

**THE COUNCIL FOR THE DEVELOPMENT OF CAMBODIA (CDC) /
THE CAMBODIAN INVESTMENT BOARD (CIB)**

**THE STUDY ON
ECONOMIC POLICY SUPPORT IN
THE KINGDOM OF CAMBODIA**

**FINAL REPORT
SUMMARY**

February 2007

**JAPAN INTERNATIONAL COOPERATION AGENCY
NOMURA RESEARCH INSTITUTE, LTD.
KRI INTERNATIONAL CORP.**

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PREFACE

In response to a request from the Government of the Kingdom of Cambodia, the Government of Japan decided to conduct a study on improvement of investment policy and entrusted to the study to the Japan International Cooperation Agency (JICA).

JICA selected and dispatched a study team headed by Mr. SAKAI Hitoshi of Nomura Research Institute, Ltd., between December 2005 and February 2007.

The team held discussions with the officials concerned of the Government of the Kingdom of Cambodia and conducted interviews at the study area, as well as in neighboring countries and Japan. Upon returning to Japan, the team conducted further studies and prepared this final report.

I hope that this report will contribute to the promotion of investment into Cambodia and to the enhancement of friendly relationship between our two countries.

Finally, I wish to express my sincere appreciation to the officials concerned of the Government of the Kingdom of Cambodia for their close cooperation extended to the study.

February 2007

IZAWA Tadashi,
Deputy Vice President
Japan International Cooperation Agency

February 2007

Mr. IZAWA Tadashi
Deputy Vice President
Japan International Cooperation Agency (JICA)

Letter of Transmittal

Dear Sir,

We are pleased to submit herewith the Final Report of “The Study on Economic Policy Support in the Kingdom of Cambodia”. This study was entrusted to Nomura Research Institute in association with KRI International Corporation, under a contract with JICA. The Report consists of Executive Summary, Main Report in Japanese, English and Khmer.

This study is designed to investigate the pros and cons of Cambodia, both from the macro and micro perspectives, as a destination of investment by overseas private enterprises, including Japanese companies, and to formulate a strategy and measures to expand investment from Japan and elsewhere for the development of the Cambodian industry. This study will support the improvement of Cambodia’s economic policy, industrial development policy and investment policy and realize fruitful results from introducing FDI in the near future.

This sort of comprehensive study has ever conducted by the JICA in development countries. However, it has a common time lag between (1) to formulate strategies, measures and (2) to produce satisfactory results in expanding FDI from Japan in such countries and to proceed to the industrial development of the country that takes full advantage of such investment. Therefore, it is necessary for implementing agencies in development countries to make even greater efforts in order to improve business environments and for foreign aid organizations to follow up and support to implementing agencies in order to make sure of the execution by implementing agencies. These measures encourage expanding FDI from Japan and elsewhere. According to the many interview surveys conducted by the JICA study team in neighboring countries, the prospects for the Japanese investment into Cambodia in the areas of garment, food processing, electronics, etc., have become more promising and the Japanese investment will surely turn to increase gradually in Cambodia.

We would like to take this occasion to express our sincere gratitude to the JICA and the Japanese Supporting Committee organized by the JICA for providing a guidance to carry out this Study. We are also the most grateful for the cooperation and assistance of the counterparts headed by CDC/CIB in the Royal Government of the Kingdom of Cambodia, the JICA Cambodia office, the Embassy of Japan in Cambodia and collaboration of the

international donors represented in Cambodia that share the same goal of improving the investment circumstances of Cambodia.

Yours Faithfully,

SAKAI Hitoshi
Team Leader, JICA Study Team for
The Study on Economic Policy Support
in the Kingdom of Cambodia

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Summary Report

1. Introduction

Cambodia, with tremendous growth potential among the GMS countries, has recently become eye-catching for most foreign investors except Japanese companies. All positive internal factors that include successful restoration of economic and political stability, abundant low-waged labor with reasonable level of quality, the country's accession to WTO, the government's commitment to economic development, etc., and favorable external factors including increased labor cost in neighboring countries, anti-dumping measures taken by the US and EU against China and Vietnam, worsening Chinese investment climate in labor-intensive sectors, etc., have been influencing most foreign investors' decisions to invest in or relocate their industries to Cambodia.

However, several factors discouraging the competitiveness of some potential industries still exist in Cambodia. Effective measures should be taken to eliminate these discouraging factors in order to enhance the Cambodian investment climate. An improved investment climate in Cambodia in turn will attract more FDI. With a view to achieving increased foreign direct investment mainly from Japan, the Cambodian government requested support from the Japanese government in September 2004. In August 2005, the two governments agreed to implement the Study on Economic Policy Support in Cambodia by Japan International Cooperation Agency (JICA), which is designed to investigate the pros and cons of Cambodia, both from the macro and micro perspectives, as a destination of investment by overseas private enterprises, including Japanese companies, and to formulate strategies and measures to expand investment from Japan and elsewhere for industrial development in Cambodia. This study mainly aims at developing a favourable investment climate in Cambodia that will, in turn, promote FDI. Cambodia has been improving its system based on international standards including ILO, WTO, etc. But in order to introduce Japanese investment, Cambodia has to adopt the Japanese production system.

2. Structure of the Study Report

The report touches on four important areas that are related to

- Policy issues
- Institutional issues
- Organizational issues
- Action plan and Technical Assistance scheme

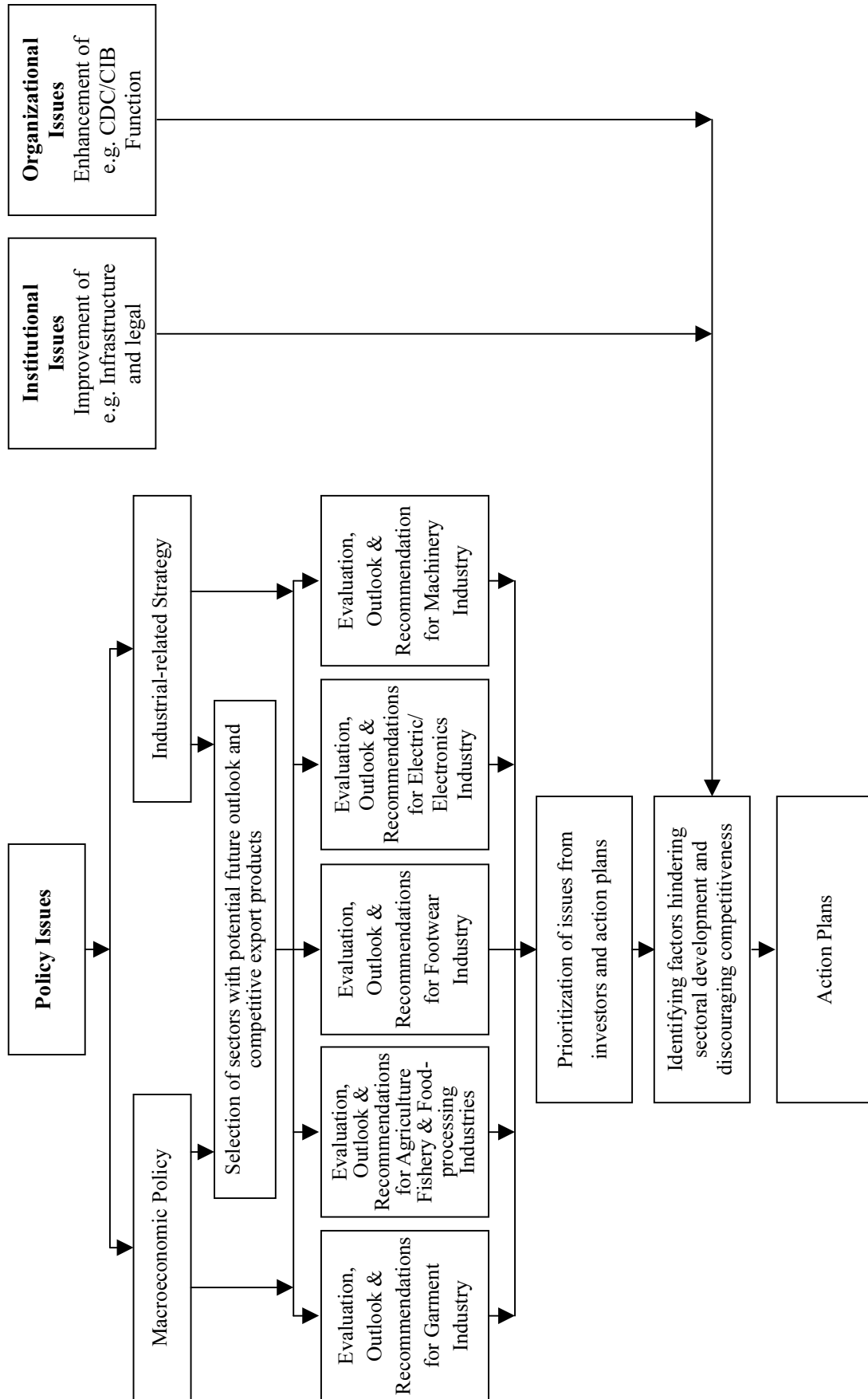
They are presented in two parts, of which part 1 mainly deals with policy issues that include macroeconomic policies and industrial strategies. Existing competitive industries/ products and those with future prospects are selected, factors discouraging competitiveness are identified and appropriate

policies and strategies for the development of these industries are recommended.

Part 2 of the report mainly deals with institutional and organizational issues. It focuses on investment promotion. Recommendations related to how legal and other important infrastructure could be improved and how the investment promotional functions of CDC/CIB could be enhanced are provided with a view to developing a more favorable investment climate in Cambodia. Action plans and technical assistance schemes for the development of important organization/sectors are given at the end of this part.

The flow-chart on the structure of the study contents could be depicted as follows.

Figure 1 Flow-chart on the Structure of the Study Contents



2.1 Policy Issues

Policy issues cover macroeconomic policies and industrial strategies required for Cambodian economic and industrial development. Based on analyses of export and industrial competitiveness, questionnaires and interview surveys, the Study Team selected five industries. The focus is on development of macroeconomic policies and industrial strategies related to Cambodian industries with future potential that include the garment industry, agricultural, fishery and food-processing industries, footwear industry, electric/electronics industry, and machinery industry.

Strategy recommendations for the development of these industries are provided because these industries are perceived to be the most promising. Cambodia possesses a higher level of competitiveness in the garment industry while there is a lot of potential for the footwear industry and agricultural, fishery and food-processing industries to grow in the medium term and ample prospects exist for the development of the machinery industry and electric/electronics industry in the longer term.

2.1.1 Macroeconomic policy

This section mainly deals with identification of the forces driving Cambodian economic development. Major factors that are anticipated to influence Cambodian industrial development are: the upward trend of FDI into the garment industry, competition with the neighboring countries, and oil/gas production.

Other key factors that are expected to have an impact on Cambodia in the future are identified as: wage rise in neighboring countries (scarcity of low-waged personnel in the garment sector in Vietnam and Thailand may become a burden on competitiveness in these countries), rapid appreciation of the Chinese Yuan after the abolishment of the US/EU safeguard against China, abolishment of the quota for Vietnamese garment products along with its accession to WTO, alleviation of anti-dumping measures for garment exports from China, etc. A quantitative forecast of the Cambodian macro-economy and policy recommendations to achieve sustainable economic growth are provided.

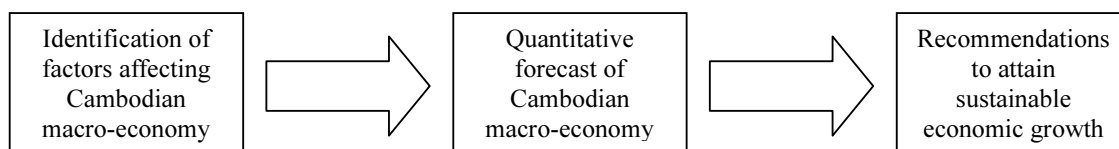
A statistical forecast reveals that, with the continued level of active foreign direct investment, economic growth of 7-9% is expected until 2010, after which it is expected to stabilize at 6-7% until 2012 during which Cambodia is expected to experience more significant growth rates when oil production commences and reaches the stable production stage. It is expected to achieve stable growth of around 6% in the long run.

While production and export of Cambodian competitive garment products continues to grow, a trade surplus is anticipated mainly in tourism and in oil production after 2012. The services sector is expected to play a more important role in contributing to a favorable trade balance in the future.

FDI has been playing, and will continue to play an important role for development of the existing competitive industry (the garment industry) and potential sectors (i.e. the agricultural, fisheries, food-processing, footwear, electric/electronics and machinery industries). Therefore, great emphasis should be placed on creating policy and strategy measures to attract further FDI and to mobilize domestic investment in these currently competitive and potential industries.

In order to maintain constant momentum of FDI inflow, fundamental policies to control inflation and to stabilize currency fluctuation are essential. Furthermore the Cambodian government should also be committed to strengthening its continuous efforts to liberalize its market, adopt prudence in fiscal policy, and to diversify its economic structure.

The main structure of this section can be depicted as follows.



2.1.2 Potential Export Products along with Changes in Trade and Industrial Structure

This sections starts with the selection of competitive products for exports. It mainly identifies potential major export items along with the structural change of industry and trade.

Extensive analyses of dynamics of Cambodian Revealed Comparative Advantages in different export products are conducted. Revealed Comparative Advantage Index analyses reveal that Cambodia possesses higher comparative advantage in garment products, footwear products, frozen fish fillet, crustaceans, and tapioca. Cambodian competitiveness in palm oil, automotive electrical equipment/parts and other parts/accessories for vehicles will get stronger in the longer term. It is expected that the trend of competitiveness in frozen fish fillet will get steeper while competitiveness in garment products will stay stable in the foreseeable future. Hence, garment products will play an important role as a major export item and footwear and processed agricultural products, especially cassava/tapioca and aqua-marine products, have potential to be main export items.

By analyzing future competitiveness of the abovementioned products for export, it is estimated that garment exports will still occupy more than 50% of the total export value in coming years. This ratio is expected to decrease towards 2010, but somewhat increase afterwards. Regarding footwear products, its export is estimated to increase and its share in total export value of Cambodia will reach 4% in 2010 and 6% in 2020. Garment and footwear product exports will be important and competitive Cambodian

exports in the future.

Export growth of frozen fish fillets and crustaceans is expected to rise. To what extent these products will become competitive in the global market depends on government policy measures in promoting this industry. Regarding the palm oil and cassava-derived products such as tapioca and bio-ethanol, a gradual increase in exports is envisaged. Again, the level of growth depends mainly on the degree of processing technology introduced in Cambodia.

In the electronics industry, it is expected to take quite a while to have this industry fully developed. Since Cambodia has just reached the early growth stage of primary products development in this industry, production of labor-intensive products such as coil, wire and wire harness has potential.

Cambodia is likely to achieve more competitiveness in garment and footwear products, processed agricultural and marine products for export. It is possible, in the long term, that machinery and electronics component industries will be established and grow along with the improvement of the investment climate in Cambodia.

Analysis of future Cambodian competitiveness for each of the abovementioned products through dynamics of Revealed Comparative Advantage Indices reveals that Cambodia is expected to lose competitiveness in garment products to some extent while its competitiveness in footwear products will get stronger. Increases in its competitiveness in tapioca, crustaceans and frozen fish fillets are estimated. The strong palm oil industry in Malaysia and Indonesia may have a negative impact on Cambodian competitiveness in this product. Regarding the electronics and machinery products, only a slight uptrend of competitiveness can be predicted.

As for potential competitive products with future prospects for export, Cambodian competitiveness in garment and footwear products is expected to be the highest in the future, and this could be followed by that of agricultural and marine processed products. Although Cambodia is not expected to be highly competitive in electronics and machinery products in the foreseeable future, policy measures to develop these industries should not be ignored since the development of these industries will play very important roles when the shift in industry life cycle occurs in Cambodia as its economy progresses in the future.

2.1.3 Industrial Strategy

This section mainly presents an overview of industrial strategy with a focus on the manufacturing sector, one of the major themes of this project. Here the term "industrial strategy" is used in the broad sense of policy for the expansion of manufacturing to contribute to Cambodia's economic growth. This word does not mean export promotion with tax incentives. At present, the fields of manufacturing being developed in Cambodia are extremely limited (essentially to the garment industry). In light of this reality, the policy areas for priority study are the following four: i) acquisition of capital and technology through attraction of FDI, ii) conditioning of the industrial infrastructure needed to attract FDI, iii) human resource development (HRD), and iv) specific measures for promotion of promising industries. In any field, the Cambodian government does not yet have a fully sufficient store of organizations, personnel, experience, and know-how at the present time, and therefore must take prompt and appropriate action with assistance from other countries.

This project selected five manufacturing fields as promising ones for development in Cambodia (i.e., garment, food processing, footwear, and simple assembly electric/electronic components and simple machining. The following sections present detailed examinations of and recommendations for each field as regards policy to attract foreign capital and promote industry, including measures to attract FDI and promote exports. The table below shows the connection between the promising industries and industrial strategy.

Table 1 Connection between promising industries and industrial strategy in Cambodia

Promising fields	Policy to attract FDI	Infrastructural conditioning policy	HRD policy	Industrial promotion policy (construction of a vision)
Garment	△	△	○	Necessary
Agricultural, Fishery and Food-processing	○	◎	◎	Necessary
Food processing	○	◎	◎	Necessary
Footwear	○	○	○	Necessary
Simple assembly electric/electronic	◎	◎	◎	too early
Electric/electronic (simple assembly)	◎	◎	◎	too early
Simple machining	◎	◎	◎	too early

Note: Double ring = absolutely necessary, Single ring = necessary, Triangle = already handled

Source: JICA Study Team

2.1.4 Competitive Industries with Future Prospects

In five industrial fields which growth is expected of in the future, it analyzed the present situation and competition environment about each field and it dug up the advantage and the fault which Cambodia has. Moreover, it did that the problem is specific, the policy reviewing which is needed in the future. As a

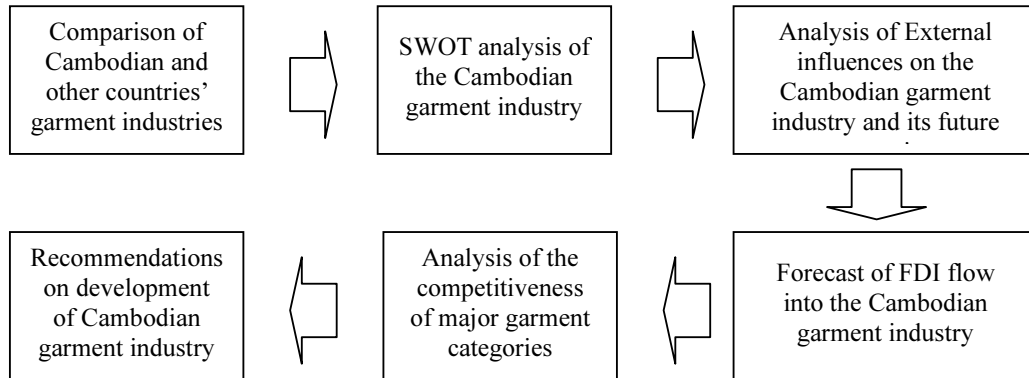
result, the thing which needs following compatible to service environment for the foreign capital attracting was proved.

(1) Garment Industry

One of the most currently competitive industries in Cambodia is the garment industry. This industry is relying more on Cambodian low-waged labor with reasonable level of quality. The garment Manufacturers' Association of Cambodia (GMAC) has been quite active in this area serving as an effective liaison between foreign investors in this sector and relevant governmental organizations. Its continuous effort to overcome negative issues being faced by existing investors and manufacturers in this industry has been playing a very important role in gaining foreign investors' confidence and the development of this sector. However, there still are many areas in this sector calling for immediate measures for development in order to sustain the pace of development. These areas are as follows;

- Since this sector is relying on Cambodia's abundant labor, it is of great importance to enhance the quality of labor with a view to increasing productivity.
- Since Cambodian garment product exports are highly concentrated in the US and EU markets, effective and promotional measures should be taken to achieve market diversification by expanding its export market to Japan, Russia, the Middle East and other Asian countries.
- Most garment industries in Cambodia are currently running on a CMP basis so that promotional measures can be adopted to foster the develop-and-export system.
- Additional measures should be taken to cut lead time with a view to enhancing Cambodian competitiveness compared with that of its neighbors. One way to reduce such lead time is to create central-bonded warehouse facilities in the SEZs so that manufacturers can procure their raw materials such as yarn, grey fabric, dyes and chemicals, etc., from warehouses at a reasonable level of cost leading to a tremendous reduction in lead time that will positively contribute to enhanced competitiveness since possible delays in shipment, shipping time, transshipment or port clearance related to the import of such inputs could be avoided.
- The Cambodian garment industry seriously lacks backward linkages and associated supporting industries. As such, emphasis should be placed on attracting both foreign and domestic investment for the development of backward linkages and supporting industries. This will further shorten the lead time resulting in a higher level of competitiveness.

- The main structure of this section can be depicted as follows.



(2) Agricultural, Fishery and Food Processing Industry

Other industries having a lot of potential to grow include Agricultural, Fishery and Food-processing industries. These industries play a pivotal role in Cambodian economic development since the ratio of the agricultural and fishery sector to GDP accounts for 32.9% in 2004¹. However, exports of agricultural-related products are still minimal. In fact, Cambodia's exports of agro products accounted for merely 0.0091 percent in world agro product exports in 2004². In addition, food and marine product processing is very limited in Cambodia. The supply and price of agricultural and marine products for processing is also unstable. Illegal exports of agricultural and fishery products are still evident. These problems make it difficult to deliver Cambodian agricultural and marine products to meet specifications and quality, which are required by the food processing industry. Accordingly, the biggest issue, the lack of linkage between producers and processing companies in the agricultural and fishery industry, remains to discourage foreign companies from making investments in Cambodia. From the point of view of the above, it is essential for the Cambodian government to call for immediate measures to be taken as follows:

- The food processing industry in Cambodia should serve both as an import substitution and export-oriented industry.
- The export market is to be expanded to a global market with price and quality competitiveness building the Cambodian brand image in the longer term.
- Major products that currently possess higher competitiveness and that should be emphasized for enhanced production include cassava (tapioca starch), palm oil, frozen food (processed

¹ Source: ADP, Key Indicators 2006

² EIC, "Cambodia Agriculture Development Report", June 2006

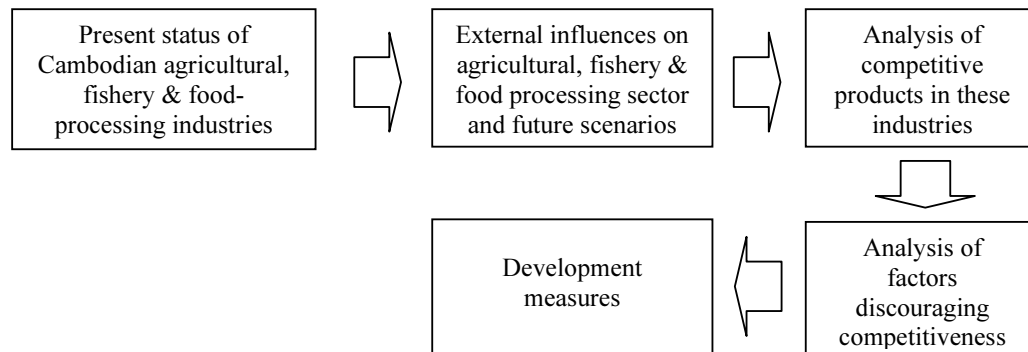
fishery products), tropical fruits, rubber, rice, organic agricultural products, and other agricultural products.

- Agricultural and fishery cooperatives should be reinforced. The agricultural and fishery product processing industry needs to procure materials from individual farmers or fishermen, or a key personnel or collaborator playing a similar role of leader of the union.
- Educational and training programs targeting farmers and fishermen should be offered to acquire increased productivity and quality improvement.
- Food evaluation criteria and a food inspection agency should be developed in Cambodia to be able to expand the export market to more sophisticated countries including Japan that are much more sensitive about hygienic factors.
- It is also necessary to establish proper facilities to enhance quality of products that include low-temperature storage facilities, cold storage or refrigerated warehouses, and a cold or refrigerated transport system.
- With a view to enhancing productivity of the agricultural sector, it is also necessary to improve the irrigation system.

In addition to the need for adoption of possible measures to tackle or improve the abovementioned areas, it is also necessary to adopt effective measures to attract FDI in the agricultural, fisheries and food processing industries with a view to achieving immediate improvement. Necessary measures should include:

- Provision of comprehensive services to foreign companies in these sectors which should include assistance in selecting appropriate sites, conducting feasibility studies, recruiting workers, etc.
- Provision of necessary insight information related to foreign investment procedures, laws/regulations, market conditions, procurement, etc. Information dissemination should be improved and such information should also be available outside the country.
- Policies and regulations related to these sectors and foreign investment in these sectors should be made transparent. Future policies should also be made transparent through master plans for the development of these sectors.
- The government's commitment to export promotion should be improved and export promotion policies should be made more pragmatic and attractive. Necessary measures taken should also include capacity building for relevant authorities to be able to make policy for export expansion and conduct studies of export procedures, enhanced competitiveness and empowerment of institutions engaged in promoting exports.

The main structure of this section can be depicted as follows.



(3) Footwear Industry

Although Cambodia's footwear industry has the potential for expansion with FDI, labor strife and management failures in recent years have triggered a withdrawal by foreign firms and induced a phase of stagnation. Nevertheless, there are signs of improvement as regards the strife, and the climate for investment in the footwear industry is embarking on a substantial recovery. The climate in China and Vietnam is worsening due to anti-dumping problems and rising wages, and the flow of footwear-related FDI in Cambodia is again starting to quicken. Production activities have apparently bottomed out and are beginning to make an upturn.

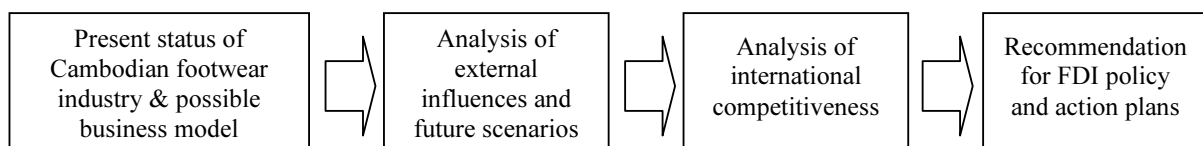
Cambodia could not necessarily be said to offer more competitive advantage for footwear production than these countries, considering factors such as the dependence on import for materials, logistic problems, limited ability to outsource processing, and low worker productivity. For the time being, Cambodia's competitiveness would therefore be confined to the segment of leather shoes, where it has an edge for supply to the EU and Japan. The question is whether or not Cambodia will be able to lay the foundation for the entire footwear industry through production in the leather shoe segment, where it has a competitive advantage, and thereby become competitive as a site for production of a wider variety of footwear in the future. Foreign-capital attracting, industrial development policies like the following are necessary immediately.

- The Cambodian government should give the industry a high priority for FDI attraction alongside the garment industry. In particular, it ought to consider diverse initiatives for effective promotion in regard to investment incentives, employment conditions, HRD, and industrial structuring.
- Work efficiency is considered poor due to insufficient elementary education, and rated productivity is about 30 as opposed to 100 for China and 70 for Vietnam. Because it would probably be hard to produce the needed personnel solely through in-house programs of

education and training, the option of establishing such programs in public institutions should be studied immediately.

- The association in the footwear industry is in effect dormant due to absence of a chairman. Association capabilities are essential for the government to deploy various measures and the industry to make policy proposals to the government. The government should actively encourage reconstruction of the association, for orderly growth of the industry in Cambodia, even if it is with a high dependence on FDI.
- Proper assurance of the lead time noted above in accordance with production schedules would require a reorganization of cargo transport within Cambodia, to diversify transport networks while making them more efficient. This could be done by reconditioning truck and rail transport between Sihanoukville and Phnom Penh and building a network for international truck transport linking Phnom Penh with Bangkok and Ho Chi Minh.
- Foreign firms sited in Cambodia in the garment and footwear industries have to spend a lot of time in filing import/export applications and getting them approved. This year will see the execution of a model project for procedural simplification at the port and harbor facilities in Sihanoukville. This project must be led to success in order to attract new investment and make things smoother for the firms already in Cambodia. It must be followed by prompt application at other organizations, simplification of related work, and correction of the malpractice of collecting extra fees.
- To encourage FDI in the footwear industry, the Cambodian government should prepare its own master plan setting forth its vision for the development of the industry, the policies to be taken to attain this vision, and the improvements in the investment regime.
- The footwear industry needs all sorts of parts and materials. Properly speaking, the ongoing advancement of the industry requires high local content to solidify cost competitiveness. Among the various parts and materials, there would be prospects for siting the tanning process in Cambodia. The competitiveness of Cambodian footwear could best demonstrated in the case of leather shoes. In the long run, it should review the domesticization of the tanning business.

The main structure of this section can be depicted as follows.



(4) Electric/ Electronics Industry

Although the electric/ electronics industry is not yet developed in Cambodia, there is much potential for its development. Japanese firms of the part in this industry operating in the neighboring countries such as Thailand and Malaysia are also showing interest in Cambodia for investment extension or relocation of their industries in order to take advantage of Cambodian low-waged labor. Specifically, there is the possibility of such Japanese firms making in roads in Cambodia in the five product areas of wire harness for the car, labor-intensive parts such as the coil and the transmission, the attachment of electric appliances such as barber products, module products such as power supply, and low-priced information and communication equipment.

The criteria applied in decisions on siting plants by Japanese firms in the electric/electronics industry reflect the relatively large scales of investment, the diverse supply sources and product export destinations, and the short lead time resulting from the contraction of design cycles. The concrete criteria include the stability of the sociopolitical situation, incentives for FDI in production, low-cost but diligent labor, industrial parks with good infrastructures, an international logistics network enabling SCM with short lead times, and residential environments enabling home-country employees to live comfortably and securely. Along with low-cost yet dependable labor, especially essential requirements are the presence of industrial parks with a stable supply of power and water that also offer EPZ functions, and an international logistics network for transport by land, sea, and air.

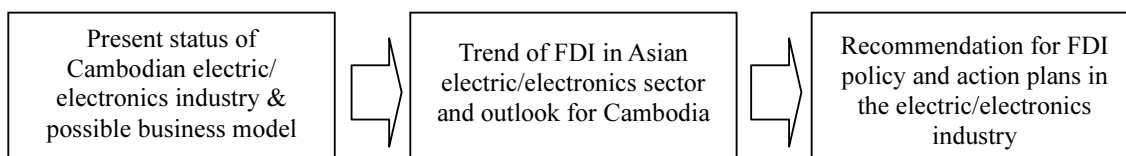
As such, in the case of the electric/electronics industry, the action plan to attract FDI mainly from Japanese firms must focus on the need for construction of the most fundamental infrastructural elements.

- The SEZ to be completed in Sihanoukville by 2009 will have to clearly establish the standard for EPZ functions and other elements of the management scheme as well as industrial infrastructural elements such as electrical power, water, and wastewater treatment. The industrial park levels defined in this process should be taken as a standard to be applied in turn to the existing industrial parks. At the same time, additional industrial parks built in the future should be up to the standard set by the Sihanoukville SEZ. In this way, Cambodia must raise the level of its industrial infrastructure. Incidentally, SEZs in Cambodia have no tax incentives in the nature of things, but are ready to be established with infrastructure, and simplification of investment and trade procedures. Therefore, they are categorized as industrial zones in the WTO concept.
- In the investment climate, Japanese electric/electronics firms place the greatest emphasis on the presence of an international logistics system enabling import of materials and components from other countries and efficient export of the products. With aid from the Japanese government and other countries, the work of improving ports and trunk road networks is anticipated to make considerable progress by 2010. Cambodia must quicken the pace of this

work for completion at an earlier date.

- FDI attraction requires promotion, by all means, of the advantages offered by Cambodia and its investment climate as it moves toward improvement. More specifically, the recommended activities include the holding of investment seminars hosted by the CDC/CIB in Japan and neighboring countries, establishment of a "Japan desk" (including the dispatch of JICA experts) aimed at attracting investment from Japanese firms, top-level diplomatic overtures to heads of state and ministerial officials for attraction of investment, and preparation of (Japanese-language) investment guidebooks.
- As a primary task, steps should be taken to improve education on the elementary and junior high school levels in order to increase the literacy rate and impart basic knowledge in the sciences. Although production in the electric/electronics industry is basically labor-intensive, plants are installed with a lot of production facilities, and production and processes are strictly controlled and managed.
- For foreign firms considering investment in Cambodia for cost-competitive production employing low-cost yet diligent labor, the problem of the working conditions such as the working hour and the paid holiday could dampen inclinations to invest. It was also pointed out that improvements must be made as regards problems with labor unions, which are triggering sharp disputes in the garment industry. For aggressive attraction of FDI in the electric/electronics industry, the Cambodian side should therefore consider the working conditions on a par with those in neighboring countries, and labor unions setup based on ties of trust with management.

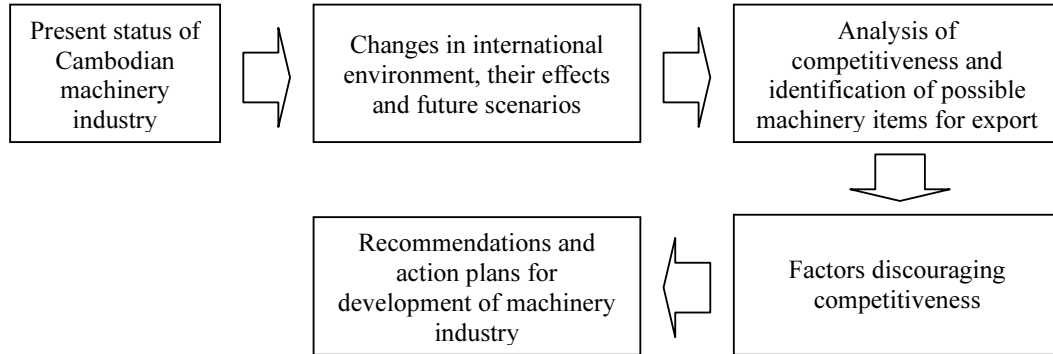
The main structure of this section can be depicted as follows.



(5) Machinery Industry

Another industry which is not yet fully developed in Cambodia but has future prospects is the machinery industry. Machinery industries in Cambodia account for approximately 3% of the total number of industries. FDI inflow to this machinery sector is still very minimal in Cambodia. Although the sector has huge potential to grow, its development pace is still limited due to several issues requiring effective remedies as follows:

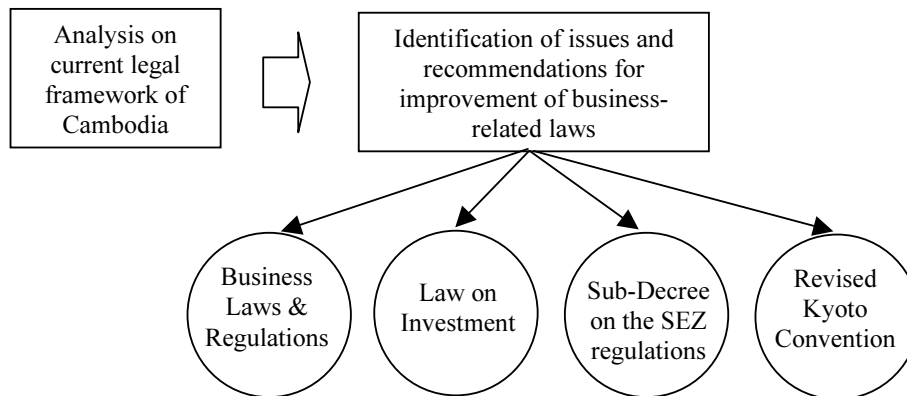
- Supporting industries in this sector are limited due to limited assembling plants, and this hinders the development pace of machinery industry in Cambodia. The government should take necessary measures to attract both foreign assemblers and supporting industries to develop this industry.
- The only way to achieve faster development in this sector is by attracting FDI in machinery industries, and transferring required advanced technology to this sector. Such foreign direct investment and technology transfer are major driving forces of industrial development. Import substituting industries in the industrial sector should be developed first and followed by export-oriented industries.
- The transport machinery industry and production of parts, which are partly labor-intensive in nature, should be developed in Cambodia. In the shorter run, Cambodia would still need to source necessary parts and materials from neighboring countries in the region. Local production of parts and materials should be developed in the medium term scenario and some Cambodian companies would have accumulated technology and started manufacturing items with higher value. Cluster industry within Cambodia should be fully developed in the longer term, which will result in production of a wider range of products including functional components and high value-added parts.
- High energy price, influx of low-cost contrabands, import restrictions on materials and manufacturing machinery, cumbersome procedures for exports and imports and high production costs associated with poor infrastructure, impose constraints on attracting direct investment. It is important to take necessary measures to remove these constraints. Improvement of proper infrastructure and development of industrial parks are driving forces for machinery industry development. As expected, the number of industrial parks developed for trade with foreign companies will increase through the enactment of the SEZ Sub-Decree. That is, further development of the current relative laws and sub-decrees under the initiative of the government would expedite the development of these industrial parks.
- Emphasis should also be placed on taking necessary measures for medium- and long-term development of supporting industries. Such measures should include preparation of the institutional framework for the development of supporting industries, expansion of investment promotion activities, improvement of the level of skills and technologies of supporting industries, development of the human resources supporting industries, and teaching managerial skills to domestic subcontractors. The main structure of this section can be depicted as follows.

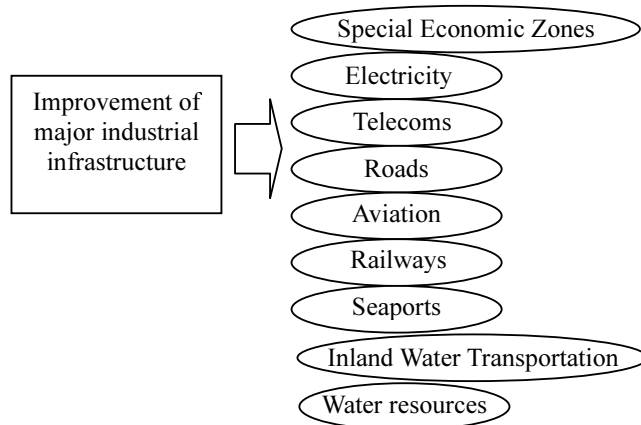


2.2 Institutional Issues

Institutional issues mainly focus on improvement of the legal framework and development of industrial infrastructures that include development of special economic zones, electricity infrastructure, telecommunications, roads, aviation, railways, seaports, inland water transportation and water resources. This section focuses on development of these legal and industrial infrastructures with a view to promoting investments, mainly FDI.

The main structure of this section can be depicted as follows.





2.2.1 Measures for Improving Legal Framework

Although Cambodia is becoming an eye-catching country for most foreign investors for possible investment and relocation of industries from neighboring countries, its legal framework still has many weaknesses. Although the Cambodian government has been trying to improve its existing legal framework, many vital laws including the Civil Code, Law on Anti-corruption, Law on Commercial Contracts, Law on Secured Transactions, Law on Insolvency (Bankruptcy), Law on Anti-dumping, Countervailing Duty and Safeguard, Law on Industrial Standards, Customs Code, and Law on Civil Administration have not yet been enacted. Most of them have already been drafted and approved by the Cabinet but not yet adopted by the National Assembly. In addition, it is also necessary to improve or amend some existing laws, for instance, the Labor Law and Law on Investment.

The Sub-Decree on the SEZ also requires various clarifications and the enactment of the Law on the SEZ is being awaited to provide a more concrete legal base for the SEZ scheme. On the occasion of the enactment of the Law, it is recommended to provide zone investors with more non-fiscal incentives.

2.2.2 Measures for Developing Industrial Infrastructure

Proper development of industrial infrastructure plays a very important role with a view to promoting FDI and industrial development. Major infrastructure required for industrial development and FDI promotion includes development of SEZs, electricity, telecommunications, roads, aviation, railways, seaports and water-resource infrastructure.

Regarding the development of SEZs, although several incentives are granted by the SEZ Sub-Decree to zone developers and zone investors, more attractive non-fiscal incentives should be additionally provided. These should include improving transparency on fees and charges, the SEZ Administration's provision of qualified workers free of charge or for a nominal charge, introducing the unified

employment contract, deducting costs for vocational training provided by employers from the net earnings of the investment project, exempting investors from advanced profit tax and allowing semi-annual payment of the said tax. Furthermore, more favorable conditions for zone investors should be given. These should include allowing investors freely import production inputs just by submitting an import declaration, applying a “single window” system for exports-imports control, applying risk management or the post-clearance audit method to all imports, exempting on-site inspection before packing, restricting labor strikes inside the zones. Additional non-fiscal incentives for investors in the GIZ should also include guaranteeing the provision of “one-stop-service”, providing a “Two-step Loan” to domestic SMEs in the GIZ, reducing the minimum investment requirement in order to promote SMEs, establishing an incubation center in the GIZ to provide vocational training, establishing a marketing center in order to assist marketing activities of SMEs in the GIZ, assisting SMEs to develop appropriate websites and organizing trade and product exhibitions for them.

Regarding the electricity infrastructure, although supply of electricity by EDC has been significantly improved, there still are some issues discouraging existing and potential investors. These issues include high costs for electricity supplied both by EDC and IPPs and lack of electricity infrastructure linking major strategic areas of Cambodia. Although it is expected that most of these issues will be addressed by 2010 according to the government’s development plans, more effective measures should be taken to hasten such developments.

Regarding the telecommunications infrastructure, although significant improvements are evident, there has been a continuous shortage of fixed-line services. Compared to other ASEAN countries, Cambodian telephone density remains low and international call tariffs remain high. With a view to improving telecommunications services, it is important to reduce tariffs for both domestic and international, fixed-line and mobile, as well as the Internet, increase mobile telephone capacity to meet peak-time demands in urban areas, increase the capacity of international call gateways, expand telephone capacity in rural areas, expand the national backbone network of the Internet to all provinces, improve the international Internet link to make available high-speed Internet connections with other countries, and expand broadband access for Internet and fiber optic connections.

Regarding the road infrastructure, the road network in Cambodia started to develop in the early 1900’s and the total coverage was approximately 39,310km, consisting of 4,695km of national roads, 6,615km of provincial roads and about 28,000km of rural roads. There is no divided expressway in Cambodia. The Road Density (km/km²) is comparable to other ASEAN countries but very inferior as to paved road density. Due to the severe floods in Cambodia in 2000, serious damage to Cambodian roads occurred. With assistance from many international donors, the rehabilitation of the road network is still underway. Approximately 98% of the renovation program is expected to be completed by 2008 for the

improvement work of NR1 to NR7 and by 2010 for the remaining section of NR1. Since road transport plays a very important role in Cambodia not only for passengers but also for cargo transport, immediate measures should be taken to hasten the renovation and rehabilitation programs.

Regarding aviation infrastructure, there currently are international flights to 7 countries/regions flying from Phnom Penh International Airport and some international flights fly from Siem Reap. There are two major operating airports in Cambodia, Phnom Penh International Airport and Siem Reap. Kang Keng Airport in Sihanoukville reopened for domestic flights on January 15, 2007, and is planning to start international flight service in the future. Kampon Chhnang Airport located in the north of Phnom Penh is also being planned to resume operations in the future. Phnom Penh International, Siem Reap and Kang Keng Airports have been contracted out to a Malaysian-French joint venture for operation, management and development.

Regarding railways, there are two railway lines in operation in Cambodia. The average speed of rail transport is less than 30km/hour. Many sections of track lack bolts for rails, and there are no traffic signals along railways. Since ADB is implementing a project called “the Study for Rehabilitation of the Railway in Cambodia” and is targeting an upgrade of the railway with US\$ 20 million in three years, the rail transport infrastructure is expected to improve quite significantly and the average speed is expected to increase to about 50km/hour. If that happens, measures should be taken to introduce a new signal system for safety.

Regarding the seaport, Cambodia has only one deep seawater port in Sihanoukville. Phase one of expansion of the container yard of 240m has been completed and the phase two expansion of 160m berth is now being implemented. This port is expected to be very international and relied upon by zone investors operating in the would-be SEZ in the Sihanoukville area. For the time being, a small port is in operation nearby Sihanoukville port and it has been absorbing considerable volume of cargo delivered by smaller vessels.

Regarding inland water transport, its network in Cambodia consists of the Mekong River, Tonle Sap River and Barzac River, whose total length is approximately 1,750km in the rainy season and may decrease in the dry season to 580km of navigable waterways. The water level difference between dry and rainy season sometimes reaches 10m. Although inland water transportation has such a limitation, measures should be taken for rehabilitation and maintenance of the river system to make inland water transport more efficient.

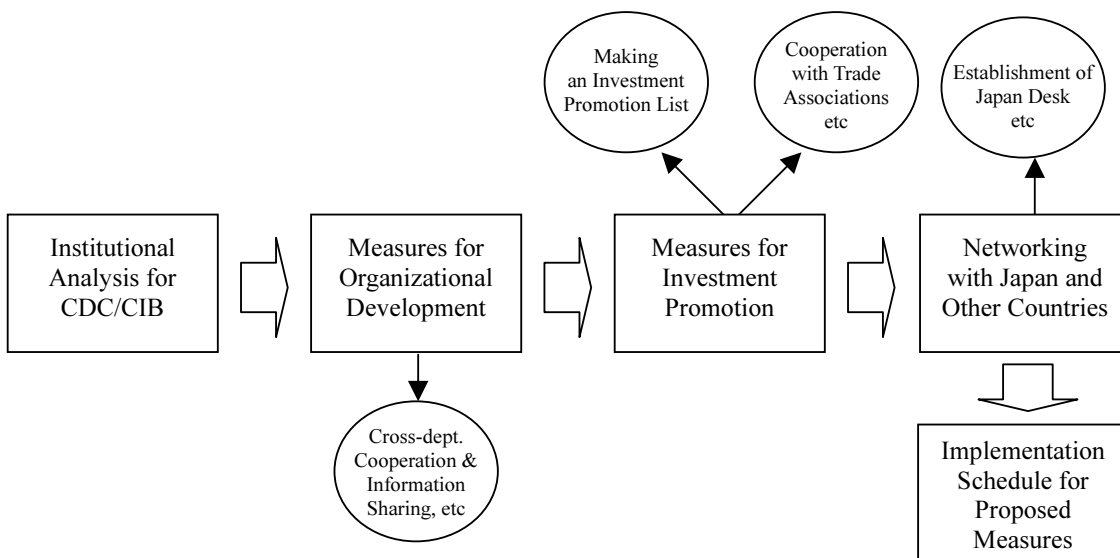
Regarding industrial water sources, there has been some difficulty in acquiring quality water for industrial use in areas where SEZs are being developed especially in the Sihanoukville area. Though

groundwater can be counted as a stable supply source, water quality may not meet requirements for some industries because of salt content. Measures should be taken to find reliable water sources. One of the ways to address this issue is to get water from the Kubar Chhay River and send it by pumps to the Sihanoukville area. Although it is costly, it would be the only way to get enough industrial water in the area if large-scale industrial zones are to be developed.

2.3 Organizational Issues

In regards to organizational issues, various measures for organizational development and enhancement of investment promotion capacity for the Council for the Development of Cambodia (CDC) / the Cambodian Investment Board (CIB) will be proposed. Particularly, investment promotion and investment networking with the Japanese market are paid special attention. The development of investment promotion capacity of CDC/CIB will greatly contribute to the economic development of Cambodia.

CDC/CIB has been focusing on the improvement of the legal environment in Cambodia, and subsequently all staff in CDC/CIB have high standards of legal knowledge. In contrast, it hardly needs mentioning that CDC/CIB has an organizational system based on practical business matters, including the identification of demands from investors. Subsequently, staff in CDC/CIB would benefit from increased practical business knowledge. The aim of this section is to establish the organizational structure with effective provision of business information for investors. The main structure of this section is as follows.



2.3.1 Organizational Development

It can be pointed out that the biggest organizational challenge for CDC/CIB is the weak cross-department cooperation and lack of information sharing. Particularly, various departments in CDC/CIB are involved in monitoring operations. However, information obtained through the operation is partially held by each department. Thus, all departments in CDC/CIB need to cooperate and share information. The most important measure for organizational development is to establish cross-department cooperation and information sharing. In addition, the establishment of a document library is proposed as a short-term improvement plan for customer services. Services in the provision of information are expected to be effective due to difficulties in collecting investment information on Cambodia. In relation to the wage system in CDC/CIB, a performance-based wage system can be introduced to motivate employees and revitalize the whole organization.

2.3.2 Investment Promotion and Investment Information Networking

In regards to investment promotion, one of the challenges for CDC/CIB officers is that they do not have extensive knowledge of the varieties of products, firms and industries in Cambodia. Therefore, investment promotion officers have difficulty in matching between domestic producer's needs and overseas investor's demand effectively. In this regard, investment promotion officers need to inform prospective investors not only of the importance of the investment climate, but also detailed business information. Information collection, in general, requires a lot of time-consuming work. However, it is very important to identify the needs from the domestic market to enhance business opportunities within Cambodia. Thus, the investment promotion list including firms and product information will be proposed in order to accumulate business information within organizations and provide the information to investors. Effective information collection can be achieved in association with trade associations including the chamber of commerce in Cambodia. Trade associations, in general, hold valuable information on companies in a particular industry or area. It can be considered that effective use of information networks of trade associations is very valuable for CDC/CIB. Hence, establishing close cooperation with trade associations will be recommended. Other important means of investment promotion include website development and issuing monthly newsletters.

In regards to investment information networking, various measures will be proposed primarily for the Japanese market. First of all, the establishment of 'Japan Group' in CDC/CIB, exclusively dealing the Japanese market, will be recommended. Japanese firms, in general, do not have any experience (even information) in the Cambodian market. Thus, the Japan Group will play a role in providing *trust* to the Japanese investors (trust is the most important business value in Japan). Secondly, investment information networking with particular organizations in Japan will be proposed. In relation to information collection, Japanese potential investors tend to use the following five routes to gather information: (i) government organizations including JICA and JETRO, (ii) general trading companies,

(iii) consulting firms, (iv) international organisations in Japan such as the ASEAN-Japan Centre, (v) others including Chamber of Commerce. Thus, it seems to be important for CDC/CIB to establish information networks with the above-mentioned organizations. Thirdly, the effective use of investment seminars and missions by providing not only legal information, but also business information, will be recommended. Other important means include making Japanese promotional materials and assignment of information staff for the Japanese market. In addition, the establishment of a representative office in Japan, a so-called '*Japan Desk*', is expected to play an important role in the future. The aims of the establishment of a Japan Desk are to conduct sales of investment proposals to Japanese firms, to provide consulting services to Japanese firms, to organize investment seminars, to collection market information, and to provide investment application services. Lastly, it might be important for CDC/CIB to utilise the above-mentioned proposed measures (by conducting similar operations) for other countries in Asia.

2.3.3 Implementation Schedule for the Proposed Recommendations

In this section, 14 recommendations across organizational development as well as investment promotion were proposed for CDC/CIB's capacity development. The implementation schedule for the proposed 14 measures is shown in the table below.

Table 2 Implementation Schedule of the Proposed Recommendations for CDC/CIB

Recommendations	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	~	2020
Organizational Development												
Document Library												
Information Sharing												
Performance-based wage system												
Investment Promotion												
Investment Promotion List												
Cooperation with Trade Associations												
Newsletters												
WEB Site												
Information Networking												
Japan Group												
Networking with Japanese organizations												
Information Management Staff												
Promotional Materials												
Investment Missions												
Investment Seminars												
Japan Desk												

The above-mentioned 14 recommendations will be prioritized from the perspective of importance, urgency, and realization for investment promotion capacity in CDC/CIB. The highest priority is selected, aiming for accumulated investment information, particularly business information within CDC/CIB. These measures include the enhancement of information sharing within CDC/CIB, making investment promotion lists, and establishing close cooperative networks with trade associations.

Second priority is given to those measures which (i) are, at present, partially in progress, such as website development and investment seminars and missions, and (ii) which aim to increase the capacity for dispersing information, including the establishment of a Document Library, issuing newsletters, organizing the Japan Group, making promotional materials, networking with Japanese organizations, and assigning information management staff.

Finally, the establishment of a Japan Desk has third priority. It will be very important for the future

development of investment promotion capacity, however, the realization seems to be difficult due to CDC/CIB's budget limitation at the moment. It might be very effective when the notion of "Investment in Cambodia" is popularized among the Japanese investors in the future. In addition, the introduction of the performance-based wage system requires careful consideration for its implementation

Table 3 Priority for the Proposed Recommendations

Priority	Proposed Measures
Highest Priority	<p><i>Organizational Development:</i> Information Sharing</p> <p><i>Investment Promotion:</i> Investment Promotion List and Cooperation with Trade Associations</p>
High Priority	<p><i>Organizational Development:</i> Document Library</p> <p><i>Investment Promotion:</i> Newsletters, Web site, Japan Group , Promotional Materials, Investment Missions and Seminars, Networking with Japanese organizations, and Assignment of Information Management staff</p>
Low Priority	<p><i>Organizational Development:</i> Performance-based wage system</p> <p><i>Investment Promotion:</i> Japan Desk</p>

2.4 Action Plans and Technical Assistance Scheme

This section summarizes issues in attracting FDI in Cambodia, makes proposals for improvement in each promising industry and for developing a technical assistance scheme for CDC/CIB. Required improvements suggested for each sector are categorized based on the following three broad categories.

- Improvements for attracting FDI
- Improvements for industrial development
- Improvements for infrastructural development

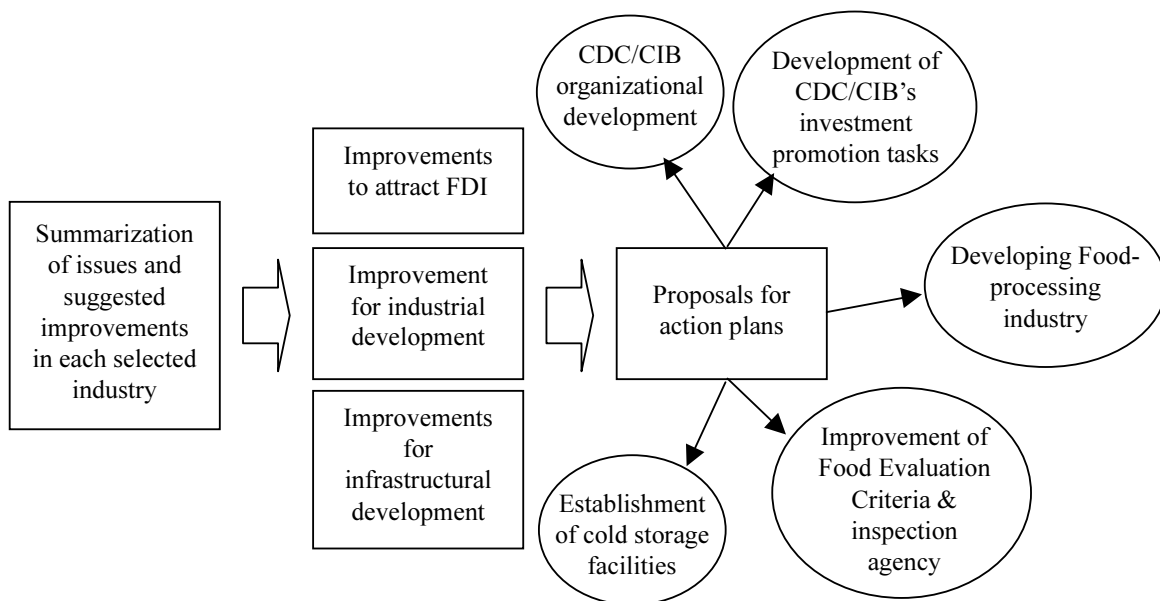
Then proposals are made for action plans in the area of FDI strategy. The proposals include:

- Action plan for organizational development in CDC/CIB
- Action plans for investment promotion in CDC/CIB that include arranging investment promotion lists, establishing cooperation with trade associations and the chamber of commerce

and holding investment seminars

- Empowerment and improvement of food evaluation criteria and inspection agency
- Establishment of low-temperature storage facilities, cold storage and refrigerated warehouses, and cold and refrigerated transport systems
- Action plans for development of the food-processing industry that include reinforcing agricultural and fishery cooperatives to ensure a stable supply of materials and strengthening investment promotion.

The main structure of this section includes:



Technical Assistance Scheme

This report further proposes a technical assistance scheme for the counterpart of this study, CDC/CIB. It is necessary to implement effective means for a cooperation scheme, which enhance CDC/CIB to promote foreign investment in Cambodia including 5 promising industries. Investment promotion capacity development as well as IT development for CDC/CIB will be recommended as a technical assistance scheme. In regards to Investment promotion capacity development scheme, the implementation schedule is proposed in two phases. The aim of the first phase is to establish a basic organizational structure for investment promotion in CDC/CIB. The aim of the second phase is to enhance marketing capacity in CDC/CIB. In addition, a technical assistance scheme for IT development is proposed in order to enhance cross-departmental cooperation within CDC/CIB and information sharing between departments within the organization.