



MINISTRY OF COMMERCE,
CAMBODIA

Integration and competitiveness study — Part C

*Sector studies — rice, diversified
agriculture, handicrafts, fisheries,
garments, tourism, labor services*

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

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Preface

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

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

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

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

Glossary

AEN	Artisanal Enterprise Network
ADB	Asian Development Bank
ATC	Agreement on Textiles and Clothing
CARDI	Cambodia Agricultural Research Institute
DOF	Department of Fisheries
EDC	Enterprise Development Cambodia
FCRMA	Federation of Cambodian Rice Miller Associations
FDI	Foreign Direct Investment
GDP	Gross domestic product
GMS	Greater Mekong Subregion
GSP	Generalized system of preference
GTC	Green Trade Company
ILO	International Labor Organization
ISO	International Standards Organization
ITC	International Trade Centre
LDC	Least developed countries
MAFF	Ministry of Agriculture, Forestry and Fisheries
MEF	Ministry of Economy and Finance
MFN	Most favored nation
MOC	Ministry of Commerce

MOT	Ministry of Tourism
MSWLVA	Ministry of Social Welfare, Labor and Veteran Affairs
MWVA	Ministry of Women's and Veterans' Affairs
NGO	Non government organizations
RGC	Royal Government of Cambodia
RMA	Rice Miller Associations
ROO	Rules of Origin
SEDPII	Second Socioeconomic Development Program
UNDP	United Nations Development Program

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Introduction

Background

Rationale for sector studies

The sector studies include practical examples of the policy, regulatory and institutional constraints to trade development; reviews of the impact on poverty of increased trade in specific sectors, and; examples of issues that need to be addressed to reduce barriers to increased trade and poverty reduction. Given that Cambodia's economic system is dominated by household units, the sector studies focus on the constraints faced by households in increasing income generating activities, including potential opportunities that could result from reducing trade barriers. The basic approach adopted in the sector studies is summarized in chart 1.1. The approach, and the focus on poverty reduction, is consistent with government development priorities as outlined below.

Government development strategy and priorities

The government's development strategy focuses on reducing poverty, from an estimated 36 per cent of the population in 1999, to 31 per cent in 2005. This is a formidable challenge in a country with an annual population growth rate of 2.5 per cent, and the workforce increasing by 3.2 per cent per year (Royal Government of Cambodia (RGC) 2001). The government aims to reduce poverty through: i) broad based, sustainable and equitable economic growth of 6-7 per cent per year; ii) social and cultural development; iii) sustainable management and use of natural resources and the environment; and iv) improved governance. The strategy also recognizes the potential benefits from developing regional and international trade and investment links.

With 90 per cent of the poor living in rural areas, the generation of increased agriculture output and off farm employment are important to reducing poverty. However, it is also important to recognize that industry and service sector output generally increase at a faster rate than agriculture

output in rapidly developing economies. The same trend can be expected in Cambodia. Unless the share of employment in non agriculture sectors increases, agriculture labor productivity (and thus wages) will increase more slowly than in other sectors and income inequality, especially between rural and urban areas, will increase.

Given that household units dominate economic activity, increased household and informal business activity will be important in increasing employment, but there is also need to remove the barriers to private investment in small and medium enterprises. Increased formal private sector employment has been pivotal in reducing poverty elsewhere in Asian economies by providing alternative higher productivity employment opportunities.

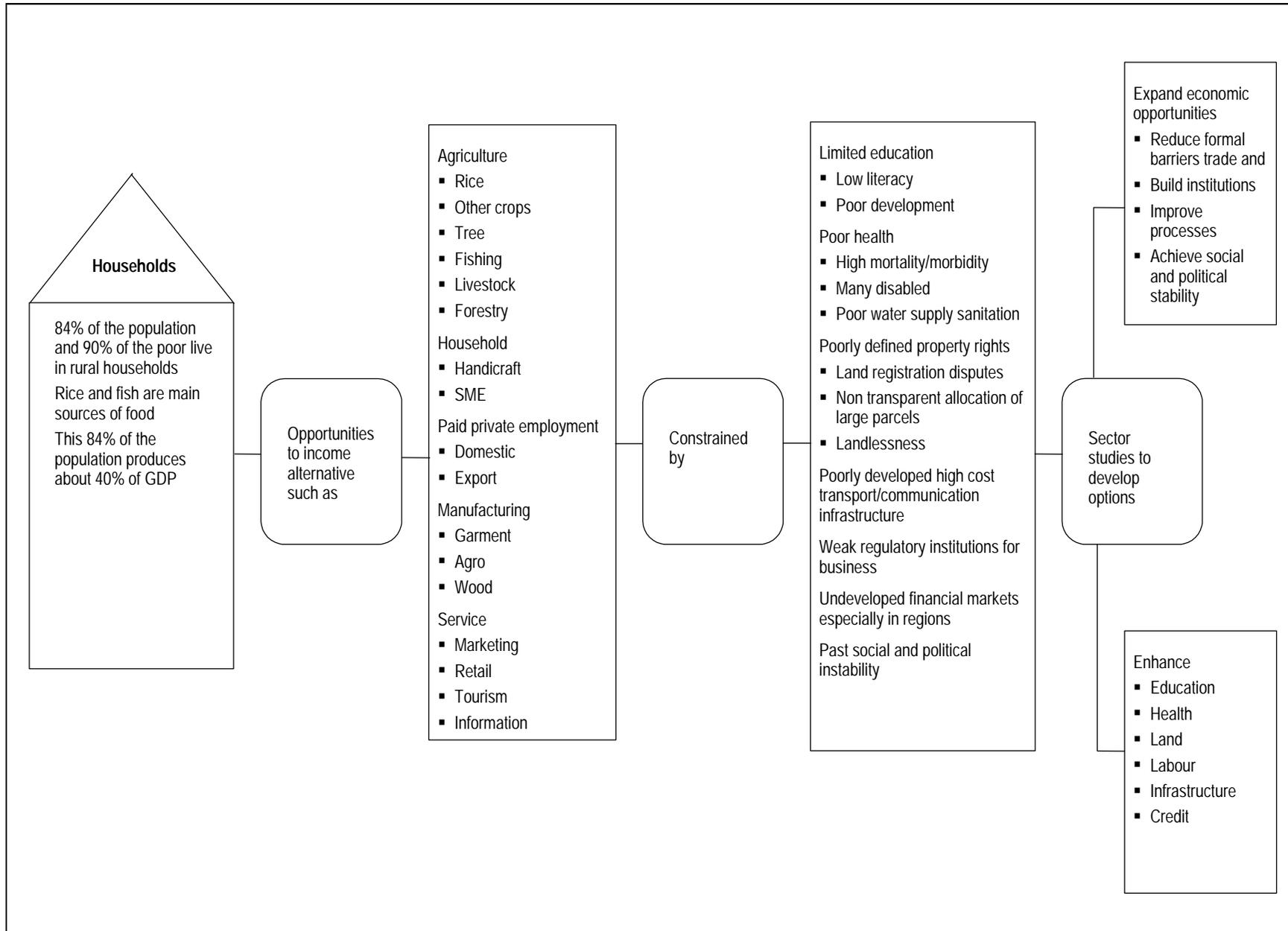
Selection of sector case studies

Seven priority sectors have been identified. These sectors are:

- rice
- diversified agriculture
- handicrafts
- fisheries
- garment
- tourism
- labour services.

The analysis draws on established material and in some cases considerable work has been done. In other cases such as labour services and handicrafts, the work is preliminary (RGC 2001). In addition to export development potential, the government selected these sectors because they met pro-poor objectives by providing opportunities for labour intensive employment creation and income generating activities in poor areas, and because of the potential to increase the value added of Cambodian exports. The government intends to prepare action plans for export development in each of these sectors drawing on existing and planned sector analysis. The preliminary sector analysis in this report focuses on rice, fish, tourism, agriculture, handicrafts and garments where substantive prior analysis already exists.

1.1 Framework for trade policies for poverty alleviation



Household economic systems and poverty in Cambodia

Structure of household economic activity

The foundations of the Cambodian economy are household economic units which employ and provide incomes for the majority of the population. Cambodia is an agrarian economy with 80 per cent of the workforce employed in the agriculture sector. The production of rice, for household consumption and trade, is the major economic output for most of the 84 per cent of households located in rural areas. Households supplement rice production with other economic activities such as fishing, production of vegetables, fruit and other cash crops, the gathering of forest products, and off farm employment. The landless depend on gathering activities, on communal or State land, and paid employment.

Some household members also earn incomes from: i) domestic private enterprise sector comprising mainly informal micro and small enterprises, but also a number of medium size enterprises are beginning to emerge; ii) foreign invested private enterprises engaged primarily in garments, other light industries, and tourism, and other services; and iii) the public sector, including a (declining) State enterprise sector. The domestic private sector is widely dispersed throughout the country, but employment by the larger private enterprises, foreign invested enterprises, and State enterprises is concentrated around Phnom Penh and other urban centres.

Summary profile of population and workforce

The most recent (1998) census estimated there were 11.4 million people (51.8 per cent female) living in 2.2 million households in Cambodia. Some 26 per cent of households are headed by females. The population is very young, with 42.9 per cent aged between 0-14 years of age. Fertility rates are high, with an estimated annual population growth rate of 2.5 per cent.

The level of human development is low by regional and international standards. Internationally, Cambodia was ranked 121st out of 162 countries in 2001 using United Nations Development Program's (UNDP) Human Development Index. In Southeast Asia, only Laos was ranked lower. Infant and maternal mortality rates have declined in recent years, but remain amongst the highest in the region. Life expectancy at birth is 54.4 years for males and 58.3 years for females. Only 37 per cent of the population are functionally literate. Only 31 per cent of urban, and 13 per cent of rural,

populations have completed school. Less than 5 per cent of the population has completed the equivalent of high school education. Addressing this deficit in human capital development is a major long term challenge for the people, business investors and the government. In the interim, analysis of export options and the formulation of export development strategies need to the reality of low levels of human development and include measures to address major bottlenecks.

The government estimates that the workforce is growing by 3.2 per cent per year, with 228 000 new entrants each year (RGC 2001). Open unemployment in urban areas was 9.2 per cent (12.2 per cent of females) in 1998, and open rural unemployment was 4.7 per cent (5.0 per cent of females). On the other hand, more than 35 per cent of workers have more than one occupation. Most (85 per cent) of workers are self employed (87 per cent of females and 79 per cent of males), with the remainder employed by the private sector (9 per cent of females and 10 per cent of males), and the State (2 per cent of females and 9 per cent of males). Only 11 per cent of the rural population earns wages, compared with 53 per cent in Phnom Penh.

Poverty profile

About 36 per cent of the population live in poverty. Poverty incidence is highest (44 per cent) in households where agriculture is the primary source of income. Some 90 per cent of the poor live in rural areas, and there is a strong correlation between poverty and remoteness from urban locations. About three quarters of the poor are self employed. Income inequality is high relative to other Southeast Asian economies (Gini coefficient of 0.42), and is reported to be increasing. Cambodia's per capita income was estimated at US\$238 in 2000 (compared with US\$286 in 1996) the lowest in Southeast Asia. Preliminary government studies suggest that economic growth has helped reduce poverty, but that the proportional benefits to the rich have been greater than the benefits to the poor (RGC 2000a). Concern has also been expressed that economic growth has yet to impact on many of those living far below the poverty line. In summary, growth has helped reduce poverty: the challenge in this report is to attempt to analyze options that may ensure that growth more directly assists in reducing poverty.

Why people are poor

The Government's Interim Poverty Reduction Strategy notes that people are poor because of inadequate human and physical resources, or the opportunity, to generate income and/or accumulate resources. Cambodia's recent violent history has resulted in many disadvantaged groups,

including internally displaced people, returning refugees, disabled people, widows, and orphans. The poor generally are disadvantaged by inadequate food supplies, poor health, physical disabilities, lack of access to land, insecure land titles, lack of skills, inadequate information, and poor access to input and product markets. Expanding higher productivity employment and other economic opportunities (paid and self employment) is crucial in reducing poverty. Increasing options will generally require progress in improving the access of the poor to land, markets, information, capital and other inputs, as well as improving the economic and regulatory environment to attract increased private investment.

Major economic sectors

Agriculture

The agriculture sector (including fishing and forestry) accounts for about 36 per cent of the gross domestic product (GDP) (1993 constant prices) compared with 46 per cent of GDP in 1995. About 80 per cent of the workforce are engaged in crop production, livestock production, fishing, hunting and forestry activities for subsistence and/or trade, mostly as part of household production units.

Production of agricultural crops accounted for 50 per cent of agriculture sector value added in 2000. Rice is planted on 90 per cent of the area currently cultivated with annual crops, but the total area planted to rice is only 80 per cent of the area planted in the early 1970s. Despite recent improvements, rice yields per hectare are amongst the lowest in the region. Economic returns to labour from rice production are as low as \$0.64 per day, or less than half the rates generated from the production of other agriculture products such as vegetables, soybeans, mung beans, cassava, sweet potato, tobacco and cotton (NESDB, KURDI and TCJDS 2001). The government aims to increase the production of annual crops by utilizing some of the 1.2 million hectares of agriculture land that is currently unused (RGC 2001). It also envisages a major expansion of rubber plantations, and other industrial crops such as coffee, cashews, palm oil, coconuts, sugar cane, and horticultural crops.

Freshwater fish production provides the major source of dietary protein and cash income for many rural households, and accounts for about 27 per cent of measured value added in the agriculture sector. The Tonle Sap, the Mekong River and its flood plains are important fishery resources. The Tonle Sap — which is of additional major significance as the major

breeding ground for fishing stock in the Mekong River and its tributaries — is under ecological threat from destructive fishing practices, agro-chemical pollution, and degradation of surrounding swamps.

Livestock and poultry production accounts for 17 per cent of value added in the agriculture sector. There is potential to increase livestock production (including eggs, poultry and pig meat) for export and domestic markets, and increase household protein supply, by reducing the above mentioned barriers to production, and by developing village based systems to reduce disease and improve animal health. This would directly improve rural incomes, food security, and provide a growing domestic market for animal feeds produced from corn, cassava, fish meal and other agricultural products. Given that many farm households use livestock as a bank or form of insurance (households sell animals when there is an unexpected need for cash), improved animal health could also help reduce the risk of poverty.

Forestry and logging accounted for 7 per cent of measured value added in the agriculture sector in 2000, compared with about 20 per cent in 1994. Log exports were the major source of export earnings during the 1990s, but forests were decimated by logging levels that the government estimates were four times the sustainable level. While there is now a temporary ban on log exports, illegal log exports continue. Improved forest management is considered a high priority. The government's medium term strategy is to introduce and enforce sustainable forest management practices to support wood products, wood processing industries, and tourism. Local community participation in forest management is seen as playing an important role in safeguarding forest resources and national parks. This, in turn, will be critical in maximizing potential returns from forest areas, while protecting water sheds and tourism development opportunities.

Government priorities for agriculture sector development include: i) improve food security through the expansion of rice production and other food crops; ii) add value to crop and livestock production by developing agro-processing industries; iii) increase income opportunities for farm households, particularly those headed by women, by diversifying crop production; iv) strengthen participatory processes in rural communities; v) ensure sustainable agriculture production through improved management of natural resources; and vi) increase the availability of rural financial services. The relevance of these priorities need to be reviewed on an ongoing basis. Given that food self sufficiency has been achieved and income earning opportunities provide alternative options for achieving food security, the need to focus specifically on expanding rice production could be reviewed.

Industry

Cambodia's limited industrial base was largely destroyed during the recent conflict. Industry has grown rapidly from a low base in recent years, with the share of industrial output (manufacturing, mining, construction, and energy and water supply) increasing from 13.9 to 35.6 per cent of GDP between 1995 and 2000. Manufacturing output increased from 8.3 to 18.4 per cent of GDP due largely to rapid growth in textiles and garments (from 1.9 to 12.4 per cent of GDP between 1995 and 2000). Garment manufacturing has been a major source of growth in paid employment in recent years. Following a decline during 1997 and 1998, the share of construction in GDP has increased since 1999.

Services

The share of services in GDP declined from 39.9 to 35.0 per cent between 1995 and 2000, mainly due to a decline in the share of trade from 13.4 per cent in 1995 to 10.2 per cent of GDP in 2000, and a smaller decline in the share of transport and communications. Given the rapid opening up of the Cambodian economy since 1995, the reported decline in the share of trade, transport and communications in both GDP and value added in the service sector, is somewhat surprising. While the decline in share of GDP may be partly due to the rapid expansion in garments, it may also reflect relatively stronger growth in informal service sector activities because of economic distortions and administrative weaknesses that contribute to considerable informal trade and widespread smuggling. The shares of output contributed by hotels and restaurants, finance, and real estate remained largely unchanged between 1995 and 2000. Government development strategies emphasize service sector development, especially tourism development, as an important source of growth in paid employment.

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Rice

Background

Paddy production accounts for about 90 per cent of the area cultivated for annual crops each year, and for 29 per cent of value added in the agriculture sector. Most households are engaged in paddy production, and rice represents the major staple in household consumption. There have been gradual improvements in productivity and increases in cultivated areas over the last decade, and Cambodia has moved from a net rice importer to a net rice exporter over the last decade (JICA 2001). Most exports are unofficial. Despite the net export status, food shortages persist in some areas because of weaknesses in infrastructure, trading arrangements, rural finance, information and low incomes. The prospects for future increases in production are largely unknown. This will depend on factors such as relative prices of alternative crops and inputs, alternative employment opportunities, technical developments, infrastructure, and technical limits resulting from the natural resource base. A recent JICA study presented a wide range of scenarios for future rice exports, from negligible levels, to 750 000 tons of exports by 2010 (JICA 2001). Regardless of export levels, improved post harvest practices, and more consistent quality, could help reduce product losses and increase farm gate prices and incomes.

Past government agriculture development strategies and support services emphasized food security, with support services focusing on increasing output (especially rice output) in recent years. While quantities have increased, returns to household effort are constrained by poor quality and the limited alternatives to paddy production. Quality problems are apparent at all stages of the rice production and marketing cycle. This limits export opportunities, and means that higher quality rice is imported to meet the demand of higher income consumers in urban areas. Returns to labor and land from paddy production are low, and future development of the sector will depend on improving quality, reducing post harvest losses, and increasing yields.

There are very close environmental inter relationships between agriculture, fishing and forestry in Cambodia, and this directly affects options for trade

development. In particular, development strategies need to recognize that any poorly managed increase in the use of agriculture inputs could have major adverse impacts on the Tonle Sap, and the inland fishing industry. Attempts to increase farmer returns will need to focus on quality improvements and reducing post harvest losses, while guarding against negative impacts of any increased use of chemical inputs.

Overview of paddy production and rice trading system

Most paddy is produced by rural household units, using low input technology, and with little contact with the market and market requirements. The main inputs for most paddy production systems are land and labor, and the output per unit of land and labor are amongst the lowest in Asia. Many farmers cannot read and have limited access to information and agriculture support services. Rice seed is often self grown, or obtained from other farmers. Thus, seed quality is variable and adoption of new varieties slow. Seed varieties are often mixed, making it difficult to obtain quality consistency and difficult to achieve management practices suited to external markets. Practices which may have been appropriate for subsistence production are proving less appropriate when producing for higher income urban and export markets. Post harvest losses are high, and there are opportunities for reducing losses and improving quality at all stages, from husking, drying, transport, storage, milling, and polishing to final marketing. Resolving these weaknesses could provide potentially substantial gains in terms of increased household incomes, poverty reduction, and increased export opportunities.

Small family mills are found in most rice producing villages, and they generally mill paddy for local farmers in return for the rice bran, or a cash fee. They also sometimes act as paddy buyers for larger mills. Medium and large size mills are located in the major rice surplus areas and in Phnom Penh. These mills usually purchase paddy, process the paddy to milled rice, and then sell to wholesalers and retailers. A few larger mills have their own wholesale and/or retail outlets. A Federation of Rice Millers was recently established to represent the interests of Cambodian millers, and to increase value added in domestic rice processing. The Federation recognizes that rice millers interests are best served by assisting farmers to produce quality rice to meet consumer needs, and has been studying options to encourage farmers to supply more consistent quality rice.

Farm gate prices are squeezed by high transport costs due to poorly developed infrastructure, weaknesses in transport services, informal tax collections along roads and other transaction points, and high shipping

costs. Weaknesses in post harvest practices and rice milling results in substantial quantities of (unmilled) paddy being exported to Vietnam and Thailand. Limited domestic milling capacity adds to marketing costs and further reduces prices paid to farmers. These are deadweight losses to the economy. Given the relatively small economies of scale in rice milling, there should be strong profit incentives to invest in improved post harvest processing to avoid these costs. Past instability and financing problems were cited as reasons for limited investments to date.

Institutional issues and options for developing rice trade

Human resources and technology transfer

Low health and education indicators constrain labour productivity, the transfer of technology, and access to market information. Lack of education stifles innovation and partly explains the limited progress towards producing export quality rice and alternative higher value agriculture crops. On the other hand, illiteracy should not be seen as a binding constraint to increased quality and trade. One investor noted that the rejection rate of corn grown under contract fell from 80 to less than 15 per cent in just four years, by using appropriate farmer training and attractive incentives. More broadly, this suggests a need to look at non conventional mechanisms for transferring skills, technology and information to farmers.

Adult literacy and skills training programs could help reduce the most immediate human resource constraints to improving household production systems, including rice production. In the longer term improved access to better quality, and more relevant, primary education is crucial to improving agriculture productivity. Plans to improve education access and quality should consider options to include agriculture production and other life skills at all levels. Increased current expenditure outlays will be needed to facilitate improvements in education and adult training programs. Donors could assist by taking a flexible approach to financing current expenditure. Options for encouraging non government financing of human resource development should continue to be encouraged, and lessons drawn from successful models.

Land markets

Efforts to improve security of land title can help encourage and facilitate investments in the rice sector, and more generally help ensure that land is allocated more efficiently. The new Land Law provides an important

opportunity to establish more efficient land markets and more cost effective financial services. Implementation of the government's new land law and land titling systems, will facilitate access to finance, reduce risks and thus provide greater incentives to invest in crop production, storage and post harvest technology. Efforts to stop the illegal private appropriation of State and community land and to develop land markets could help increase resource use efficiency and promote increased production of rice and other agriculture products. The need for more efficient land markets is highlighted as an important concern at the end of this report.

Agriculture support services and input supply

The Ministry of Agriculture, Forestry and Fisheries (MAFF) is responsible for providing agriculture support services, including agriculture research and extension. Past emphasis on food security has resulted in government support services and subsidies focused on increasing rice production, with little attention to improving quality and post harvest technology. Extension activities have been limited. The government has recently increased the priority and resources give to extension activities, including the dissemination of information via the mass media.

Limited attention has been given to exploring options for diversification into non rice alternatives that might provide opportunities to increase returns to labor and capital, and/or reduce seasonality in production and labour demand. The diverse needs of a market economy suggest a need for a broader farm systems focus. A farm systems approach to improving agriculture support services could also help provide the sort of information that will allow more direct targeting of poverty reduction by increase returns to exiting farm systems, while also meeting household concerns about the need to limit food security risks.

Fertilizers were provided on a subsidized basis through a State owned marketing agency, but the subsidies and the agency have been abolished since 1999, and the private sector now supplies most fertilizers. The Agriculture Material Bureau of MAFF is responsible for agriculture input quality standards. In practice, many agriculture fertilizers and chemicals are smuggled into the country and there is little capacity to ensure quality standards. While there are concerns that farmers are sometimes sold fertilizers with diluted nutrient content, the need to maintain reputations as reliable suppliers will provide strong incentives to meet quality standards as private suppliers become established and information systems improve.

A government research institute, Cambodia Agricultural Research Institute (CARDI), is responsible for developing new rice varieties and seed

multiplication. Of 34 varieties released by CARDI since 1990, only IR66 has widely spread to farmers. However, it has been difficult to sustain seed quality because of poor distribution systems, and lack of farmer information about the impact of seed quality on productivity and quality. The Agriculture Quality Improvement Project is supporting efforts to improve seed supply, develop seed certification, and develop and train farmer seed production groups.

The government should regularly review institutional arrangements for support services, including analysis of any overlap in responsibilities between the separate ministries dealing with rural development, water resources, the environment, and agriculture, forestry and fisheries. There is need to assess continuing central level resource needs in the context of decentralization efforts.

The government could also learn from privately financed agriculture support services such as those implemented by an investor in animal feeds production using corn, and recent initiatives by another investor to provide the support farm households to produce the high quality fragrant rice for the export market. Options for encouraging more widespread investment in such programs could be examined. In this regard, it is important that support being provided by external donors to develop the public agriculture extension and seed supply services do not crowd out private initiatives. In particular, the government could explore options for contracting out extension and seed supply services to the private sector on a competitive basis. More systematic evaluation of ongoing initiatives, including efforts to decentralize and devolve government services, could assist in early identification of bottlenecks and actions to address these bottlenecks.

Rural infrastructure

Poor transport infrastructure, high fuel costs (due to high taxes) and poorly developed transport services add to the costs of rice trade and to consumption costs, but reduce prices paid to farmers. These costs are exacerbated by informal fees that are reportedly collected at checkpoints on the road network. While such fees are frequently reported, no concrete estimates of the costs of these fees are available. Total transport costs account for 5–10 per cent of retail prices in Phnom Penh (Sik 2001). Railway and port services are generally provided by State enterprises with low levels of efficiency and informal fees (see section on the role of government in rice trade). Increased private sector participation in all transport sub sectors, combined

with an appropriate regulatory framework, is an option that could contribute to reducing transport costs.

Only about 10–15 per cent of farmland is irrigated. Institutional and resource constraints have resulted in poor operations and maintenance of irrigation facilities. Government policy, since 1999, is to transfer responsibility for the operations and maintenance of irrigation facilities to capable water users association. The private sector is now encouraged to invest in the development of irrigation infrastructure and services. Given resource constraints, an immediate government priority should be to improve the management of existing schemes.

There are plans to expand the Seila program. This is a government program to decentralize decision making, improve governance and to achieve more sustainable and cost effective development of community infrastructure projects. The Ministry of Rural Development has established Village Development Committees (VDCs) in up to half of all villages to encourage greater community participation in identifying formulating and implementing village level infrastructure development. Administrative decentralization is expected to be extended following the election of commune councils scheduled for February 2002. These efforts are at an early stage and will require substantive capacity building at the all levels to facilitate implementation. Local level administrations could be an important force in attempts to remove remaining informal barriers to trade. Efforts to facilitate information about the impacts of trade, and the costs of informal barriers to local communities, could facilitate that process.

Information constraints

Weaknesses in disseminating information on market prices and quality requirements, new varieties, and improved production and post harvest techniques is hampered by low literacy, weaknesses in internal communications, and limited access to mass media. Information constraints are further constrained by weaknesses in quality standards that leave farmers vulnerable to the adulteration of agriculture inputs. Similarly, there are limited opportunities for farmers to verify measures of weight or moisture content. Farmer associations can help address such concerns, while also providing farmers with low cost access to information. In the longer term, increasing competition, and the need to preserve reputations, provides powerful incentives for millers and traders to deal honestly with farmers. High international telecommunications costs limit access to international markets.

Rural finance

Despite market determined interest rate policies, and government commitment to developing market based financial services in rural areas, the reality is that few businesses (and very few farmers) in rural areas have access to formal sources of finance, and lending spreads are very high. The lack of financing has been a major constraint to investment in improved post harvest processing and storage of rice. Banks cite high costs of monitoring and recovering debt in rural areas, and the time and high cost of foreclosing on land mortgages, as important factors contributing to high lending costs and a reluctance to expand to rural areas. Banks will inevitably develop in urban areas first where cost structures are lower, and business opportunities more diverse. Informal money lender, families and non government organizations (NGOs) are the major sources of rural finance, and will likely remain the most major source for most farmers for some time. Government efforts to encourage NGO supported rural financial services to be established as formal micro finance institutions, should be closely monitored to identify opportunities to extend successful micro finance programs.

Rice marketing and processing services

Current rice processing arrangements raise some important questions. Why is paddy transported to Vietnam and Thailand for processing, and then re imported as milled rice for consumption? Why have Cambodian (or Thai or Vietnamese) investors have been slow to invest in improved rice milling and processing capacity when the levels of technology and investment required to develop improved rice milling and polishing are not great? Millers note a number of challenges including:

- the large number of paddy varieties grown in each village and even on the same plots makes quality control and consistency difficult;
- farmer awareness of improved post harvest technology remains weak. Improved husking, drying and storage techniques are needed to reduce the ratio of broken rice, and moisture and pest damage and other losses;
- high financing costs and difficulties in securing medium term financing for new equipment. Bank financing for operating costs (for example to buy and store paddy in the main harvest season (December to February) for subsequent milling) is expensive and not readily available; and
- past instability meant increased investment risks, and made it costly to enforce contracts.

More recently, there is evidence of investments in new and improved rice milling capacity. At least one investor has combined major investments in a new mill with contract farming approaches, private extension and input supply services with the aim of producing high quality fragrant rice for export. This investor had contracted 30 000 farmers to sow 20 000 hectares of paddy using high quality seeds. Harvesting is due to start November 2001. Another (foreign) investor in a Cambodian animal feed processing factory used a similar approach to reduce the rejection rate of corn offered for sale, from 80 per cent in the first year of operation, to 10–15 per cent four years later in 2001. In this example, higher prices paid for improved quality corn has proved to be a powerful incentive for farmers to increase the supply of quality corn.

The role of government in rice trade

Extensive government interventions in rice procurement, pricing and marketing were largely disbanded during the 1980s. Government fertilizer subsidies were abolished in 1997 and now most inputs are supplied by the private sector. Input and output prices are set by market forces. However, attempts to avoid taxes result in substantial smuggling of fuel, fertilizers and other agriculture inputs

The government remains involved in food aid distribution, and the army purchases domestic and imported milled rice for soldiers and their families. A state enterprise, Green Trade Company (GTC), has responsibility for purchasing rice on behalf of the State, including the purchase and storage of rice reserves required under the ASEAN Food Security Reserve Agreement. GTC also engages in profit seeking activities, including trading activities. Transport and other operating costs of GTC are reportedly much than private enterprises. The World Food Program (WFP) and other donors buy domestic rice, as well as importing rice, for food for work programs. Politicians and better off families also purchase rice for distribution to the poor, especially during emergencies and election campaigns.

There is need for better information on the effectiveness of current government involvement in rice procurement and distribution, including a study on options for introducing transparent and competitive bidding procedures for any government rice purchases. Demobilization may provide opportunities to monetize the part of soldiers salaries that is currently provided as rice and, thus, reduce government involvement in procurement decisions.

Officially, the government has lifted all quotas and tax barriers to exporting and importing rice. However, exporters are legally required to obtain a

permit before exporting rice. The stated aim of this licensing is to ensure food security. While there are no official charges for licenses, exporters report that facilitation fees are required to secure licenses. The Cambodian Rice Millers Association has identified 'irregularities' as a major constraint to exporting rice from Cambodia. Moreover, the current licensing arrangements have limited impact on food security as large quantities of paddy are smuggled informally. Thus, existing regulatory arrangements reduces competitiveness but does not achieve the stated regulatory objective. On the contrary, existing arrangements encourage corruption and discourage the export of rice through formal channels. According to some estimates, unofficial costs nearly double the cost of export procedures through official channels as shown in table 2.1.

2.1 Cost of milled rice export procedures

<i>Expense item</i>	<i>Amount</i>
	US\$/20ft container
1 Expenses with proper receipts	
Custom officer (tax free, but permit required)	0.00
Ministry of Commerce - licensing	0.00
Camcontrol (@ 0.1% of licensing fee)	36.00
Photo sanitary (if required @ US\$0.5/ton)	10.00
Handling (storing into a container)	55.00
Subtotal	101.00
2 Expenses without 'proper' receipts	
custom officers (me kouy)	30.00
customs officer (inspector)	30.00
customs officer filling export documents	26.13
Camcontrol (inspector)	7.81
Photo sanitary (inspector)	10.00
Economic police	5.22
Border police	5.22
Handling, workers	26.13
Commission fees	40.00
Subtotal	180.51

Source: EDC 2000,

The total cost of export procedures add about US\$14/ton to the cost of exporting rice. The costs of unofficial exports of paddy have been estimated at US\$10–15/ton of paddy. (Sik 2000, p. 18) estimated that the total cost of this ineffective regulation could be equivalent to 85–126 per cent of total government expenditure on the agriculture sector in 1999. Reductions in formal and informal charges and barriers to rice exports would greatly increase incentives to invest in improved post harvest processing of paddy, could greatly increase value added in the rice industry, and reduce the currently widespread smuggling of paddy across the Thai and Vietnamese borders. A detailed review of the costs and benefits realized from privat-

izing all export handling procedures could greatly assist the government in identifying options to ensure more equitable distribution of the benefits of trade.

Potential economic and poverty impacts of increased rice trade

The potential economic gains from reducing inefficiencies in agricultural production trade can be substantial as was demonstrated in Vietnam during the late 1980s and 1990s. Rapid expansion of trade in rice and other agricultural commodities contributed to the substantive poverty reductions in Vietnam during the 1990s.

In Cambodia, most efficiency gains are to be realized from reforming the domestic production, processing and trade systems, rather than from reforms at the border. Resulting reductions in intermediation costs would benefit both producers and consumers. While Cambodia is a net exporter of rice, and domestic rice generally reflects export parity prices, there is some market segmentation. Higher quality paddy is exported, while high quality milled rice is imported. Improving the quality of local rice could reduce the need to import high quality rice and, by reducing transport costs, would result in lower prices of high quality rice in urban areas. Increased domestic production of higher quality rice, in the absence of other efficiency gains, could result in reduced supplies and increased prices of lower quality rice.

In localized areas where there are currently no opportunities to access other domestic and international markets, increased trade opportunities would result in an increase in local rice prices. This would benefit those with adequate resources to produce surplus rice, but would increase costs of purchasing rice for those who lack the resources to produce all household rice requirements. On the other hand, improved access to trade and higher farm gate prices would provide improved incentives for increased investment in production and this would generate increased employment. Thus, households with rice surpluses would benefit, but it is not possible to be sure about the net affect on rice consumers.

While it is possible that some of the poor (for example, those that are net consumers of rice) could suffer welfare losses from increased rice trade, proposed improvements are expected to have a major positive net contribution to reducing poverty.

3

Diversified agriculture and agro-processing

Background

The small holder and household enterprise character of agriculture in Cambodia, the importance of rice, and the major constraints on agricultural production and agricultural marketing in general, have been described in the introduction to these case studies, and in the sector studies on rice and fish. The majority of attention devoted to development of Cambodia's agriculture in the past decade has been focused on rice, as the primary food security concern. Yet the Cambodian landscape presents a variety of additional and alternative options for increasing food production, and for gaining access for Cambodian products into international markets. This chapter describes some of the opportunities and challenges for development of a diversified agriculture and agro-processing sector in Cambodia, responding as much as possible to current reality on the ground, and to the policy of the RGC that such a development should be affirmatively pro-poor.

It is suggested here that technical and marketing support (domestic and export), to existing micro, small and medium scale agro-processing enterprises in the private sector, and the creation of enabling trade mechanisms throughout the Cambodian economy, will help create a demand pull for increased production of higher quality farm products. Complimentary support to associations of farmers and other forms of producer organizations will provide the basis for coordinated responses to domestic and international market demand. These efforts will contribute to employment generation, especially in rural areas, both on and off farm.

Some ideas are offered for initiatives to help make this happen.

Policy orientation:

Among the government's primary macro policy objectives is the reduction of poverty, especially rural poverty. As stated in the draft Five Year Plan (SEDP II):

'Poverty in Cambodia is primarily a rural phenomenon. The overwhelming majority of the poor get their livelihood from agriculture, and the incidence of poverty is also much higher among farmers than among other occupation groups. Approximately 84 per cent of the population, and 90 per cent of the poor, live in rural areas, and agricultural activities are their main source of income. At the same time, agriculture provides over 40 per cent of the GDP. Therefore, the Government's strategies for developing the economy and for poverty reduction demand a much stronger focus on agricultural development, which is the most effective way to create more employment. *But more crop, livestock, fisheries and forestry production will only lift people out of poverty if specific measures are taken to protect and assist the poor and if the country's natural resources are managed sustainably...* (emphasis added) (Ministry of Planning 2000, page 99.)

As seen in the previous sections, for agriculture the issues of social and physical infrastructure development are germane, but they are underlain by more basic issues of social justice, rational planning, and long-term environmental stewardship. An example is given in box 3.1. The pro-poor trade development strategy is intimately linked to the rest of Cambodia's reform agenda in this way.

The RGC priorities for the development of the agriculture sector, as laid out in the SEDPII, require or are at least consistent with a smallholder and micro-enterprise oriented development model.

- *Improve food security through the expansion of rice production and other food crops.* As noted in the rice case study, there may be potential for expanded rice production. But other food crops are also produced in a great diversity in Cambodia, mostly on a household and micro scale, in kitchen gardens and for neighborhood markets. This is true both in rice growing areas, and on extensive upland areas where rice production is less appropriate. There are some small commercial market operations close to urban areas, and some export oriented production, but most farming in Cambodia is at the subsistence level. Food security must be associated with people's participation in the market economy. Market orientation, and market responsiveness of farm production must somehow be greatly increased if production is to be expanded. Cambodian agriculture and most of its industry are presently small holder and micro enterprise based, and it is with that social and

3.1 Agricultural development models

In addition to rice production at the household level, the approach of the RGC to agricultural development is significantly concerned with the expansion of plantation agriculture, producing commodities for export in raw or primary processed form. Rubber has been an important export crop since colonial times, and the model of granting large tracts of land for production purposes to individual management units (state-owned, quasi-private, or private enterprises) remains very attractive to policy makers, in the current stage of transition from a command economy to one which is market-driven.

Many large-scale agricultural concessions continue to be granted in Cambodia, for a variety of schemes (pulp-wood, bamboo, palm-oil, cashew nut, maize, and soybeans), often to well connected individuals or firms and without environmental impact assessment, public participation or open bidding. The problem of 'land grabbing' by locally powerful interests has been well documented (Cambodian Development Resource Institute (CDRI) 2000). The problem has been recognised by the government, as for example the recent Prime Ministerial order that agricultural concessions may not be larger than 10 000 ha (Some up to 30 000 ha are in place). These practices will decline as the new Land Law (signed into law by the King in August 2001) and other legal reforms take effect.

While land ownership amongst Cambodians is widespread very few people have official land titles. There is active transfer of land but there are also issues of land encroachment and disputes over transactions. Unclear title and preferential allocation are major obstacles to poor people improving their incomes. If they own land, they are inhibited from using it to best advantage including activities which might involve employment of people who own either small parcels or no land. If land subject to dispute, owners are reluctant to invest in it and they cannot borrow anyway. Land which is granted to preferred people is also unlikely to be used to best advantage and it is reported that many plantation concessions are little more than spectacular schemes. The important thing for both income generation and poverty alleviation is that human and land resources not be wasted. The new land law is a good start and the next steps are to secure its widespread understanding and acceptance.

economic reality that a pro-poor agricultural development program ought to begin.

- *Add value to crop and livestock production by developing agro-processing industries.* Value added processing in response to market demand is one of the keys to increasing the level of economic activity in rural areas. Both large and small enterprises can do that. This objective is of itself scale-neutral.
- *Increase income opportunities for farm households, particularly those headed by women, by diversifying crop production.* Increased income opportunities for farm and other rural households requires increased opportunities to sell products that can be produced locally, from available resources. In the Cambodian context, this means the creation of local, natural resourced as enterprises which maximize employment. An affirmative orientation toward the needs of female headed households in particular requires that enterprises be local (close to homes and community institutions like schools and clinics).
- *Strengthen participatory processes in rural communities.* The creation of agro-processing industries, at any scale, will require social mechanisms to assist farmers to improve the quality and quantity of their output.

They must acquire knowledge and become more self-reliant. The contract farming operations which are emerging in Cambodia are one example of participatory processes. The more they respond to and balance the needs of all participants, the more likely they are to be viable in the long term. The delicate and democratic fostering of grassroots, producer and processor organizations, the application of the farmer field school techniques and related approaches, all offer some hope of success.

- *Ensure sustainable agriculture production through improved management of natural resources.* The move of the RGC toward decentralization and deconcentration of government affects natural resources management, including agriculture, in a very direct way. The new law on commune administration, and its sub-decrees, will place the responsibility for natural resources management at the commune and provincial levels, with central institutions playing a supporting role. Sustainable management of natural resources therefore will require farmers' associations and agribusiness associations to play a strong role in management at the local (and indeed national) political levels. Sustainable agricultural production systems also require environmental responsibility.
- *Increase the availability of rural financial services.* One of the impediments to the development of rural financial institutions in the country is the low repayment rate experienced by so many rural credit programs to date. One not very successful approach to solve this has been to force the creation of loan groups, so that members guarantee each other. Experience with the new rice millers' associations is now showing that the associations can themselves provide a mechanism for selecting credit-worthy loan applicants, and for ensuring a high rate of repayment. Associations of small farmers and small rural enterprises may turn out to be similarly credit-worthy institutions.

The RGC's development policies are thus seen to imply an attempt to build on the existing structure of the rural economy wherever possible. That is not to say that there is no place for larger scale activity, but that may be expected to emerge as the institutional underpinnings of a market economy become established. Those underpinnings will include widespread understanding of the new Land Law so that land title is recognized and accepted as collateral and land parcels can be bought and sold and land holdings be consolidated or partitioned as marketing and production requirements change. It would also include institutional arrangements which ensured allocation of public land to private sector investors which are transparent and open to all.

Marketing and processing

The structure and function of agricultural commodity marketing in Cambodia was reviewed in 1997 by a team in the MAFF Agricultural Marketing Office, supported by Food and Agricultural Organization (FAO) (MAFF 1997). A team from the International Labor Organization (ILO), with support from UNDP, carried out in 1999 a review of 'Micro and Small Enterprise Development for Poverty Alleviation in Cambodia' (ILO 2000).

Agricultural processing and marketing is largely informal, except for the larger rice millers and the rubber and other plantation enterprises. Agricultural products flow from small producers to consumers fairly quickly and through short channels, given that storage and processing infrastructure is minimal. Producers either bring commodities directly to local markets themselves, or sell to collectors (middlemen) who deliver to retailers in larger market centres especially Phnom Penh. Some wholesale enterprises exist, especially for commodities that may be transported to other provinces or exported to Thailand and Vietnam, but even these are informal enterprises, often without fixed operating locations or storage space.

Agricultural products are traded within and between provinces where local surpluses and deficits of rice, fruit, fish or other staples exist. Commodity supplies and requirements are often seasonal, with many non rice crops being produced in the wet season. Net flows may reverse from season to season, as for example the import of oranges to Phnom Penh in February and export of oranges from Battambang to Thailand at other times of the year. Many commodities will be in glut on the markets for a short time, then disappear to be replaced by others in season.

Border trade in rice and fish has already been described in the relevant sector studies. The pattern for other agricultural products is similar. At Poipet for example, produce is offloaded from trucks, subjected to formal and informal taxes and handling charges, and manhandled across the border, to where Cambodian traders are at the mercy of their Thai colleagues. Here again it is the high value and high value added goods which flow into Cambodia, and unprocessed or dried smoked and fermented products which are exported.

Cambodian markets display a broad range of locally processed agricultural products, for example milled rice, smoked dried fermented or salted fish, fermented cabbage and pickled vegetables; noodles, baked goods, and dried fruit. Much of this material is from household and micro-enterprises, although a few larger processing operations do exist, in addition to the rice

millers. A recent study of larger manufacturing enterprises in Phnom Penh showed 20 per cent of the sample to be food processors such as noodle manufacturers, small canneries, and bottling plants (MPDF 2000). Unfortunately, that study was essentially confined to Phnom Penh, and moreover the analysis did not provide a disaggregated description of these operations. More detailed field study is required to identify and describe household level and larger operations in other centres, and especially in rural communities.

Data from the Ministry of Industry Mines and Energy show 24 895 registered industrial establishments in 1998 of which 24 061 (96 per cent) employed less than 10 persons (micro enterprises). It is not known how many unregistered establishments there may be. Earlier data suggest that about 11 per cent of rural households operate some kind of business from their homes, a figure which rises to about 20 per cent in Phnom Penh. Of the 24 061 registered micro-enterprises, fully 18 419 or 77 per cent were in the category 'food, beverage and tobacco'. Among these many entrepreneurs there may be particularly fertile ground for business development support, aimed at both domestic and export markets.

Cambodia has a well developed, largely informal and micro or small scale agro-processing and trading system, peopled by economically rational participants who respond effectively to perceived constraints and opportunities. The conclusion is that Cambodia already has some of the key elements on which a modern production, processing, and marketing system could be built. Initiatives are needed both to remove the constraints, and to enlarge the perception of the opportunities. An active commitment is needed from Government, to enabling and supporting the leadership of the private sector

Obstacles to expansion

In the domestic and international trade of non-rice agricultural commodities, the problems facing Cambodia are very much the same as described for rice. The ILO study cited above also provided essentially the same list of constraints on small and medium enterprise development in Cambodia.

Transportation. The poor state of Cambodia's transportation infrastructure has been described and acknowledged. Considerable investment is now being made to improve critical road transportation, both at a national strategic level, and at the tertiary level of access to individual communities at some distance from main roads. Emphasis on local and participatory transport planning approaches (for example, Integrated Rural Access

Planning) will help make transport infrastructure investments more efficient in terms of strategic priorities for local enterprise development especially agro-processing.

Telecommunications infrastructure has until recently been very poor in Cambodia. However the coverage of internet capable cellular telephone technology is now near complete nationwide. This means that market, weather, pest outbreak, and other critical information can be made readily available, through dial up and even broadcast text messaging systems. Radio and television coverage is everywhere and accessible.

Energy costs in Cambodia are high, as electricity is almost entirely derived from diesel generating equipment and there is no national grid. Recent research funded by the World Bank has begun the analysis of the existing informal electric generation industry in the country. Clear possibilities have been shown for rural electrification based on the already common relatively small scale (10KVA) rural utilities (battery charging and neighborhood lines) operated by the local private sector. Some rural electric producers in Cambodia have already added ice plants to their investment, with obvious implications for the potential of a vegetable processing industry.

Information. Means are needed to get current market and technology information to producers and processors, in a form they can use. Most Cambodian farmers and small business people have been living as if on a desert island for the past 30 years, cut off from an understanding of competitive markets game. They do not know, for example, that in some countries, producers routinely organize themselves into associations of one kind or another, to share resources and indeed to influence prices where possible. They don't know where to get information about technologies and methods required to meet customers' quality expectations in a cost effective way. The MAFF Department of Agricultural Marketing began planning for a market radio service in 1997, but this has not materialized.

Trust and Risk. Like most farmers, but painfully more so, Cambodian farmers are self-reliant survivors. The Khmer Rouge social engineering experiment succeeded in severely damaging the social contract in the country, and attempts by authorities to induce farmers to form associations or cooperatives are greeted with suspicion. People are reluctant to make the sorts of agreements necessary to implement any kind of future contract between buyer and seller, in the absence of effective means for dispute resolution. Attempts to organize producers will need to proceed through private sector support mechanisms.

Private Sector Capacity. Private sector agencies capable of supporting business development in agro-processing and other rural based enterprises are urgently needed. The skills required for successful business development are not widely present in the population, to whom modern education and exposure to scientific knowledge are only just reappearing. At least one Cambodian NGO is working in this particular field of human capital formation, but is itself only just beginning to develop.

Credit. There has been considerable growth in the capacity and coverage of microfinance institutions in Cambodia over the past several years, but access to financial services remains limited. There is an increasing focus on individual loans for small business activities, which needs to be complemented with training in business development.

Opportunities for market oriented production and processing

National agricultural statistics are presented in the SEDPII for a limited number of crops entering larger markets, (rice, maize, cassava, sesame, sugar cane, soybean, mung beans, peanuts, tobacco, rubber, jute, cattle, pigs, poultry, and fish). The usual impression is that there are not many non-rice options other than these few. The Agriculture Market study referred to the above lists a number of additional crops which enter domestic and international markets. These crops include fruit — mango, jackfruit, durian, pineapple, banana, oranges, limes, various melons, and coconut — and leaf vegetables — especially cabbage, kale, and water convolvulus, and gourds.

However, an attentive walk through a few Cambodian farms reveals a wide diversity of crops which are grown for subsistence or very local markets in ‘kitchen gardens’ or which are protected and utilized in common areas like roadsides and forest margins. One finds an astonishing variety of vegetables, including leafy greens, especially, but not only brassicas, roots and tubers like taro, ginger, sweet potato and Irish potato, annual fruits like chilli, melons, ladyfinger, cucumber and other cucurbits, tree-fruits in profusion (more than 10 local types), aromatic herbs and spices, traditional medicinal plants, and a number of small animals especially in the aquatic environment of the rice fields. These crops and gathered items are fundamental to the food security of Cambodian rural households given the uncertainties and low yields of rice production. Garden systems are usually designed to ensure at least some productivity in the face of unpredictable weather and other sources of crop loss.

Rice in Cambodia is largely a lowland crop. Large areas of Kampong Cham, Kampong Thom (high population provinces) and parts of the north-western provinces are poorly suited to rice production but will support so-called upland crops. These systems present significant opportunities for increasing and diversifying Cambodia's agricultural and agro-industrial sector, a process which has already begun. The kinds of products and services which can be derived from them are in growing demand as 'specialty foods' among both 'northern' and 'southern' partners in the global economy, particularly but not exclusively among more affluent consumers, who have effective demand for increased variety, year-round availability and quality in their diets. Moreover the improvements in transportation infrastructure currently planned or actually under construction will link these areas to major urban markets in Thailand and Vietnam. The challenge for Cambodia is to capitalize on these opportunities in a structured way, to ensure the biological and economic sustainability of the enterprises, and the equitable, indeed the affirmatively pro-poor distribution of the benefits.

At least for the next decade, successful micro, small and medium agro-industrial enterprises in the rural areas of Cambodia will in large part be based on such easily grown or familiar commodities, to which value can be added in relatively low cost work-places, using simple technologies (not primitive, but modern and appropriate in design to small and medium enterprises). High value density products especially but not only frozen and dried fruits and vegetables, spices, juice concentrates, fragrances, essential oils etc, will be initially favored until transportation infrastructure is improved.

Most of the commodity examples given in box 3.2 are conventional, in the sense that technologies and approaches totally new to Cambodia are not required. No one item will provide a magic bullet. A program of support to a range of enterprises of this kind, which builds private sector capacity to overcome the identified constraints, will over time assist the modernization of the Cambodian rural economy and the off farm employment gains which that will bring.

3.2 Some specialty crop export opportunities

Fresh, frozen and preserved Asian vegetables: Vegetable producers in Australia, Thailand, and Vietnam provide high quality fresh, frozen and pickled vegetables to the Asian specialty food market worldwide. Specialty products like baby corn, lady finger (okra), the Japanese bar-snack *edomame* (boiled young soy beans in pod, eaten with salt) and many others may represent significant opportunities for Cambodian enterprises. The Australian government's Rural Industries Research and Development Corporation (RIRDC) has carried out research and published guidelines for producers and processors wishing to access such markets (see www.rirdc.gov.au).

Spices and herbs: Cambodia produces black pepper, chillies, cinnamon, cardamom, betel, star anise, and other spices, plus a wide range of kitchen herbs including lemongrass, aloe vera, hibiscus, basil, and the many *chi* or salad herbs. Dried chillies are a significant product for domestic and export markets. Black pepper from Kampot Province was once a world renowned Cambodian specialty and is currently undergoing a resurgence in planted area, both by smallholders and as an estate crop.

Fruit and juices: The 'Pursat Orange' (mostly grown in Battambang Province) is prized by Cambodians for its fine flavour. In the prewar time, there was a juice concentrate factory in Battambang town, the shell of which still stands. There is a seasonal diversity of fruits (for example, pineapple, watermelon, guava, durian, jackfruit, papaya, kaffir lime) which farmers are now bringing back into production

Vegetable seed production: Cambodia's upland biotopes, especially in the northeast region and in Pailin (known here as Cambodia's Chiang Mai) have the right climate and soils for the production of seeds for the many domestic vegetable crops which do not set seed well in the hotter lowlands.

Oil seeds: Cambodia now produces maize, soya, ground-nut, sesame, and castor seed, almost all of which are exported unprocessed to Thailand and Vietnam. Significant opportunities may exist for adding value through production of export quality sesame and soy oil, with by-products entering the local food industry. Sesame-based confections (*halawi*) may find niche markets in the Middle East. Cambodia has an emerging production of castor seed, partly in response to a large volume contract between a Thai castor oil processor and a private Cambodian producers' association.

Essential oils: Cambodia already markets internationally a reasonably good quality of 'tea tree' oil, a home remedy popular in Australia and elsewhere for muscle aches and skin infections and a source of turpene compounds for industrial synthesis of vitamin A and other materials. Many candidate species of essential oil producing plants are already grown in Cambodia. International markets are well developed and growing.

Varietal rice: Specialty food shops in developed countries are now marketing many different varieties of rice, recognizing the flavor and texture qualities which are among the reasons why farmers all over the tropics prefer and preserve their indigenous varieties. Rather than being limited to competing head-on with well established producers of high-yielding, standard varieties, Cambodia could seek a position in this emerging specialty market.

Sericulture: Silk weaving is considered in the sub-section on handicraft exports. Cambodia produces very little of the silk yarn which is used in traditional weaving, the majority being imported from Vietnam. Cambodia has its own indigenous varieties of silk-worms which produce very high quality fibre of a particularly beautiful natural golden color. Attempts are underway to re-establish mulberry plantations and the related sericulture technology which were a feature of the Cambodian economy before the war.

Solutions

Capturing these opportunities, and turning them into development of an export oriented agro-processing sector, will require coordinated support from the RGC, strongly oriented toward enabling the private sector to

develop and take the lead. The systemic problems of governance and poor infrastructure, treated in this and the other sections of this report, are not exclusive to the trade sector, and will have to be dealt with over time and with significant political will.

Meanwhile the pro-poor strategy identifies the Ministry of Commerce (MOC) as the focal point in the trade sector. Institutional capacity building is required to enable the MOC to carry out effectively its important role in promoting small-scale private sector initiatives. Capacity is required to provide a number of services:

- carry out a detailed overall market oriented agricultural and agro-industry sector analysis and strategic planning effort, in cooperation with concerned ministries and the private sector, using an integrated approach.
- From the analysis, identify groups of existing agro-processing operations (for example, fish, soy and chilli sauce manufacturers) which might benefit from business development services, and provide those services. Link these entrepreneurs with groups of producers.
- Identify high quality 'green', Asian specialty, and other niche markets for semi processed and finished agricultural products and determine market requirements for quality, price, and availability.
- In consultation with industry and other ministries, especially Agriculture and Health, examine the potential benefits of a national Cambodian export quality brand identity scheme, with quality management programs for export commodities, taking into account all of the food chain, from 'farm gate to consumer plate'. Enlist assistance from organic, International Standards Organization (ISO), and other international quality certification programs and service providers.
- Assess demand for an information service, for production and agro-processing investors, on opportunities and constraints in specific areas of the country, disaggregated to the district or even commune level.
- Promote strategic partnerships between Cambodian and international private sector agencies, through government to government contacts and reaching down to industry associations and individual firms.
- Develop trade facilitation services such as a trouble shooting help desk for sellers and buyers, global market intelligence services, and investor support services.

Specific suggestion for action: An Incubator Project

Nothing succeeds like success. For the diversification of Cambodia's agriculture, and the development of a vibrant rural agro-processing industry, some success models are urgently needed, which identify and explore solutions to known constraints and demonstrate what can be done. A pilot project could provide both an opportunity for a more detailed opportunity analysis, and an 'enterprise incubator' capability, in which private sector production, processing and marketing enterprises would be identified, nurtured and launched. This is not a new approach, being very effectively used in the high technology sector worldwide. The effort should focus squarely on micro and small enterprises. Program efforts to date to provide project development support to medium and large scale enterprises have not had much impact, due to the lack of activity at that scale, and to the recognized constraints which discourage larger investment. It will be important in the beginning to work with the situation as it is, among the existing participants.

Components of the Incubator Project might include the following.

Identification and support of Interest Groups among sector participants

As noted, a comprehensive analysis of the existing agro-processing industry in Cambodia is needed to identify interest groups of participants among household level micro, and small enterprises. The industry study cited previously indicated that a number of the food industry participants in Phnom Penh were in fact manufacturers of chilli sauce, surviving in the face of heavy competition from Thai and Vietnamese imports. This may be an example of an interest group which could respond effectively to the kind of support which stimulated the formation of the Cambodian Rice Millers' Associations and National Federation. Dried chillies are presently exported from Cambodia, probably to supply processing operations in other countries, as is the case for Cambodian rice. Other examples could be given, and more information about the actual entrepreneurs and their operations is required.

Analysis of Cambodia's comparative and potential competitive advantage in international agricultural commodity markets

The International Trade Centre (ITC) has produced a powerful series of reports analyzing developing country opportunities, constraints, and strategies in accessing developed country markets for many products: coffee, bananas, pineapple, organic products, coconut, coir, cut flowers, handicrafts, and more (see www.intracen.org). The reports represent the output of some months of intensive work by qualified professionals for

each study, an intensity of effort not possible in the time and resources allowed for the present report. A series of several such analytical studies might focus on items identified by the comprehensive survey, starting perhaps with chilli and other sauces, frozen vegetables, herbs and spices, cashew nuts and essential oils. ITC Staff or other suitable consultants would work with teams of locally contracted personnel in carrying out the studies. Results would be used to target the enterprise incubator program to high potential products.

Basic production resource assessments in target areas

Agro-ecological, economic, and social assessments of particular locations are a primary asset for targeting crop diversification and agro-processing enterprise development. Preliminary studies have been carried out in some places (for example, Kampong Cham and Kampot provinces) by the Department of Extension of MAFF, under the Cambodia Agriculture Extension Phase II (CAEPII) project with AusAID funding. However CAEPII has capacity building objectives in MAFF, which mean that results will take several years to have impact. The Incubator Project could provide a means for fast-tracking detailed assessments of resources and constraints in identified candidate areas, and for making this information publicly accessible for use by all private sector participants at low cost.

Support to organisation of production

There are many social models for ensuring that processing facilities have a steady supply of produce as inputs, at prices and of a quality responsive to the demands of target markets. Examples of cooperatives, contract farming, farmer producing and marketing associations, agricultural estates, and the open market, are all present in Cambodia. As noted, contract farming operations, some quite large, have emerged in Cambodia, around tobacco and fragrant rice, and in castor seed production. Associations of primary producers and of processors, around specific product groups are another model. Whatever the form, these arrangements can be successful when there is a means for information flow, and some kind of disciplined and democratic governance. In general these models work best when there is a basis of mutual interest among all parties, and where there are satisfactory means of conflict resolution. Imposition of social forms from above rarely works well, particularly in Cambodia with its historical and continuing abuse of authority in public office. The Incubator Project could introduce members of identified producer/processor interest groups to the possibilities, through training workshops and through study tours to successful examples in Cambodia and in neighboring countries. This approach has been a key element in the early success of the Rice Millers'

Associations, and appears to be having some positive impact on Cambodia's Rural Electric Enterprises.

Setting standards and facilitating quality

A key component of the strategy will be niche marketing, with the niche defined primarily by green quality criteria including: pure, natural, pesticide free, certified organic, biodiversity sustaining, environmentally friendly, and health/vigor/longevity promoting. The global marketplace increasingly demands such attributes, and this demand represents a significant opportunity. Experience of other countries has been well reviewed by ITC, and the specifics of Cambodia's situation should be analysed, including possibilities for organic and ISO certification.

National brand identity promotion

Related to niche marketing is the development of a Cambodian identity in the market. As Cambodian products begin to enter successfully into international markets, it may be possible to build their reputation by promoting a 'made in Cambodia' label identified with the green quality criteria mentioned. The Incubator Project would assess such a strategy in Cambodian terms, and if warranted prepare a plan for its implementation.

Private sector extension and business development services

Technical capacity to deliver many or most of the services required is present in Cambodia, but it is not organized into an institutional capacity. A fund for contracting in agribusiness development services on behalf of producer associations, processors, and other players selected under 'pro-poor' criteria, would create effective demand for agribusiness 'extension' services and thereby induce a supply response to that demand. Contracts would be let under normal procurement procedures. The idea is to jump-start a professional services industry serving Cambodian micro and small agribusiness, contributing to the rapid development of both.

Access to investment capital

As suggested above, producer/processor organizations may provide a means for identifying credit-worthy enterprises. The Incubator Project could provide a financial leverage facility, offering loan guarantees or other means of encouraging investment in promising ventures.

Export trade facilitation

The Incubator Project could provide the necessary support to the Export Promotion Department in the Ministry of Commerce, to provide trouble shooting help desk services, government to government liaison, and international promotion of Cambodian products.

Conclusion

The Cambodian rural economy is composed predominantly of semi-subsistence rice farms, and household and small enterprises employing less than 10 people. There is a wide range of opportunities to build on this base, to diversify and expand agricultural production and value-added processing activity, with an orientation toward domestic and international markets. Constraints are of two classes:

- the systemic ones, including poor infrastructure, governance issues especially informal taxes and transaction costs, access to information, and access to capital; and
- specific constraints most importantly the lack of effective support to the small scale private producers and processors, in particular extension services for non-rice production and business development services for agro-processing entrepreneurs.

This review highlights the need to address directly the RGC's poverty alleviation objectives, through employment generation especially in rural areas. The suggested means is through encouraging the existing small scale private sector to diversify agricultural production and to expand and develop agro-processing enterprises. A number of specific possibilities and approaches have been described. The proposed Incubator Project could provide a mechanism for a more in-depth analysis of the sector, and the identification and nurturing of some initial successes.

4

Handicrafts

Background

Handicrafts offer considerable potential in the context of a pro-poor trade strategy. Handicraft production can be organised through household units to fit around the timing of seasonally driven activities such as rice planting and harvesting. The rich tradition of handicraft production in Cambodia has yet to be brought to the attention of international buyers. But many obstacles stand in the way of this happening. Years of war and civil strife broke the chain of traditional transfer of skill and design. And as these capacities are slowly reassembling linkages between craftspeople and markets are virtually non-existent. Box 4.1 summarizes material from a recent report on handicrafts in Cambodia.

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

Local tourism is also expanding as Cambodians feel more secure traveling within their own country. Up until very recently Cambodians have tended to stay close to home out of fear of security risks in the countryside.

Opportunities also exist in export markets as these markets are exposed to the unique design characteristics of Khmer arts and crafts. Small amounts of handicrafts are already being exported to Europe, Japan and the U.S. however exporters continue to be confronted by numerous obstacles in meeting the quantity, quality and cost demands of these markets.

In order for producers to be able to take advantage of new economic opportunities and capture new markets the need assistance to expand their production capacity: upgrade the quality of their products to the standards demanded by potential buyers: and, overcome the many obstacles noted above.

4.1 Handicraft production in Cambodia

Traditional handicrafts were once an integral part of Cambodian culture and entire families would be engaged in the production and sale of handicrafts. Two decades of civil strife and social dislocation disrupted such cultural practices and values. Production of high quality crafts ceased as the Cambodian people focused on mere survival. Most examples of Khmer fine arts and crafts were lost during this period of disruption. Today, most Cambodians are unaware of the richness of their own cultural heritage and have no appreciation of its uniqueness and beauty. The tradition of handing down skills from generation to generation was also lost during the period of strife and now few young people have an interest in learning these skills. Master craft makers still exist however in rapidly diminishing numbers.

Handicraft production is generally viewed as a secondary source of livelihood in rural areas with priority given to rice production. Thus, craft production is often set aside during the planting or harvesting periods. Home or village-based craft production could, however, be a significant source of supplemental income. And, in a country where a high percentage of households are unable to grow enough rice to feed their families for the whole year, alternative sources of livelihood are essential.

The Cambodian handicraft sector as a whole is faced with numerous problems. Access to the means of production — raw materials, equipment, production skills and capital — is severely constrained. In addition, awareness of potential markets and appreciation of the design and quality demands of these markets is extremely limited. Most handicraft producers rely on traders or middle persons traveling through the countryside to get their products to markets. Poor transportation infrastructure, and until quite recently, security concerns, are obstacles to accessing markets. Women producers in rural areas in particular have little direct contact with markets and thus limited information about market preferences or prices.

As Cambodia opens up to increased tourism and interactions with the outside world there is a growing interest in the unique designs found in traditional Khmer arts and crafts. Unfortunately Cambodia's capacity to recapture its lost traditions, much less respond to growing market opportunities, is extremely limited.

Source: Cheng 1998.

Initiatives from the Ministry of Women's and Veteran's Affairs

In 2001 the export possibilities for crafts and cultural items were reviewed by the Ministry of Women's and Veterans' Affairs (MWVA) (Phavi and Urashima 2001). Their review focused both on the needs of women, and on those of vulnerable groups particularly demobilised veterans. A significant proportion of crafts people in Cambodia are women. Most but not all of the issues in the sector affect both genders.

Women tend to be engaged in the production of crafts such as weaving, baskets, mats and clay pottery which are suited to home-based production, made mostly from locally available raw materials, and requiring relatively small amounts of capital. Products are most often sold to intermediaries, primarily men, who travel through the countryside buying up goods from small producers and take them to market centres. This relative isolation of women from the market makes it difficult for them to access the information

and support needed to make their businesses a more sustainable source of livelihood (Phavi and Urashima 2001).

The MWVA report discusses the possibilities and constraints in five craft disciplines: silk-weaving, silver products, basketry, clay pottery, and traditional food products. In all cases the opportunities are generally the same: unique Cambodian traditional designs suitable for discerning niche markets, some still living master crafts-people who can teach the skills, and some existing mostly informal market channels including domestic markets and exports to Thailand and Vietnam.

The identified constraints include:

- access to technology, in this case both to traditional methods being lost as older masters die off, and to modern refinements (for example, wood finishes, clothes fasteners) for higher quality and productivity;
- high costs or scarcity of some raw materials;
- high transport costs;
- competition from imported goods, both in local markets for utilitarian items like baskets, and in the tourist market in the form of non-indigenous handicrafts sold as souvenirs to visitors;
- poor market intelligence and inability to appreciate and respond to market signals;
- lack of institutional means for establishment and control of standards;
- atomistic organisation of production, with consequent poor bargaining power for producers;
- part-time nature of craft work, especially for women heads of households; and
- limited access to capital.

Strengths and weaknesses of producers

The survey team identified the following strengths and weaknesses of existing craft producers and these are listed in table 4.2

4.2 Strengths and weaknesses of producers

<i>Strengths</i>	<i>Weaknesses</i>
Traditional Khmer designs	Limited capacity to analyze the value of products
Capacity of producers to adapt	Low level of creativity and commercial appeal
Basic market channels in place	Shortage of techniques
Access to some capital	Poor workmanship and finishing
Master craftsmen and women	Low quality accessories
Improvements in product quality	Poor durability and reliability
	Poor or no packaging
	Little understanding of price vs. quality
	Lack of cooperation between producers

Obstacles

In addition to the many weaknesses identified in the capacity of producers and product quality noted above, handicraft producers also face a number of obstacles related to:

- access to raw materials
- access to appropriate tools and equipment
- access to technical support and training
- access to credit
- access to markets poor reputation
- poor transportation infrastructure
- complex export procedures
- lack of a supportive policy environment.

The strategy proposed by MWVA for development in the handicraft sector has five elements:

- regional specialization where traditional craft specialties, available raw materials or other factors warrant;
- integrated enterprise development support through local centers, including business development services, and vocational training;
- micro-credit facilities including risk-sharing and concessional terms for ramp-up;
- market identification and development support; and

- organized cooperation among ministries and agencies at the policy and program levels, for vocational training, cultivation or extraction of raw materials, trade facilitation, quality control, facilitation of producer organization, etc.

MWVA is currently negotiating with the German Government for support in pursuing several components of this strategy. Key partner agencies include the private sector and NGOs, and the Ministries of Commerce; Culture and Fine Arts; Agriculture, Forestry, and Fisheries; Rural Development, and Industry Mines and Energy.

As for other dimensions of trade promotion for least developed countries, the ITC has published comprehensive analyses, guidelines and recommendations for development of the handicraft sector (ITC 1998).

ITC also supports the Artisanal Enterprise Network (AEN) whose website at www.craftscenter.org provides market and trend information, best artisanal product business practices, training programs for artisanal business development, and answers to frequently asked questions (FAQs).

AEN's training for artisan entrepreneurs is based on a modular curriculum, teaching small business planning and management skills. Written by entrepreneurs, the lessons and examples are based on business owners' actual experiences running micro — small and medium-scale businesses. The curriculum covers over 50 specific topics, grouped in the following modules.

- *Identifying the entrepreneurial traits* and specific talents needed for business success and learning how to hire the right people to form a management team.
- *Building the management team:* How do micro- and small businesses get the support they need without hiring full-time personnel to provide it?
- *Product design and development:* Making the case for, and teaching the principles of, Market-Driven Product Development.
- *Marketing* as an integral part of product development and business growth strategy.
- *The science of costing and the art of pricing:* for local, national, regional and international market opportunities;
- *Production:* How to plan for it; how to maintain quality control;
- *Packaging and packing:* the necessities to ensure safe shipment; value-added labeling and packaging; customer requirements.

- *Shipping*: details of freight options; how to find a good freight forwarder; where to learn about all documentation requirements;
- *Preparing to enter (or making a better entry into) the international market*: brochures, catalogs, trade shows, websites, promotion, evaluations of market options;
- *Managing financial and physical resources*: budgeting, cash flow, capital, debt, equity, traditional and alternative sources of money, tax compliance, facilities and equipment;
- *Technology*: what low-level technologies are available to increase productivity or profit margins; what new technologies need to be learned to communicate with foreign markets; the role of the Internet and the computer for small businesses;
- *Maximizing human resources*: defining job descriptions and competencies needed for each job; salary and employee benefits; evaluating job performance and improving it; balancing teamwork and individual excellence; balancing work and family; shared ownership options.
- *Business relationships*: between you and your vendors, wholesale and/or retail customers, sales representatives, agents, etc.; the importance of timely communications; what honesty means across cultures; etc.
- *Resources for continuing development*: linking owners to institutions and sources of information and financing for growth

Cambodian artisans face the same challenges as their colleagues elsewhere in the developing world, with additional difficulties created by the destruction of the past few decades (although they are not unique even in that respect). Applying the kinds of techniques and resources offered by ITC's AEN to the Cambodian situation, may contribute significantly to advances in the sector.

Conclusion

The handicraft sector in Cambodia has much in common with the agro-processing sector, in terms of its SME character and of its constraints and opportunities matrix. Increased production activity and development of successful export oriented enterprises will require both improvements to the policy environment and direct programmatic support, to enable Cambodian producers to compete effectively with their counterparts in more advanced neighboring countries. Direct project interventions cannot

substitute over the long term for a vigorous private sector working in a supportive and adaptive policy environment. Still it is suggested that at this stage in Cambodia development support, by way of incubator projects to support capacity building, is necessary.

4.3 Tabitha and certificates of origin

Tabitha Cambodia is a non-profit non-sectarian Christian organisation whose purpose is to enable the poorest of the poor in Cambodia to recognise their inherent beauty as individuals and families. With this understanding, people are encouraged to acknowledge their own inherent skills and abilities and to utilize these in ways that will enable them to recognise and change those areas of life which, they believe, keep them poor.

Tabitha's focus is on community development, through increasing family incomes and savings. Tabitha's tools are small personal savings programs based on quality of life 'dream cycles', support for micro-enterprise development, and cottage industry (handicrafts). A more complete description of Tabitha, its programs, and its handicraft products (silk weaving, children's cloth toys, crocheting and embroidery, and silver ornaments and jewelry) may be found on the internet at www.tabitha.ca.

At present, Tabitha is working directly with about 5000 families, some 40 000 people in total, in five Cambodian provinces. Net annual program costs of Tabitha's operations amount to about US\$20 for each family, or \$100 000 in total, including local staff salaries, operational costs, and the 10 per cent interest which Tabitha pays to participants in its savings programs (an encouragement to families for faith in their own abilities). These program overhead funds come from donations from Tabitha's international network of friends and supporters, and from profits on the approximately \$300 000 worth of annual sales of handicrafts produced by Tabitha's beneficiaries.

Tabitha has dealt successfully with many of the problems facing artisanal producers. Raw materials are sourced centrally at wholesale prices. Product quality standards are maintained through ongoing supervision and training by staff members, and by the growing self esteem of the producers. International export market access is achieved through several channels, including i) sales to tourists from shops in the capital Phnom Penh, in Siem Reap town, the site of the Angkor Wat temple, and soon from a shop in the Phnom Penh airport departure lounge; ii) sales to hotels; iii) an international network of volunteer sales people in Singapore, Canada, USA, Europe, Australia, and Taiwan, composed of people who have seen the value of Tabitha's work and want to contribute; iv) international wholesalers and retailers, especially adherents of the fair trade movement; and v) direct sales through the internet.

With success and increasing visibility have come new challenges. In the past, Tabitha's shipments have been carried in suitcases as excess baggage by returning friends, or in lots too small to attract the attention of customs authorities in receiving countries. At this time of writing, Tabitha has a larger US\$40 000 shipment of handicrafts arrived in Canada and being assessed for import duties ranging from zero up to 100 per cent of value, depending on type. These duties would be mostly waived if the shipment were accompanied by appropriate Cambodian certificates of origin. However obtaining such documentation from the responsible Cambodian authorities, who are used to dealing with much larger garment manufacturers and other clientele, appears to cost nearly \$1000 in official and unofficial service charges. Tabitha has appealed to the responsible Minister, and it is expected that a solution will soon be found.

This anecdote underlines the need for capacity building on both sides. Tabitha (and likely every other producer in the handicraft sector) needs help to learn how to navigate the complex rules and procedures which govern international trade. The RGC needs capacity building to enable it better to serve its whole range of clients

5

Fisheries

Background

For decades, the economic and ecological value of Cambodia's fisheries resources has been recognised by the Cambodian people and their government, regional governments, and development agencies. As a result of this recognition, development and government agencies have financed dozens of studies of the fisheries sector and supported the Department of Fisheries (DOF) to build technical capacity. The studies consistently reaffirm the need to improve management of the fisheries sector so that the resources continue to serve as an important food source, generate foreign currency, and provide enjoyable livelihoods for millions of Cambodians.

Nearly every research study has concluded that Cambodia's primary fisheries stocks are being depleted and that modern agricultural practices, increased forest logging, and a growing population have combined to further degrade fisheries stocks. Previous and current government and development agency initiatives focus considerable attention on upgrading resource management. Among the several broadly based initiatives that were recently instituted, are the following.

- In early 2001, the Prime Minister ordered approximately 56 per cent of the fishing areas under fishing lot management to be released for public use.
- The DOF was ordered to establish community management of these public areas.
- A sub decree on Establishment of Community Fisheries was drafted to encourage communities to manage the fisheries resources through community based organizations.
- The leasing of special 'research fishing lots', which were controversial due to the non transparent manner in which they were awarded, were cancelled.
- The fees for middle scale fishing gear were cancelled for inland waters. This reform was designed to eliminate unofficial taxation by local authorities.

- Several coordinated projects began on the Tonle Sap Lake including: a UNDP-GEF project on sustainable resource management; a Capacity 21 project on awareness training and participatory practices; and an Asian Development Bank project on managing the resources for economic growth and development (UNDP-GEF 2001).

Thus, there is support and effort currently being expended to nurture Cambodia's fisheries sector and improve its economic value and financial return. But many problems remain. The scale of the fisheries resource, its importance in the lives of so many Cambodians, and the scope of the economic and environmental problems mean there is a premium on identifying the pressing issues and tackling them.

This report concentrates on how the various parties in the supply chain from the people catching fish through to wholesalers and retailers, with support of government and development agencies, can be encouraged to participate in establishing a competitive market for fish and fish products. With proper incentives and a reduction in irrational market interventions by government agencies, private sector participants can be encouraged to participate in the development of the sector, help preserve fisheries resources, and improve opportunities to alleviate poverty and promote international trade.

The report identifies existing production, processing, transportation, marketing, and exporting participants and trade structures. Some of these participants and related activities and trading structures are no longer functional in the emerging competitive market economy and some may be encouraging resource degradation. The report then considers sector specific measures directed at developing the necessary technical and management capacities, social relationships, and business linkages to promote competition and improve resource utilization.

Role of fisheries in Cambodia

As a source of food and livelihood

Cambodia is the world's fourth largest producer of freshwater fish, producing about 400 000 tons of fish with a market value between US\$150 and \$200 million per year. (Oxfam GB 2000) More than 80 per cent of fish production comes from the Tonle Sap Lake, the Mekong/Bassac River basin, and other rivers and tributaries. Marine fishing contributes about 10

per cent or 30 000 tons per year to production, and the balance comes from aquaculture, with annual production of about 13 000 tons.

As a food staple, fish represents about 70 per cent of Cambodia's animal protein intake, with consumption estimated at about 30 kilograms per person annually or about 300 000 tons in total (Infofish 2000). Thirteen of the twenty one Cambodian provinces are considered fishing provinces and more than three million Cambodians, about 25 per cent of the population, live in the six provinces bordering the Tonle Sap Lake. The fisheries industry seasonally employs an estimated 140 000 persons, not including the tens of thousands of families who subsist on fish and other aquatic resources.

As a source of export income

The value of live and processed fish exports was estimated to be at more than \$10 million in 1998 with export of between 30 000 tons and 100 000 tons of freshwater and marine fish, which represented about 25 per cent of the total fish catch. It is estimated that one half of the total are exported illegally. Unofficial or illegal export channels do serve to generate income for some people, but as a rule such channels are costly and inefficient. One reason why exports happen through illegal channels appears to be to avoid official taxes and charges.

It is estimated that 75 per cent of exports are delivered to Thailand as fresh, iced fish and seafood, and another 15 to 20 per cent are exported to Vietnam. Due to a number of factors, including limited export experience, relatively few fish processing and packaging facilities, and poorly developed marketing capability, Cambodia is not benefiting from value added exports. Rather, it appears that Thailand and Vietnam, which possess better market knowledge, trade experience, and modern processing and packaging facilities, are reaping benefits by importing fresh, iced fish from Cambodia at very competitive prices, then further processing and packaging them and marketing them to Asian markets located in Bangkok, Hong Kong, Malaysia, Singapore, Europe, and the United States.

Table 5.1 lists the imports of Cambodian fish products in the respective countries, by value, in US dollars. While the reported export quantities are imprecise, the values indicate the significant revenues to be realized through high value exports, especially live fish exports. Currently, most of the exported fresh fish and seafood goes to Thailand, which is paying the lowest value per ton.

Industry structure, market participants, and trade issues

A brief overview of the industry structure, participants involved, and various trade issues follow. The simplified diagram below depicts the primary linkages between main participants (see chart 5.2).

Department of Fisheries

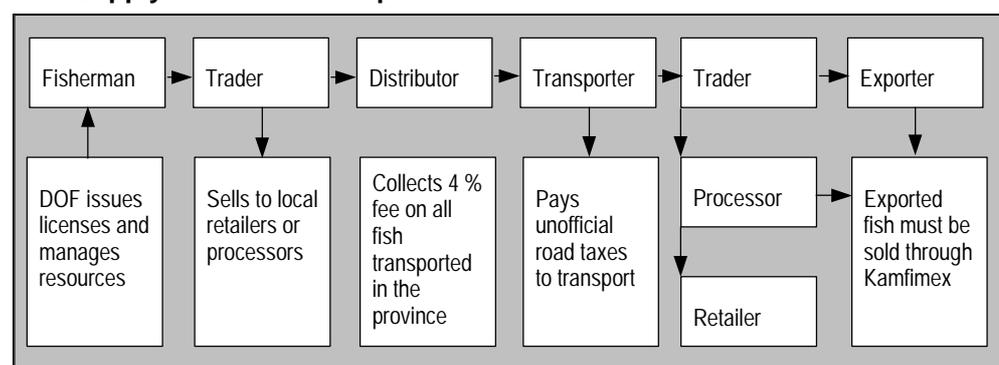
The Department of Fisheries (DOF) has a staff of more than 1 500 and facilities located in each province. It is headquartered within the MAFF in Phnom Penh and has the regulatory authority to promote and manage Cambodia's fisheries resources. In addition to establishing industry regulations for the sector, DOF staff is responsible for enforcing regulations, collecting fees from market participants, and controlling the smuggling of fish to neighboring countries. The DOF obtains revenues from the sale of fishing lots, collection of fines and penalties, and by implementing donor and government funded fisheries resource management projects.

5.1 Fish imports from Cambodia, selected countries

<i>Importing country</i>	<i>Quantity</i>	<i>Value</i>	<i>Value</i>
	t	US\$	US\$/t
Hong Kong	648	6 137 820	9 472
Malaysia	173	2 632 849	15 218
Thailand	3 342	1 224 989	367
USA	280	1 063 464	3 798
Singapore	108	100 000	920

Source: Infofish 2000.

5.2 Supply chain for fish exports



Data source: EDC 2001.

Ministry of Economy and Finance

The Ministry of Economy and Finance (MEF) collects a 10 per cent export tax on all fish exports. As noted, the DOF is responsible for ensuring that the export tax is paid. Cambodia is the only country in the region to levy an export tax on fish products.

KAMFIMEX

KAMFIMEX is the Kampuchea Fish Import and Export Company, a State owned enterprise managed by the MAFF. KAMFIMEX is the sole licensed exporter of fish products. It owns four processing plants that it leases to private sector enterprises, and manages all live fish exports at Pochentong airport, where it collects an export license fee of US\$1 per kilogram, and Kompong Som port. The existing export market arrangements specify that fish for export must be sold to or through KAMFIMEX. KAMFIMEX takes no physical possession, but instead resells the fish to licensed export agents or processing plants. KAMFIMEX also sells one distributorship in each province through a competitive bidding process. The distributorship entitles the holder to collect a 4 per cent fee on the value all fish exported through the province. The fact that considerable export activity is reported to take place unofficially, and at low prices, indicates that the fees and taxes imposed yield little in the way of marketing services.

Fishermen

Fishermen and fish companies are classified as small, medium, and large scale, depending on size of catch potential and type of equipment used. There are three categories of fishermen and fish companies for inland fisheries, and other classifications for marine fisheries.

Small scale fishers are family scale fishermen (1–3 persons) who fish primarily for family subsistence. They pay no fees to the DOF and are permitted to catch fish throughout the year in areas outside fishing reserves and fishing lots. The numbers of small scale fishers is increasing annually as the population grows and as alternative livelihoods become scarce.

Medium scale fishers are extended families and village level partnerships (3–6 persons) who catch fish for income and processing using non industrial fishing methods. They pay an annual fee to the DOF (no details on these fees were obtained) and are limited to 8 or 9 months of fishing per year. There are few restrictions on the type or size of fish medium scale fishers

can catch. Due to the annual fee structure, their incentive is to catch as many fish is possible during the fishing season.

Large scale fishers are more sophisticated organizations (50–80 persons) who, in general, have improved production and processing methods, and better access to marketing and trade information. Still, many use existing inefficient transport and trade structures to export lower value fish to Thailand and Vietnam. Large scale fishers lease fishing lots (20 to 350 km²), which are awarded through a competitive bidding process every two years by the DOF. At an average lease price of between \$30 000 and \$70 000, it is estimated that these fees represent an income of between \$2 and \$4 million for the DOF. There are few restrictions on the type or size of fish large scale fishers can catch. Due to the large fee structure, their incentive is to catch as many fish is possible during the fishing season.

Marine fishers own boats to catch fish or raise fish and shrimp in Cambodia waters located in the Gulf of Thailand. More than 4 000 Cambodian owned boats are registered and licensed by the DOF (no details of the fees were obtained). Thai fishermen can also purchase fishing licenses for Cambodia waters, but accurate information on these sales was not obtained. Marine fish catches are significantly under reported and nearly the entire catch is sold to Thai traders at sea. It was reported that some Cambodian marine fishers are required to sell their catches at less than market prices to licensed processing facilities in Kampong Som for the privilege of obtaining an operating license.

Traders

Traders are the middlemen and wholesalers that facilitate trade primarily by providing capital and market access to fishermen at every level in the trading system, both for inland fisheries and marine fisheries. The services they sell to fishermen include access to price information and better linkages to transporters, processors, and markets. Studies have concluded that profit margins for traders are very high relative to other market participants. Traders who export must follow export market arrangements and sell all fish to KAMFIMEX. Traders who distribute to the domestic market, and who transport fish through a province, pay the provincial distributor a 4 per cent fee. Traders who purchase and sell fish within the same province in which they are purchased, pay only transportation costs. There do not appear to be official barriers to assuming a role as trader, but unofficial barriers may exist.

Transporters

Transporters own the trucks and boats that transport fish from the fish landing sites located alongside the lake or marine shorelines to processing facilities and markets in Cambodia and export points in Thailand and Vietnam. Most fish exported to Thailand are transported in pickup trucks piled high with fish and ice. Up to 50 per cent of the fish spoil before they reach their destination due to poor cold storage facilities, poor road infrastructure, and inefficiencies associated with unofficial road taxes and license fees. Transporters pay a registration fee to the DOF and also pay a series of unofficial road taxes from the landing site to final destination.

Distributors

Distributors are licensed by DOF to serve as middlemen. One license is sold in each province for a term of five years through a competitive bidding process. The licenses are reported to cost up to \$50 000 each. They entitle the distributor to establish an office and collect a 4 per cent fee on all fish exported through the province. There are no services provided for this fee. Between 20 and 50 per cent of fish are smuggled across border areas to avoid distributor fees.

Processors

There are four major fish processing facilities in Cambodia. All are owned and leased by KAMFIMEX, the State owned fish export company. One facility is leased to Cambodians and the other three, located in Kampong Som, are leased to foreign investors who export high value shrimp and processed fish to Hong Kong. The processors hold export permits issued by KAMFIMEX.

There are no fish processing facilities located near the production sources on the Tonle Sap or other river areas. Due to the huge fish spoilage factor, most domestic fish processing is performed in local villages by small and medium scale fishing families and in the provincial cities and Phnom Penh by small scale enterprises. About 50 per cent of the freshwater fish is processed into low value dried fish and salted fish or converted into low value fish paste or fish sauce.

Cambodia has robust retail markets located in all major provincial cities and throughout Phnom Penh. The specific supply chains for the markets were not examined in detail for this report, but it is assumed that fish are supplied by traders to retailers on a wholesale basis. Retailers, consumers,

and small scale processors who live near fishing areas can also purchase fish directly from fishermen at the landing site, but the scale and scope of direct purchases is not well documented.

Export markets

KAMFIMEX, is granted sole authority by MAFF to control fish exports. KAMFIMEX has no direct competitors in Cambodia for fish exports. Official export points are located in the northwest (to Thailand), southeast (to Vietnam), Pochentong airport, and Kompong Som port. KAMFIMEX has offices and distribution facilities at these locations or licenses others to perform the processing, marketing, and export delivery functions. Private sector exporters of live fish from Pochentong airport, pay a US\$1 export license fee plus a 10 per cent MEF imposed fisheries export tax.

A recently released research study by Enterprise Development Cambodia (EDC) concerning the export process in the northwest was made available for this report (EDC 2001). The export location is the city of Poipet that connects to Arranyaphatet, Thailand. On the road leading to Poipet, a distributor who is licensed by the Governor of Banteay Meanchey province, instead of DOF, collects a fee of 4 per cent of value from each fish transport truck passing on the road to Poipet. The office of KAMFIMEX is a little further up the road.

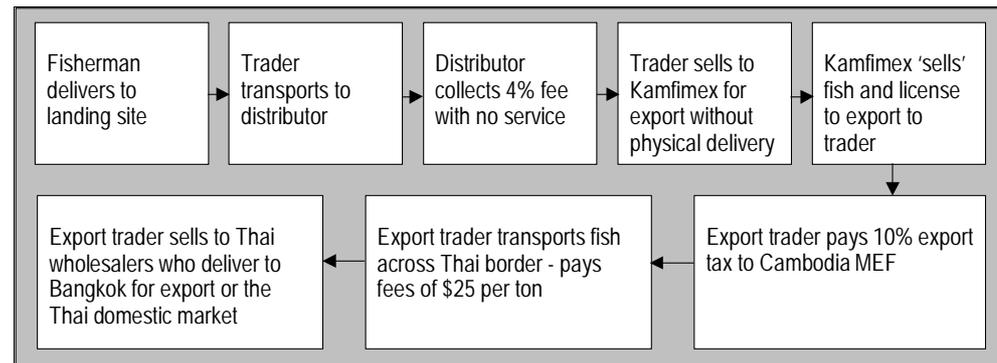
All fish destined for export must be sold to KAMFIMEX. KAMFIMEX does not take physical delivery of the fish, but instead licenses five export traders to purchase all the fish and transport them across the Thai border to the Arranyaphatet fish market. In most cases, the fish transported to the KAMFIMEX office are reloaded onto other trucks with fresh ice. The export volumes are large. Export traders and Thailand Department of Fisheries agents interviewed for the recent study stated that 90–100 tons of exported fish are delivered every day during the fishing season (November through April). There is no other legal method of exporting fish to Thailand than through KAMFIMEX.

The Arranyaphatet fish market is located just inside the Thai border. There seems no logical reason why Cambodia's freshwater fish market is located in Thailand. Because Thailand does not allow Cambodian transport trucks to deliver the fish to the market, the fish are unloaded from the transport trucks, re-iced and placed in push carts that hold about 3 tons. Fish are pushed across the border to the fish market and sold to Thai fish traders.

According to reviewed reports, the average price for these exported fish is about 35 cents per kilo, which is about one fifth the retail price for the same

fish in Phnom Penh. In addition to the cumbersome procedures involved in crossing the border, export traders must also pay official and unofficial fees totally about \$75 for each push cart for fish to Cambodian and Thai authorities on either side of the border. Chart 5.3 provides an example of the export trade system used for exporting fish to Thailand through Poipet.

5.3 Fish exports through Poipet



Data source: EDC 2001.

No information about the export of fish at the Vietnam border was reviewed for this report. In addition, little information is available concerning fish exported from the Kompong Som port, except that the three KAMFIMEX leased processing firms export only about 1 200 tons of fish and shrimp annually, primarily to Hong Kong.

Promoting competitive market behavior and improving resource utilization in the fisheries sector

Promoting competitive market behavior and improving fisheries resource utilization is a national agenda. Any measures implemented to promote and improve the competitive market for the fisheries sector are equally applicable in like form to other resource sensitive sectors. Promoting competitive behavior and rationalization of scarce resources supports the government's pro-poor development policies and its stated intention of transforming the Cambodian economy from a command economy evidenced by state owned enterprises and inefficient distribution systems, to a competitive market economy where the role of government is to enable markets, not control them.

Significant inhibitor to competitive market performance in the fisheries sector

The most significant hindrance to developing a vibrant and competitive fisheries sector is the depth of intervention by government agencies in

nearly every aspect of every market transaction. The level of government intervention that permeates the fisheries sector proportionately diminishes the attractiveness of the sector to private sector investment. The rents charged by these many interventions decrease the profit potential to such a degree that private sector participants are unlikely to invest in the modern production, processing, transportation, and trade technologies necessary to create a sustainable fisheries industry. Examples abound, from the auctioning of short term fishing lot rights, to selling market functions such as distributorships, to operating a State owned fish export monopoly such as KAMFIMEX to control *all* exports.

Strengthening the private sector

Development agencies have properly invested billions of dollars in Cambodia to rebuild the infrastructure and instill technical capacity in government ministries. Few of these funds have been invested in developing a sustainable market economy where government agencies promote, enable, and encourage efficiently operated and managed private sector firms, business associations, and civic organizations that are essential to a strong market economy.

Instead, government agencies, due to their rational need to finance their operations, are encouraged to support themselves through direct market interventions, invasive regulations, and revenue seeking regulatory enforcement, all of which are highly evident in the fisheries sector. These practices will not only continue to inhibit development of a competitive and vibrant fisheries sector, it will also continue to encourage degradation of the fisheries resources.

Building a competitive fisheries industry

Private sector businesses, similar to government institutions, road and telecommunications infrastructure, and the general landscape sustained significant damage during 30 years of civil war. The social relationships and fabric necessary to transact business deals and the trust required between market participants to promote expanded trade activities are broken and need financial and technical support to be developed. This will take considerable time and effort.

Examples of successful private sector initiatives exist. They demonstrate that rebuilding the social contracts in a relatively short time is possible in Cambodia. The most notable example of how quickly private sector transformation can take place is the development of the Federation of

Cambodian Rice Miller Associations (FCRMA). In 1997, a UNDP initiative that ended in 1999 with the formation of the EDC, set out to support private sector development. EDC encouraged rice millers to meet together and discuss common problems and solutions. Few rice millers had ever talked to each other during the previous years and the distrust between these businessmen was obvious even to the casual observer.

By facilitating business level discussions, exposing rice millers to new milling technologies and operating practices in neighboring Thailand, and encouraging upgrading of the industry and quality standards, more than 350 rice mills have now formed nine Rice Miller Associations (RMAs). In February 2001, the Associations formed the Federation. One of the first orders of business for the Federation was to promote the organization and facilitation of rice farmers, since without a linkage and partnership with rice farmers, the rice millers realized they could never effectively obtain higher quality products. A next order of business was to develop quality standards for the industry, marketing linkages and export channels. The success of the RMAs and FCRMA speaks volumes about how relatively quickly the level of working relationships can develop and effectively function in Cambodia.

The facilitation techniques and organization efforts promoted by EDC do not follow the traditional development project model; one of intentionally establishing working groups or associations to serve some preconceived development objective. To the contrary, participants are simply encouraged to participate in a group discussion with other sector participants and determine for themselves after the discussion if they perceive value in creating long term business relationships and linkages. Development agency support for these efforts must extend for at least three years, since experience has shown that participants take a longer term view when they realize there is sustainability of the organization.

Recently, various proposals have recommended that government agencies and government staff promote the formation of private business associations, and in the case of the fisheries sector, community fisheries councils. Experience has shown that, in general, government staffs of a transitioning economy (command economy to competitive market economy) are unlikely to have either the financial resources, technical knowledge, or required mindset to build private sector institutions. Decreeing the development of a market economy is not possible, and the development community should discourage these activities, at least in the short and medium term. Instead, initiatives to develop the private sector are best managed with the support and leadership of the private sector

itself, along with professional facilitation services from neutral, non government agencies.

Resource management, production systems, processing techniques, transport methods, marketing skills, and export market functions are linked in a variety of obvious and not so obvious ways. Therefore, initiatives proposed to assist one market function of the fisheries sector are likely to affect other market functions. Therefore, a holistic methodology in developing a competitive fisheries industry is the recommended approach.

Sector specific initiatives

For the fisheries sector to become competitive and market responsive, and for the fisheries resources to be managed more effectively and efficiently, a rapid transformation, rather than a gradual transition may encourage more tangible results. A new set of values and business operating practices need to be integrated into the evolving Cambodian culture if a market economy is to develop during the next decade. Individual enterprise management skills as well as sector level business capacities need to be developed.

Competitors in a market economy operate with common understandings, work from a generally understood set of business ethics, rules, and structures and normally agree on self governance and accountability for their industry, and accept responsibility for their collective interests. A transformation of this nature in Cambodia will require the commitment and partnership of the public and private sectors as well as an equally significant commitment of long term financial and technical support from development agencies.

The following specific initiatives are suggestions only and require further analysis and discussion with market and resource management participants, development agencies, and the government.

- *Develop a long term collective vision for the fisheries industry that promotes efficient resource utilization and promotes export trade.* This pro-poor vision should be developed through a *facilitated* public and private sector partnership of interested government ministries, such as DOF, MEF, and MOC, and private sector organizations, such as local fisheries councils and fish transport and export associations.
- *Develop a comprehensive strategy for developing a profitable, private sector driven fisheries export sector.* Strategy development will require participation and support from fisheries resource management interests, fishers at all levels, government ministries, and private sector participants at all market levels of the fisheries trading system. From a

well defined strategy, specific objectives can emerge that continually place emphasis on private sector driven initiatives.

- *Decrease government intervention in the marketing channel and stop the selling of market functions.* This is a critical and necessary step that may need a short period of transition, but should be accomplished as quickly as possible. There will likely be both public and private sector special interest lobbying to transition State owned enterprises, such as KAMFIMEX, into private sector enterprises. Selling the assets, such as the warehouses, production facilities, and vehicles, in a transparent manner is absolutely necessary. But selling and maintaining functions, such as a monopoly for exports or distributorships that simply collect fees and offer no services will only further inhibit competitive sector and industry development.
- *Support the development of private sector institutional capacity.* From the development of local community level organizations and working groups to enterprise and sector private business associations, private sector firms need to receive sustained support to upgrade their organizational, technical, and management capacities. Support can be provided individually through curriculum developed for technical and management schools or even more effectively through the development of sector specific organizations, private business associations, and working groups.
- *Support the development of private-public sector partnerships to improve technical and business management capacity.* To effectively develop an understanding of their inter related roles in a market economy, one where government staffs enable and support the private sector rather than compete with and eliminate it, training in market economy principles and practices should be provided to a broader range of government staffs and private sector firms. While partnerships cannot be forced, there appears to be willingness for professionally facilitated forums where private sector firms and fishermen have the opportunity to share their viewpoints with those of the government representatives. Further research is needed to identify the best forum in which to provide such information, but workshops, trade fairs, and local community meetings would seem appropriate venues. It is recommended that development agencies fund selected demonstration projects to determine the long term viability of such an approach.
- *Provide neutral facilitation to rebuild the relationships between private sector participants and develop private-public sector partnerships and working groups.* There is a critical lack of experience for communities, private sector participants, and government to collectively solve issues in a democratic and participatory manner. Until this experience can be

developed and demonstration projects can be successfully presented as models, neutral facilitators should assist in accomplishing these initiatives. Development agencies can support these efforts first through technical assistance and then advanced facilitation training for private sector based business development service providers.

- *Develop an effective market demand and price information system for all participants in the fisheries sector.* Market economies work best with an efficient and timely source of market and price information. As a pro-poor strategy, the development of a market and price information system will assist individual fishers to better negotiate with traders and other market players. Improved information systems will also assist participants to make better resource allocations. A system of data collection and dissemination is essential to the continued development of the industry.

6

Garments

Background

Cambodia's export performance since 1997 has been remarkable. Total exports rose from a negligible \$51.3 million in 1992 to \$1.1 billion by 2000. Export of garments explains most of this growth. Table 5.1 charts the performance of the garment industry since 1994. Up until 1995, garment exports were almost non-existent. With increased stability, relatively low wages and with no quantitative restrictions to the EU and US markets, and reflecting the fact that some neighboring countries were close to using all of their quota, foreign investors shifted their production to Cambodia. Consequently, garment exports jumped from US\$24.2 million in 1995 to US\$79.4 million in 1996, tripled to \$227 million in 1997 and by 2000 garment exports were \$965 million, accounting for 87 per cent of total exports in that year. While the rate of growth has been unusually rapid, this pattern of manufacturing exports — dominated by labour intensive products such as garments — is typical of a labour abundant economy such as Cambodia. Indeed, this pattern of export composition characterized the very early stage of development of the manufacturing export sector of several neighboring countries including Malaysia and Indonesia.

In a developing country such as Cambodia where labor is abundant and concentrated in the rural areas, expansion of labor intensive modern sectors is critical to absorb unskilled workers at the earlier stages of industrialization. Going on experiences in other Asian countries, as incomes increase the share of employment in agriculture is likely to drop. The choice of technologies in traditional industries will change as the rising cost of labor together with technological advances, encourages new methods. Typically, job opportunities expand in services and industry, as employment in agriculture and the informal sectors declines and workers move to urban areas and the formal sector. Given the large supply of unskilled workers in Cambodia this process will continue for many more years.

6.1 Cambodian garment industry, 1994–2000

Year	No. of factories	No. of employees	Exports				
			US			EU	Total
			Total	Quota items	Non-quota		
1994	7	8 024	-	-	-	4	4
1995	20	18 703	1	-	1	27	27
1996	24	24 015	2	-	2	75	79
1997	67	51 578	99	-	99	112	227
1998	129	79 231	360	-	360	76	378
1999	152	96 574	585	434	83	58	553
2000	186	122 644	749	520	229	221	985
2001	na	na	480 ^a	282 a	198 a	na	na

^a Data refers to the first 7 or 8 months of 2001.

Source: MOC 2001

The garment and footwear and tourism sectors have been the engine of growth in the economy and largest generators of employment in the formal sector over the last four years. In 2000 there were about 200 garment factories in Phnom Penh employing more than 120 000 workers, of which most are young women (table 6.1). Some estimates put the number of workers in 2001 at 160 000 (CRDC 2001). Earnings of garment workers are high relative to other job opportunities in Cambodia and even compared to garment workers in competing countries such as Bangladesh and Indonesia. While reliable data on wages or earnings of other workers are scarce, the data that does exist suggests that workers in the garments sector are relatively highly paid compared to most other workers in both the formal and informal sectors and the civil service. To the extent that export expansion of garments has created relatively high wage jobs for some workers, 'wage inequality' will emerge. However, the process of shifting workers out of low paying jobs in the informal sector to higher paid jobs in the formal sector will make more and more workers better off compared to the opportunities they currently face.

Market access for Cambodian garments

United States access

In the case of the US, exports from Cambodia are restricted in certain categories and by import tariffs. The surge in garment exports (especially of woven trousers and knitted shirts) to the US market triggered the US government to impose volume restrictions on 12 categories of Cambodian exports in 1999 on the grounds that this level of exports was disrupting the US garment market (see table 6.2 and box 6.3).

6.2 Market access conditions

1. Tariff and quota barriers in the QUAD

The main products in the top 50 export commodities of Cambodia at the six digit level of the Harmonized System are items of apparel (74 per cent), footwear (5 per cent), wood products (4 per cent) and rubber products (3 per cent). Together, these top 50 export commodities account for 87 per cent of Cambodia's total exports. The main export markets for apparel exports are US and EU. In 1999, the US imported more than 67 per cent of Cambodia's apparel exports and in 2000 the US imported 76 per cent. In 1999, the EU imported 23 per cent of apparel products in the top 50 export commodities, and 23 per cent of total garment export in 2000. The main export markets for Cambodia's footwear are EU (60 per cent) and Japan (35 per cent).

1.a Tariff and Quota Barriers in US

Cambodia has duty free access to some 4,600 tariff items to the US market under the US Generalized System of Preferences (GSP). In addition, since 1997, Cambodia has also had duty free access to a further 1,783 additional products for which only least-developed developing countries have duty free access under GSP.

Export from Cambodia to US took off in 1997, with an average annual growth rate of nearly 70 per cent from 1997 to 2000. More than 97 per cent of Cambodian exports to the US are Miscellaneous Manufactured Articles, which are mainly apparel products. These products are considered by the US trade representative as 'sensitive' import items, and are therefore excluded from the GSP system. Thus those export commodities of Cambodia which are competitive on US markets do not have tariff free access and in fact the current average MFN tariff rate for US apparel imports is 17.6 per cent. In addition, according to the bilateral textile agreement signed by both governments in 1999, twelve categories of Cambodia's garment items are currently under quantity quota restriction for a period of three years. This bilateral textiles agreement is due for renewal at the end of 2001. While there is a built-in 6 per cent growth rate for the base line quantity for the twelve categories, an additional growth rate up to 14 per cent is subject to review by the US government conditional on labor conditions in Cambodia. The weighted average tariff rate for imports from Cambodia is more than 12 per cent with 39 items above the 15 per cent tariff peaks. The estimated tariff revenue collected by the US government from Cambodian exports is US\$78 million.

1.b Tariff and quota barriers in EU

Cambodia has duty-free quota-free access to the EU market under the Everything-But-Arms Initiative (EBA) because of its LDC status. Under the EBA initiative, which is part of the GSP program of EU that was put in effects in February 2001, all products from all the 48 LDC may have duty-free quota-free access to the EU market, provided that rules of origin requirement are satisfied. In the past, Cambodia's export of garments to EU were guided by the three year Cambodia-EU bilateral textiles agreement which was signed by the governments in May 2000, which allow garment export to EU from Cambodia to be free of quantitative restriction subject to market share considerations as well as rules of origin requirement. A product will be considered to have a Cambodia origin if it has no less than 40 per cent of local content. In addition, under the EU program, Cambodia is allowed to have cumulative origin with ASEAN and EU. Thus, materials imported from ASEAN or EU countries can be counted towards local content of Cambodia. Under the special waivers, granted to Cambodia and three other LDCs, certain textiles products from Cambodia are allowed to have cumulative origin with ASEAN countries, as well as member countries in the South Asian Association for Regional Cooperation (SAARC) and African, Caribbean and Pacific (ACP) countries, up to a certain quantity limit until the end of 2001. However, given that most of the materials input of Cambodian's garment industry are from Hong Kong and China, most of Cambodian's garment exports to EU do not satisfy the rules of origin requirements and do not have duty free access to the EU market.

1.b Tariff and quota barriers in EU (continued)

If all products do not satisfy rules of origin requirement and therefore are facing MFN tariff, the estimated total revenue collected by EU on Cambodian's products would be around US\$34,000, with an average tariff rate at 8.8 percent. On the other hand, if all products satisfy rules of origin requirement, then the tariff revenue collection of EU would be zero. The actual revenue collected is likely to be on the high side, given that data from the Ministry of Commerce shows that 8 out of 9 shipments of garment products from Cambodia to the EU do not meet the 40 per cent local content requirement.

The quota agreement is initially for three years ending in December 2001. Apparently, negotiations for a new agreement have not yet begun and a one-year extension of the existing agreement may need to be considered until a new one is agreed. Under the current arrangement, quantitative restrictions applying to Cambodia are eased by 6 per cent per annum during the agreement period, 1999 to 2001.

Additional easing of quantitative restrictions on Cambodian exports is linked to progress on labor standards. According to this agreement, up to a maximum of 14 per cent quota increase is possible if Cambodia 'substantially complies with labor standards' including those set out in Cambodia's labor laws and the four core ILO conventions. The ILO defines 'internationally recognized core labor standards' as covering four elements:

- freedom of association and the effective recognition of the right to collective bargaining;
- the elimination of all forms of forced or compulsory labor;
- the effective abolition of child labor; and
- the elimination of discrimination in respect of employment and occupation.

Following on from an assessment of Cambodia's labor standards, the US government eased restrictions by 9 per cent in 2001. The US did not commit to the full increase on the basis that it did not make substantial progress in respect to the core labor standard of freedom of association and the right to recognize and bargain collectively. However, the basis for this decision is not well documented. The condition 'substantial compliance' with labor standards is vague and open to non transparent assessments. Evidently, several US buyers had criticized the US government's assessment of Cambodia's labor standards for the 2000 quota for its apparent lack of transparency. In the opinion of one large US buyer 'the level of secrecy in the assessment fuels the perception that the 1999 adverse decision was based more on politics and protectionism than on facts'. The lack of transparency in Committee for Implementation of Textiles Agreements (CITA) decisions is now being partly addressed through an ILO Garment Monitoring Project in Cambodia. In conjunction with the Garment Manufacturer Association of Cambodia and the Cambodian Government, the ILO monitors 185 factories for compliance with Cambodia's labor laws and ILO core conventions.

This process began in June 2001 and the first report will be published on the ILO website in October. This report will be used as input into the US government's assessment of labor conditions in Garment factories and

quota determination. Sources of funding for the ILO project are the US Government (\$1 million), Cambodian Government (\$200 000) and the Cambodian Garments Producers Association (\$200 000).

An argument often used to allay concerns about the lack of market access of least developed countries (LDCs) to industrial country markets is that garment quota arrangements and preferential schemes such as generalized system of preferences (GSP) are especially designed to help these countries sell their products in industrial country markets. There is evidence, however, that the US garment quota arrangement has restricted Cambodia's export growth to the US. In this regard, there are two important notes. First, it is important to note that while the US made Cambodia a beneficiary under its GSP regime, this scheme specifically excludes textiles and garments from the list of goods that are subject to low or zero tariff rates. Thus, Cambodian garments (both quota and non-quota garments) are therefore subject to the higher MFN tariff rates, averaging 17 per cent for Cambodian export garments. Second, the annual easing of the quota of up to 20 per cent during the agreement period is less liberal than it first appears. In fact, the largest annual relaxation in quota restrictions so far has only been 15 per cent in 2001 — the guaranteed 6 per cent annual increase and a 9 per cent increase for progress on labor standards.

The 15 per cent easing of quota restrictions in 2001 falls short of the annual increase in Cambodia's exports of these items to the US in the few years leading up to the quota restrictions (table 6.2). Further, quota utilization rates for some of the major categories is high indicating that quotas on these items are binding. Table 6.2 reports the quota and utilization rates for each category from 1999 to 2001. In 2000 four of the 12 categories had relatively high utilization rates of which two of these categories (338/339 and 347/348 and 647/648) are by far the largest quota items. In response to ceilings on export expansion in these items, Cambodia's garment producers increased exports to non-quota items. Evidently, total exports in non-quota items increased from US\$82.6 million (or 16 per cent of total garment exports to the US) in 1999 to \$229 million (31 per cent of total garment exports) in 2000. For the first 7 to 8 months of 2001, exports of garments not covered by quota amounted to \$198 million or 41 per cent of Cambodia's total garment exports to the US. Rapid growth in the non-quota items indicate that Cambodian firms remain competitive against US production and other competing imports of these items, even though Cambodian exports are subject to MFN tariff rates.

6.3 Cambodia's exports to the US markets

Category	Quota			Utilization rate	
	\$			%	
	1999	2000	2001	1999	2000
331/631 (Dzs-Prs)	1 300 000	1 281 945	990 093	92	65
334/634 (Dzs)	180 200	197 030	208 852	96	73
335/635 (Dzs)	68 900	82 680	83 989	50	67
338/9 (Dzs)	2 900 000	2 956 000	3 071 350	99	99
340/640 (Dzs)	795 000	1 001 700	969 105	63	75
345 (Dzs)	99 640	125 546	121 461	57	104
347/8 & (Dzs)	3 600 000	3 427 800	3 685 620	100	96
647/8					
352/652 (Dzs)	636 000	541 961	494 833	60	43
438 (Dzs)	96 300	108 703	100 127	96	69
445/446 (Dzs)	116 600	133 320	129 043	52	48
638/639 (Dzs)	954 000	1 043 100	1 105 686	88	87
645/646 (Dzs)	171 952	301 507	260 743	14	43
Total value of garment exports covered by quota (US\$million)	434	520	282 ^a		
Total value of garment exports not covered by quota (US\$million)	83	229	198 ^a		
% share of total exports to US	(16%)	(31%)	(41%)		
Total exports			517	749	480 ^a

^a First 7 months of 2001.

Source: MOC 2001.

In response to domestic pressure, large international buyers now carry out their own continuous assessments of labour conditions in their suppliers' factories. In addition, the international accounting firm PriceWaterhouse-Coopers carries out a regular Social Compliance Audit for several large US and UK buyers. This scrutiny has the effect of raising or consolidating worker returns and conditions for those workers with jobs but there has also been some perverse effects on the most vulnerable workers in Cambodia — young women. In recent years foreign media has accused a number of Cambodian garment factories of using child labour. A British documentary screened in 2000 accused a Cambodian garment factory of employing child under the age of 14 years. As it turned out, the girl was 18 years and there were counter-allegations that the journalist paid the young women to make the claims (see *Asia week*, 22 December 2000). The result of these accusations, and pressure from their major buyers, has had the effect of encouraging factory managers to dismiss workers and reject job applications from women who are believed to be under 18 years of age, even though the legal working age in Cambodia is 15 years. This means that a large segment of the labour force is excluded from participating in the most productive and relatively high paying jobs in Cambodia and to prevent them from escaping poverty.

European Union access

Cambodia's second major destination for garments is the European Union. In 1993 the EU established trade relations with Cambodia on a MFN basis; that is tariffs applied to Cambodian exports were no less favorable than exports from other countries. There were no additional restrictions on Cambodian exports, because at the time Cambodian exports were negligible. However, with exports to EU rising and especially concerns over third country garment exports entering the EU under fake Cambodian rules of origin (ROOs) certificates, a new agreement came into force in April 1999. This agreement promised not to restrict market access for Cambodian garment exports for three years; that is, Cambodian exports have access to the EU without duty or quantitative restrictions. Garments to the EU subsequently increased from \$51 million in 1999 to \$221 million in 2000.

Special incentive arrangements covering labour and environmental protection also applied which provided for an additional preferential margin awarded on the basis of compliance. As of 5 March 2001, the 'Everything but Arms' amendment to the EU GSP scheme grants unrestricted duty free access to all products originating in least developed countries excluding arms. While the scope to offer additional margins no longer applies compliance, international labor and environmental standards is a general requirement of GSP status.

However, unrestricted access to the EU requires Cambodia to observe stringent ROO requirements. One of the conditions for GSP access to the EU market is that Cambodia has to observe a 'full makeup' rule of origin when exporting to EU destinations. This means that to qualify as being of Cambodian origin, garments have to be processed in Cambodia from yarn in the case of knitted items, or from uncut fabric in the case of all other items. The Cambodian government implemented this ROOs by requiring exporters to prove that locally generated value added was greater than the cost of imported fabric or yarn. In principle this restrictive ROOs was relaxed when Cambodia joined ASEAN in 1999, which now permits garment producers to source fabric and other textile products made in other ASEAN member states under the EU cumulative origin provisions of the EU-ASEAN bilateral trade agreement and, thus, retain its GSP concessions. However, the Cambodian government continued to require exporters to prove that locally-generated value added was larger than the cost of fabrics. This unnecessary strongest ROOs requirement mainly came out of the government's concern that third country exports using fake Cambodian labels could undermine Cambodia's 'preferences' to the EU. The government has recently relaxed this requirement and now only

requires exporters to present the ASEAN fabric suppliers' GSP certificate as proof that the fabric originates from another ASEAN Member State (see box 6.4).

Another constraint on exports to the EU comes from a policy of the Cambodian Development Commission itself. The CDC prohibits garment producers without its approval from participating in the EU's outward processing trade. Outward processing trade involves EU firms ship and cut parts to low cost countries for assembly and subsequent re-export to the EU. The CDC is of the view that this trade will not develop the local industry.

6.4 Documentation procedures for garment exporters

As part of the licensing process the exporter must obtain a Certificate of Processing from the Ministry of Industry, Mines and Energy as proof that the garments are made in Cambodia. Ministry officials will visit the factory to verify origin. In the next step, exporters obtain a Certificate of Temporary Authorization to Export from the GSP division at the MOC. Officials do not carry out verification of origin at this stage. The stated purpose of this is to speed up export facilitation. Both Camcontrol and Customs carry out a pre-shipment verification of exports at the factory premises and issue a certificate of inspection. Containers are then permitted to leave Cambodia before the Certificate of Invoice or Origin is issued. All documents are sent to the GSP division at MOC for issuance of Certificate of Invoice if garments are exported to the US and Certificate of Origin if exported to EU. Exporters supply detailed cost and price data to GSP for calculating local content. Based on these calculations, the GSP division issues the appropriate Certificate of Origin. For exports to the EU, Form A is issued if the shipment satisfies the EU ROO (and therefore entitled to GSP status in EU market) and Form N if garments do not satisfy required ROO (thus, subject to MFN rates from EU). Under the EU bilateral agreement with ASEAN, fabrics sourced from other ASEAN member countries are treated as local content. In this case the garment exporter is only required to produce a copy of the fabric supplier's GSP certificate as proof that the fabric originates from ASEAN. If the fabric is sourced from non-ASEAN/EU suppliers, then the garment producer must observe the 'full makeup' rule. The MOC implements this rule by requiring garment producers to prove that locally generated value added exceeds the cost of imported fabric. If exporting to the EU, the exporter must also obtain an export license from the Department of Foreign Trade at MOC. The Minister of Commerce must sign both the export license and the GSP form on the same day. The Cambodian government continues to insist that garment producers meet EU ROOs and have an export license even though they are not required if the garment producer is not requesting GSP.

Overall, the documentation process is cumbersome compared to other exporting countries such as Indonesia. There appears to be no reason why the Ministry of Industry, Mines and Energy participates in the approval process. Camcontrol's functions essentially duplicate Customs area of responsibility. This process is costly and time consuming. As it is heavily dependent upon the physical inspection of shipments by three agencies, and is thus very much open to abuse by petty officials. One reason for this elaborate licensing procedure was in reaction to EU and US concerns about third-country garment exports arriving at their ports using forged Cambodian certificates. Apparently, just after the US bilateral agreement with Cambodia came into force, about 700 forged Cambodian certificates were submitted by US importers to clear shipments at US ports, which had in fact originated from China. This problem has been largely addressed with the recent introduction of the electronic visa identification system to the US (known as ELVIS) and EU. Under this system the MOC electronically transfers information on certified shipments of garments to the US customs, which is then able to identify fake Cambodian exports arriving at US ports. According to MOC officials, since this system was implemented early in 2001, US custom complaints about fake shipments have virtually ceased. A similar system has been implemented for exports to the EU.

Returns from preference schemes and distribution of these returns

Impact on export revenues of preferential access

Returns from exporting to restricted markets are attractive for current exporters because they mean access (albeit restricted) to the US market where prices are much higher as a result of restrictions which all exporters to the US face. Thus, while US consumers lose and garment producing countries lose in general these losses are offset to some extent in those garment producing countries which secure some access. The size of this offset is determined by the prices on the US and EU market, the duty applied, the prices that would be received on other next best markets and quantities sold on this preferred market.

This value is sometimes called a *rent*. Estimating the value of this rent is not easy, as it requires comparison with the actual prices producers receive for their exports under the restricted access arrangement with prices they face in other next best markets — that is, the prices they would have received for products sold under quota. However, with some strong assumptions and simple manipulation of existing data from the quota auction it is possible to make illustrative estimates of quota rent value. According to data from MOC, total exports under quota were \$520 million in 2000 (or utilized quota). Assume that the government auctioned 10 per cent of this amount, this would be equivalent to \$52 million of the utilized quota. According to MOC, revenue received from quota auctions in 2000 was \$4.5 million or 8.7 per cent of export quota auctioned. Assuming quota rent to the US is approximately worth 8.7 per cent of quota exports to US of \$520 then the imputed value of the quota rent to the US would be \$45.2 million

Does access to preferential, but not quota markets, have a rent value? For the EU market an estimate of the value of access at zero tariff would be the quantity sold at duty free prices multiplied by the MFN rate. In 2000 exports to the EU were \$221 million. The average EU MFN rate is about 8.8 per cent. Thus the maximum 'rent' possible would be \$19.9 million (\$221 million times 8.8 per cent). The question then becomes: what proportion of exports to the EU were subject to zero tariff? It appears that this could be a relatively small share around 10 per cent and that most exports to the EU are subject to the MFN rate. If this is the case the 'rent' on the EU market would be around \$2 million. Again this exercise warrants further development. The initial estimate of rent also raises the question of treatment of garments sold on the US market out of quota and at MFN prices. In this case as other competitor countries still face quotas,

Cambodia's access at MFN rates would be of extra value depending on the price raising effect of quotas inhibiting exports from other countries. Taking these qualifications and unknowns together it appears that the value of rent is at least \$45 million and more depending on the value of preferential access.

Other impacts of preferential access

While these returns, or rents, appear to be a valuable consideration, this apparent 'good deal' needs to be qualified as follows.

- Preferential access can encourage specialization in products where there is no comparative advantage.
- The allocation of the benefits of preferential access can create inefficiencies which hurt competitiveness.
- Granting of preferences depends on the existence of continuing protection in developed country markets.

Specialization in activities unsuited to the economy

An example where preferential access has encouraged continued production in inefficient areas in the preferential access the EU accorded Caribbean banana production. In this case Caribbean countries produced bananas, not because they were suited to doing that, but mainly because of the preferential access (see box 6.5). In Cambodia's case it appears clear that garment production is well suited to the present stage of development.

The success of the garment industry in Cambodia is a barometer for attracting other Foreign Direct Investment (FDI). Typically, the garment industry is one of the first manufacturing export sectors to develop in a low-income country. In part this is because much garment production relies on low cost labor, but also because of the perceived high risks of operating in developing countries that often delay other types of investments, especially those that require significant outlays in capital and or human resources. In particular, one of the long term benefits of the garment industry for Cambodia is that it acts as a platform for creating a pool of productive workers for new FDI. There are early indications of this already happening as demonstrated by the recent entry of footwear producers in Cambodia. For these reasons, foreign investors watch the success of the garment industry before deciding to invest in that country. In other words, *success breeds success*. Investors are particularly concerned about government regulations and 'hidden' taxes that increase the costs of doing business in a country and uncertainty in the policy framework.

6.5 The benefits and risks of preferential arrangements

The growth of Cambodia's garment industry is remarkable and well known. That an industry could grow from virtually zero activity in 1996 to some 200 factories and 150 000 jobs in 2001 would be little short of spectacular in any country let alone one which during the period in question went through a period of political upheaval, and is widely considered to have run down infrastructure, poor if not corrupt administration and a poorly educated labour force. People might draw several lessons from this experience. One is that despite all the problems that go with being a developing country, the obstacles to rapid development in Cambodia are not overwhelming. That would be a sensible lesson. A second lesson might be that this rapid development only happened because of trade preferences, and that in this case the trade preferences from the US and Europe were useful forms of aid.

This would be a surprising conclusion and not in accord with the general experience with preferential trade arrangements which generally shows them to have a range of effects. Consider for example of preferential quota restricted access accorded by the EU to imports of bananas from Caribbean countries. The main effects of this policy are as follows. First, quota restrictions drive up the EU common price doubling the world price. Second, the EU imports a lot of bananas (40 per cent of all internationally traded bananas) so it costs EU consumer a fortune — about \$2 billion a year due to the higher prices. Third, not much of this \$2 billion reaches recipient countries — about \$150 million a year — so if you think of it as aid it is awfully expensive aid. Fourth, one reason why so little aid gets through is that it is appropriated along the way — in the first instance by large buyers and eventually by getting built into marketing and production cost structures. Fifth, other banana producing countries — mainly developing countries in South America — suffer (losses of \$149 million per year) because their access to the EU market remains restricted. The Mauritius sugar story is another example of trade preferences going wrong. Mauritius sugar exports have preferential access to the EU. As a result Mauritian sugar producers receive prices that are on average double the world price. But far from being a blessing for the Mauritian industry, these preferential arrangements have directly led to a high cost and ossified industry. In order to allocate the 'benefits' of the preferential access Mauritius has enacted laws which restrict the way land and labour is used. And the Mauritian sugar industry is returning at a loss. It also appears to be imposing costs on other industries.

Currently Cambodia is a poor country. Wages are low. This should be one basis for its capacity to attract investment and ideas from abroad. While the minimum wages and other costs arising from 'appropriate compliance' with labour standards might be a way of redistributing some of the value of preferential access to some labour in the short run, in the long run, there is a risk that Cambodia will become a high cost producer in one of the areas where it is most likely to have a comparative advantage at this stage of development. If the lessons from other developing countries are a guide, this is a real risk.

One of the issues worrying policy makers in Cambodia is what will happen in 2005 when restrictions of major developed countries on garment imports are phased out. When this phase out was negotiated as part of the Uruguay Round Agreement on Textiles and Clothing (ATC) it was expected that it would be a boom to developing countries such as Cambodia. No longer would the costs arising from the intricacies of quota allocation involving arcane definitions of ROO and the like be borne. Demand for garments would grow as prices in the US and Europe fell and uncompetitive production in these countries ceased. And demand for other goods which might also be produced by developing countries might also grow as consumers started to spend some of the money saved by having access to cheaper garments.

So 2005 and the loss of preferential access is not necessarily a matter of doom and gloom for Cambodian garment producers (Van Sou Ieng 2001). It will only be that if Cambodia has come to have a cost structure built around preferential arrangements and so is unable to compete in unrestricted markets. Given the relative youth of Cambodia's garment industry, flexible production and low cost structures ought to be within reach. Perhaps a bigger risk is that the relatively slow adoption of the ATC and the propensity of the major importers to adopt other barriers to trade, will mean that come 2005 restricted market access arrangements will still exist.

Sources: A. Stoeckel and B. Borrell, *Preferential Trade and Developing Countries: bad aid, bad trade*, Rural Industries Research Development Corporation (RIRDC) 2001.

Van Sou Ieng 2001, *The Future of the Garment Industries Post 2005*, Globalisation Conference Business and Law Perspectives, Ministry of Commerce, Phnom Penh, 27 June 2001.

Effects on efficiency

There are concerns that inefficiencies in some existing institutional arrangements — such as relatively high minimum wages, restrictions on work shifts, unofficial taxes — as well as regulatory compliance costs are raising the cost structure of the garment sector. While legal minimum wage rules may benefit existing workers in the short-term, they can put expanded employment in the industry at risk, if preferred markets cease to exist by creating a cost structure that is only viable with preferences. Further, by putting in place permanent institutional rigidities the development of other potential export sectors is also at risk for the same reasons.

One way of looking at how these inefficiencies raise costs is to examine how the rents from the preferences estimated above are allocated among different stakeholders. In principle, distribution of rents among different stakeholders is not undesirable if the allocation is done in a way that is low cost whereby few or no inefficiencies are created. One common example of this low-cost way of capturing rents is the competitive auctioning of quotas. Indeed, governments in many countries competitively auction rights to fisheries and log quotas. This approach has the advantage of capturing rents and discouraging inefficiencies. However, if rent appropriation activities raise costs of doing business in the economy then this would adversely affect competitiveness.

In Cambodia, both low cost and high cost ways of capturing garment quota rents exist. In this construction, three stakeholders are capturing the quota rent; government including government officials; workers and garment producers. The Government has implemented a flexible quota system for these categories whereby about 80 per cent of the quota has been allocated to firms operating in Cambodia in 1998 based on their past export performance and production capacity. Up to ten per cent can be allocated to exporters as a reward for current export performance and compliance with the country's labor laws. The remaining 10 per cent or more is auctioned to garment producers through competitive bidding carried out under the auspices of the MOC. The general view among garment producers and industry analysts is that the auction is done in a transparent manner.

Three different taxes apply. These taxes are in part fees for services but to some extent may also capture rent. They include:

- the visa fee amounting to \$10 million on exports to the US;
- minimum turnover tax on quota exports to US amounting to \$5.2 million; and

- Camcontrol inspection fee of 0.1 per cent amounting to \$.53 million on imports of fabrics and exports of garments.

Based on this approach, the total rent captured by the government amounts to \$20.23 million or 44 per cent of our estimated rent value. The bureaucracy also captures rents in the form of 'unofficial' or 'hidden' taxes and facilitation payments. According to recent reports these bureaucratic costs are around \$70 million (CLDRC 2001). This would mean that bureaucratic costs completely swamp quota rent. Another estimate of bureaucratic costs is based on the Trade Facilitation section, where it was estimated that informal costs of exporting garments amounted to between \$110 and \$150 per container consisting of \$30 000 (f.o.b.) worth of garment exports, plus formal costs of \$138 per container. At say informal costs of \$130 per container the estimate of total informal trade facilitation costs to the garment sector would be around \$4 million. Clarification of these widely different estimates requires further study.

A second group that benefits from the rent is garment workers. The government increased the minimum monthly wage from \$38 to \$50 (including the additional \$5 monthly bonus for full attendance). Assuming 120 000 workers the additional cost of the increase in minimum wage would be \$17.3 million. This could be considered as to a transfer from producers to workers. However, some of this transfer was gathered in by job brokers. Evidently, to secure a job garment workers must pay job brokers, usually security guards or shop stewards. According to one survey of garment workers, 50 per cent of all workers paid an average fee of \$38 in 1999 to secure their jobs (CDRI 2000). The same survey found that 57 per cent of these workers had to take out a loan (from informal lenders) to pay the fee (see box 6.6 sharing the benefits of market access).

While garment factory owners condemn such a practice, according to the survey, no workers were willing to make a complaint to the owner in fear of reprisals from brokers. However, since the regulation of minimum wages and bonus system has been increased, a young person seeking a job in the garment factory in 2000 must find up to \$120 as a payment to security staff or a shop steward. In 2000, more than 30 000 new jobs were created in the garment sector. Assuming that 50 per cent of these new workers had to pay a fee of \$120 to brokers to secure their jobs, then the capture of rents by these brokers could have been \$1.8 million, and as much as \$3.6 million if all 30 000 new workers had to pay a fee. In any case, the \$120 brokerage fee is equivalent to 84 per cent of the increase in the annual minimum wage of garment workers in 2000, indicating that brokers were capturing the bulk of the additional rent designated for new workers in 2000.

6.6 Sharing the benefits of market access

Bon San is a 20 year old Cambodian woman from Preah Vihear Province in the north of Cambodia. She is one of 120 000 young people who have come to Phnom Penh to work in Cambodia's garment industry since garment exporting took off in 1997. At least 75 per cent of these young people are women. Bon San's life is difficult — she has not been home to see her family since coming to Phnom Penh twelve months ago. She shares a small room with two other women in a house not far from the factory. She works six and sometimes seven days a week. The work is boring and repetitious. And because Bon San works on a piece rate system, she is under constant self applied pressure to perform.

Bon San is a hard worker, she has a good attendance record and occasionally works overtime. When the factory is busy she earns around \$70 a month. Conditions in the factory are good, the lighting is adequate, there are fans for cooling and there is a medical centre on site. To secure the job Bon San's family paid \$30 to the factory shop steward. Since then her wages have risen following the regulation of minimum wages and a bonus system. Now a young person seeking a job in a garment factory must find \$120 as a payment to security staff or a shop steward. This fee, plus transport and living for a month without salary, is way beyond the means of most families in Bon San's village. For them, the investment to get a family member into garment work is now as forbidding as it would be for an American family to send a child to an Ivy League school.

Bon San is sometimes confused about whether she owes her relative good fortune to the Singapore company that owns the factory, or to its manager or to the various inspectors that regularly visit. Some of these inspectors are from the Ministry of Social Affairs, Labour, Vocational Training and Youth Rehabilitation. Others are from the Project on Monitoring the Working Conditions in the Garment and Textile Factories and others again are representatives of big name US buyers. These people seem very concerned about her welfare and from time to time ask if she is happy and whether she has any problems with management?

Bon San sometimes thinks what a pity it is that these caring people have not been to her home village to insist on such good conditions for the young people there. It is in villages like this where over a million young Cambodian people live in real poverty. Their chances to get work are erratic and seasonal and might involve spending days up to their knees in water bending over to plant paddy. One of Bon San's brothers works on a fishing boat. The hours are long and the work is dangerous. Another brother stokes boilers in a brick works. It is a long time since Bon San has heard from him and she sometimes worries that he has been maimed or killed. She also worries about her 17 year old younger sister Povi. Povi spends about half her time either planting or harvesting rice. The rice is for family consumption and Povi barely knows what money is for. When she is not working in the fields, Povi spends most of her time sitting and waiting on a cane bench in the open area under her family's house. Povi would gladly come to work with her elder sister and at 17 years she is legally entitled to do so. But since a foreign TV program claimed a leading garment producer was employing people younger than 16 years, producers have steered well clear of anybody under 18 years old.

What about Bon San's puzzle as to why she, who is relatively well off, gets inspected so much when others much worse off never get inspected at all? One explanation for this puzzle is that Bon San's wages and working conditions are part of a deal. Her employers gets restricted access (for goods they produce out of Cambodia) to a protected and therefore high priced market, provided that Bon San and her workmates enjoy good wages and working conditions. Is that a good deal for Bon San? The answer in the short run is probably yes. But it is not such a good deal for Povi, who has no real job. If Bon San's bosses had lower costs, that is, could pay lower wages, and run night shifts without paying double time they might be able to better compete on non preferred markets and so invest more, expand output and employ young people like Povi. And in the long run, the good wages and working conditions would not be so good for Bon San either if preferential markets were to go and producers were to move out of Cambodia because costs of operating were higher than in other countries.

There are also regulatory compliance costs that reduce rents accruing to producers. Many of these costs are difficult to quantify. For example,

garment producers incur costs (for example, staff time) to obtain appropriate documentation to export including the complicated, cumbersome process of obtaining certificates of ROO for exporting to the EU and US markets. The cost of monitoring labor standards in garment factories is another cost of regulatory compliance imposed on garment factories, as garment producers are required to contribute funding to this project. Under the US-Cambodian garment agreement, the ILO is responsible for monitoring labor standards in the Cambodian garment industry. To this end the Cambodian Garment Monitoring Project in Phnom Penh was established jointly between the ILO, the Cambodian government and the Cambodian Garment Producers Association. The Cambodian government contributes \$200 000, the Cambodian Garments Producers' Association contributes the same amount and the US government provides funds up to \$1 million for the project. This can be seen as not so much transfer of rents but a dissipation or waste of rent. It is frequently the case that buyers or agents in importing countries gather some rent.

This allocation of rents may be sustainable in the short-run while existing producers have preferential access to the EU and US markets and sufficient rents exist. However, the quota system is due to be disbanded in 2005 and garment producers will have access to the US market on equal terms with all other competitors, thus any current rents will be dissipated through competition in the US market. The most efficient competitors will gain market share and employment at the expense of less efficient producers. The preferential trade arrangements, resulting labor policy outcomes, and other inefficiencies may risk future growth in the garment industry as well as other potential labor-intensive, export growth sectors by creating a rigid, high cost structure that is only viable with preferential schemes.

Cambodia's minimum wage of \$45 per month (for garment worker) based on a 48 hour working week is higher than those in most other competing countries in the region (for example, Bangladesh, India, and Indonesia), but below rates prevailing in more developed neighboring countries such as Thailand (table 6.7). There is tentative evidence that minimum wages are pushing up market wages in the garment sector. The minimum wage makes it difficult for managers to use pay schemes as a means for promoting productivity. For instance while piece rates are still common, in some cases some workers elect to simply take the minimum wage. Yet piece rate systems provide opportunities for efficient workers. Consequently, managers need to supplement the minimum guaranteed wage with additional incentive schemes. According to a recent survey, average monthly wages are about \$61, although evidently garment workers can earn up to \$80 per month with over time.

6.7 Working hours and wages in the garment industry in selected Asian countries

Country ration	Year	Legal hours of work	Minimum wage set by law	Average salary per month	Hourly wage rate	Minimum wage to average wage	%
Malaysia	1995	48	none	296	1.42		na
China	1997	40	12-39	191	1.14		6-20
Philippines	1999	48	130	182	0.88		71
Thailand	1999	48	93-109	106	0.51		88-103
Sri Lanka	1998	45	29-37	63	0.31		46-59
Cambodia	2000	48	50 ^a	61	0.29		82
Vietnam	2000	48	45	60	0.29		75
India	1999	48	6-54	57	0.27		11-95
Indonesia	2000	40	43 ^b	46	0.25		94
Bangladesh	1996	48	12-76	40	0.19		30-90

^a for purposes of this table, the \$5 full attendance bonus is included in the minimum wage rate. ^b Minimum wage in Jakarta.

Sources: Cambodian Development Research Institute, US Department of Labor and Bureau of International Labor Affairs and the Indonesian Department of Manpower 2001.

There are growing concerns in the private sector that relatively high minimum wages and other labor market restrictions risk reducing long-term competitiveness of the Cambodian economy with potential negative effects on modern sector employment growth and therefore poverty reduction. For example, firms are normally only permitted to operate two shifts per day. If one shift happens to fall between 10pm and 5am, then the wage rate is double the normal rate. Excessive restrictions on operating night shifts could create inflexibility in the production and service sectors. This is particularly important in the garment sector where factories often have to meet short deadlines for delivery, particularly during the peak season. Night shifts are also an integral part of the service sector, particularly the tourist and catering industries. However, managers complain that these restrictions make it costly to provide over time and employ additional workers for night shifts. Labor laws in most other countries, including many developed nations, do not restrict firms from operating a night shift.

Experience of other countries that have implemented relatively high minimum wages show that there are both short term and long term effects on employment growth and poverty. In the short term, one effect is to raise wages for people who have a job. Another short-term effect is to create opportunities for people allocating jobs to charge fees as discussed in section 4. In the long term, however, relatively high minimum wages risk reducing the competitiveness of the modern economy, by making the country's production high cost so that it is only profitable to operate in restricted markets and thus vulnerable if those markets go. In early stages of development, low cost labour is a powerful source of comparative advantage. Tampering with the price of this labour by way of minimum prices has frequently spoiled this source of comparative advantage. The

6.8 Effects of minimum wages on employment: evidence from other developing economies

There are two clear and divergent views on the impact of minimum wages on labor markets in developing economies. One view is that minimum wages redistributes resources in a welfare enhancing way, and as such have the potential to reduce poverty, enhance productivity and foster growth. The other view is that minimum wage intervention leads to depressed wages where most of the poor are found - in the informal urban sector and in the rural sector.

If these are the divergent views, what is the evidence? A number of developing countries have applied minimum wage legislation. These 'experiments' provide a growing body of evidence that setting minimum wages close to or above the market-clearing wage does have an adverse effect on employment growth in the modern sector and can undermine efforts to reduce poverty in the long term. Recent research in Latin America, for example, shows that setting relatively high minimum wages has created a protected high paying formal sector characterized by relatively slow employment growth and increasing concentration of workers in the lower paying informal sector. Relatively high minimum wages increase the cost of structure of the labor intensive industrial sector thereby making it internationally uncompetitive and, thus, reducing long term economic growth. In contrast to the Latin American experience, many Asian labor markets are relatively flexible - particularly with respect to wages. Malaysia and Singapore do not have minimum wage legislation. Korea has a minimum wage rate for workers as a social safety net policy, but this is set well below market wages. Consequently, there are relatively small differentials in wages, labor costs and productivity between modern and quasi-traditional sectors. Much of the modern sector is internationally competitive because they use the country's most abundant resource, labor, more intensively. Relative to per capita income, a high share of labor is involved in the modern sector compared to many Latin American countries.

Mexico and Columbia are two countries that have contrasting wage policies. Columbia implements a high minimum wage policy whereby minimum wages are around 50 per cent of unskilled workers' market wages. Mexico has adopted a more flexible approach, whereby minimum wages are set well below prevailing market wages (about 30 per cent of average wages of blue collar workers). A recent study found substantial unemployment effects of minimum wages in Columbia, where the impact is greatest on low skilled employment. A 10 per cent increase in minimum wages reduces employment by 3 per cent for unskilled workers and 2 per cent for skilled workers. In contrast minimum wages had no impact on employment in Mexico because minimum wages there are too low to have any effect. Recent evidence for Indonesia suggests that minimum wages are beginning to adversely effect employment. Indonesia has had a minimum wage policy since the early 1980s, however, it was not until the early 1990s that the government began to vigorously implement the wage policy. A recent study estimated the effect of rapid increases in minimum wages on different types of workers and found substantial unemployment effects for women, young people, and unskilled workers. A 10 per cent increase in the minimum wage reduced employment of women and young workers by 3 per cent, unskilled workers by 2 per cent and factory workers fell by 1.4 per cent.

These findings have important implications for poverty reduction strategies. While in the short term, increases in minimum wages benefit those workers who have jobs, in the long term, high minimum wages reduce employment opportunities in the modern sector, crowding workers in low productive, low paying jobs in the urban informal sector and the rural sector. The workers most affected by high minimum wages are those that are most vulnerable to poverty such as women, especially single women heads of households and young women, and unskilled workers.

experience of several Latin American countries demonstrates that setting minimum wages above market clearing wages leads to greater segmentation of the labor market into a protected high paying formal sector characterized by relatively slow employment growth and increasing concentration of workers in the low productive and paying informal sector (see box 6.8).

Positioning for unrestricted market access

The barriers to imports of garments and textiles that confront all countries wishing to export to the US and the EU are scheduled for dismantling by 2005. One of the adjustment problems looming as that happens will be the need for firms that have depended on those barriers to adjust. This obviously includes domestic firms attempting to operate labour intensive activities in wealthy high wage countries. Paradoxically adjustment might also be a problem for exporting countries which have had cost blow outs as a result of the way preferential access has been allocated.

Cambodia faces a choice at this early stage of its economic development: should it go the East Asian or Latin American route in terms of the structure of output, employment, wages and income. International experience suggests that it can take decades to reverse the political processes that lead to the creation of a small, elite and protected work force which inhibits modern sector job expansion. To some extent, Cambodia's approach to labor policy is constrained by its exchange rate system. Cambodia is a highly dollarized economy and is likely to remain so for some time yet. With a dollarized economy Cambodia does not have the option to devalue its currency whenever there is an external shock to the economy. Adjustment in the economy will need to come through prices including wages. This is what happens in Hong Kong. A vigorous implementation of minimum wages would slow wage and price adjustment and as a consequence unemployment persist.

While the government is concerned about providing basic protection of workers, raising wages independently of output and productivity is not a proven recipe for investment and growth. The interests of all those workers outside the modern sector is threatened by attempting to push increases in wages more quickly than productivity increases in the modern sector especially given competition in highly competitive export markets.

The greatest improvement in the incomes and welfare of workers will come through providing them with more productive jobs through the growth in both modern and informal sectors. Raising productivity in agriculture is important for employment and wage improvements. But it is the transfer of workers out of these sectors into more productive activities, many of which are associated with modern sector growth, which offers the prospect of greatest improvements in incomes and poverty decline. It is important to have policies for supporting a growing and internationally competitive modern sector in an employment friendly development strategy. Both domestic and FDI are important in this context.

7

Tourism

Background

Cambodia is one of only four LDCs in the World with tourism income exceeding US\$100 million per year. Located in the center of the fastest growing tourism region in the world, Cambodia is positioned to gain from tourism through:

- long term employment opportunities for a young, growing population;
- constant demand for high quality handicrafts and locally produced goods;
- year round demand for Cambodian grown fresh fruits and vegetables to supply hotels and restaurants; and
- permanent and growing tax base from which to support infrastructure development, finance Ministry of Tourism (MOT) tourism promotions, and expand private-public sector partnerships.

Tourism is a re-emerging industry rather than a new one for Cambodia. During the 1950s and 1960s, along the southern shorelines near Kompong Som and Kompot, Cambodia was a popular year round tourist destination. Thirty years of civil war destroyed most of the infrastructure connecting tourist destinations and all but eliminated the social capital and hospitality skills required by a fast growing tourism industry. On a more positive note, the closed borders resulted in the preservation of much of Cambodia's natural beauty. Dozens of Khmer temples remain hidden in the jungles, untouched for centuries, and Cambodia's vast forests are considered the best in Southeast Asia.

More recently, Cambodia has experienced tourist growth rates averaging nearly 30 per cent for each of the past two years. While most of this sudden growth can be attributed to the release of pent up tourism demand. Cambodia's innovative private-public sector partnerships have facilitated an effective supply response. Recent decisions by the government, with the support of airlines and tourism related businesses, have created economic incentives for local and foreign investors to build hotels, establish tour and

travel agencies, open a variety of restaurants, and bring modern transportation to Cambodia. The open skies policy encouraged regional airlines to fly directly to Siem Reap and allowed the magnificent temples of Angkor Wat to become available to a much broader set of tourists.

The tourism business in Asia, especially the Greater Mekong Subregion (GMS) is highly competitive, and Cambodia is surrounded by strong and capable competitors. For example, in 2001 Cambodia expects about 500 000 tourists (MOT 2001). Thailand, with 50 years of tourism experience, a skilled work force, world famous beaches and entertainment, and internationally recognized tourism promotions, is expecting more than 5 million tourists and continued 10 to 15 per cent annual growth rates.

Extent of economic leakage

Economic leakage is high in Cambodia, as it is in other LDCs that lack an industrial and agricultural supply industry. It is estimated that up to 75 cents of each tourist dollar is returned to Thailand or Vietnam to import fresh vegetables, fruits, flowers, handicrafts, paper products, and furniture (Jameison W. 2001). National and local initiatives aimed at improving the production of high quality agricultural and handicraft supplies would help retain the economic value of tourism. The development of a smallholder agricultural industry to produce high quality vegetables, fruits, and flowers supplied to hotels and restaurants, and the development of a high quality handicrafts industry are two fundamental industries that would help retain and spread the economic benefits of tourism to a much broader constituency, provide cash incomes, long term rural based employment, and ensure that the maximum portion of each tourist dollar remains in Cambodia, thus increasing the in country multiplier effect and benefit to the economy. Already Cambodian entrepreneurs are exploring ways of better marketing handicrafts involving such things as packaging handicrafts to a consistent standard and establishing of handicraft villages.

There is concern among tourism commentators that Cambodia's growth rates are not sustainable and may begin to stabilize or decline soon. They say that Cambodia is one of the most expensive package tour destinations in Asia and the price to service quality value is low relative to other GMS countries. Some observers are concerned about having 570 000 tourists arrive in 2001 without promotion or coordinated efforts by the MOT and private sector firms. The fear is that the industry will become complacent and fail to improve service quality or expand destination choices. Complacency could result in the loss of focus necessary to continuously

encourage private sector investment, build long term social capacity and service skills, improve service quality, and promote tourism with a passion.

How appropriate such concerns are only time will tell. Until now there has been a remarkably effective supply response facilitated by good airport infrastructure, an open skies aviation policy and apparently few barriers to entry for tourism support services such as buses, hotels, restaurant and internet services.

Focus of this report

The research for this report included a lengthy literature review and interviews with MOT officials, private sector businesses, and tourism industry experts. Volumes of preparatory analysis and planning materials have been produced for Cambodia's tourism sector as a result of UNDP technical assistance in 1996 and more recently, the Asian Development Bank's (ADB) TA 3454 Tourism Project focused on building institutional planning capacity at the Ministry of Tourism. ADB's current project is broad in scope. Some of the key components of its approach are:

- poverty alleviation through the formation of pro-poor development strategies and action plans;
- gender mainstreaming and social equality;
- revenue capture by local communities;
- shareholder involvement in planning; and
- systematic development of private-public sector partnerships.

The ADB project identifies critical links in the tourism value chain, along with the institutional needs of the MOT, and defines the need for private-public and stakeholder partnerships. The objective of this report is to identify how international trade linkages and private sector participation can enhance tourism development, enhance the economic benefits, and assist development agencies, the Cambodian government, and private sector firms to promote pro-poor trade policies and development practices. The report presents sector specific initiatives to further develop business linkages, build social capacity, and promote competition and cooperation.

Industry snapshot

Table 7.1 provides a snapshot of the value Cambodia receives from tourism. If current growth trends continue, the tourism sector, which is

supported by many service industries, could become Cambodia's leading contributor to GDP growth.

7.1 Selected tourism statistics

<i>Statistical Category</i>	<i>Published data</i>
Tourist arrivals expected in 2001	570 000
Growth rate from 2000	30%
	MOT ~ 30%
Annual growth rate expected for years 2001-2005	ADB < 15%
Estimated tourism related employment	30 000 jobs
Direct tourism related wage income	\$115 million
Estimated economic impact	\$650 million
Tourism related businesses	2,423
Direct tourism related investments	\$900 million
Direct tourism related taxes paid	\$50 million

Source: MOT 2001.

The tourism products currently offered in Cambodia are:

- cultural heritage tourism
- handicrafts, and
- festivals and events.

Products which are proposed to be developed include:

- village tourism
- eco and nature based tourism
- adventure tourism, and
- coastal zone tourism.

Past, current, and projected rates of growth

Cambodia's tourism industry experienced a relatively high average annual growth of 10 to 15 per cent from 1995 to 1999. For 2000 and 2001, tourist arrivals have grown by 30 per cent each year. MOT officials project tourist arrivals will continue to grow at a 30 per cent annual rate, resulting in 1.2 million tourist arrivals by year 2005. The ADB consultants interviewed for this report estimate tourism growth of 8 to 15 per cent per year for each of the next five years, resulting in 745 000 tourist arrivals by 2005. To provide relevance, an eight per cent growth rate is about twice the average tourism growth rate of Asia and about four times the average worldwide tourism growth rate.

Can growth at these rates continue?

The two fairly well developed tourist destinations in Cambodia are the capital of Phnom Penh and the temples of Angkor Wat located in Siem Reap. Phnom Penh is currently under utilized as a tourist destination and already possesses the hotel, restaurant, and travel agency capacity to host about one million visitors per year. Service quality is low and continuous investments are required to develop human resource capacity and tourism infrastructure; improving service standards will take considerably more concerted efforts.

Hotel operators in Phnom Penh report that occupancy rates are lower now than they were prior to the events of July 1997. As a result, several medium quality hotels recently closed. Restaurants in Phnom Penh complain of only moderate profitability, but tour and travel agencies report a profitable and lucrative tourist business.

Tourism commentators believe continued 15 to 30 per cent growth rates will soon begin to stress the service capacity of the hospitality industry in Siem Reap, and the road and other infrastructure capacity of Angkor Wat. As of 2001, Siem Reap has or is currently completing 7 200 hotel or guest-rooms, and will require only about 500 more rooms before 2005 to meet a 30 per cent growth rate. Occupancy rates at most hotels and guesthouses were reportedly 30 per cent or lower, except during the four high season months from January to April. The number of international and domestic flights arriving in Siem Reap is already capable of supporting about one million tourists

While it may be structurally feasible (that is, hotel rooms and airline seats) for Cambodia to support tourism growth of 30 per cent, a few industry commentators feel that institutional service quality levels may already be beginning to deteriorate. This is a primary concern because once tourists begin to experience low service quality while paying premium prices they will not return and will tell others not to visit. Recent data, obtained from discussions with hotel operators and members of the private-public sector working group, suggest that the average lengths of stay and expenditures per day have already begun to decline in Siem Reap and that many tourists are choosing to skip Phnom Penh entirely. Therefore, while the numbers of tourists are increasing at double digit rates, the time and money each tourist is spending in Cambodia appear to be decreasing.

If Cambodian tourism firms and supportive government agencies collaborate to address service quality issues promptly, begin to build a tourism supply chain that incorporates supplies from local cost efficient

producers, and diversify and promote tourist destinations to such categories as eco village, and adventure tourism, then perhaps accelerated rates of growth may be manageable and attainable.

Priority issues for tourism trade development

The following list of priority issues was identified in literature searches, through interviews with tourism commentators, and in papers prepared by the Private-Public Sector Tourism Working Group.

- A dearth of tourism related data and analysis from which to plan and invest inhibits the government from effectively planning initiatives that ensure continued industry growth and inhibits investors and private sector businesses from increasing tourism sector investments and improving human resources. An effective tourism development strategy, defined through private-public sector collaboration and based on accurate and timely analyzed data, will better ensure that government and private sector investments are based on informed decisions. In addition to a need for an initial in depth tourism study, there is an equally important need to develop a systematic process for continuous data collection through tourist arrival and customer satisfaction surveys.
- A serious deficiency in capable, trained, and skilled local staff within the MOT and the private sector indicate improvements to the sector will be slow and service quality levels will remain below those of competing countries. In order to effectively facilitate, encourage, and enable the private sector to grow the industry, staff at MOT must be at least as skilled and knowledgeable as their private sector counterparts. Without a pool of skilled hospitality employees, the private sector will find it difficult to improve service quality and expand the industry.
- Ineffective promotion of Cambodia in international and regional markets and lack of coordinated promotions initiated through private-public sector partnerships risk having the tourism market stagnate once the existing pent up demand is exhausted. Whether the current double digit growth is an autonomy or not, continuous and innovative development and marketing of tourism products to the world traveler is essential to improving Cambodia's competitive position.
- Limited international and intra national air, land, and waterway routes into Cambodia from neighboring countries and between destinations within the country reduces the diversity of tourists, inhibits cross regional tourism, and fails to encourage investment in eco, village, and adventure tourism sites where local Cambodian's can benefit most from the expansion of specialized tourism products.

- Low level of locally produced food and handicrafts products to support the tourism industry creates an economic leakage of tourist dollars that inhibit rural economic development and reduce economic benefits to a broader constituency of beneficiaries.

Developing institutional and social capacity to promote tourism

In reviewing the volumes of development plans, interviewing tourism specialists, and discussing issues with tourism related firms, it appears obvious that there is a severe shortage of institutional capacity and social capital from which to manage current levels of tourism, much less a base from which to quickly expand. Improved international and regional trade and resulting economic benefit depend on well developed business and social linkages.

Most of these linkages are created through the efforts of private sector organizations, such as working groups and sector specific trade and business associations. The government's role is to facilitate and support the development of these organizations, promote international and regional trade relationships, and promote national interests. Development agencies, the government, and private sector firms can assist by facilitating the development of these institutions.

Rather than analyze and present specific capacity shortfalls of which there are many, it is more helpful to first define the roles performed by participants in robust tourism industries of other countries. From that basis, one can identify initiatives to encourage tourism sector participants in Cambodia develop the necessary institutional and social capacities from which a robust tourism industry can emerge. Although there is no one best method for developing tourism, experience has shown that a few fundamental institutions and social structures are required before an economic activity, such as tourism, can become sustainable. Development agencies should consider if the initiatives they fund are complementing these roles of inhibiting their development Public Sector Roles.

Tourism related government institutions usually serve as facilitators, coordinators, stimulators, catalysts, and supporters of the tourism and hospitality industry. These institutions create incentives for tourists to come to a destination and for private sector participants to invest in businesses and products that satisfy customer demand. Among the functions of the public sector are:

- promotion of tourism products to international and regional markets;

- management of a national tourism image, internationally and regionally;
- development of trade linkages nationally, internationally and regionally;
- facilitation to ensure economic and social benefit is equitably shared by all members of the population;
- incentives for the private sector to broaden and diversify tourism products and satisfy continuously emerging customer demand;
- encouragement for developing private-public sector partnerships and private sector business associations;
- adoption of equitable license systems and enforcement methods with written receipts for all fees paid and services rendered;
- development and promotion of education campaigns on the value of tourism, tourist safety, proper disposal of litter, personal and food related hygiene, and improved supply of health services; and
- development of inter ministerial working groups that ensure that tourism issues are addressed at a national level by the Ministries of Interior, Health, Public Works, Finance, and others. These include safety and security, health, transport, taxation and other key issues.

In Cambodia, the MOT is the government institution most responsible for guiding developing, and managing development of the tourism sector. The MOT employs about 900 persons, of whom 300 are full time staff, and has offices in all 23 provinces.

Private sector roles

The role of tourism related private sector businesses, sector specific working groups, and private business associations is to develop structures to self regulate the industry through codes of conduct, quality standards, and grading systems. The functions of private sector firms includes:

- investment in tourism products, such as hotels, restaurants, and transportation systems that ensure a positive tourism experience and repeat business;
- establishment of conflict resolution procedures to ensure customer satisfaction and positive working relationships among participants;
- privatization of regulatory monitoring and enforcement through the development of liability insurance and other risk sharing practices;

- promotion of tourism at the local level, business to business linkages at an international and regional level, and diversified product development;
- development of private business associations and stakeholder working groups to ensure businesses and stakeholders are collaborating to identify and solve problems;
- promoting and actively encouraging private-public sector partnerships to the benefit of society, the industry, and individual businesses; and
- development of human resource capacity and continuous improvement of service quality that is based on customer expectations.

At least three sector specific private business associations have been formed in Cambodia. The Tour Guide Association located in Siem Reap and the Hotel Owners Association and Cambodian Association of Travel Agents located in Phnom Penh. Associations offer a mechanism for representing tourism related interests and concerns with local and national government agencies. With proper facilitation and encouragement, private business associations have the capability to establish quality standards and classification systems, as well as self regulating the industry, enforcing codes of conduct, promoting training, coordinating services, and improving marketing and information exchange. These associations should be strengthened to achieve these objectives.

Private-public sector partnerships

Institutionalizing systematic consultations between private and public sector institutions can have positive, long term effects. In addition to promoting a self regulated private sector, these partnerships can assist government institutions, which in Cambodia generally lack experience in competitive markets, to understand the interconnections between good governance and economic growth. These partnerships assist in developing industry standards with the customer perspective and long term customer satisfaction in mind, while relieving the government of the burden of enforcement.

For example, by jointly developing with private associations a professional code of business ethics and conduct, a template for fair trade practices, and quality standards, government institutions, such as the MOT can focus on more important promotion and linkage activities. They can be confident that the tourism sector will develop efficiently and without the constant need for oversight by government institutions. Among the essential functions of the private-public sector partnerships are:

- regularly scheduled and facilitated communication between government institutions and private sector business interests;
- efficient dissemination and collection of customer satisfaction surveys and tourism data;
- methods for discussing issues of self regulation and enforcement;
- development of tourism boards, marketing boards, and other tourism institutions that require coordinated private and public sector participation; and
- development of a tourism industry ombudsman institution so that tourism customers, tourism businesses, and government institutions have effective dispute resolution mechanisms.

The tourism related private sector businesses in Cambodia have taken on an increased presence through the formation of the Tourism Working Group. This is a private-public sector partnership that meets monthly and is chaired by the MOT. Participants of the partnership who were interviewed for this report felt that the partnership has been very successful at identifying and solving tourism related problems.

Sector specific initiatives to enhance tourism trade

Tourism in Cambodia has experienced phenomenal growth in that past decade. The rates have exceeded all expectations and are several times the average annual growth for any Asian competitor. While there is a limit to how long double digit growth can continue without running up against human resource, infrastructure, environment or institutional barriers, that is no reason to stop promoting the wonders of Cambodia to an even broader international audience.

Tourism growth has risen so fast for so long that neither the government nor the private sector have been able to build the required capacity to sustain the growth and keep quality high. Rather than identify the shortfalls that have resulted, this report has presented a template from which participants and the development community can contribute to the industry. The roles of the private and public sectors are mutually exclusive in many components and interdependent in others. The ability of the participants to develop the proper mix of interests, create partnerships that are properly focused, and continually develop new products and services will be the determining factor in how Cambodia's tourism trade benefits the country and helps to alleviate poverty.

The government should strive to become a facilitating, coordinating, dynamic agent for change that promotes partnerships, understandings, and self governance through a set of standards developed by private sector firms with support of public sector institutions. These skills will require a change in mindset and actions, but will set in motion the confidence building necessary to encourage continued tourism sector investments by the private sector in physical as well as human resources. The development community's role is also essential. The manner in which the community invests scarce financial and technical resources will have a determining effect on how well all participants can fulfill their roles.

Initiatives to enhance tourism trade

The following sector specific initiatives are recommendations that require further analysis and discussion with tourism sector working groups, ADB tourism advisers, development agencies, and the government.

- *Perform a detailed market and tourism impact analysis for Cambodia.* To make informed decisions, private sector participants need accurate data from which to weigh alternative business choices, and government agencies need accurate data from which to analyze the economic impacts of various tourism promotions and initiatives. For example, with accurate data, one would have a rational basis upon which to determine whether the current growth patterns can continue, whether or not it is cost effective to improve and reopen the Sihanoukville airport, or if village and eco tourism are the appropriate tourist draws for Cambodia. Only after a broad survey is conducted and data is gathered and analyzed can the private sector and government begin to make informed decisions about how best to enhance tourism trade.
- *Support private sector institutional development.* The private sector needs help to develop its social capital, management skills, and technical capabilities (Working group 2000). From the development of local community level organizations and working groups, such as those necessary for village and eco tourism plans, to enterprise and private sector business associations, the private sector needs to receive sustained support to upgrade their organizational, technical, and management capacities. Support is most effectively delivered through sector specific organizations, private business associations, and working groups.
- *Support the development of private-public sector tourism related partnerships.* In general, the experience of Cambodian government agencies working with private sector firm in an egalitarian manner is limited and requires professional and independent facilitation. To effectively gain

an understanding of their role in a market economy, a role where government staff enable and support the private sector rather than control all economic activity, relationships need to be facilitated. Once relationships are developed, private-public sector partnerships can collaborate on the priority issues of tourism promotion, human resource capacity development, economic leakage, and improved trade linkages and destination development.

- *Improve and promote trade linkages with regional (GMS) countries. Improved trade in proportionately related to market access.* In conjunction with market and tourism impact analysis, private-public sector partnerships should work to improve GMS land, air, sea, and water access routes, encourage ever more direct flights into Cambodia, and improve overall travel convenience and safety. More overland and water border crossing, visa capable entry points and a corridor across the region should improve trade and draw more visitors to rural Cambodia.
- *Promote the development of agricultural products and handicrafts supply chains for the tourism industry.* Market and tourism impact analysis will include analysis of trade flows and economic leakage. This will lead to the development of strategies to promote small holder development in delivery of high quality agro-industry and handicrafts products to the tourism industry. The development of locally grown fresh fruit and vegetable suppliers and a high quality handicrafts sector will help to ensure that more of the economic value from tourism is accessible to more Cambodians.
- *Promote sustained improvement of human resource skills.* Human resource development is a serious constraint to tourism trade development and to improving service quality levels. Few training courses for the hospitality industry are offered in private or public sector education institutions. The solution is unlikely to be for the MOT to develop tourism training institutions and train the private sector in how to manage tourism attractions, operate hotels, and provide culture tours, as has been proposed.
- *Enhance the investment, land, and tourism laws to promote private sector pro-poor investments.* The objective of this broad initiative is to involve the private sector in the development of laws and regulations that promote investment in Cambodia's tourism industry in a manner that spreads more benefits to more Cambodians. The initiative would assist in removing barriers to foreign investment, openly communicate laws and regulations to investors, provide a simple and general licensing system for all tourism operators, and shift issuance, inspection, and enforcement of licensing functions to a private-public organization.

8

Labor services

Background

The export of labor has been an important option for reducing poverty and improving household livelihoods in many Asian economies, including the Philippines, Sri Lanka, Thailand and Vietnam. Remittances from export workers are an important source of foreign exchange earnings for these countries. While these remittances have come at some considerable cost in terms of family disruption, there have been long term benefits in the form of developing skills, contacts, business networks, and linkages to markets and information.

Cambodian government policy is to encourage increased official labor exports to (i) improve the living conditions of the people; (ii) enhance professional skills; (iii) absorb unemployed and underemployed labor, and; (iv) raise State revenues (Article 1 of the Anukret on the Export of Khmer Labor to Work Overseas, N. 57 29 July 1995). Official labor exports from Cambodia have been limited to less than 1000 people to work in manufacturing industry and plantations, and as maids, in Malaysia. Another contract was recently signed to supply about 1200 construction workers to Greece.

There is also considerable unofficial migration of workers, mostly to Thailand, but also to Malaysia. Estimates of unofficial migration to Thailand range from 50 000 to 100 000 workers. Unofficial labor exports are the only option for some poor rural communities to earn income during period of economic hardship. On the other hand, the unofficial nature of these exports leave workers vulnerable, and they frequently have to pay a large portion of their wages to facilitate access to such work. There are also unofficial imports of Vietnamese into Cambodia who work in trading activities, fishing, wood processing, machinery, construction, and the entertainment and commercial sex industries.

A variation on labor export is for foreign based businesses to outsource the production of goods and services by Cambodian workers. Many garment manufacturers effectively involve the export of Cambodian labor, with

most other inputs being provided, and the final product sold, by foreign interests. With new information technology, there are also emerging opportunities for labor services such as data processing, technical support services, and computer animation and programming to be subcontracted to workers in foreign countries. This is an emerging source of employment growth in countries such as India, the Philippines, and Vietnam. Such employment in Cambodia has been limited to minor cases of data entry, but with supportive training and information technology policies, such employment could increase in the longer term.

Opportunities and labor supply issues

The ratio of active workforce per/hectare of cultivatable land is relatively low in Cambodia compared with other regional economies. Population pressures are much greater in countries such as the Philippines and Vietnam which are major exporters of labor as shown in table 8.1. This suggests that the pressure for exporting labor in Cambodia might be less than elsewhere in the region, or at least, a greater potential to develop alternatives options.

However, with 36 per cent of the population living in poverty, the reality is that higher wage rates in neighboring countries provide strong incentives and potential economic benefits to look for employment outside of Cambodia. A recent DAN survey identified major differences in casual daily rates for unskilled labor on the Thai side of the Cambodian border as shown in table 8.2.

8.1 Population Densities in Southeast Asia

<i>Country</i>	<i>Active population (million people 15-64 years)</i>	<i>Active population/km² of total land</i>	<i>Active population/ km² of cultivatable land</i>
Cambodia	6	32	105
Lao PDR	3	11	151
Vietnam	40	124	511
Indonesia	98	54	233
Philippines	30	102	270
Thailand	36	71	170

Source: DAN 2001.

A major constraint to labor exports is high illiteracy rates, poor education levels, and health indicators which rank amongst the lowest in the region. Many of the skills demanded by labor importing countries (for example construction, maid, tourism services) are in short supply in Cambodia. Indeed, workers are frequently imported from Vietnam and elsewhere to make up for skills shortages in Cambodia.

8.2 Wage comparisons, Cambodia and Thailand

<i>In Cambodia April-May 1999</i>		<i>In Thailand April-May 2000</i>	
<i>Type of Work</i>	<i>Wages (US\$/day)</i>	<i>Type of Work</i>	<i>Wages (US\$/day)</i>
Fishing	0.5	Construction	3.7
Hunting/gathering	0.5	Porter	6.1
Firewood collection	0.7	Agriculture	2.2
Agriculture	0.8	Food production	3.9
Construction	1.6	Garments	3.5
Small trade	1.5	Fishing	3.2
Motor bike taxi drivers	1.9	Shop worker	4.8
Handicrafts	0.8		
Other	0.9	Other	4.0

Source: DAN 2001.

Institutional and regulatory issues in labor exports

Official exports

The Ministry of Social Welfare, Labor and Veteran Affairs (MSWLVA) is responsible for the regulation of labor exports, and cooperates with the Ministry of Interior with regard to issuing passports for export workers, and with the Ministry of Foreign Affairs an International Cooperation for the management.

A company wishing to export labor must apply to MSWLVA for permission, and MSWLVA is required to respond within 45 days (Article 2 of the Anukret on the Export of Khmer Labor to Work Overseas, no. 57, 29 July 1995). The regulations appear to be directed at labor broking companies who enter contracts directly with workers on behalf of the enterprises that require export labor. The regulations specify that labor conditions for export workers are specified in contracts agreed between workers and the exporting company (that is, the exporting company employees the workers) in line with government regulations (but contracts must be approved by the MSWLVA). Each laborer is required to provide copies of a security clearance, medical certificates, qualifications (if any), passport, and labor license. Export workers are subject to Cambodian tax laws. Labor exporters are required to deposit with MSWLVA a surety fund of US\$100 000 within 7 days of official authorization to export labor. This surety may be reduced when an employer directly hire workers to work rather than through an agent. The surety is set aside to be used to compensate workers in the event the exporting company fails to implement any provisions of the work contract. Unused funds are returned to the labor export company at the expiry of the contract and the return of the workers. The labor exporter is required to cover MSWLVA expenses on

official duty to inspect the working conditions and the living accommodations of the workers, and to provide unspecified remuneration and service fees to MSWLVA for document preparation. This later condition could substantially increase labor export costs and if regularly enforced would act as a major disincentive to the export of small groups of workers.

Only two companies have so far been licensed to export labor. Both companies are licensed to export maids to Malaysia. One company, Human Resource Development, has also been licensed to export plantation and industry workers to Malaysia. Less than 1 000 workers have been exported at this stage, well below initial expectations. The other local company, Cambodian Consulting Associates, has signed a contract with a foreign company to supply about 1 200 workers to assist in construction associated with the 2004 Olympic Games in Greece with salaries ranging from \$400 per month for construction workers to \$1 800 per month for an engineer.

Some reasons given as constraints to increased exports of workers include:

- poor levels of basic education and foreign language skills;
- declining demand for export labour — and increased supply from competing economies — because of the Asian economic crisis;
- concern by foreign employees that Cambodian workers were receiving an inadequate wage because of high margins between wages paid by foreign employers and salaries received by workers because of high government regulatory compliance costs and the lack of competition;
- initial difficulties and costs caused by complex regulatory and administrative requirements resulting in high costs of securing passports and other official permits; and
- poor pre-training (language and basic work skills) of initial groups of Cambodian workers reduced their effectiveness.

Assessment of the relative impacts of these constraints warrants further analysis. There is a prima facie case for good regulations to protect workers rights and maximize long term benefits, and an important role for government support in negotiating bilateral agreements to open up new opportunities. There is considerable regional experience in developing labor markets that should be tapped in formulating government policy and regulations to develop Cambodian labor exports, and protect the interests of workers and labor exporting agents.

Unofficial labor exports

Despite the risks and fees, working in Thailand without proper documentation remains the most attractive economic option for many of the poorest Cambodians. In some cases labor brokers/guides travel to Cambodia looking for workers for factories, plantations, fishing boats, and construction companies. In addition many Cambodians regularly travel to Thailand to engage in border trade, and some of these people end up finding employment in Thailand. Cambodians account for a large proportion of sellers in many Thai border markets. Most such workers young (17–35 years) and are typically employed in plantations, factories, farms, households, and in the commercial sex industry. Females are most likely to immigrate temporarily for seasonal work. Males are more likely to take longer term work. Day passes can be obtained at the Thai border without a passport for at a cost of 10 Baht (about \$0.23), but additional informal facilitation charges are also often reported. Higher wages can be obtained in Bangkok and other cities, but workers report paying brokers/guides up to 3 000 Baht for such employment. Wages and opportunities for Cambodians to work are reported to have declined markedly since the Asian financial crisis.

There are reports that some Thai factories have withheld part of total wages owed to Cambodian workers, threatening to report workers that complained to the authorities. The incidence of such actions is reported to have increased since the onset of the Asian financial crisis. However, many illegal immigrants are still willing to accept such risks, because of the limited alternatives in Cambodia. A recent DAN study found that most long term migrants reported long term positive outcomes from their experience, including being able to meet short term food requirements, buy land, open a small business, renovate housing, and purchase motor bikes (DAN 2001). Migration was also seen as positive in developing construction, tailoring and other skills.

While their illegal status leave such immigrants vulnerable to exploitation, attempts to control such migration would greatly reduce the options available to the poorest segments of society and increase their vulnerability to poorly paid immigration officials. An alternative option would be to encourage increased information flows, and to provide mechanisms for illegal workers to raise concerns (for example, including through the press and NGOs) and to disseminate information on risks and safeguards to potential illegal workers in Cambodia.

In the longer run, the government might facilitate Thai and other investors to relocate labor intensive businesses to the Cambodian side of the border

to take account of lower labor costs. An improved regulatory framework for business, reductions in ‘red tape’, improved infrastructure (possibly concentrated in industrial zones), and improved health and education indicators are needed to attract such investors.

Improving options for labor export

Further recovery from the regional economic demand could result in a recovery in demand for unskilled and semi skilled export workers. Areas for further action to increase national gains from labour exports include the following.

- Improved human resource development, including adult education, that focuses on literacy, basic work and life skills, and foreign languages.
- Improve the regulatory framework to ensure that export worker rights are protected, while also ensuring that regulations do not stifle competition and the entry of new labour export companies. Donor support could help ensure that lessons from other developing countries are reflected in the regulatory framework for Cambodian workers.
- Reduce formal and informal costs paid for government labor inspections, passports, labour licenses and other labour export permits.
- Provide mechanisms for export workers to air their concerns about administrative procedures, and any failure to honor contract provisions.
- Continue efforts to reach bilateral agreements for temporary migration of Cambodian workers. Disseminate information to more developed countries on the impacts of increased temporary migration of workers in reducing poverty, transferring technology, and developing the economy.
- Facilitate the relocation of businesses to the Cambodian side of the border to take account of lower labour costs in Cambodia, while also benefiting from the better infrastructure in Thailand.

9

Land, markets, property rights and regulatory processes

THE DEVELOPMENT OF AN EFFECTIVE SYSTEM of property rights and contract enforcement is crucial to the development of a competitive market economy. Clarity and certainty about the enforceability of property rights facilitates the use of land as collateral for investments in land and land related businesses, and can facilitate financial sector development. With land use rights being the major asset for most domestic private investors, streamlining of administrative arrangements for protecting and transferring land use rights should be a high priority area for reform. There is also need to address the broader issue of contract enforcement, and the constraints to the development of efficient factor markets for capital and labor.

The development of efficient land markets has been constrained by the slow pace of land titling, and increasing land disputes as land prices increase and community and State land are appropriated for private purposes. Official transfers of private land use rights are constrained by cumbersome and time consuming administrative arrangements. The large number of disputes, and the long time taken for courts to resolve disputes raise concerns about land tenure security. There are also concerns about the lack of transparency in awarding large areas of forest and other agricultural land for commercial use, that were previously used by poor communities for subsistence foraging activities. The administrative allocation of land administrative, rather than market based, can have negative consequences for resource use efficiency and equity. Full ownership rights to land are limited to a small proportion of residential land.

Recent developments in land use policies

The government reintroduced private property rights in 1989, and instructed that land rights established prior to 1979, that all land belonged to the State, and any prior rights to land use were no longer valid. Private entities were able to use and sell the land provided by the State for

residential and productive purposes. Residential and productive land was redistributed to people. Other land was retained by the State. The 1992 Land Law created ownership rights for residential properties, and recognized State public land and State private land. State private land could be released as concessions. The 1993 Constitution recognized land ownership rights in a broader sense. A recent national Land Policy Workshop (17–18 July 2000) identified some key regulatory and administrative problems arising from existing arrangements, including:

- Land use planning and enforcement mechanisms remaining weak, and this constraints natural resource management and urban planning.
- There is frequent encroachment onto protected areas, illegal logging, 'land grabbing', and loss of rights to subsistence uses of natural resources. This constrains the sustainable exploitation of forests, fisheries and water.
- Land administration remains weak and inconsistent. Land users and potential concessionaires cannot be certain that no other claims will exist over land. Land disputes take a long time to resolve.
- There are no clear guidelines governing land acquisition and distribution. Administrative discretion provides opportunities for corruption and inefficient land allocation. Capacity to enforce concession agreements is weak.
- Land markets are constrained by overlapping and fake titles. Systematic land registration has only been piloted. Cadastral mapping that shows the location of land could help prevent duplication and overlapping land rights.
- There is ambiguity about the roles of different government agencies in land administration with no appropriate mechanisms for coordination.
- The demarcation between 'private State' and 'public State' property remains unclear. The awarding of concessions, leases or transfers of State private land is constrained by current legislation.
- There are persistent claims that the disenfranchised are being disposed of land because of the lack of legal safeguards.
- The process of issuing titles is slow and most private entities do not have formal title to land.
- Most of the population has a poor understanding of their legal rights and responsibilities. Without such understanding, the legal framework provides little protection.
- Many people do not obtain land titles in order to avoid land transfer taxes.

Current land policies

The government issued a land policy statement in April 2001. Stated policy objectives of land policy are to i) strengthen land tenure security and land markets, and prevent or resolve land disputes; ii) manage land and natural resources in an equitable, sustainable and efficient manner, and; iii) promote land distribution with equity. These policy objectives are to be achieved by focusing on improvements to land administration; land management, and; land distribution. The main proposed initiatives in each of these areas is given below:

- land administration:
 - enact the land law, complementary laws, and related legislation;
 - the Council for Land Policy, guided by the Supreme Council for State Reform, will promote and monitor land policy implementation;
 - create an inventory of, and classification system for, State land;
 - implement a nation wide land registration system;
 - resolve land disputes through the local Administrative Commission, the Provincial/Municipal Land Dispute Commission, and the courts;
- land management:
 - develop land use plans for priority areas;
 - coordinate land use planning with natural resource management;
 - decentralize land management and planning to local and provincial authorities operating under national land use guidelines and supervision;
- land distribution:
 - using consultative process implement pilot projects to create a land distribution strategy for needy groups;
 - prevent illegal land acquisition and land concentration.

Land issues are an important focus of the government's reform program. The Interim Poverty Reduction Strategy states that land policy reform is one of the six key areas for promoting opportunities in order to reduce poverty (RGC 2000a). The SEDP II recognizes that land reform is a crucial determinant of the prospects for economic growth and poverty reduction (RGC 2001).

The 2001 Land Law

The draft 2001 Land Law extends private ownership rights to non urban land, delegates land administration from the central to provincial/municipal level, provides for official certification of land ownership, creates a single land registry authority, removes the need for administrative approval of land transactions, requires all land transactions to be registered, protects private rights to transfer, prohibits foreign ownership, recognizes communal management rights of indigenous and ethnic communities, includes provisions for use of land as security, dispute resolution mechanisms, and provides remedies for violations of the law. This provides a basis for substantive improvements in land use efficiency. Resulting improvements in land administration could also facilitate property based taxation to finance local public services and infrastructure. However, much remains to be done in terms of issuing implementing regulation, and in developing institutional capacity, in order to generate tangible benefits.

Effective implementation of the Land Law also requires new, or revised, legislation on forestry, water resources, and fisheries. Drafts of these laws have been prepared and are being further developed in consultation with civil society. The Land Policy Council, established in December 2000, is responsible for providing guidance to ensure consistency in legal concepts, administrative arrangements and enforcement mechanisms among these laws and other related legislation.

Implementing regulations will need to address a broad range of issues, including land title registration agency; land registration procedures; mortgages and procedures for foreclosure; the transfer of State property; expropriation; leasing; resolution of disputed land claims; land transfer taxes; survey and mapping standards and professional conduct; recognition of indigenous communities as legal entities, and; guidelines related to land concessions.

Support is being provided by a number of donors to facilitate Land Law implementation. ADB is providing technical assistance in support of drafting implementing regulations dealing with the issuance of concessions. The governments of Finland and Germany are providing institutional support to assist reforming land registration, including land surveying, mapping and planning. The World Bank is working with the government to formulate a Land Administration Project with components for i) land policy development; ii) legislative framework and policy dissemination; iii) institutional development, capacity building, and training; iv) implementation of accelerated land titling; v) development of

land registration system, and; vi) strengthening land dispute settlement mechanisms.

While informal enforcement arrangements, including reputations and sanctions, are important at all stages of development, investors require more formal contracting institutions as economies develop and the scale of business activity increases and contracting becomes more complex. Such arrangements are important in i) encouraging longer term investments; ii) facilitating entry of new participants; iii) providing access to formal financial institutions; and iv) providing timely information on failures. The need to develop more formal mechanisms is particularly important for Cambodia because the protracted period of violence and the relatively recent collapse of most major institutions means that ‘business networks’ and the informal ‘rules of the game’ that facilitate informal contracting are relatively less developed. On the other hand, the scope to utilize the judicial system is also constrained by institutional weaknesses. This reinforces the need for regulatory simplicity. Given weaknesses in public institutions opportunities for using non judicial arbitration arrangements could be explored.

Regulatory environment for business

Need for improved regulation

Investors note that frequent institutional and regulatory changes leave businesses vulnerable to *ad hoc* interpretation of the changing (and sometimes inconsistent) legal and regulatory framework by bureaucrats in administrative agencies. Such difficulties are compounded by ambiguities in the roles, responsibilities and accountability of government agencies. In some sectors, attempts to regulate in excessive detail result in unnecessary transaction costs, reduce competition, and increase opportunities and incentives for corruption. Moreover, ambiguous and inconsistent regulations often result in outcomes counter to stated policy objectives. Specific examples are discussed in the sector studies.

Improvements in the regulatory framework could help promote increased investment and trade, and thus increase employment. Efforts to develop a regulatory environment conducive to business development are constrained by i) limited institutional capacity and/or commitment to analyze and promote regulatory reform; ii) the influence of vested interests; and iii) inadequate involvement of those most affected by regulatory reform. Inadequate stakeholder consultation also means that the public

support needed for efficient enforcement of laws has not adequately developed. The net result is a regulatory framework for business that:

- imposes significant disincentives to business investment;
- changes frequently;
- is poorly and/or inconsistently enforced;
- does not provide the institutional basis needed to support an efficient, equitable and competitive market economy;
- often appears to be adjusted to extract rents from profit making entities; and
- imposes unnecessary transaction costs that inhibit investment and trade, and limits opportunities for disadvantaged groups to break out of poverty.

An improved regulatory environment will only generate benefits if it is enforceable, and will only be enforceable if there is strong stakeholder support for regulations. A key step to improving the regulatory framework is to improve regulatory process to improve stakeholder participation, to reduce the costs of compliance, and to facilitate enforcement.

Improved regulatory processes

Finding the appropriate balance between the risk of not regulating, and excessive regulatory costs, is a critical challenge for policy makers. Good regulations should:

- be necessary (to achieve clearly identified policy goals)
- be clear, simple and practical for all stakeholders
- be effective & equitable (benefits should justify costs)
- be enforceable and have a sound legal basis
- facilitate and encourage (rather than stifle) innovation
- have the support of the main stakeholders
- be compatible with international practices.

A trend in developed countries is to require regulatory impact assessments. Australia requires regulation impact statements for '*All reviews of existing regulations, proposed new or amending regulation or proposed treaties which will directly or indirectly affect business, or restrict competition.*' (Productivity Commission 1998-99). Some transition economies (for example. Hungary) and some Asian economies (for example South Korea) include regulatory

impact assessments as elements of their reforms process (for example, see OECD reports on regulatory reform in Hungary and Korea). Some key principles for improving regulatory processes are described in the following box.

Provision of public services and infrastructure

National and regional linkages

While more than 50 per cent of total public investment during the period 1996–2000 was directed to improving transport and communications infrastructure, poor transport infrastructure remains a major constraints to trade development. Flooding caused major damage to infrastructure during 2000, and maintenance of all roads is constrained by lack of operations and maintenance resources. Poor enforcement of axle load limits and other regulations add to these problems. Further improvements in infrastructure, through public and private investment, plus institutional strengthening to improve sector regulation and planning remain important priorities if the benefits from increased trade are to reach most rural populations. The focus of past efforts has been on rehabilitation of damaged infrastructure. The government is now aiming to develop a longer term strategic approach to sector development and is receiving support from ADB to formulate a transport development strategy to identify options to accelerate transport development, and to promote private sector participation and competition in providing transport infrastructure and services.

Pro-poor trade development requires that rural producers be integrated with urban markets, urban producers need to be able to trade with rural areas, and rural and urban populations need to access international markets. This requires investments in infrastructure in urban centers and rural towns, and in transport linking rural towns to domestic and international markets. Rural electrification and water supply improvements can facilitate commercial development via impacts on new commercial opportunities, greater productivity, human development, and consumer demand. With appropriate infrastructure, areas of concentrated populations in rural areas can provide the scale economies needed for the competitive development of commercial business. Coordinated efforts to reduce the informal barriers to integration of rural town economies with higher income domestic and international markets are needed to maximize the returns from such investments.

9.1 Some principles for improving regulatory processes

1. Simplify regulatory and compliance systems
 - use simple language and minimize provisions. Make it easy for users and the public to understand.
 - aim for less regulatory agencies with broader responsibilities.
 - consider options for self regulation.
 - help business comply by making it easier and less costly. Analyze, document and publicize information on regulatory objectives and systems.
 - streamline regulatory agencies and systems (one stop shops, simple forms with clear instructions, use new information technology where appropriate)..
 - encourage a service provider mentality in regulators.
 - procedures should be consistent and transparent, with no duplication of responsibilities
2. Consult with stakeholders during reforms
 - consult to ensure that reform is needed, and to inform stakeholder on the goals and strategies of reform.
 - encourage the formation of business and consumer groups to represent the interests of key stakeholders.
 - encourage open and informed public discussion to explain the benefits of reform, and to counter interest groups that may resist reform.
 - learn from international experiences.
3. Make regulatory agencies accountable for regulations
 - regulatory agencies must be accountable. If not, regulatory complexity will increase, reforms will not be sustained, and further reform will be needed.
 - establish clear and transparent performance indicators, appoint stakeholders to management boards of regulatory agencies, build in formal consultative mechanisms, publish annual performance reports.
4. Closely monitor impact of regulatory reform
 - regularly review existing and proposed regulations to ensure that they are consistent with good regulation from the perspective of the user as well as the regulator.
 - require regulatory impact assessment as part of the regulatory approval, reporting & review processes.
 - introduce automatic review processes by setting time limits on business regulations ('sunset provisions').

Source: Modified from OECD 1998, Report on Regulatory Reform, OECD, Paris.

Human resource development

Infrastructure development needs to be coordinated with efforts to develop vocational skills that match market demands, and to improve basic education and health standards. In the longer term sustainable improvements in labor productivity will require improvements in the delivery of education and public health services, including improved water supply and sanitation. Adult literacy and skills programs should include information on income generating opportunities. Given resource constraints, the private sector should be encouraged to invest in education, especially in vocational and higher education.

Access to information, markets and technology

Given high illiteracy rates, telecommunications, radio and television have a relatively more important roles in the dissemination of business information. While the domestic mobile telecommunications network is efficient and relatively inexpensive, international telecommunications costs are higher than in competing countries. While access to internet and Email communications is presently limited, this is expected to become increasingly important. Cumbersome procedures to secure business visas to most developed countries constrain access to information, technology and international business networks. The government should review telecommunications pricing and competition policies, and work with external agencies to reduce barriers to travel by Cambodian business people.

Major investments are now being made to improve physical transport infrastructure linking Cambodia with Thailand and Vietnam, as well as to improve sea and air access to international destinations. These developments could greatly reduce transport costs and increase the competitiveness of Cambodian products on export markets. However, the full benefits of such developments will only be realized if people and goods can move across border at minimal cost.

While detailed discussion of trade facilitation is included in a separate section, it is important to highlight the major potential impact of trade facilitation on options for sector development and poverty reduction. Many border areas have relatively high incidence of poverty. Improved facilitation of trade and the movement of people should result in an expansion of service activities (hotels, restaurants, entertainment and transport), handicrafts and agro-processing at border crossings and along major transport links.

Most regulatory constraints to cross border trade are already circumvented in practice, but the informal arrangements that facilitate this impose deadweight costs to the economy and the Cambodian people. High costs stifle information flows, reduce networking opportunities, and constrain the development of trade and export labor. In addition to better regulations, efforts to streamline procedures, to share inspection activities, and to introduce electronic processing of border controls are potentially important in reducing such costs.

Past instability has been a major constraint to investment. Instability increases risks. Periods of instability have been followed by declines in investment from the domestic private sector, foreign investors, and by external donors. Instability also greatly increases the risks and transaction

costs of trade. Recent developments indicate considerable success in moving towards greater economic and political stability. Investors are also looking for greater stability and predictability in the regulatory and institutional environment for business. The earlier proposals regarding regulatory processes should help in this regard.

Lessons from sector studies for trade development

Cambodia has made solid progress in recent years to reduce the regulatory and institutional barriers to business investment and economic integration. The foundations are being laid for new models to for addressing business and trade constraints that involve major stakeholders in the reform process. Some of the major policy changes to promote increased trade are already in place. Less progress has been made in developing some of the key institutions needed to facilitate the development of an efficient market economy that is competitive in international markets. Further institutional development is needed to:

- protect land and other property rights and develop efficient factor markets;
- establish a regulatory environment that facilitates business investment;
- accelerate the provision of public services and infrastructure;
- facilitate domestic and international trade; and
- reduce instability, increase predictability and reduce corruption.

Institutional weaknesses constrain economic growth and exacerbate inequalities in income distribution. Well connected individuals and State enterprises can use their networks to facilitate contract enforcement and to secure favorable administrative decisions. Discretionary and opaque decision making generally favors larger or better connected investors with better access to decision makers. Institutional weaknesses limit their opportunities for informal enterprises to expand and/or move into the formal sector. This constraint the emergence of a dynamic small and medium enterprise that typically play an important role in processing industries, developing new labor intensive export industries, and generating increased paid employment. Institutional weaknesses are a particular problem for groups with limited representation in government decision making.

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