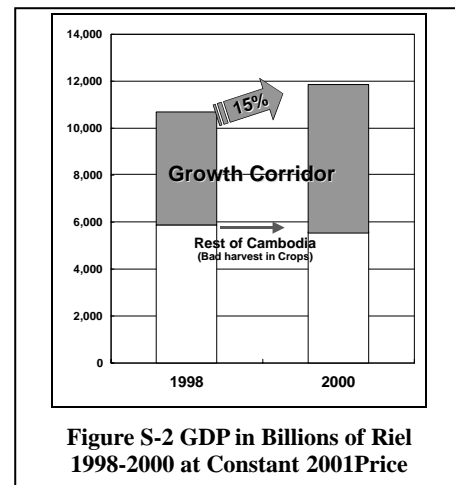
⁸ Five provinces are Provinces of Kandal, Kampong Spueu, Takev, Kampot and Kaoh Kong.

⁹ AFTA stands for ASEAN Free Trade Area.

further to 0% in 2015 within ASEAN countries. In addition, the urgent-term was set at 2005, when the existing quotas for Cambodian garment export would expire.

2.04 Why a “Growth Corridor”?

The Growth Corridor Area already leads the recent growth of the Cambodian economy. Between 1998 and 2000, the GDP of the Growth Corridor Area increased by 15%, while that of the remaining area of Cambodia stayed almost constant due to poor crop harvests. The Growth Corridor Area solely brought about the economic growth of Cambodia in this period. This area will continue to be the engine of the economic development of Cambodia, particularly in industry.



2.05 Source of Economic Expansion in the Growth Corridor Area

Despite the fact that the Kingdom of Cambodia is predominantly an agrarian nation, the present day growth of the Cambodian economy comes chiefly from secondary industry. A staple of manufacturing industries within the Growth Corridor Area is garment-related in the Greater Capital and Sihanoukville areas, and the output of *secondary industry* grew 25% between 1998 and 2000. *Tertiary industry* in the Growth Corridor achieved a growth of 15% in the same period due partly to the expanding trade in industrial goods.

2.06 Priority Area in Growth Corridor

The priority area for the industrial development in the Growth Corridor was set for the two areas; the Sihanoukville and the Greater Capital Areas, which are the important growth centers of the region (Refer to **Section 4.02**). Additionally, the areas along the two national routes connecting the two; National Route No. 3 and 4; were considered as likely sites for future expansion of *secondary industry*, as this area provides vast unused land with relatively good access to the market and the international gateway in Sihanoukville and Phnom Penh.

3. Central Issues of the Economic Development in Cambodia¹⁰

3.01 Difficulty in Attracting FDI

As the general level of industrial and capital accumulation in Cambodia is low, FDI is an essential instrument for Cambodia to introduce new technologies and capital, and thus advance industrialization. FDI boomed after 1994 with the enactment of the Law on Investment, and peaked in 1998 with the sum of US\$ 389 million invested on 89 projects in Cambodia. The political unrest in the latter part of the 1990's cooled the boom, and the current level of investment is about the half of the peak. With the accession of China to the

¹⁰ Please refer to Section 5.1 of Main Report for full description.

World Trade Organization (WTO), funds are moving away from most of the ASEAN nations to China, leaving Cambodia in an extremely weak position to compete for additional input of FDI.

3.02 Growth on a Narrow Base

Despite the fact that Cambodia was the first LDC to achieve a US\$ 1 billion of export, it has a very narrow base for growth. The expansion of the *secondary industry* in the recent years has been driven by the growing outputs of garments and footwear production of FDI enterprises. The quick expansion was brought originally as a result of the generous conditions enabled under the General System of Preference (GSP). This uplift was sustained when an export quota was assigned to nations exporting garments to the U.S., including Cambodia. In 2000, the garments and footwear, most of which went to the U.S. market, accounted for 70% of Cambodia's export earnings.

3.03 Weak Links to the Local Economy

As the FDI garment manufacturers, for example, mostly utilize imported fabric as raw materials, they have little linkage with the local economy except for labor supply. Locally available resources other than labor are at present scarcely utilized for the processing for export. The same is true for other major export industries such as footwear. Agro-fishery products, on the other hand, have little access for export due to the limited capacity for processing, and in most cases bought raw by foreign buyers to cross the border.

3.04 Vulnerability to Changes in External Factors

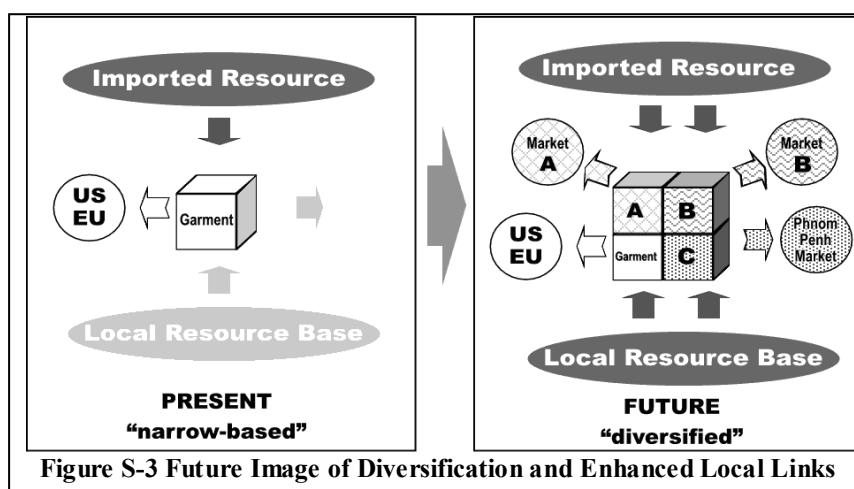
As the Cambodian economy relies heavily on a very limited number of commodities and markets, changes in the external factors, such as quotas for garment by the U.S. Government, could impose serious effects on the Cambodian economy. As the ongoing Multinational Fiber Agreement expires at the end of 2004, a significant change in the export environment for Cambodia is expected to occur then. If the exports quota for Cambodia provided by the U.S. Government should be removed in 2005, the base on which the Cambodian economy has recently enjoyed the upward trend would come to an end. This risk of monoculture needs to be administered properly to avoid an extensive and deadly damage to the economy.

PART III: DEVELOPMENT STRATEGIES FOR GROWTH CORRIDOR

4. Approaches for Development¹¹

4.01 Creating New Basis for Growth

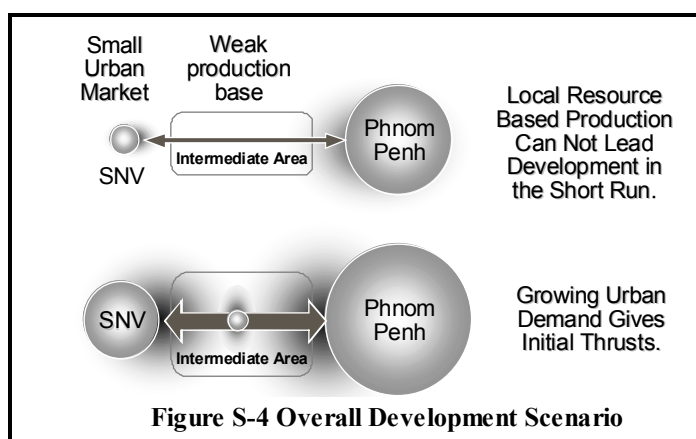
The challenge facing Cambodia is how to diversify its industrial production, particularly of export commodities, and cultivate markets other than the U.S. and EU. Cambodia needs to make better utilization of locally available resources (such as fruits, vegetables, wood, rubber and sea food and some of the mineral resources), and not just the inexpensive labor force for the garment industry. For this purpose, Cambodia needs to introduce an entirely different environment geared to promote FDI, with renewed administrative procedures and systems, to a level competitive with the neighboring nations such as Thailand and Vietnam. This pertains in essence to the entire country of Cambodia in the long run.



As the first step, a spatially delineated pilot area must be advocated for a quick effect, where the best and most desirable administrative procedures and systems will be extended suited for FDI entrepreneurs to do business in Cambodia. This will enable Cambodia to compete for FDI to broaden its basis of development, and promote better utilization of local resources, other than labor, and strengthen Cambodia against a possible change in the external factors, such as US quotas. This initiative could then be dispersed nationwide for a broader and lasting effect.

4.02 Demand-Driven Development

Although the Growth Corridor area has various local resources, the resources alone are not appealing enough to induce new industries to locate there. Agriculture in Cambodia has a generally low yield due to a lack of irrigation, and importation of food is not trivial. Modern



¹¹ Please refer to Sections 5.2 and 5.3 of Main Report for full description.

agriculture such as extensive plantation is faced with unproductive soil condition, uncertainty in land titles and insufficiency of domestic capital. In this regard, a local resource-driven development scenario will be difficult to materialize in the short term.

Recapturing the growing urban demand for food and raw materials is a typical demand-driven scenario that is effective alternative to the local resource-driven development. Growing urban centers such as Phnom Penh and Sihanoukville will provide impetus for food supply and import substitution of food and consumer goods, and thus create a basis on which domestic light industries to grow.

4.03 Importance of FDI as Engine for Development

As the level of capital and technological accumulation in Cambodia is low, FDI will continue to play a crucial role of activating economic development of Cambodia by incubating new export industries. In the long term, this role will have to be converted to domestic enterprises gradually by expediting human resources development for manufacturing and management, and supporting the growth of domestic SMEs. Improvement of quality control and production management will be critical for domestic firms to seek export markets, and they should learn the essence of effective business practices from FDI firms in operation.

4.04 Indicative Development Targets

The population of the Growth Corridor is 4.8 million in 2000, and is growing steadily. Based on the 1998 Census projection, the population in the year 2015 is expected to be 7 million, with an annual growth rate of 2.6%. The highest growth of population will occur in Sihanoukville, with an annual average growth rate of 3.9%. Additional labor force will be in the range of 130,000 to 140,000 every year, and this will have to be absorbed chiefly by jobs created in the *secondary* and *tertiary industries*. These are the sectors that have provided the engine for development in the recent years and are expected to continue doing so in the planning period. *Primary industry*, with agriculture, fishery and forestry, will continue to be an important sector for Cambodia, although the capacity for employment is limited.

According to the development targets for the period between 2000 and 2015, the GDP of the Growth Corridor will grow on an average rate of 7.0%, while the per capita GDP will increase on an average rate of 3.6%, if positive industrial development measures are to be adopted. The per capital GDP (or average income) will be increased from US\$345 in 2000 to US\$573 in 2015.

the border town of Kaoh Kong, Cambodia and Thailand shall have an important alternative coastal route besides the present inland route, enabling quick and effective transportation of heavy cargo between Bangkok and Phnom Penh. This new route will encompass the industrial areas and seaports of Thailand and Cambodia via the coastal zone in a single leg. Sihanoukville will thus find itself located at the core of the Southern Economic Corridor¹³ linking the three nations of Thailand, Cambodia and Viet Nam.

Role of Sihanoukville

The advantage of Sihanoukville is the presence of the deep seaport, which gives direct access to overseas ports. In addition, National Routes No.3 and 4 provides good connection between Sihanoukville and Phnom Penh, making all the administrative and business services located in Phnom Penh accessible easily. While Sihanoukville is a “boom town” with a rapidly growing population (annual increase of 4.5% between 1998 - 2000) and expanding economic activities, it is also gifted with natural beauty suitable for a coastal resort.

Together with Phnom Penh, Sihanoukville probably has the greatest appeal in Cambodia as a location for FDI in export-oriented manufacturing and related service/trading/logistic functions. This appeal has to be sustained and even further enhanced to attract more FDI and deliver its effects to the domestic economy.

4.06 Role of the Greater Capital Area

The Greater Capital Area has a total population of 2 million and accommodates the capital of Cambodia. This area houses the best human resources of Cambodia and provides the largest employment opportunities for services and manufacturing.

There is plenty of land in its western outskirts around the international airport, which provides for future expansion of the urban areas, as well as export oriented industries. Proximity to the largest consumer market of Cambodia and availability of the best human resources will continue to be an advantage for this region. The Greater Capital area continues to provide location for various types of high-tech industries seeking to operate in Cambodia, and serve as a diversified supply base for various consumer products and services.

4.07 Role of the Intermediate Area

Between the two major urban centers at both ends, the Intermediate Area is predominantly a rural area with potential for agro-fishery production, such as pineapples and cashew-nuts in the inland area, pepper and fruits in Kampot and marine products in the coastal area. With an inefficient rural infrastructure, the potential of the Intermediate Area to supply food for the urban population and raw materials for manufacturing is not well cultivated. Roads other than Route No. 3 and 4 are poorly maintained, and are often inaccessible during the rainy season, hindering the transportation of agro-fishery products to markets. Cambodia presently imports a substantial amount of vegetables for consumption in urban areas, while

¹³ Southern Economic Corridor is one of the regional economic development initiatives under the Mekong Sub-Region Program, advocated by ADB.

agro-fishery products such as fruits and seafood are exported as raw material without much processing. Recapturing the demand for food in urban areas to substitute for imports and improving the value added with the introduction of processing technologies will help boost the agro-fishery output in the Intermediate Area, and facilitate better use of local resources as raw material for manufacturing.

4.08 Medium-Term Scenario

Sihanoukville Area

For the target year of 2008, it is imperative to focus on the enhancement of Sihanoukville as the direct international gateway. Diversifying the export industries will be an imperative measure for the economic development of the Growth Corridor to achieve the development targets established in **Section 4.04** above. The most important step for this purpose is to realize a Special Promotion Zone (SPZ) framework to attract FDI to Sihanoukville by all feasible means to widen the range of export industries. To achieve this, a comprehensive law and the appropriate managing organization need to be established for Sihanoukville SPZ as a model to display a success within a limited spatial extent. Improvement of the port that is currently in progress is an important element to enhance the competitive edge of Sihanoukville as the gateway to Cambodia.

The improvement of connecting roads, particularly of National Route No. 48, will be essential for providing Sihanoukville with a relative advantage for growth, strengthening the linkage with Thailand and giving impetus for future coastal zone development. The SPZ framework could then be used to induce FDI enterprises in the sphere where greater use of the local resources could be secured, such as processing of locally available fruits and seafood.

The Greater Capital Area

In the Greater Capital Area, efforts need to be made to prepare industrial estates to accommodate new FDI export processing firms in the suburbs of Phnom Penh. As the western suburbs of Phnom Penh are faced with strong pressure for development, planning of infrastructure such as arterial roads, water and electricity will be essential. Human resources development will be the most effective in the Greater Capital Area, and emphasis will be placed on vocational and managerial training to foster middle management level Cambodian workers to replace expatriates, and broadening of vocational training into more high-tech, information related area.

The Intermediate Area

It will be important to prioritize the necessary infrastructure development in the Intermediate Area. Rural roads and small scale ports directly affect the livelihood in the rural area, and need to be given attention. As the area is predominantly rural, planning of water resources development to rationalize the water sources and uses will be necessary. Sites for locating local resources based industries such as agro-fishery processing needs to be selected. In parallel, plans need to be formulated for assessment and sustainable use of natural resources, such as marine, forestry, mining resources including.

In order to improve the livelihood in the rural area, efforts need to be made to commence projects geared to income generation at villages, utilizing the locally available resources. The potential area for such endeavors will include agro-fishery processing, handicraft catering to the tastes of international tourists, promotion of village and natural tourisms.

4.09 Long-Term Scenario

The long-term development scenario of Cambodia up to the year 2015 will depend naturally on what could be achieved in the medium-term period. Growth of urban centers in the Greater Capital and Sihanoukville areas will induce further demands for consumer products and services, which ought to be catered for chiefly by Cambodian manufactures and service providers. The bases of secondary industry need to be widened, with export commodities and target markets diversified. The SPZ established firmly for Sihanoukville will serve as the basis to further expansion in other sites in provinces to accommodate FDI in a variety of goods production, particularly those utilizing locally available resources.

The effects of SPZ will be expected in two essential aspects of the Cambodian economy. The first is the creation of employment at new factories and service providers, most of which are operated by FDI. The other will pertain to the promotion and development of Cambodian receptor firms to interact with FDI in various forms such as related manufacturing and service provision. The latter will enhance the backward linkage of FDI to the Cambodian economy, which is important task in the long-term scenario.

Regulatory measures for the urban planning and preservation of the environment will have increased importance for the sustainability of the Growth Corridor area. Urban and rural master plans stipulating balanced land use and sustainable use of natural resources, such as forestry and fishery, need to be formulated extensively. Basic initiatives for these measures, such as providing guidelines for implementation, carrying out a pilot project and enhancing systems for enforcement, need to be advocated in the medium-term phase, so that these measures could take full effect in the long-term phase.

5. Strategies for Economic Development for the Growth Corridor¹⁴

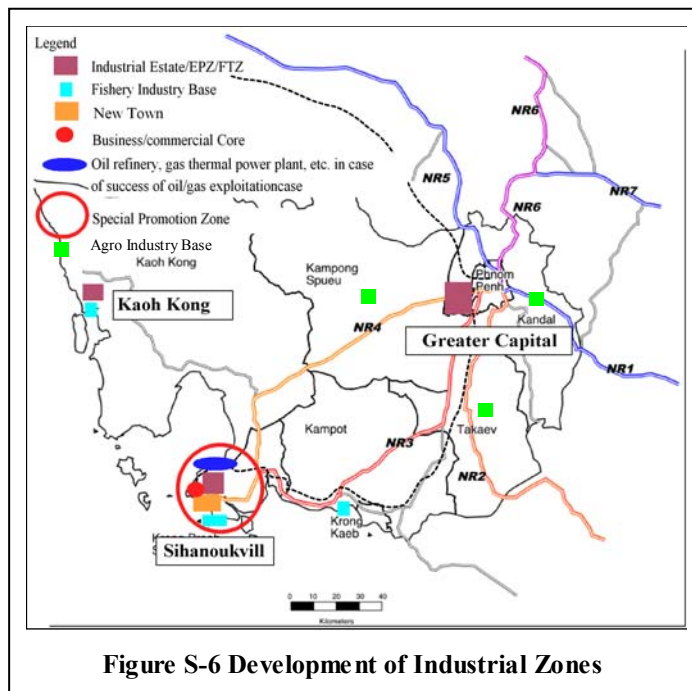
5.01 Development Image of the Growth Corridor

Two industrial cores should be developed; one in Phnom Penh and another in Sihanoukville. The Kaoh Kong EPZ, planned as the joint development with Cambodia and Thailand on the western boarder area, will be coordinated with the projects of the Growth Corridor in terms of the demand of the labor intensive industry. Development of an oil refinery, which is contingent on the result of the exploitation work for oil/natural gas in the Siam Bay, will presumably be accommodated in the coastal area of Sihanoukville, and provision will be made for such development in land use and infrastructure planning. Development of agro-fishery processing industry will have strategic importance to the rural area, depending on

¹⁴ Please refer to Section 5.4 of Main Report for full description.

the locally available resources. Small scale industrial estates primarily for agro-fishery processing industry will be located in the Intermediate area.

Enhancement of local transport systems, such as improvement of arterial roads and rehabilitation/maintenance of rural roads, improvement of local sea and river ports need to be accelerated. The role of local transport systems is important for small scale shipment of products between regions and neighboring nations and supplement the transportation hubs such as the Port of Sihanoukville, as advocated by RGC in its Open Waters Policy.



5.02 Strategy for Industry Development by Type of Industry

Sustaining and Enhancing Competitiveness of the Garment Industry

The total employment of the garment industry in 2000 is 232,000 in the Growth Corridor Area. As most (75%) of the present Cambodian garment exports go to the U.S. market, diversification of export target markets will have to be pursued. Technology improvement and quality control will add to the competitiveness of the industry, for which promotion of vocational training will be important. Provision of a freer environment for importation of material fabrics and auxiliaries and exportation of the finished goods and the development of human resources will be necessary, for which a 0 % import duty is proposed for materials for garment production. Enhancement of domestic enterprises in production garment and related peripheral industries will play a key role in sustaining the garment industry beyond 2005, which will be an important function of a promotion zone proposed in **Chapter 9**.

The medium-term target of the garment industry is for substantial growth from the current dominance of low price products. To boost the value-added of products to make them competitive in the middle-price market, development of relevant industries for the manufacturing of ancillary materials, such as ribbons, buttons and collar stays and other garment accessories will be important. Support for business incubation with Cambodian initiatives will be essential to widen the Cambodian garment industry base and start anew a process of industrial accumulation. Departing from the present contract-base manufacturing to direct access to export markets will require strengthening of the marketing capability, for which the human resources development in trade promotion will be crucial, which will be taken up as part of the human resources development programs.

Promotion of the Agro-Fishery Processing Industry

The agro-fishery industry is sometimes called an industry between the *primary* and *secondary industries*, which converts the outputs of agriculture and fishing into industrial products. The agro-fishery industry will not only increase the value-added of the agro-fishery products, but also help generate additional income in rural areas, mitigate seasonal fluctuation of income and thereby stabilize the livelihood in the rural communities. This will also open a possibility for establishing a local resource-based export industry. The potential area of agro-fishery industry will be seafood, such as fish, shrimp, squid and seashells, and fruits and vegetables. Attention needs to be exerted as to utilize easy-to-maintain technologies, and choose to locate the processing facilities in small scale lots in the rural communities. Industry estates geared for agro-fishery processing are proposed in the Intermediate area.

Promotion of the Assembly Industry

Product assembly is a labor intensive industry requiring an inexpensive but good labor force. Without a great deal of industrial accumulation in Cambodia, it may not be possible to manufacture sophisticated goods from scratch. An alternative method is what is called knockdown or semi-knockdown production, where all or most of the required parts manufactured elsewhere are imported and assembled in Cambodia. Possible products for the assembly industry are electric appliances, transportation machinery, and wire harnesses for automobiles. Seeking linkage with existing production facilities, such as automobile and electric appliances manufactures in Thailand, for example, will be crucial.

Recycling of Used Machinery; Automobiles, Electric Appliances and Computers

A large quantity of used machinery, particularly automobiles, electric appliances and computers, is disposed of or discarded in Japan and other developed countries. Used machinery would have a substantial value if the usable units are selected and repaired or restored, or if the usable parts are extracted. Recycled machinery or parts could be marketed in Cambodia or exported to neighboring nations. Cambodia could host such functions and serve as a gateway to the Indochina market as a whole. The proposed FZ will provide a good site for displaying and sales of refurbished items.

As this type of industry tends to impose nontrivial impact on the environment, location may need to be limited to an industrial estate with good facilities for solid waste and waste water treatment. Basic principle to apply will be the PPP (Polluter Pay Principle), and the manufacturing entrepreneur will be required to process the waste to a level acceptable for the treatment plant therein. Caution needs to be exerted to ensure effective enforcement of related laws and regulations to protect environment.

Recapturing of Domestic Market¹⁵ for Consumer Goods

Cambodia imports a range of products for which the raw materials are locally available. Agro-based commodities, such as processed food, account for 3% of the total imports. With ample local resources in agro-fishery, some part of the imported processed food could be

¹⁵ “Recapturing of Domestic Market” in this Study refers to what is ordinarily denoted by “Import Substitution”.

locally manufactured to replace imports. Processed meat, fish, canned or dried fruits and vegetable oil are typical commodities in this category. Recapturing of the domestic market by “Made-in-Cambodia” products will contribute to the betterment of the trade imbalance and nurture a base for future export.

As the domestic consumption market of consumer goods is small in Cambodia, a feasible step shall be promoting export oriented manufacturers, and require them to supply to the domestic market at the same time. Improvement of technology and quality control will be the key for the growth of agro-based industries and stringent control of smuggling would be an absolute condition for promoting the industries.

Promotion of the Construction Materials Industry

Construction is a sizable industry in Cambodia, representing 5% of the total output of the Cambodian economy. With regard to the materials needed for construction, only a small fragment is manufactured locally, such as simple bricks. As urban centers and industrial estates continue to expand, there will be a sizable demand for construction materials. In order to recapture this market, capabilities need to be boosted in and around the Greater Capital area for the production of construction materials including: concrete secondary products, such as concrete pipes, slabs and panels; galvanized iron steel sheets; and more sophisticated bricks and tiles. Construction materials are bulky and heavy, and are generally deemed suitable for import substitution.

Cambodia presently imports cement in a large quantity. With regard to mineral resources including limestone that makes cement, a comprehensive assessment of the available resources and feasibility of commercial development needs to be made.

Promotion of the Footwear Industry

Footwear manufacturing is an existing export industry with an annual value of US\$ 38 million. Provision of a freer environment for material imports and product exports will be an essential factor, and improvement of technology and quality control will be the key for the growth of the footwear industry. For the footwear industry to pursue a better business environment, design would be an important factor for boosting the value-added of the products. These are the areas where joint efforts by the public and private sectors will be needed.

By provision of freer environment of material imports and product exports, especially in the SPZ, the more overseas footwear manufacturers would be interested in the investment in Cambodia. Through the accumulation of such FDI in footwear industry, the technology and quality control improvement and building-up of designing capacity could be anticipated.

5.03 Upgrading of Small and Micro Industry

Small and micro (handicraft) enterprises (SME) are an indigenous base for economic development in Cambodia, providing substantial employment. Although the output of SME is not yet high, advantages of SME are in close ties with the domestic economy through capital and technical accumulation, employment and potential for quick incubation in reaction to the needs in the market place. Employed technologies for manufacturing are often

conventional or traditional, where ample room for improvement exists. Managerial skills are often not sufficient, requiring support for sophistication. Financing for prospective SME entities is not sufficient, due mainly to the lack of a formalized mechanism for SME support. A strong public sector initiative will be required to support the enhancement and growth of SME. A law which defines the SME and stipulates duties and obligations of the public sector in enhancing the SMEs in Cambodia shall be a meaningful first step in this regard.

5.04 The Need for Industrial Estates with Competitive Infrastructure

While neighboring nations such as Thailand and Vietnam have been active in the last decade or so in providing industrial estates with competitive infrastructures, Cambodia has little to offer to potential investors to relocate their production facilities. Utilities are expensive in Cambodia, particularly electricity. Transportation costs are substantially higher than most of the neighboring nations, particularly in Phnom Penh. Efforts need to be exerted to facilitate industrial estates with competitive and efficient infrastructures.

Table S-2 Comparison of Cost for FDI in Asian Nations

Country		Cambodia		Thailand	China		Vietnam	
City		Phnom Penh	Sihanoukville	BKK	Shenzhen	Shanghai	Hanoi	Ho Chi Ming
Monthly salary (US\$/Month)	Worker (incl. of fringe benefit)	60-70	60-70	140	40-110	190-280	75-115	95-140
	Engineer/Supervisor	100-500	100-300	300	120-250	280-460	190-310	155-290
	Manager	500-2,500	n.a.	620	340-720	430-910	470-540	470-620
	Minimum wage by law	45	45	3.71/day	69.35	59.2	41.6	41.6
Land/office price	Factory lot purchase price (US\$/m ²)	20 – 40 (outside IE)	n.a.	30-70	14 (50 years)	25 (50 years)	80 (30 years)	100 (40-50 years)
	Factory lot lease in IE (US\$/m ² /month)	0.1 – 0.2	n.a.	unknown	0.24	unavailable	0.22	0.23
	Office floor (US\$/m ² /month)	10-20	10-20	10	12-14.5	30	22	16
	Apartment (US\$/month)	1,000-2,000	800-1,500	1,350-1,460	360-970	2,150-4,000	1,700	1,800
Utility	Electricity (US\$/kWh)	0.21	0.21	0.04	0.09-0.12	0.07	0.07	0.07
	Water (US\$/m ³)	0.20	0.25	0.21-0.36	0.23-0.29	0.15	0.23	0.23
	Telephone (US\$ per 3 min. to Japan)	4.8	4.8	2.3	2.9	2.9	6.9	6.9
Transport (US\$ per 40 ft container to Yokohama port Japan)		1,800	1,600	1,450	1,250	700	1,500	1,500

Source: Data for Cambodia by Study Team's factory interview survey, all other data from JETRO. All data are as of November 2001

5.05 Overview of Industrial Development in Growth Corridor Area

The manufacturing industries in the Growth Corridor area will be diversified to new types, and dispersed area-wise. Heavy concentration to garment industry will be remedied by introducing new types of export oriented industries, reflecting the characteristics and expected roles of the three sub-areas, as tabulated below.

Table S-3 Matrix of Economic Development Directions

Sub-Area	Present (2002)	Development Goal	Short-term (Up to 2008)	Medium to Long-Term (Up to 2015)
Greater Capital Area	<ul style="list-style-type: none"> • Garment and footwear (labor intensive industries) • Supply of agricultural products for urban consumption 	Creation of economically active suburbs with sustainable environment	<ul style="list-style-type: none"> • Development of agro-processing industry • Airport based industry (high value added, labor intensive industry) • Electric appliance /transportation machinery assembly 	<ul style="list-style-type: none"> • Enlargement of agro-processing industry • Development of import substitution industries • Electric appliance /transportation machinery assembly and production • Development of IT industry • Logistic center
Sihanoukville Area	<ul style="list-style-type: none"> • Garment and footwear (labor intensive industries) • Beverage production • Marine products processing • Improvement of port facility • Beach resort for domestic visitors 	Promotion of strategic development of industries to diversify export	<ul style="list-style-type: none"> • Development of agro-fishery processing industry • Port based industry (Garment; used machinery reuse; light manufacturing) • Enlargement of beverage industry • Port-oriented industry (ship repair; boat building) • Coastal tourism for domestic visitors 	<ul style="list-style-type: none"> • Development of agro-fishery processing industry • Development of import substitution industries • Electric furnace semi-assembly/ production • Enlargement of used machinery reuse and recycling industry • Export of beverage products • Coastal tourism for international visitors
Inter-mediate Area	<ul style="list-style-type: none"> • Cottage and handicraft industry • Vegetable and fruit production • Cattle farming • Fishery 	Establishment of stable and sustainable rural society	<ul style="list-style-type: none"> • Enhancement of suburban agriculture for import substitution • Modernization of cottage industry • Promotion of village tourism • Agro-fishery processing 	<ul style="list-style-type: none"> • Further improvement of agro-fishery processing for export

5.06 Improvement of Agriculture and Fishery

Improvement of Suburban Agriculture

The primary target of agricultural improvement is in its restructuring to cater for the growing urban demands for food supply. Promotion of suburban agriculture focusing on the diversification of crops, including introduction of cash crops in the suburban areas of Phnom Penh, will be needed together with the enhancement of crop yields through irrigation and proper farm management. To enhance the value of agricultural products, establishment of an effective farm market system and provision of reliable market information will be essential. Improvement in post-harvest activities will also be necessary.

Improvement of Fishery

Although Cambodia has a rich marine resource for domestic consumption as well as for export, not much has been exploited for export. One cause of under-exploitation is in the excessive interference of the public sector in seafood exportation. By eradicating the present institutional process to be replaced by a market-oriented mechanism, export of raw seafood as well as processed forms will expand accordingly. Promoting the establishment of seafood

processing facilities within the FDI for export will contribute to the increase of value of fishery products. In the medium term, it is important to allow for appropriate use of ocean fishery resources through the implementation of fish farming and the protection of natural resources in coastal area.

5.07 Promotion of Tourism

Enhancement of Phnom Penh as a Destination for Tourists in Cambodia

Tourism is an important source of foreign currency earnings. The number of international tourists to Cambodia is steadily growing, reflecting the recent stability of the nation in general. The focus of international tourism is, and will continue to be, the ruins of Angkor Wat in Siem Reap. It is important to establish Phnom Penh as the second destination for international tourists to Cambodia, and as one of the gateways to Angkor Wat. Phnom Penh has various tourism resources including the Royal Palace and National Museum, while most of the others are latent and untapped. Creation of optional tour menus in and around Phnom Penh is important in this regard. Optional destinations will include the ancient capital of Cambodia in Oudon, the coastal resort of Sihanoukville and village tourism sites, which will be discussed later.

Coastal Resort in Sihanoukville

Sihanoukville is a coastal resort town in Cambodia and a popular weekend getaway destination chiefly for domestic tourists and expatriates resident in Cambodia. Beaches on the coast and in the islands and marine sports are the main appeal to visitors to Sihanoukville. In the short term, Sihanoukville should continue to promote visitors from within Cambodia by enhancing the amenities at the beaches and upgrading hotel/guesthouses. In the mid to long term, Sihanoukville should strive to become host to international tourist resorts, with the development of related high grade accommodation and service facilities. The role of FDI will be critical in this regard. The city's expansion will have to be managed efficiently so that the development of industrial estates does not impair the tourism related resources.

Promotion of Village Tourism

Village tourism denotes a type of tourism that focuses on hands-on experience of cultural, traditional and indigenous livelihoods. Though such experiences may look commonplace and uninteresting to local residents, there is usually latent appeal to a fraction of foreign tourists seeking to learn about different cultures and traditions. Khmer silk clothes and handicrafts in Kandal and Takaev Provinces are well known, and souvenir items are sold chiefly in Phnom Penh markets. Village handicraft industries tend to stick together in a small area, where the traditional production technology is handed down from parents to children. Silk Island in the Mekong north of Phnom Penh, or the island of Kaoh Dack in Kandal Province, provides a good site for village tourism for traditional Khmer silk weaving. Kaoh Cheng near Oudong in Kandal Province provides a site for metal carving for silver and copperware. These sites, presently a minor destination for exceptional tourists, may well become much more popular tourism sites with a program for marketing with tourism agencies and facilitation of souvenir shops and/or rest houses.

5.08 Promotion of FDI

The 1994 Law on Investment (LOI) is in the process of being amended based on basic principles of simplicity, transparency, predictability and non-discretion¹⁶. The Amendment calls for an automatic approval for qualified investment projects (QIP) on condition that they are not on a negative list and the incentives to be provided are clearly confirmed. Provision of a one-stop-shop for various licenses for foreign investors with QIP will be provided under the Amendment. While these measures will support FDI promotion in Cambodia, there is also a questionable part of the amendment in the form of a reduction in fiscal incentives for QIP. The stipulation of a Special Promotion Zone in the 1994 LOI remains in the Amendment, but much of the fiscal incentives to QIP investors are to be eliminated including the preferential corporate tax scheme. The issue pertaining to Amendment is in essence how to substantiate the SPZ under the Amendment to enhance the competitive edge of Cambodia to attract FDI. A supplementary law needs to be enacted to facilitate a framework of SPZ with allowable maximal conditions to attract FDI to Cambodia.

6. Strategies for Social Development for The Growth Corridor¹⁷

6.01 Need for Social Development

Cambodia needs to devise various measures to initiate economic development, as discussed in the previous chapter. When the strategies for economic development in the previous chapter are effectuated, there will be potentially extensive social changes in rural and urban areas, effects of which need to be accommodated and mitigated. In urban areas considerations need to be exerted to balance the development and conservation of natural resources, and accommodation of influx of new residents in harmony. In rural areas, sustainable societies will be the basis of rural livelihood. The strategies for social development are considered to address these aspects.

6.02 Establishment of an Urban Master Plan

Necessity of a Pilot Urban Master Plan

A large part of the output of economic activities comes from urban areas, and thus urbanization is in progress at a rapid pace. The issue of urbanization is constituent, particularly in two areas: Sihanoukville and suburbs of Phnom Penh. Sihanoukville is a city where active industrial development is in preparation. Phnom Penh sees an outward expansion of the urban core of Phnom Penh and in parallel industrial development is in progress. The Law on Land Use Planning, Urbanization and Construction stipulates that a development master plan and land use plan shall be formulated for approval for each urban center, although no such a plan has been approved yet. An urban master plan shall delineate a protection area and specific functional zones within the urban area, so that a harmful

¹⁶ The amendment was enacted on March 24, 2003.

¹⁷ Please refer to Section 5.5 of Main Report for full description.

mixture of conflicting functions would not occur. There needs to be a model master plan, preferably for Sihanoukville to set an example.

When this urban master plan is formulated and approved, master plan for major cities such as Phnom Penh, Siem Reap, will follow, broadening the basis of urban planning in Cambodia. These will serve as the model for other smaller cities to follow.

Enhancement of Enforcement Mechanism and Capacity Building

It is imperative for Cambodia that urban planning be taken up as a continuous program that oversees the balanced and sustainable management of urban environment as well as an instrument to control the urban expansion. For this purpose a step-by-step guideline for workable and effective urban planning practices needs to be devised with external assistance. In parallel, capacity building of staff in charge of urban planning, particularly on the provincial levels, need to be accelerated. This will help provincial authorities to facilitate appropriate urban plans for their local urban centers under a local initiative.

6.03 Human Resources Development

Progress in technology and information systems requires qualified human resources. Many countries pay attention to the quality of the labor force as a key to economic development. While Cambodia has made certain progress in the provision of primary education, there are a number of issues to be solved in order to develop a labor force that will be responsive to the market needs.

Due to the political instability during the past two decades, the education system in Cambodia deteriorated. Currently, the major employers of labor force in Cambodia are the export processing firms that have been established by FDI. These FDIs alone cannot provide jobs to all the new entries to the labor market every year.

The relationship between the human resources development and industrial development is something of a “chicken or the egg” dilemma. While it may appear unnecessary to develop many highly qualified people in engineering or other professions, when there are few employment opportunities requiring such qualification, yet without a base of trained personnel, efforts to develop industry may face an obstacle in acquiring any momentum. Experience from many countries shows, however, that demand for particular occupations does not necessarily come in tandem with the supply of suitable human resources. Ultimately though, this does not justify waiting until the demand arises to develop an educated populace.

Unless the RGC takes measures for human resources development and creation of employment, there will be too many underemployed and unemployed young Cambodians with unstable livelihood and low salaries.

The sector strategies for human resources development are;

- To improve the capabilities of the growing population of young Cambodians by improving the relevance and quality of education, and
- To provide productive/formal employment opportunities to those young Cambodians

There are two major important issues to implement the above strategies.

Higher Education

There is a sizable gap in the supply and demand for human resources in Cambodia. Higher education is highly concentrated in Phnom Penh. Besides the regional imbalance, enrollments at higher education institutions by discipline show that nearly half of the enrollments are in business, while enrollments in engineering are merely 4% of students. Disparity in supply and demand of human resources will pose a serious problem in the near future. Encouraging enrolments in engineering and career guidance at secondary schools would be effective for solving this disparity.

Vocational Training

Many vocational training schools in Cambodia focus on languages and computer skills. The remaining schools - mostly public - provide sewing, welding and other traditional vocational training areas. Though the importance of language and computer skills will not be denied, training of skilled workers and technicians will be needed in large numbers in many industrial and service enterprises.

6.04 Social Dimensions

Empowerment of Rural People

Poverty reduction remains the central issue in rural development. Enhancement of small scale development projects for rural and basic infrastructure should be advocated. The infrastructure in rural area should be such that it allows for participation of local people in maintenance and operation. In parallel, efforts need to be made for the generation of additional income in rural societies, focusing mainly on agro-fishery processing, natural and village tourism, handicraft. These income generation projects will not only improve the livelihood of rural households, but also improve the use of locally available resources for economic development. This should be accompanied by empowerment of rural people through health education to prevent diseases and improve the health condition.

Preventive Measures for Development Projects

When social change due to intensive development is foreseen in areas such as Sihanoukville and the outskirts of Phnom Penh, participatory community development ought to be adopted as the basic means for adaptation. Community participation could be rendered through the establishing of a committee for community development consisting of representatives of residents, local government officials, and NGOs. This aims at catering to the development needs of the communities, as well as facilitating the self-help efforts of the residents.

6.05 Environmental Management

Environmental management is a crucial element in the promotion of sustainable development in Cambodia. As environment related laws and regulations have already been in effect, institutional capacity building for effective enforcement of the environmental legislations is imperative to accomplish appropriate environment and natural resource management. To minimize negative impacts on the environment, strict control and monitoring of pollution

sources are required in the areas where extensive industrial development is anticipated, such as Sihanoukville and the suburbs of Phnom Penh. In addition, appropriate waste and wastewater management systems need to be introduced, focusing on reducing, reusing and recycling, to cope with rapid increase of solid waste and wastewater discharge.

7. Strategies for Infrastructure Development for The Growth Corridor¹⁸

7.01 Infrastructure Development

The level of service associated with infrastructure in Cambodia is generally poor and often expensive. The basic strategy for infrastructure development is to realize economical, competitive and sustainable infrastructure to cater for the economic development of the Growth Corridor Area. As the availability of funds is limited, prioritization of candidate projects and phased implementation will be essential.

Infrastructure development in the Growth Corridor will focus on the two essential facets. The first is the infrastructure necessary to sustain the industrial and economic development of the priority areas, comprising of transportation network, water sources and supply system, electricity generation, transmission and distribution network and reliable and effective telecommunication networks. The other is the rural infrastructure for the rural communities. The latter is important as part of the poverty reduction and improvement of rural livelihood.

One issue pertaining to the infrastructure in Cambodia is the shortage of funding for construction and maintenance. External assistance on essential infrastructure needs to be accelerated. Allocation of government budget must be rationalized based on priorities of specific projects. A concession agreement method, based on a BOT (Build-Operate-Transfer) type of contract, is a practical solution for the lack of funding, and is extensively utilized for infrastructure development in Cambodia. As the concessions are often rendered without substantial competition, scrutiny of the economic and financial viability of such a method needs to be carefully conducted and compared with the soft loan alternative financing scheme.

7.02 Strategies for Specific Infrastructure Development

Roads and Rails

In order to activate the regional economy of the Growth Corridor, a network of good roads linking the supply areas and demand centers is imperative, chiefly in the Phnom Penh and Sihanoukville areas, and further connecting with international borders. Improved access to Thailand along the coast via National Route No. 48, which is to be chiefly financed by the Thai government, will provide a crucial international linkage for the Sihanoukville area. While National Route Nos. 3 and 4 have been (or are planned to be) improved to a good condition, provincial and rural roads are poorly maintained. In urban areas in Phnom Penh and in Sihanoukville, traffic conditions are deteriorating as a result of increased volumes of

¹⁸ Please refer to Sections 5.4 through 5.6 of Main Report for full description.

freight movement. Primarily, additional bypass roads will be needed around Phnom Penh, or in the vicinity of the urban areas in Sihanoukville.

Rails are in operation between Phnom Penh and Sihanoukville, though the quality of service is very low, as the facilities are obsolete and equipment outdated. As the rails provide alternative means of transport, particularly for bulky cargo, it will be important to apply essential maintenance so as to keep them operational.

Water Supply

In Sihanoukville, the service ratio is only 13%, and when the connection rate increases, the existing capacity (3,000 m³/day) could soon come to a limit, and new sources will be needed soon. As it requires a long period of time to develop new water sources, preparatory works including a feasibility study for water supply system improvement needs to be started at an early stage.

It is estimated that only 17% of the population is served with piped water and approximately 40% of the population is served by tube wells with a hand pump. Clean water supply directly relates to the health condition of residents, and thus serves the basic human need. Exploitation of water sources will be necessary for rural water supply. In order to advocate a rational use and supply of water resources, a nationwide water resources master plan needs to be formulated.

Electricity

Establishment of the national transmission network including interconnection with neighboring countries for power trading is an urgent task to eliminate the current power shortage in major cities and provincial towns. Development of large-scale and indigenous source of electricity, such as hydropower and/or gas combined cycle (contingent on development of the natural gas resource in Siam Bay) will be the next step to cater for the suppressed demand and provide reasonable and stable services to public and industrial consumers through the established power grid. Some of the obsolete generators and distribution systems with low energy efficiency at scattered towns in the Intermediate Area need to be replaced to lower the energy costs at the generation ends and the stable service at consumer ends.

Promotion of electrification in rural areas is important from the viewpoint of the basic human needs in rural areas. Until the national transmission grid is in place, small-scale independent power sources such as diesel generators or renewable energy sources such as small hydropower, wind and solar power will be harnessed in isolated systems.

Telecommunication

The telecommunication network is a common and indispensable infrastructure for business operation. It is important to provide a fiber optical cable between Phnom Penh and Sihanoukville. This will not only enable data communication between the two cities and improve the Internet connection, but also provide better international connection.

Capacity building in information technology (IT) is also indispensable in transforming the nation to more adaptive to the improving information environment. Extensive training to foster IT engineers with a provisional target of one million and enhancement the IT platform in Cambodia will be an urgent task.

8. Priority Projects for Growth Corridor

8.01 Proposed Priority Projects

Based on the strategies for economic, social and infrastructure development, some of the projects were proposed for consideration to achieve the development goals of the Growth Corridor. In view of the urgency, conformity to the development strategies, sustainability and admissibility, a partial set of the projects were selected as the priority projects. The priority projects are recommended for commencement by 2005 or earlier¹⁹.

The following are proposed as priority projects. The costs for the technical cooperation component, such as feasibility studies and designing, are estimated at US\$ 33 million. Roughly estimated costs for implementation, such as construction and installation, are separately estimated at US\$270 million, although the costs for implementation need to be refined at the time of technical cooperation. The breakdown by the sectors is as below;

Table S-4 Sectoral Cost Breakdown for the Priority Projects
(US\$ million)

Sector	# of Projects	Technical Assistance	Implementation	Total
Economic Development	8	20.7	17.2	37.9
Social Development	7	6.6	3.0	9.6
Infrastructure Development	10	5.9	249.9	255.8
Total	25	33.2	270.1	303.3

The proposed and schedules and primary players for the implementation of the projects are discussed in the Main report²⁰.

8.02 Priority Projects for Economic Development

The most important priority project for the economic development is the development of Special Promotion Zone in Sihanoukville, which will be discussed in Part IV in detail. Other priority projects for the economic development are tabulated below. The focus was given on the better use of locally available resources such as agricultural and tourism resources, promotion of FDIs and assistance to preparation for materializing the SPZ.

¹⁹ Each projects are provided with respective project identifiers, such as A-4 and B-6. Description of projects could be found in Section 5.7 of the Main Report, and Annex 1 (all the projects) and Annex 2 (priority projects).

²⁰ For detail, refer to the Section 5.7.2 of the Main Report.

Table S-5 List of Priority Project for the Economic Development of Growth Corridor

Type	Sector	Project Title	Objectives
Economic Development	Primary Industry	A-4 Outer City Agriculture Promotion Program	To enhance farm income through expansion of crop diversification and modernized agriculture in outer city area
		A-7 Vegetable and Fruit Processing Project	To increase value of vegetables and fruits through processing activities
	Secondary Industry	B-4 Upgrading of Small and Micro Industries	To faster the traditional and new SMEs by small scale business incubation, rearing domestic capital and entrepreneurship and assist access to market and technology information
		B-6 Garment and Footwear Industry Revitalization Project	To promote the marketing of the products in markets other than USA; To provide vocational training to future and current garment workers for higher skills
	Tertiary Industry	C-4 Tourism Master Plan for the Greater Capital Area	To boost the international tourism in and around Phnom Penh, capitalizing on the existing and potential resources in a better network and quality
	Export Promotion	D-1 Establishment of Special Promotion Zone in Sihanoukville	To establish a SPZ in Sihanoukville to attract FDI and activate backward linkage and better use of locally available natural resources
	Legal and Institutional	E-1 Computerization of Customs Clearance Procedures	To computerize the customs clearance system to improve cargo reporting, shorten the clearance time, better valuate duties and taxes and facilitate effective Post Clearance Audit (PCA)
		E-2 Dispatch Experts from Japan for facilitating the Legal and Institutional Framework of the SPZ	To firmly establish the legal and institutional framework for the proposed SPZ to foster investor confidence and governance of the zone

8.03 Priority Projects for Social Development

For social development, an emphasis was given to human resources development in support of the economic development, urban as well as rural development and sustainable environmental management. For urban planning, a master plan for the rapidly growing city of Sihanoukville was proposed, as the need for a balanced land use planning will be indispensable for the development of a SPZ there. Capacity enhancement for the environmental protection will also be imperative for the sustainability of the economic development proposed in this Study. Others include vocation training and enhancement of rural entrepreneurship development, and income generation activities in rural areas.

Table S-6 List of Priority Project for the Social Development of Growth Corridor

Type	Sector	Project Title	Objectives
Social Development	Urban Planning	F-3 Urban Master Plan for Sihanoukville	To facilitate sustainable management of urban development and devise good balance amongst the different economic activities
		F-1 Enhancement of Planning and Enforcement Mechanism of Urban Planning	To establish guidelines of the development master plan and land use plans, and to establish autonomous criteria for the provision of construction permissions
	Human Resources Development	G-6 Assistance for Rural Entrepreneurship Development	To strengthen the capacity of provincial government officials and MoEYS through joint activities for identifying products, entrepreneurial training for women and exploring marketing of products
		G-3 Strengthening Sihanoukville Municipal Vocational Training Center	To provide practical vocational training primarily for garment production, and but gradually shift to new types of industries
	Rural Development	H-2 Income Generation Activities for Farmers in Kandal Province	To improve livelihood of the vulnerable population in rural area through income generation activities
	Environment	I-1 Capacity Enhancement for Effective Enforcement of Environmental Legislation	To enhance the institutional capacity to conduct effective enforcement of environmental legislation
		I-3 Construction of Controlled Landfill Site	To provide with a controlled type landfill site in Sihanoukville for appropriate treatment of solid waste

8.04 Priority Projects for Infrastructure Development

Providing reliable and affordable infrastructure will be essential for the economic development of the Growth Corridor area. The following table presents the priority projects for respective fields of infrastructure development. Eight projects are proposed in all for respective infrastructure development sectors. In addition, two projects are selected in relation to the development of the Free Zone in Sihanoukville, which will facilitate environmental protection for wastewater and solid waste disposal.

Table S-7 List of Priority Project for the Infrastructure Development of Growth Corridor

Type	Sector	Project Title	Objectives
Infrastructure Development	Transportation	J-2 Container Distribution Center Project	To improve and rationalize container inflows and outflows
		J-6 Phnom Penh Urban Transport Project	To mitigate traffic congestion
		J-9 Route 48 Upgrading Project	To upgrade the existing Route 48 to all-weather road, including 4 bridges
	Water Resources	K-1 Master Plan Study on National Water Resources Development and Management	To prepare an inventory of water users for all the river systems and groundwater and to formulate a master plan for integrated water resources development of the whole country
		K-4 Improvement of Urban Water Supply in Sihanoukville	To secure a water source to increase the capacity and service ratio and to improve the operation and maintenance of the existing system
	Electricity	L-5 F/S on Transmission Line between Kampot and Sihanoukville	To provide a feasibility study for the extension of transmission lines between Kampot and Sihanoukville at 220 kV
	Telecommunications	M-1 Nourishment of Qualified IT Related Human Resources	To train and foster one thousand information technology (IT) engineers
		M-2 Development of Optical Fiber cable Network between Phnom Penh and Sihanoukville	To lay fiber optical cable between Phnom Penh and Sihanoukville to enable high speed and large capacity communication
	Free Zone Development in Sihanoukville	N-1 Development of Wastewater Treatment Plant for the Sihanoukville Port Free Zone	To plan, design and install a wastewater treatment plant for the Sihanoukville Port Free Zone. This will be a desirable project, if the Free Zone is commercially financed.
		N-2 Development of Solid Waste Landfill for the Sihanoukville Port Free Zone	To plan, design and install an environmentally friendly landfill and its related systems for the Sihanoukville Port Free Zone. This will be a desirable project, if the Free Zone is commercially financed.

8.05 Action Plan for Growth Corridor Development

The regional development of the Growth Corridor area involves 7 Provincial and Municipal governments and various central government ministries and agencies. As the development resources in Cambodia are fairly centralized, it is important that the main players in each sector take actions in the proper time frame. The Study does not propose a unilateral approach, such as creating a Growth Corridor Development agency in the short run, which would not fit into the government structure of RGC. The realization of the proposed strategies and projects will thus depend primarily on the relevant Ministries and Agencies taking the leading role in collaboration with the provincial/municipal authorities.

Dialog among the relevant stakeholders will be important in successful implementation of the Growth Corridor development initiatives. As all the relevant central and regional authorities are represented in the Steering Committee for this Study, this Steering Committee should be enhanced with re-definition of their task as to follow up the proposal made for this Study. International donors acting as development partners for Cambodia should be invited to the committee to continue dialog, as necessary.

PART IV: DEVELOPMENT OF SPECIAL PROMOTION ZONE²¹

9. The Special Promotion Zones

9.01 Definition

The Special Promotion Zones (SPZ) of Cambodia are special economic zones (SEZ) that denote a specific and clearly delineated area where different economic principles, taxation systems, FDI treatment and/or institutional procedures are applied. The basic aim of the SPZ is to promote investment, primarily by FDI for foreign trade, especially export, implant imperative up-to-date technologies, and consequently create new employment and stimulate economic activities.

The principal mechanism of the SPZ would be to create a small showcase where the desirable principles, systems and procedures, tailored to the needs of business operators, are introduced, when it is possible or extremely difficult to implement them at a national level. When the workability and effectiveness of such different principles, systems and procedures are confirmed, they will be extended nationwide. This way, the SPZ would contribute to the administrative reforms of the nation as it enables the government to promote, induce and accelerate sound and balanced industrial, economic and social development as a whole.

9.02 History and Extent of the Special Zones for Export Promotion

Special zones with fiscal arrangements designed to promote multinational companies are popularly practiced in a number of nations in the world. The following table shows the extent to which fiscal incentives are adopted in various regions of the world; a total of 103 nations worldwide, 17 in Asia, provide some type of fiscal incentives for investment promotion.

Early trials of such special zones began in the 1950's and became popular worldwide in the 1990's, particularly in the form of export processing zones (EPZ). In recent years, broader frameworks, such as the special economic zone (SEZ), that encompass a wide extent of economic development facilities have been implemented successfully throughout the world, including in southern China. These SEZ focus not only on export processing, but also on other essential services and business development.

²¹ Please refer to Chapter 6 of Main Report for full description.

Table S-8 Types of Incentives Used by Region

Region/ Major incentives	Africa	Asia	Latin America & Caribbean	Central & Eastern Europe	Western Europe	Other Countries	Total
No. nations with incentives	23	17	12	25	20	6	103
Tax holidays	16	13	8	19	7	4	67
Accelerated depreciation	12	8	6	6	10	5	47
Investment allowances	4	5	9	3	5		26
Import duty exemption	15	13	11	13	7	4	63
Duty drawback	10	8	10	12	6	3	49

Source: UNCTAD 1995

9.03 Basic Concept of a SPZ for Cambodia

The SPZ in Cambodia is designed to remedy the shortfall of a simple EPZ to facilitate more proactive measures on generating linkages between the FDI operators and the host economy of Cambodia.

The objectives of the SPZ are

- To create an area where the present obstacles for investment in Cambodia are removed altogether and the best and preferable business practices prevail so that investors would feel secure and willing to invest in Cambodia.
- To facilitate effective linkage with domestic industries in Cambodia in support of the entrepreneurship of Cambodian export
- Be proactive for the promotion of domestic enterprises to interact with FDIs

Basic Principles of SPZ Establishment

The SPZ in Cambodia shall be developed into an autonomous, decentralized, self-reliant and self-sustaining industrial, servicing, commercial/trading, agro-industrial, tourist/recreational, financial and investment center with minimum government intervention.

The basic principles of SPZ establishment are:

- Maintain consistency with the existing policy framework;
- Secure transparency both in policy making and operations;
- Ensure accountability to the investors;
- Provide the investors with access to information required; and
- Keep the ultimate independence in respect of the principles of economic operations, systems, institutions and/or organizations

Location of the SPZ

The location of the SPZ shall be identified and delineated under the following criteria:

- Accessibility to international gateways, such as seaports and/or airports, and to the domestic market;
- Potential as a regional growth center, with a comparative advantage in Cambodia and a strategic location;
- Availability of competitive infrastructure and abundant water/energy sources;

- Availability of vacant land for development; and
- Availability of required labor

The Study Team concludes that the Sihanoukville area best serves as the candidate site for the SPZ in Cambodia, in consideration of all the requirements above.

9.04 Structure of the SPZ

The proposed SPZ in Cambodia shall be divided into the Free Zone (FZ) as a separate customs territory in the core of the SPZ area; and the Promotion Zone (PZ) as a domestic tariff area surrounding the FZ.

Free Zone (FZ)

The FZ is a fenced-in area and shall be provided with various functions such as an export processing zone (EPZ), a free trade zone (FTZ) and/or a free port (FP). The FZ is basically designated as an export-oriented production base. It houses duty-free wholesalers/retailers, and export-related traders and service providers. The authorized investment enterprises in the FZ will be granted a wide range of preferential privileges, which include duty-exempt imports of raw materials and capital goods and a reduction in corporate tax. Movement of these imported goods from the FZ to non-FZ areas in the country shall, however, naturally be subject to import duties and relevant taxes.

Promotion Zone (PZ)

The PZ is a promotional area for industrial, service, commercial/trading, agro-industrial, tourist/recreational, real estate and financial businesses for general purposes. The authorized investment enterprises will be granted a limited range of preferential privileges. The PZ is important as a mechanism to facilitate receptor effects of FDI investments in the FZ within the domestic economic structure of Cambodia.

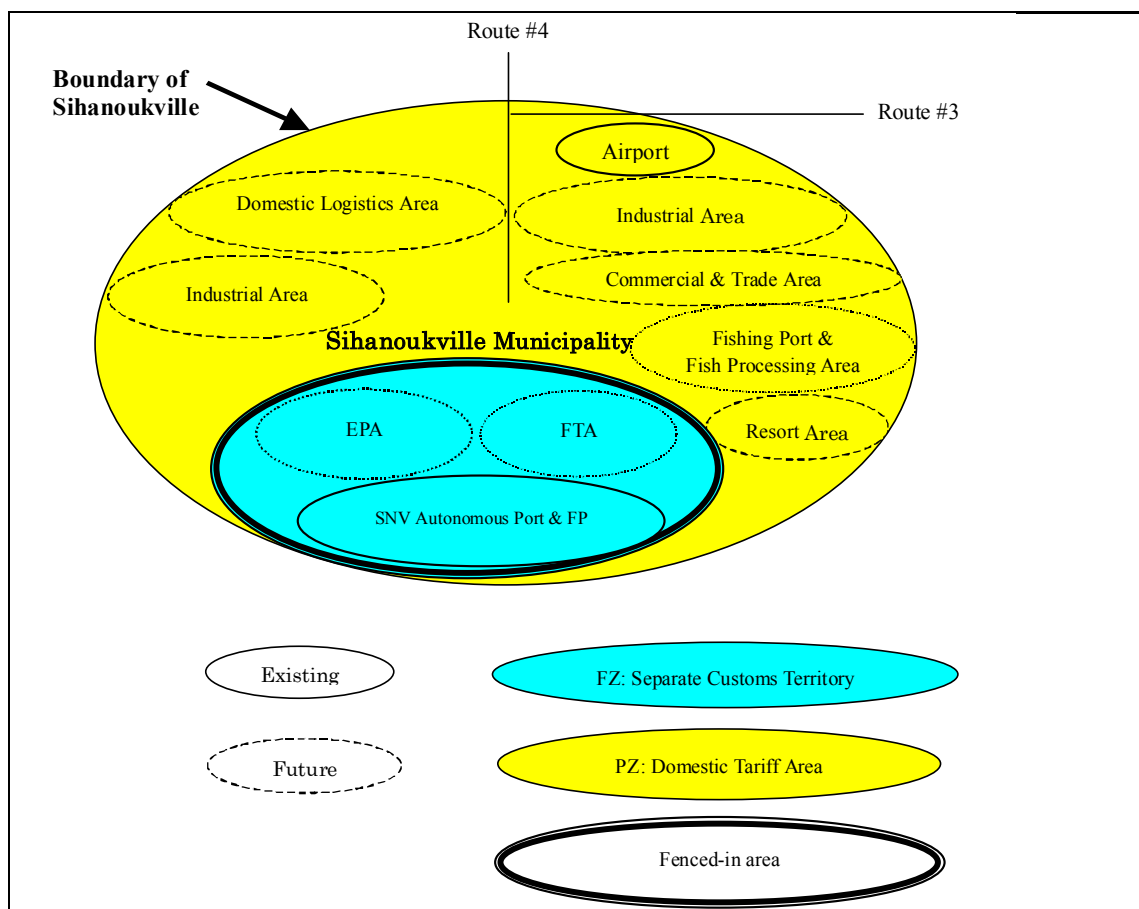


Figure S-7 Scheme of Cambodian Special Promotion Zone

9.05 Comparison of EPZ and SPZ

There are now two different proposals about the special zones for export promotion in Cambodia. The one is the proposal of EPZ, an export processing zones, such as the ones for Koah Kong and Poipet made in the Thai-Cambodian Border Study. The other is the SPZ proposed in this Study. The two proposals have different objectives and implications to Cambodia, as shown in the table below.

Table S-9 Comparison of EPZ and SPZ

Name	EPZ = Export Processing Zone	SPZ = Special Promotion Zone
Purpose	Single Purpose	Mixed Purpose
Activity	Manufacturing	Manufacturing, Services, Trade, Logistics, Tourism, Residential, ETC
Player	FDI – mostly from a neighbor nation	FDI (mostly in FZ) from various nations and domestic and joint-venture SMEs (mostly in PZ) working in collaboration
Overall Framework	Industrial development, limited to the designated estate	Regional development with sustainable and open-end economic growth
Backward linkage	Little, or none	Domestic and joint-ventures in PZ will INTERACT with FDI to facilitate backward linkage
Outcome	Increased export and employment	Broadening of industrial base and sustainable economic growth
Advocate	Neighboring nation (e.g. Thailand)	Host nation (Cambodia)

Export Processing Zone

The EPZ generally follows the concept of a widely practiced “Border-type” zone, which utilizes labor forces of the host nation in conjunction with the industrial activities already in operation in the neighboring

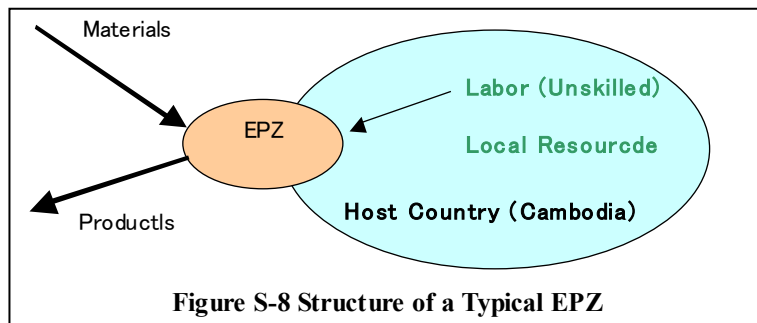


Figure S-8 Structure of a Typical EPZ

nation in an attempt to outsource part of the labor intensive elements. EPZ tends to be a single purpose, border-type zone, and backward linkage is said to be difficult to come about.

Special Promotion Zone

The SPZ as proposed in this Study is a much broader concept, aiming to achieve regional development with increased accumulation of economic activities in the area where the SPZ is designated. It enacts a mechanism to promote the incubation

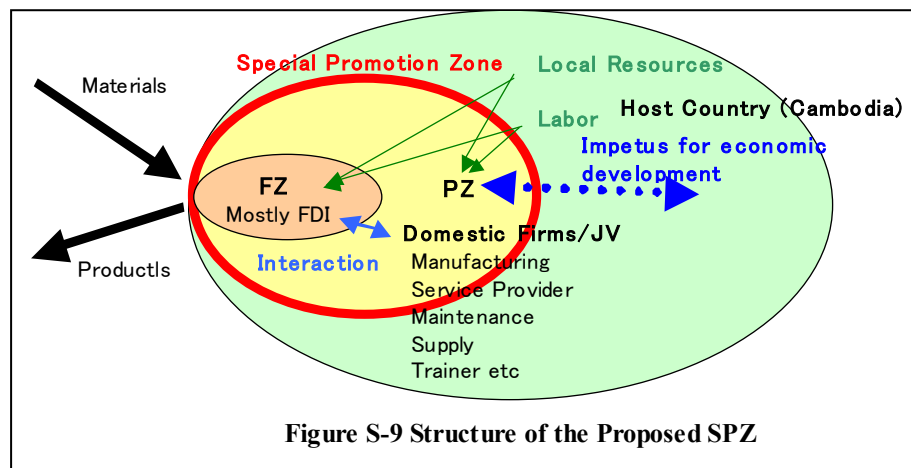


Figure S-9 Structure of the Proposed SPZ

of domestic or joint-venture enterprises that interact with FDI in various manners, and capture the effects of the economic activities by FDI and deliver an impetus for the economic growth of the nation as a whole. The SPZ is an open-end zone for international and domestic firms in the areas of manufacturing, trading, services, logistics, tourism and so on.

9.06 The SPZ Authority

In order to materialize and operate a SPZ in Cambodia sustainably and successfully, a specific governing body of the SPZ needs to be established. The authority, tentatively called the Cambodia Special Zones Authority (CAPZA) will be an autonomous and independent public corporation, but is proposed to be under the guidance of the Council of Ministers²². The proposed Structure of CAPZA is shown below.

²² The Study Team is aware that in the course of discussion to sign-off the Draft Law on Industrial Zone, agreement was reached to put the operating body under a department within CDC. This would not be a good place to place such an organization, as the administrative requirements governing the organization would be highly complex. In order for the organization to be autonomous and independent, the counterproposal made in this Study will have to be considered seriously. A bad decision in this context may carry the risk of losing investor confidence, and thus this will be a critical issue in successfully implementing the concept of the SPZ into reality in Cambodia. The final decision will belong to RGC.

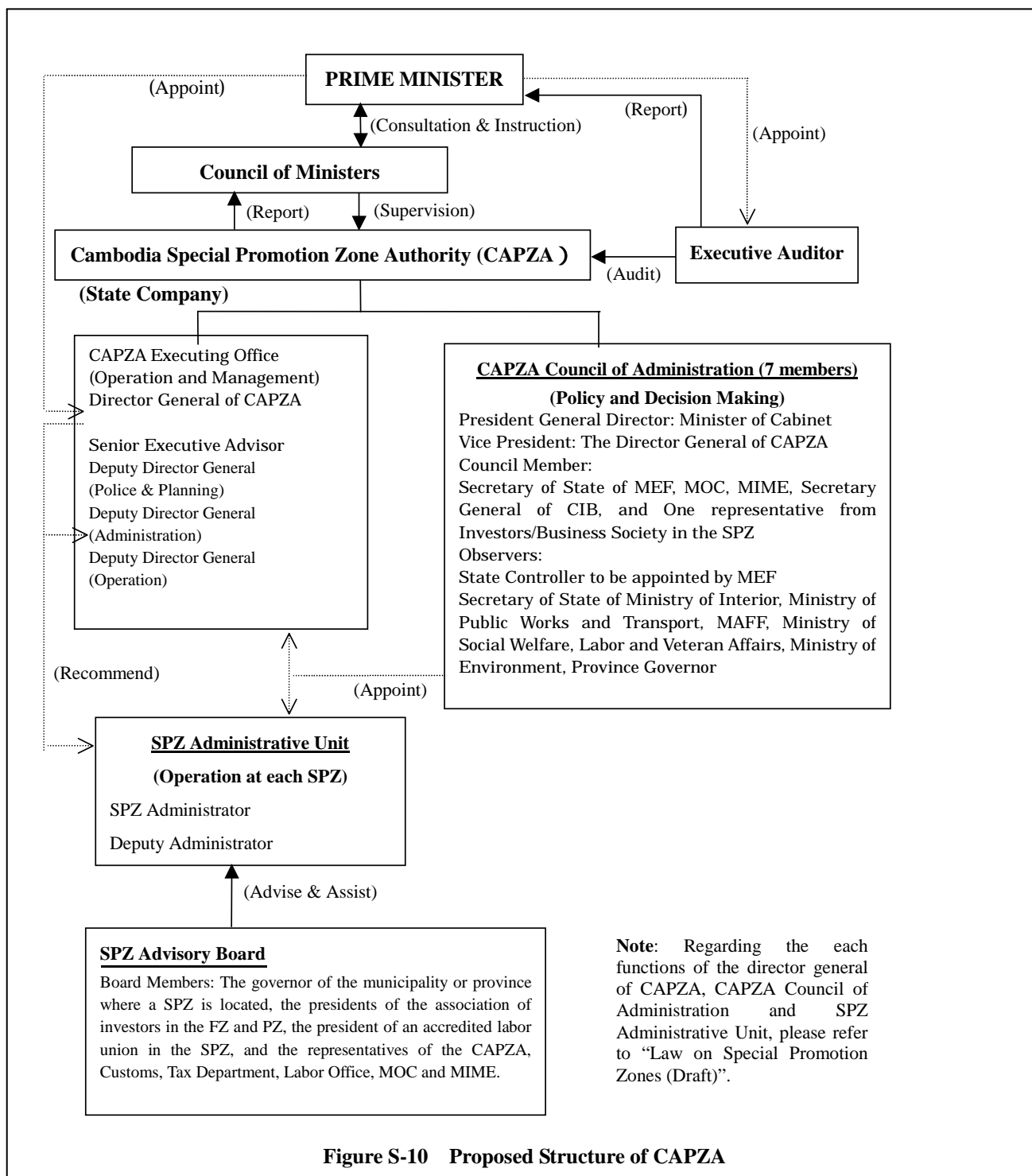


Figure S-10 Proposed Structure of CAPZA

Management of CAPZA

The director general of CAPZA is recommended to originate from outside the current government circles, because his/her experience and knowledge in the private sector will be valuable in dealing with the private sector investors.

Officials of CAPZA

The officials of CAPZA may be dispatched or transferred from relevant sections of the government or institutions. Upon taking up positions in CAPZA, they would cease to be public servants. Private persons, including foreign nationals with appropriate abilities, experience and expertise would also be invited to take up the positions.

Income of CAPZA

CAPZA can be funded from charges and fees levied on the various services rendered to the entities located in the SPZ. The services may include: provision of one-stop shop center regarding the investment approvals; infrastructure such as water supply and wastewater treatment, electricity and telecommunication, registration of new companies; issuance of various licenses and approvals; employee training; and security. The fees for such services will be determined at competitive levels, be publicly disclosed, and applied on a transparent and non-negotiable basis.

9.07 Functions of CAPZA

CAPZA will keep its own functional units that provide or arrange for provision of various services. The following is a summary of proposals by the Study Team for the functions of CAPZA with regard to the imperative services it provides.

One-Stop Shop Center

CAPZA will establish a One-Stop Shop so that all necessary licenses, permits and/or approvals for the operation and business activities in the SPZ could be obtained at a pre-determined fee.

Customs Clearance Unit

The Customs Clearance Unit will be comprised of customs officers dispatched by the MEF under the control of CAPZA. It will execute customs clearance of cargo into and out of the SPZ. For enterprises in the FZ, the green lane policy based on document inspection will be adopted in principle for smoother flow of cargo; this procedure would utilize a database of existing investors in the FZ with their profiles with a post-clearance audit (PCA) conducted as necessary. For enterprises in the PZ, the unit will try to minimize physical inspections.

Taxation Unit

CAPZA will establish the Taxation Unit with dispatched officers from MEF under the direct supervision of CAPZA for transparent and quicker tax valuations and refunds. At the same time, as this unit deals with a limited number of enterprises, it will carry out more effective, accountable and accurate tax collection.

Labor Relations Unit

CAPZA will establish the Labor Relations and Employment Office and appoint its own labor inspector under an agreement with the Ministry of Labor. The Labor Office will prepare a master employment contract in Khmer that contains all the requirements of the relevant laws and regulations. The Office shall hold seminars for new employees to raise understanding of

the employment contracts and motivate worker/management partnership. The Office will also provide an employment service for enterprises in the SPZ.

SME Promotion Unit

The CAPZA will provide financing for qualified SME in the SPZ. This function will be essential for promoting the establishment of domestic SME or foreign/domestic joint-venture enterprises primarily in the PZ zone that will interact with export-oriented industries in the FZ. International donors active in the field of SME support in Cambodia are encouraged to provide facilities.

9.08 Proposed Reforms in Customs and Taxation Schemes in the SPZ

Substantial reforms will be necessary primarily in customs and taxation schemes in order to make the SPZ attractive to potential investors to locate their facilities therein.

Taxation on Capital Gain in the SPZ

In order to eradicate possible speculation over the land in the SPZ, it is recommended to introduce a taxation scheme on the capital gain applicable only to the SPZ area. The tax rates shall be diminished with the length of the land holding period to allow for non-speculative land ownerships.

Provision of Duty Free Importation of Materials for Garments and Footwear

As a measure for retaining and even enhancing the attractiveness of Cambodia for the garment and footwear industries, which have provided a large number of employments and substantial export earnings in the past decade, it is recommended to adopt duty free importation of materials for garment and footwear production in Cambodia. The import duty generated from textiles was merely around half a million dollars in 2000.

The proposed duty free importation of materials will allow existing businesses to freely import any necessary materials so that they could accommodate clients' needs more flexibly and in a shorter time, which is often crucial for obtaining high valued added production contracts. Thus, the garment and footwear producers could reduce approximately 2 weeks of time and relevant cost could be saved.

9.09 Proposed Fiscal Incentives for the SPZ

In order for the SPZ in Cambodia to be competitive, an effective set of fiscal incentives needs to be worked out. Attention must be paid to the conditions provided at similar export oriented sites in neighboring nations such as Viet Nam and Thailand. The following table shows a comparison of relevant conditions rendered in the special zones in Thailand and Vietnam, together with the conditions stipulated in the Amended Law on Investment.

Table S-10 Comparison of Investment Incentives

Item	Cambodia (Amended LOI)	Thai EPZ/IE	Vietnam EPZ/IE
Preferential Corporate Profit Tax	Tax holiday : Trigger period* years + Priority Period** *Trigger period: 1 st year of profit or 3 years after earning first revenue, whichever sooner ** Determined by Financial Management Law	3-8 years tax holiday (3years in IE of Zone I, 3-5 years in Zone II (5 years in IE), 8 years in Zone III & Laem Chabang IE) *Laem Chabang IE will be categorized in Zone II after 2005.	4 years tax holiday in EPZ 1-2 years tax holiday for outside EPZ (4 years tax holiday for enterprises with 80 % export or over) 8 years tax holiday for high-tech industry
Other Tax	No concession of profit tax from the ordinary tax rate of 20% Special Depreciation 40% in the first year of operation, but as an alternative to the tax holiday.	50% reduction (thus 15%) for 5 years after tax holiday in Zone III & Laem Chabang IE. Note: normal tax is 30% Until the end of 2004 for Laem Chabang IE.	Reduction to 10% for manufacturer in EPZ, enterprise with 80% export or over, and high-tech industries (15 years). Reduction to 15% for service industries in EPZ & enterprises with 50% - 80% export (12 years). Reduction to 20% for enterprises with less than 50% export (10 years). Note: normal rate is 25%.
Organization for investment license	CDC (Council for the Development of Cambodia), nationwide (no special arrangement for SPZ)	BOI nationwide, but an independent organization IEAT (Industrial Estate of Thailand) specifically for IE	Province/city authority can independently work as the one-stop service center.

The following table sets out the proposed fiscal conditions to be provided within the SPZ.

For fiscal incentives, the Amended Law on Investment provides a uniform corporate tax rate of 20% for the nation and *either* a tax holiday *or* a special depreciation. In consideration of the weak international competitiveness and little accumulation of industries and shortage of qualified human resources, Cambodia needs to device strong enough incentives to attract FDI in the SPZ. The proposed fiscal incentives for the SPZ in Sihanoukville will include a reduction of the corporate tax rate to 15% in the PZ and 10% in the FZ, both for 3 years after the tax holiday stipulated in ALIZ, and *concurrent* application of the tax holiday *and* special depreciation. If such fiscal incentives were not provided, comparable measures would need to be taken to offset the absence.

Table S-11 Proposed Fiscal Incentive Schemes in SPZ

Description of Fiscal Incentives	FZ (Free Zone)	PZ (Promotion Zone)	2002 Amendment Law on Investment
Corporate Tax	10% for 3 years after the tax holiday; 20% thereafter (5% for FZ developers)	15% for 3 years after the tax holiday; 20% thereafter	20%
Tax Holiday	Trigger period* + 3 years Priority Period **	Trigger period* + 3 years + Priority Period **	Trigger period* + 3 years + Priority Period **
Special Depreciation	40% in the first year operation on production equipment	40% in the first year operation on production equipment	40% in the first year of operation (In case of using the entitlement for a tax holiday, a QIP shall not be entitled to claim any special depreciation.)
Corporate Tax on Reinvestment of profits	Not applicable	Not applicable	No description (Applicable as proposed in the Draft of Amendment Law on Taxation)
Corporate Tax on Distribution of dividends and profits	Applicable	Applicable	Not addressed (Applicable as proposed in the Draft of Amendment Law on Taxation)
Export Tax	Exempt	Exempt	Exempt
Duty free import	Production equipment, construction materials and production input materials	Production equipment and construction materials	Export QIP and Supporting QIP: Production equipment, construction materials and production input materials Domestic-oriented QIP: Production equipment and construction materials
Minimum Tax	Not applicable	Not applicable	Not applicable
Pre-payment of Tax on Profit	Not applicable during tax holiday period	Not applicable during tax holiday period	Not applicable during tax holiday period
Loss carry- forward	5 years	5 years	Not addressed (5 years as stipulated in Law on Tax)
Withholding tax on salary for expatriates	10%	10%	Not addressed (20% as stipulated in Law on Taxation)
Tax on house and land rent	Not applicable	5%	Not addressed (10% as stipulated in Law on Taxation)
Value Added Tax	Exempt direct exports & indirect exports #	Exempt direct exports & indirect exports ##	Not addressed (10% as stipulated in Law on Taxation)

* Trigger period: 1st year of profit or 3 years after earning first revenue, whichever sooner

** Priority Period : Determined by Financial Management Law

Exempt for exporting products, imported materials to be used in the production of export commodities and other materials to be purchased from domestic markets, which are deemed as imported materials, transactions within FZ

For indirect exports, VAT amount payable shall be kept in books and actual payment will not be involved. When the final products are exported, the corresponding VAT amount is erased from the VAT record book.)

9.10 Outline of SPZ Law

A new legal base shall be established in line with the above principles, to create the SPZ scheme as a separate customs territory and to set up an independent organization for its operation. This will have to be made in the form of a new law.

Systems and Facilities to be stipulated by SPZ Law

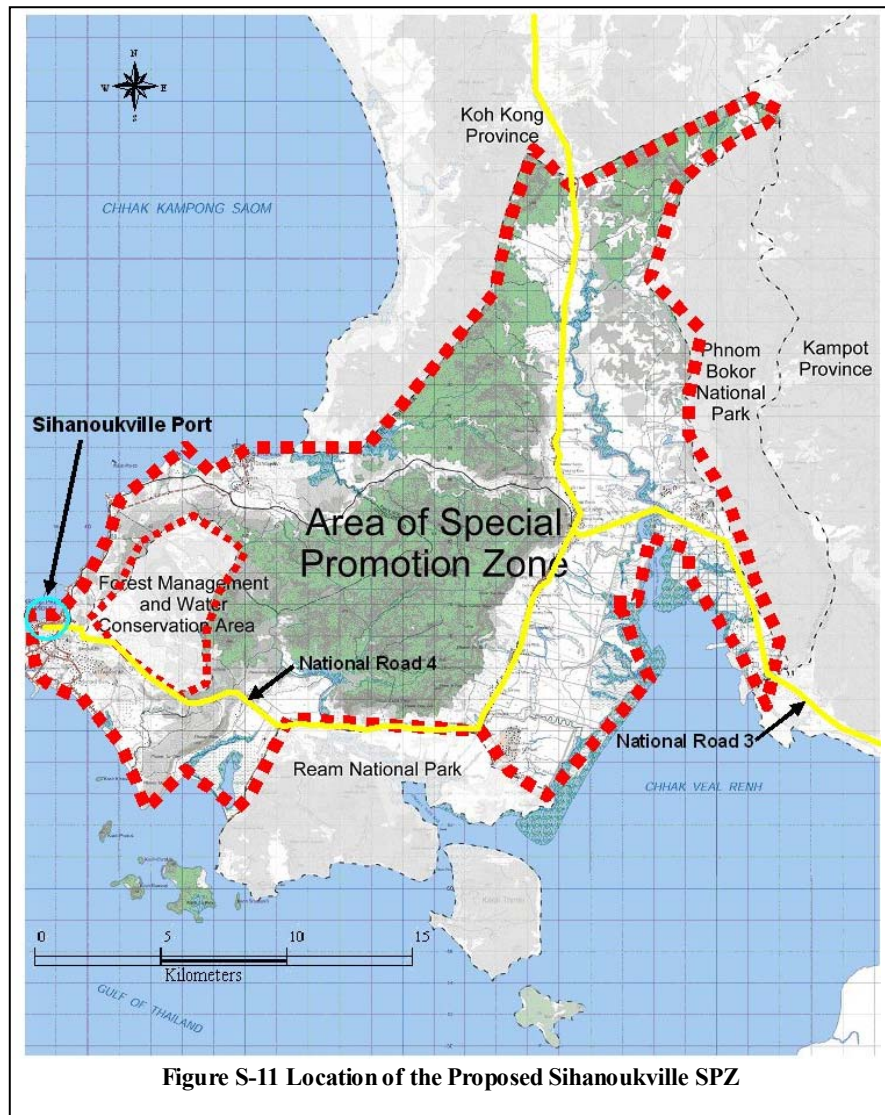
The new SPZ Law would offer the following system and facilities among others:

- Full range of investment incentives including fiscal such as preferential rate of corporate profit tax, tax holidays, special depreciation, etc. and non-fiscal incentives
- Smooth, transparent and efficient customs clearance procedures

- A simpler and predictable license provision system
- A transparent fee and charge system for the services rendered by the SPZ Authority
- Transparent and freer land leasing and use system
- Flexible labor relations and use of foreign labor
- Limited interference from the central government and governmental agencies
- Economic freedom based on the market economy principle
- A more rational corporate operation system
- Freer transaction and use of foreign currencies, especially for accounting purposes

9.11 Proposed Sihanoukville SPZ

The proposed area of the Sihanoukville SPZ will be basically the entire administrative area of the Municipality of Sihanoukville, excluding the two national areas and the designated Forest Management and Water Conservation Area. The spatial delineation of the Sihanoukville SPZ is shown below. An FZ will be delineated for the area located behind the Sihanoukville Port.



9.12 Businesses Suitable for Sihanoukville SPZ

Manufacturing Industries

The SPZ in Sihanoukville will be a strategic zone for Cambodia to diversify export industries and create new jobs for Cambodian nationals. The emphasis will be given to implanting new export industries and services presently not existing in Cambodia. Export processing will be an essential function of the SPZ, whilst the SPZ concurrently promotes recapturing of the domestic market (import substitution) with Made-in-Cambodia products manufactured therein.

Table S-12 Type of industries to be attracted to the SPZ

Zone Division	Category of prospective industry	Specific types of industry	
Free Zone (FZ)	Non-traditional, export oriented and labor intensive industry	Garment/fabrics (High to medium quality), sportswear	
		Wooden, stuffed and plastic toys	
		Processed Fishery Products	
		Electric Appliances/Components	
		Machinery components	
		Automobile parts and components such as Wire harnesses/accessories	
		Ceramic products – ceramic tiles, roof tiles etc.	
		Rubber products – surgical and medical rubber gloves, condoms	
	Paper products – packing and cushioning materials, paper containers		
	Others (jewelry, etc)		
	High value-added, recycle oriented and labor intensive industry	Used car/motor cycles and used tire – for reassembly, rebuild and recycle	
	International Wholesaler	Temporal duty-free storage of goods for transshipment	
Promotion Zone (PZ)	Export-oriented (traditional) and labor-intensive type	Garment – outerwear, shirts, pants, infant wear and uniforms	
		Footwear – leather shoes and synthetic shoes	
	Export-oriented, partly import-substitute and domestic resource based industry	Processed agricultural products – processed vegetables, fruits and nuts	
		Export-oriented, partly import-substitute and labor intensive industry	Electric appliances assembly – washing machines, refrigerators, electric fans
			Machinery assembly – small pumps, generators and engines
	Metal processing – galvanized iron sheet, steel cutlery, building materials		

Service Industries

The SPZ in Sihanoukville will also provide an area for services, logistics and trading necessary in relation to the various manufacturing activities in the SPZ. The services provided in the SPZ will be broadly divided into two; the logistics that facilitate smooth flow of goods internationally and domestically; and trading of goods and services necessary to operate the businesses in SPZ. In reference to the actual services industries in industrial estates in Thailand, the following table depicts the types of services to be located in the SPZ.

Table S-13 Type of services to be attracted to the SPZ

Zone Division	Category of prospective services	Specific types services
Free Zone (FZ)	Logistics	Warehouse
		International freight forwarder
		Repacking of bulky materials for re-export
		Light processing, sorting and labeling
		Automobile/machinery recycling
		Others (with high import tax with high value added)
	Service and trade	Converters for garment materials
		Wholesaler
		Retailer
		Trade agents and traders
		Banking/insurance
Promotion Zone (PZ)	Logistics	Warehouse
		International/domestic freight forwarder
		Transportation
	Service and trade	Real estate
		Wholesale
		Trade agents and traders
		Tourism and resorts
		Banking/insurance.

9.13 Human Resources Development in the SPZ

Education and Vocational Training

The ultimate goal for human resources development in the SPZ will be to foster a pool of Cambodian employees with entrepreneurial mindset and capabilities, from which a future generation of Cambodian business entrepreneurs would emerge. A measure to achieve this goal will be a “Workers Continued Study” program, in which the employees could receive lower and/or upper secondary level education at their work place. Arrangements should be made for FDI to bear the expenses for the dispatching of teachers, while the government should provide accreditation for the completion of the program. For more skilled workers and technicians, encouragement should be given to attend university level education while working. These continuing education programs will contribute to the workers motivation with a better chance of promotion, skill development and wage increase.

Another emphasis will be on providing specific vocational training programs tailored to the needs of the enterprises within the SPZ. Within the SPZ a common platform for specific vocational training may be devised, where a public and private partnership will be promoted in realizing such programs.

In order to enhance and upgrade the training facilities, a multi-purpose training facility is proposed within the SPZ; it would have basic equipment that FDI enterprises in the SPZ could utilize. This type of training facility could reduce the financial burden on FDI for workshops, equipment and materials. It is also important to foster human resources so that positions for skilled workers and middle managers, mostly occupied by expatriates at present, could be filled by Cambodians. This will be greatly effective with regard to a reduction of labor disputes.

Human Resources Development for SPZ Governing Body

The staff of the operating organization of the SPZ must have required capacity and expertise for operating the SPZ smoothly, gaining the investor confidence and handling issues of various fields proactively and confidently. In this respect, the human resources development for the future core staff of CAPZA will be indispensable. Considering that the functions of CAPZA will be diverse and multi-ministerial, capable and willing young administrators from relevant ministries need to be selected, to whom intensive human development training needs to be rendered.

9.14 Mitigation of Negative Social Impacts

As the SPZ will facilitate a model of preferred development in Cambodia, attention needs to be paid to providing for readily considered processes of development as well as providing lawful practices during its operation. Any possible negative impacts that may accrue from the SPZ in construction and operation phases will be mitigated through various measures.

Involuntary Resettlement

Involuntary resettlement should be avoided where feasible. If it is not avoidable, after exploring all options, measures to minimize negative impacts posed and compensate losses incurred to the people affected should be taken and provided, upon agreement from the people. The implementation of necessary resettlement rests on RGC where the relevant policy, laws and regulations must be observed.

CAPZA should support the existing official mechanism at different levels of resettlement, such as the resettlement committee/working group, by way of participating and monitoring the procedure and providing necessary cooperation and advice.

For the development of the SPZ, and in particular of the FZ, attention needs to be paid to the following:

- Sufficient and timely provision of compensation and support from the project proponents to the people affected to restore the lost or hindered means of livelihood to pre-project levels
- Sufficient information provision to and consultation with the people affected about the resettlement and compensation options
- Promotion of participation of the people affected in the resettlement plans and the compensation
- The absence of an official land title by some affected groups should not preclude compensation

Environmental Protection

To minimize negative impact on the environment and natural resources and facilitate sustainable development in the SPZ concurrently, it is imperative that the Law on Environmental Protection and relevant and applicable regulations are followed.

Special attention needs to be paid to the following;

- Any expected negative impacts accruing from the SPZ development should be avoided, minimized or mitigated by taking possible measures in the planning process and if necessary, an alternative plan should be considered
- Consultation with the stakeholders should be advocated during the planning stage of the SPZ development to discuss appropriate measures for environment/natural resource conservation

9.15 Urban Development Planning

For balanced and sustainable development of the SPZ, an urban master plan will be devised consistent with the relevant and applicable laws and regulations of RGC. The plan will facilitate a clear spatial vision of the SPZ in Sihanoukville, together with necessary regulatory measures to control and realize the vision in a sustainable and implementable manner.

The formulation and implementation of an urban master plan shall be advocated to serve as a model for an urban development management instrument in Cambodia. International donors are encouraged to finance this initiative for sustainable development. Focuses of the proposed urban master plan will be:

- Designation of conservation area in consideration of precious natural and/or cultural heritage
- Development of land use plan with the divisions such as the industrial zone, residential zone, commercial zone, resort and recreational zone etc., where the zones with potential mutual conflict would be minimized
- Development of infrastructure development plans including the road network, water supply and sewerage plans, power supply plan, telecommunication plan etc.
- Formulation of the natural resources management plan in a harmonized framework including forests, fisheries, coasts, waterways, mineral deposits

10. Feasibility Study on Sihanoukville Port Free Zone²³

10.01 Basic Principles for Planning

Sihanoukville Port Free Zone will be a modern industrial estate provided with all the necessary requirements for a Free Zone to be attractive to FDI with a view to stimulating investments in Cambodia. The zone will have two components; an export processing zone, where primarily export-oriented manufacturing industries will locate; and a free trade zone, where logistics and service providers will be located. The FZ will be a separate customs territory, and provided with a direct linkage to the Sihanoukville International Port. **Chapter 10** will present the summary of the feasibility study on Sihanoukville Port Free Zone.

²³ Please refer to Chapter 7 of Main Report for full description.

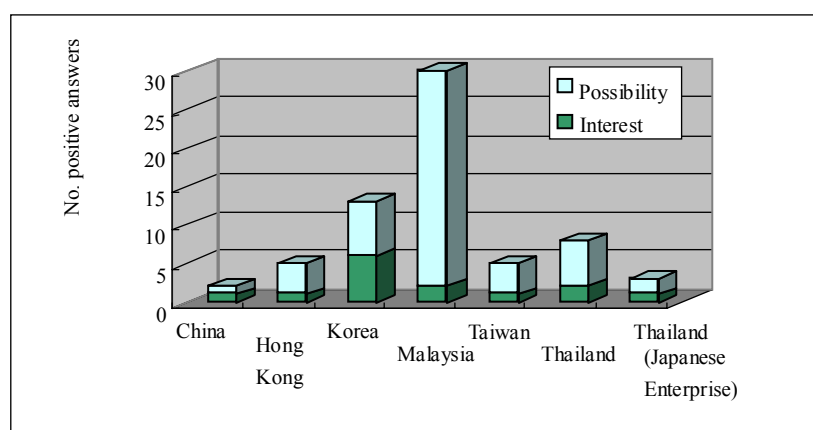
Through the course of development of the *Sihanoukville Port Free Zone (SPFZ)*, special considerations will be paid to involuntary resettlement and environmental conservation issues based on the principle explained in **Section 9.14** above.

10.02 Demand for Industrial Development

Considering the economic framework for the Growth Corridor area, a total area of 2,100 to 2,500 ha of industrial land will be necessary within the Growth Corridor Area by the year 2015. The industrial land will be required chiefly in the Greater Capital and Sihanoukville Areas. In Sihanoukville, approximately 250 ha of land for industrial estate will be needed by 2015; while in the same period 350 to 700 ha will be needed for the Greater Capital Area. In addition, small-scale agro-fishery processing estates will be necessary in the coastal areas.

10.03 Potential Investors to the Sihanoukville SPZ

The Study Team conducted a questionnaire survey of manufacturers in seven nations in southeastern and eastern Asia to elucidate investment interest in Sihanoukville. Out of 8,700 enterprises contacted, 634 responded, of which 14 enterprises answered that



they have “keen interest” in **Figure S-12 Positive Interests for Sihanoukville SPZ by Countries** investment in Sihanoukville.

An additional 52 enterprises answered that there is a possibility of their investing in Sihanoukville. Enterprises in Korea, Thailand and Malaysia showed relatively strong interest, while enterprises in China, Hong Kong and Taiwan displayed less interest.

The categories of industries that displayed strong or possible interest in investment were diverse, including food, apparel, paper products, pottery and electric appliances/components.

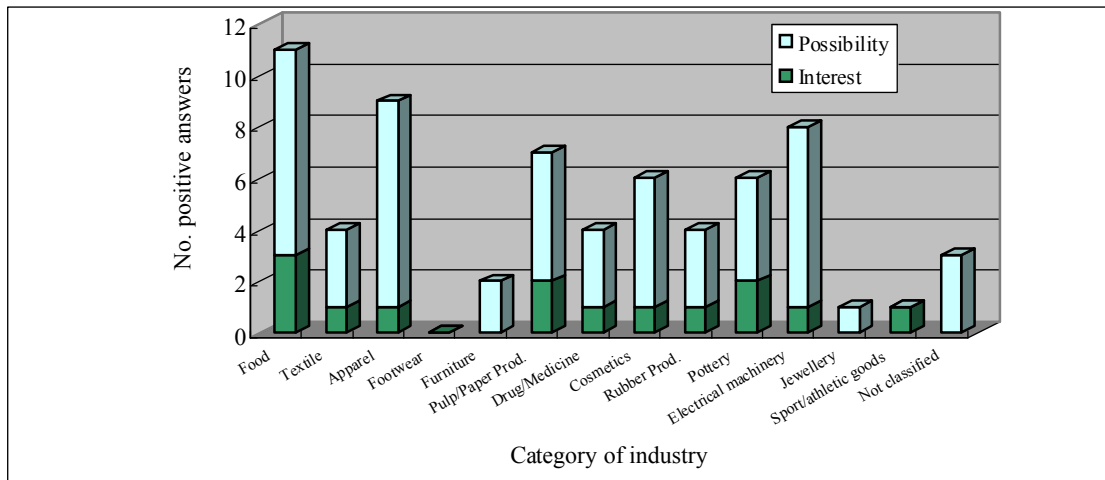


Figure S-13 Positive Interests for Sihanoukville SPZ by Category of Industries

10.04 Candidate Sites for FZ Development

Seven sites were delineated as candidates for industrial development for in Sihanoukville. All the candidate sites are located along an existing or planned road that will provide good access to the Port of Sihanoukville. The proposed protection land in the hills and areas close to the existing beaches were excluded.

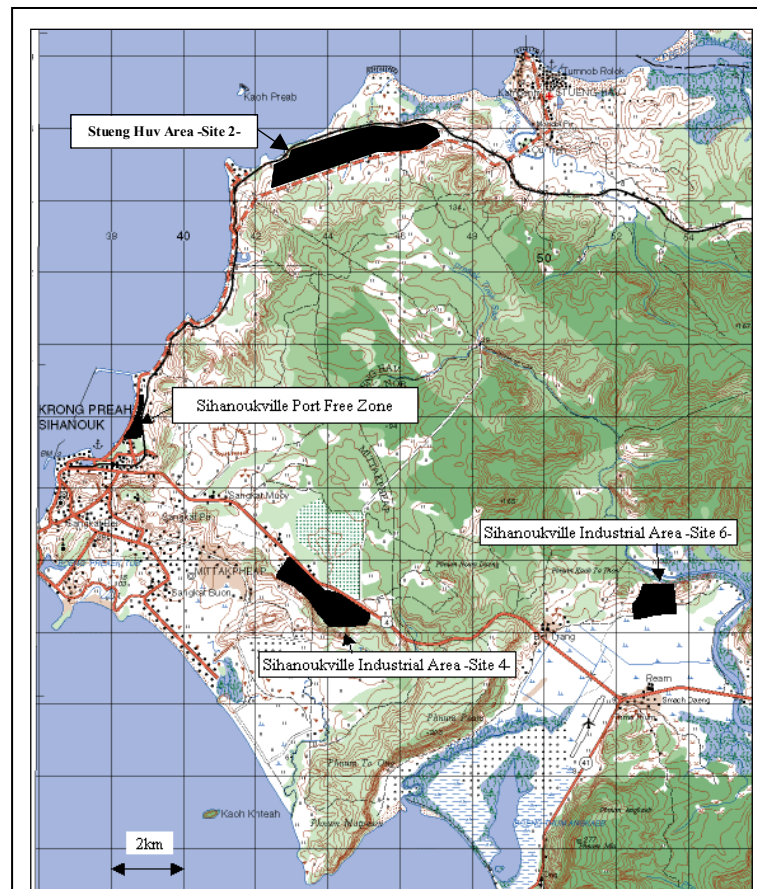


Figure S-14 Site for the Free Zone and Industrial Area in Sihanoukville

10.05 Selection of a Site for FZ Development

Based on the field survey and a comparative study, *Site 1* of Sihanoukville, located directly behind the Port, was selected for immediate implementation. The southern part of this area is heavily populated and had been excluded from development to minimize resettlement. The site thus encompasses a total area of 43 ha, for which the land title has been secured for the Port Authority of Sihanoukville. This site, hereafter denoted as the *Sihanoukville Port Free Zone*, (SPFZ) is proposed for development as an FZ as an urgent project to be completed by 2005. It is important that this development will serve as a pilot for future development by consolidating necessary reform processes and establishing necessary laws and regulations.

Subsequently, demand for expansion of industrial estates of about 100 ha will be accommodated either at *Site 4* or *Site 6*, either as an FZ or as a general industrial estate.

Development of the Stueng Huv area (*Site 2*) will be either an alternative to the combination of *Site 4* and *Site 6*, or an option for petroleum refinery which is contingent on the identification of an exploitable resource of crude oil in the on-going exploration in the Siam Bay.

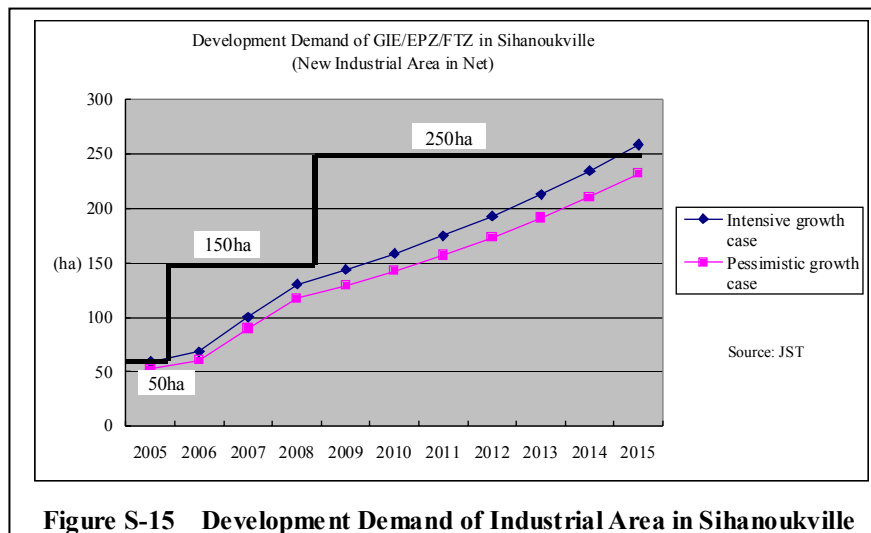


Figure S-15 Development Demand of Industrial Area in Sihanoukville

10.06 Land Use and Infrastructure Development Plan

The land use plan of the Free Zone was formulated, as shown below. The total area of SPFZ will be 43 ha (including the access road to the port), of which 29 ha (68% of the total) will be factory/trader plots. The zone includes roads, plots for utilities (water supply, sewerage treatment plant, power station and stormwater ditches) and 12,000 m² of parks and reserve green areas

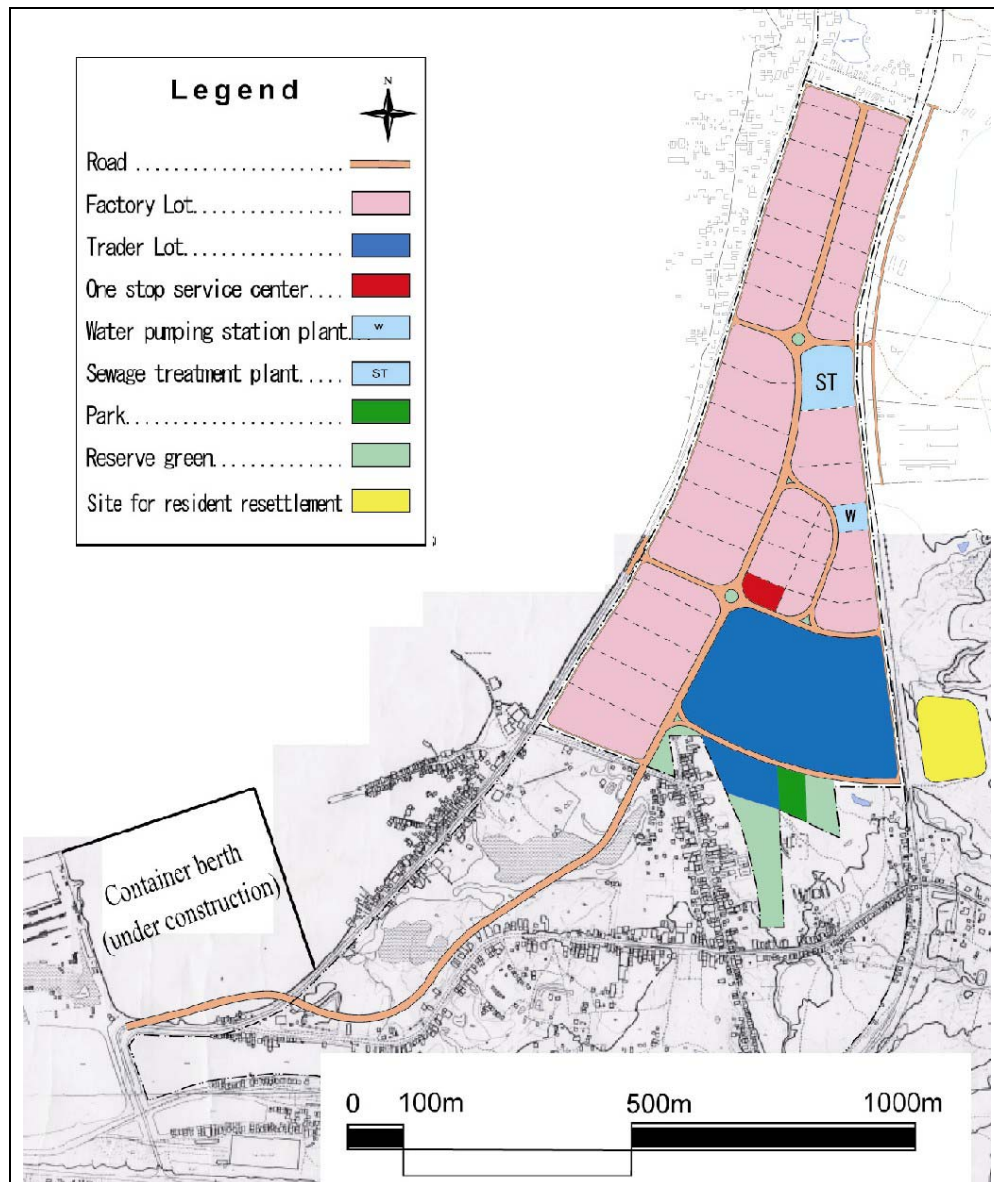


Figure S-16 Proposed Land Use Plan for the Sihanoukville Port FZ

Water Supply

Water supply capacity in the Sihanoukville City is very limited. The river flow declines to almost nothing in the dry season, while the groundwater potential is not high in Sihanoukville province. Water sources will not be sufficient to supply water for a large demand without a water impounding reservoir in this area.

At present in 2002, the plant capacity of the water supply system is only 3,000 m³/day, and the service ratio is reported to be only 13% (1,400 households) of the population in the service area. An expansion project (funded by the World Bank) is in progress to extend the capacity to 6,000 m³/day (service ratio of 50% for 4,000 households) by increasing the capacity of the existing reservoir and sinking an additional three wells. As the future water demand in Sihanoukville City in 2020 is projected at 86,000 m³/day in this Study, there will be a substantial deficit in the water supply capacity in this city.

The basic concept of the water supply for the proposed Free Zone (FZ) or future industrial area (IA) in Sihanoukville is summarized as follows.

- Water supply for the proposed FZ shall be supplied from additional six-(6) new deep wells. The average daily water demand for the Sihanoukville Port Free Zone is estimated at 1,960 m³/day in 2005. The wells will be located around the FZ area.
- The water demands for the future industrial areas at *Site 4* and *Site 6* are estimated at 9,500 and 12,000 m³/day, respectively. As it will be very difficult to supply water for such a large volume from groundwater wells, it will be necessary to plan a water impounding reservoir in the Prek Toek Sap River.

Electric Power Supply

The electricity supply in Sihanoukville is managed by EDC through their isolated distribution network. To prevent future power shortages, EDC plans to establish an interconnecting transmission line with Viet Nam with a branch line to Sihanoukville; the line will be completed around 2008. The procedure for supplying power to the free zone and industrial areas is proposed according to the availability of this power grid in Sihanoukville as follows:

- 1) Up to the year 2007: Electricity is not available from the national power grid in Sihanoukville

EDC intends to expand the generating capacity of the power station to meet the industrial demand of 3.3 MW in the free zone. Two (2) special feeders of 22 kV distribution line between the power station and the free zone will be set up to feed the power.

- 2) After the year 2008: Electricity will be available from the national power grid in SNV

A transmission line from the national grid substation will be established to feed the power to the industrial areas of site 4 and site 6 with demands of 11.6MW and 12.5 MW, and an on-site substation will be constructed at the industrial areas.

In the free zone and/or industrial areas, 22kV underground distribution network with ring main units for consumers will be set up from the beginning.

Drainage

A drainage system will be furnished to remove rainwater and prevent flooding. The drainage system will consist of stormwater channels (open inverted trapezoidal shape) and, depending on the site, will be accompanied by sedimentation ponds to remove sediment from stormwater before discharge. The collected rainwater will be discharged into nearby public water bodies such as the sea or rivers. Though not enough rainfall data are available for accurate design, a tentative rainfall formula has been established based on records collected by the regional office of the Ministry of Water Resources and Meteorology. In the Sihanoukville Port Free Zone, the drainage should include an offsite catchbasin to prevent stormwater generated offsite from passing through the site.

Sewerage

A sewerage system for treating wastewater generated from the factories will be furnished to maintain a hygienic environment and preserve the water environment in nearby water bodies. The sewerage system will consist of sewers (collection pipes), a wastewater treatment plant and a treated water discharge system. The treated wastewater will most probably be discharged into the nearest public water bodies. In the Sihanoukville Port Free Zone, the treated water should be discharged outside the breakwater of the port to avoid the possible contamination of sea water inside the breakwater.

Solid Waste Management

In order to reduce the burden on the environment, disposal of solid waste needs to be done properly. The existing public landfill in Sihanoukville, which is currently used for disposal of municipal garbage, adopts simple dumping. Therefore, the public landfill must be renovated to provide an environment-friendly controlled landfill equipped with adequate safety measures. It was assumed that the renovation of the public landfill will be completed by 2008 and solid waste from the Sihanoukville Port Free Zone and the industrial areas will be disposed of at this landfill. Before the completion of the renovation, a small controlled landfill will be constructed for disposal of the garbage generated from the free zone. This landfill will be located within the site of the existing public landfill.

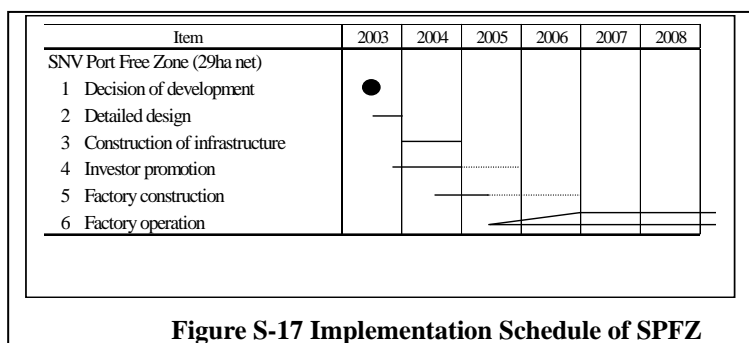
Telecommunications

The telecommunications network should be improved to cater for the expected expansion in telecommunication demands due to industrial development and population growth in Sihanoukville. The most urgent task will be the installation of optical fiber cables from Phnom Penh to Sihanoukville together with a local switching facility. An adequate telecommunication network within the Free Zone and industrial area should be developed so as to facilitate the data communication.

10.07 Development Schedule and Implementation Arrangement

The FZ is proposed for completion by the beginning of the year 2006, and full operation is expected by the beginning of the year 2007.

The Port Authority of Sihanoukville will be responsible for land arrangement including resident resettlement. A joint corporation established by the private and public organizations could develop the infrastructure of the SPFZ under an appropriate contract with CAPZA, and provide the facility for the one stop service center, operated by CAPZA.



10.08 Activities in the FZ

Within the *Sihanoukville Port Free Zone*, in an area of 29 ha, divided into 39 plots, will be leased to potential investors for industries and services. It is estimated that approximately 3,600 jobs will be provided within the zone, and 1,200 indirect job opportunities will be created outside of the zone for various supporting services. The annual output is estimated to be US\$6 million from manufacturing and US\$2 million from services.

10.09 Justification of the FZ Development

Cost Estimation

The development cost of the proposed Sihanoukville Port FZ was estimated at US\$17.2 million, including the construction cost, engineering cost and physical contingency as shown in Table S-14. The estimated cost includes all the infrastructure and environmental measurements such as the sewage treatment plant and solid waste facility. With an effective area of 29 ha, the cost per ha per effective area will be US\$59/m². A slight reduction in cost will be necessary to compete with comparable locations in Thailand and Viet Nam. A proposal is made in this study that cost of environmental protection measures, the sewerage plant and solid waste disposal, be met separately by grant type aid. The cost of these environmental measures will be US\$3.4 million. With this, the cost per effective area will be reduced to US\$47/ m².

Table S-14 Summary of the Cost Estimation for SPFZ Development

Item	Cost (Million US\$)
(1) Land Acquisition	<u>0.00</u>
(2) Construction Cost	<u>13.92</u>
a) Land Grading	3.22
b) Road	1.67
c) Water Supply System	2.02
d) Sewage System	2.77
e) Power Supply System	1.18
f) Drainage System	1.85
g) Telecommunication	0.28
h) Solid waste Disposal System	0.56
i) Others	0.37
(3) Administration Cost	<u>0.28</u>
(4) Engineering Cost	<u>1.41</u>
(5) Physical Contingency	<u>1.56</u>
Total	<u>17.17</u>

Economic Evaluation of the Proposed FZ Development

An economic evaluation was conducted to test the economic viability of the proposed development. The cost of the project was estimated from the financial cost estimation. The benefit of the project was assessed from the estimated value-added pertaining to the new jobs created by this project. The economic internal rate of return (EIRR) was estimated to be 21.6%, indicating that the proposed project is economically sound and viable.

Financial Evaluation of the Proposed FZ Development

A financial evaluation was conducted to test the financial viability of the proposal. The overall financial internal rate of return (FIRR) was calculated as 10.6% on the condition that the costs of the sewage treatment plant and solid waste disposal facility (amounting to US\$3.4 million in total) were borne externally by a grant aid program. This indicates that the proposed FZ development will be financially viable under private development, although relatively low interest on financing will be preferable. If the costs of environmental protection for the sewage treatment plant and solid disposal facility are not externalized the financial viability will drop to 6.7%, which will be viable if a soft loan could be rendered.

10.10 Financing Options

There are three possible options for financing of the proposed FZ within the spectrum of public to private initiatives. The public initiative would have the public sector as the ultimate developer of the zone. This would be possible if a soft loan was to be made available and capacity building for the public sector advocate was readily provided. Public-private partnership (PPP) initiative would utilize the private sector firm acting as the developer under contractual arrangement with the public sector. The private initiative would be proceeded primarily by a private sector firm, while the public sector would provide regulatory function only.

Considering the urgency of development, the PPP initiative would be the likely, but not necessarily the only choice of the financing option.

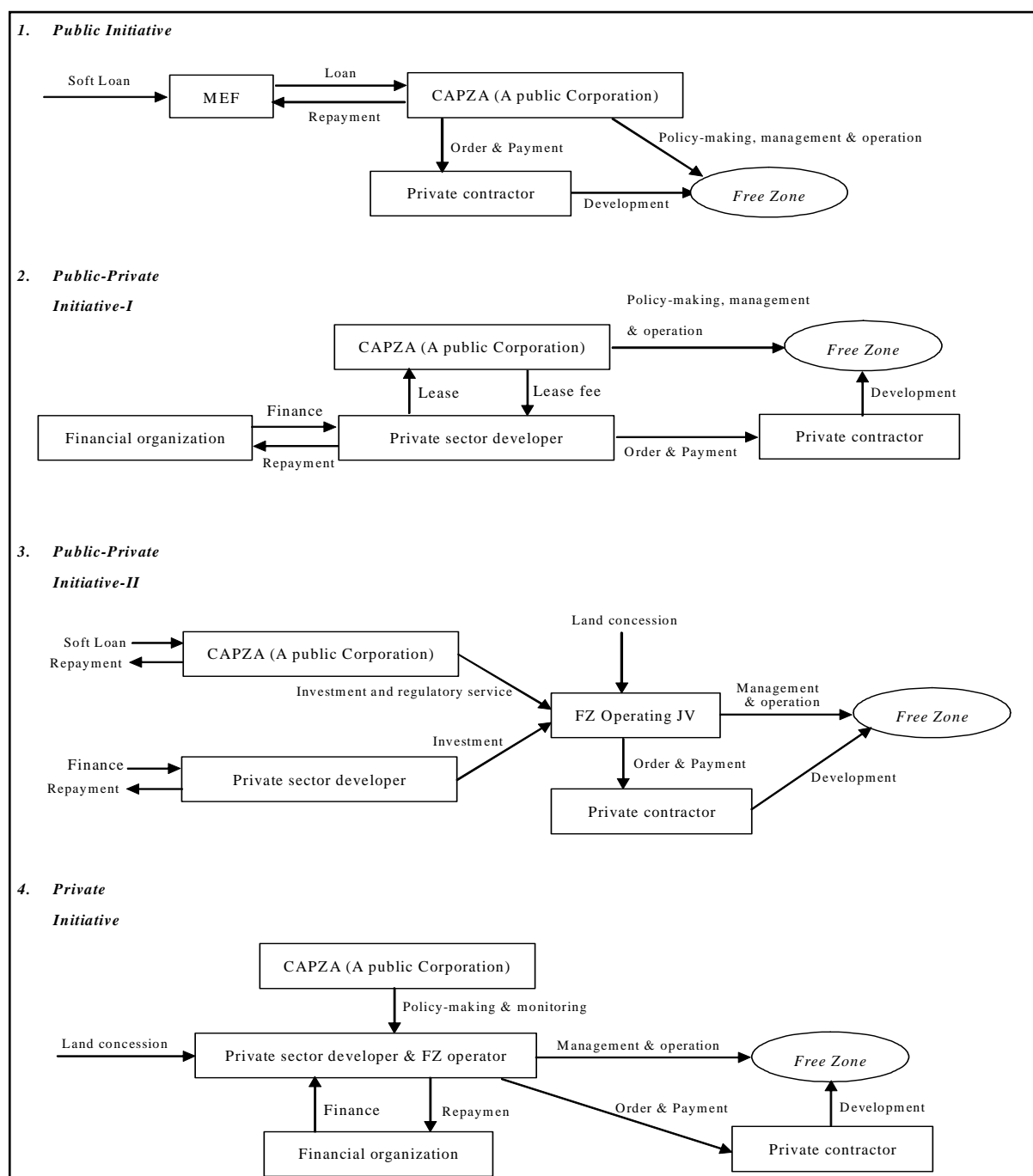


Figure S-18 Financing Options for Development of FZ

10.11 Initial Environmental Evaluation on Sihanoukville Port Free Zone

Screening and scoping was carried out for 19 specific environmental issues that could potentially be affected by the project. Mitigation measures for environmental protection were identified. The prevention/mitigation measures should be taken to maintain and enhance the livelihood of the residents influenced by the project, and preserve valuable natural environmental assets. The prevention/mitigation measures will be incorporated in subsequent detailed feasibility or design studies.