COMPETITIVENESS THROUGH PUBLIC-PRIVATE PARTNERSHIP:
SUCCESES AND LESSONS LEARNED

A Trade Perspective

A COUNTRY PAPER
CONTRIBUTED BY
THE CAMBODIAN STRATEGY TEAM

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1. INTRODUCTION

On December 8, 1994 Cambodia applied for accession under article XII of the Agreement Establishing the World Traded Organization (WTO) and a working party on Cambodia’s accession was established on December 21, 1994. Cambodia submitted on May 21, 1999 its Memorandum on Foreign Trade Regime (MFTR) to the Accessions Division of the WTO and had it the first Working Party (WP) on May 22, 2001. Cambodia committed itself to an aggressive accession agenda with the second and third WP meetings held in February 2002 and November 2002, respectively. After the fifth WPs, which were concluded on July 22, 2003, Cambodia was admitted to the WTO at its 5th Ministerial Conference in Cancun, Mexico on September 12, 2003.

On August 31, 2004 the National Assembly ratified the accession package by an overwhelming majority, after debating the agreement with 106 yeah of 107 lawmakers present. The country is slate to become the 148th member of the WTO this fall.

Accession of Cambodia to the WTO is part of the general strategy of trade policy of Royal Government of Cambodia (RGC), which is directed to effectively integrate the country into the world economy and global trading system. The RGC believes in the role that, trade is purported to play in promoting economic growth and reducing poverty. Increased trade, promoted by liberalization policies, acts as a powerful stimulus to domestic growth, and such open trade regime will lead to higher rates of growth and economic development. Trade facilitates international diffusion of knowledge, thereby speeding up and spreading out new ideas and innovations. In many ways, trade may even occasionally substitute for aid in the development process. The statistics in the annex clearly shows these effects.1

2. OVERVIEW OF THE PUBLIC-PRIVATE PARTNERSHIP

This paper is a summary analysis of the Agro Business & Agro Processing survey (ABAP), which was conducted by the Government Private Sector Forum (PSF) Working Group in ABAP. The issues and recommendations being analyzed for this paper represent those of the private sector who participated in the survey.

The RGC – PSF Working Group in ABAP faces unique challenges. It is this Working Group that represents a sector that contributes 37% of Cambodia’s GDP and employ’s 80% of Cambodia’s labour force.2 It is estimated that 90% of Cambodia’s poor live in rural areas3 and that the majority of the poor (79%) are those with heads of household primarily employed in the agriculture sector.4 Whilst agriculture provides three-fourths of all employment, agro-industry provides less than 1% of total employment and accounts for only 3.2% of GDP.5 The agro sector is critical for the economic development of Cambodia and the policies of the RGC reflect this importance. The Socio Economic Development Plan II 2001 – ‘05 (SEDP II) notes that: “The Government recognizes that agriculture growth is of enormous importance to poverty reduction because: a) it is the primary direct source of incomes in the rural economy; b) its multiplier effects can potentially have a strong reverberations into the rest of the economy and on the development of off-farm sources of income; and c) it is associated with strong seasonal variations in the welfare of the rural poor. Productivity improvement in agricultural is key therefore for broad based economic growth and poverty alleviation and there is empirical evidence that there is much potential for improvement.6 Furthermore, whether through donor report or the RGC policy the private sector’s central role in stimulating growth, reducing poverty and diversifying the industrial base is well documented and indisputable.7

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1 See macro-policy review in Annex ‘A’
6 RGC, SEDP II, 2001 – ’05.
7 Textile, wearing apparel, and footwear belong to the fastest growing of this sector in Cambodia’s economy. IMF Country Report no. 03/59, March 2003. See macro-policy review in Annex ‘A’.
Since private sector issues are well known to the RGC, this paper provides a brief overview of ten priority issues, which severely and negatively impact agro export potential which is the core sources of growth for pro-poor trade policies. The accompanying chart 1/1 (next page) illustrating the number of times an issue was shared across provinces during the survey. Using the top ten issues from this graph, the paper focuses on braking these issues down to illustrate why they are the barriers to development and what the private sector recommends to solve these issues. Analysis of the survey's report identified twenty broad issues to categorize the concerns raised by the private sector as impediments and negative impact on business. The ten most commonly raised issues within the survey's report are:

1) unofficial charges;
2) market related constraints, i.e., market access, market information, infrastructure, support and services;
3) access to finance;
4) cost and access to transportation;
5) farmer extension services;
6) product quality;
7) access to agro processing;
8) road development, maintenance, and rehabilitation;
9) law enforcement issues; and
10) smuggling.

In analyzing the survey’s report an understanding of the day-to-day operating environment of the private sector in the ABAP sector can be magnified. For example, agro business decision-making process is constrained by lack of access to market information and lack of industry specific education within the provinces. Lack of competitiveness in transportation because of poor road conditions limited user choices. Hence, transport costs are artificially high due to many levels of unofficial fees and the rising cost of fuel. Largely, due to lack of market information and access farmers tend to sell locally and base crop sizes on historical trends accordance to local demand and traders arriving at the farm gate. Quality and yield are also an issue that precludes many growers and traders from achieving high returns. Where quality is at an export level, i.e., in the fisheries sector, unofficial costs reduce margins and market access appears to be restricted by a lack of basic infrastructure and trading practices. In this instance market access related constraints the fisheries sector from reaching buyers in the regional and international markets. The private sector operates in a recognizably difficult environment and has offers some pragmatic solutions to improve the business environment.
The ABAP Working Group is still evolving. The development of Agro Business Association located throughout the country will in the future provide an important input into the work of the ABAP Working Group. Although the private sector seeks greater Government accountability it recognizes the limitations of the RGC and the problems confronted by poorly paid local officials. Recommendations are often measured by an understanding of the constraints of the RGC. This is reflective of other PSF Working Groups, which are advocating an “incremental” approach to reform, i.e., an approach that recognizes a shared issue, takes into account the likelihood of achieving reform and selecting a recommendation that is achievable in the near-term whilst looking to solve the problem in the long-term.

There is no silver bullet and/or single solution to enabling the private sector development in Cambodia. Many issues such as the high cost of transport, unofficial fees, and law enforcement can be seen to be interdependent. The private sector and the Government have a role to play in developing a private sector where the environment can be improved to stimulate investments that will enable the private sector to produce, added-value, trade, and improve the living standards.

3. IMPEDIMENTS AND CONSTRAINTS

a) Unofficial charges are those made without receipt and are not a formal part of any official fee payment schedule/process. The private sector rarely debates the need to pay for public services. The private sector is also aware of the difficulties confronted by low paid officials. However, the lack of transparency, the high number and cost of unofficial payments and the value for payments made is a concern for the private sector. As will be seen, the cost of unofficial fees is restricting the ability of the private sector to grow and contribute further to the development of the economy.
b) The RGC has worked diligently at developing trade related agreements that will provide domestic agro businesses with access to international markets. Through the analysis of the survey agro businesses identified the inability to interact with the broader domestic market (e.g. from Province to Province) as main restriction, in which impair their abilities to greater benefits from agro enterprises. Firstly, focus on domestic market access should lead ultimately to the ability of agro enterprises to interact with the international trading environment and benefit from a greater access to the worlds markets.

c) Access to finance. “The most important issue is finance. If there is a solution for access to financing, other issues can be managed and our business on rice export will be moved forward.” Battambang Province, Rice Miller. Bankers and Lenders have acknowledge recent positive developments in the agriculture sector, “there is a remarkable development and improvement in the agriculture sector in corn, soybean, mung bean, and cassava crops in three districts along the Thai border in the Pailin area”. Despite improvements however “...high element of risk remains in the investment environment in Cambodia. In addition, exchange rates pegged to exchange rate of the Baht and US$.” Battambang, Banking & Finance Sector. High risk is a deterrent for banks to invest in the private sector. Businesses are restricted by the high cost of borrowing due to the lack of transparency and accountability management systems. The inability of firms to access finance, regardless of reason, is limiting the opportunities for the agro business sector to invest in new technology, expand, and develop businesses that will improve it risk profiles to attract bankers and lenders to invest in Cambodian businesses. There are myriad reasons for the difficulty to access financing. These include the risk profile of Cambodian business, the lack of commercial banking infrastructure, management capability and technical expertise whether for banker or business owner. Regardless of the reasons, access to finance is an issue for the ABAP Working Group, which is restricting the development of the agro sector.

d) Toll fees are unregulated and are not transparent. Tolls are paid on roads throughout Cambodia. The private sector has noted that the fees are high, mostly unofficial and do not appear to be reinvested in the road network. A fee payment system based on “user pays” structure is rarely disputed by the private sector since maintaining and rehabilitating the road network is a necessary expense. The challenge for the Government therefore is to better regulate payments made by the private sector to

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provide tangible results and benefits to the users. Improved road network thus leading to reduced transit times, wear and tear on vehicles, reduces accident and fuel consumption, and increases competition from other transport operators. For agro businesses these improvements would lead to a reduction in transport costs and make domestic agro products more cost competitive and greater improve opportunities to enter domestic and international markets.

Administrative /Market Barriers to Competitiveness Faced by the Rice Exporting Sector

<table>
<thead>
<tr>
<th>Critical Issues</th>
<th>Impact</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Business Environment</strong></td>
<td>High cost of fertilizer, Large unofficial outflow of paddy to Vietnam and Thailand, High production costs, low yield rates, poor quality or inadequate use of agricultural inputs reduces the competitiveness of export rice, Investments in expanding milling capacity are discouraged.</td>
</tr>
<tr>
<td><strong>Supply Chain</strong></td>
<td>Deficit in milling capacity, High cost of support services, Poor on-farm labor skills.</td>
</tr>
<tr>
<td><strong>Infrastructure</strong></td>
<td>High milling cost, High transplanting cost and high milling cost for self-generating electricity.</td>
</tr>
</tbody>
</table>

Transport, Shipping and Customs clearance Charges for Exporting Neang Mali Rice to Hong Kong (20 foot container)

<table>
<thead>
<tr>
<th>1 Mill – Sihanoukville</th>
<th>Total Cost</th>
<th>Fee payment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mill – Sihanoukville</td>
<td>$140.00</td>
<td></td>
</tr>
<tr>
<td>Road (NR4)</td>
<td>$6.51</td>
<td>12%</td>
</tr>
<tr>
<td>Customs/CamControl/Police inspections</td>
<td>$329.03</td>
<td></td>
</tr>
<tr>
<td>Customs clearance</td>
<td>$5.58</td>
<td>11%</td>
</tr>
<tr>
<td>Customs permit</td>
<td>$4.65</td>
<td>9%</td>
</tr>
<tr>
<td>CamControl quality certificate &amp; analysis</td>
<td>$4.65</td>
<td>9%</td>
</tr>
<tr>
<td>CamControl survey</td>
<td>$0.42</td>
<td>1%</td>
</tr>
<tr>
<td>Vessel Loading fee</td>
<td>$30.00</td>
<td></td>
</tr>
<tr>
<td>Lift empty &amp; laden at factory</td>
<td>$1.40</td>
<td>3%</td>
</tr>
<tr>
<td>Port Charges</td>
<td>$220.00</td>
<td></td>
</tr>
<tr>
<td>Terminal handling charge</td>
<td>$3.26</td>
<td>6%</td>
</tr>
<tr>
<td>Documentation fee</td>
<td>$0.70</td>
<td>1%</td>
</tr>
<tr>
<td>Banker adjustment factor</td>
<td>$1.16</td>
<td>2%</td>
</tr>
<tr>
<td>Fumigation</td>
<td>$0.93</td>
<td>2%</td>
</tr>
</tbody>
</table>

Phytosanitary certification $ 2.79 5% MAFF
Lift empty $ 1.40 3% Shipping company

5 Shipping charges

<table>
<thead>
<tr>
<th>Destination</th>
<th>Cost($)</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sihanoukville - Hong Kong (low quote)</td>
<td>$ 14.88</td>
<td>37%</td>
</tr>
<tr>
<td>Sihanoukville - Hong Kong (high quote)</td>
<td>$ 19.53</td>
<td>37%</td>
</tr>
<tr>
<td>Sihanoukville – Shanghai</td>
<td>$ 30.23</td>
<td></td>
</tr>
</tbody>
</table>

6 TOTAL $ 52.98 100% $ 1,039.03

e) Smuggling of goods across Cambodia’s borders is prevalent, efficient, and long standing practice. Goods are smuggled in and out of Cambodia. Livestock and paddy rice were the most commonly smuggled export. Smuggled imports are wide ranging from petroleum to counterfeit spare parts and from low quality livestock to fertilizers and pesticides. As smuggling is so institutionalized legitimate businesses are not able to compete on a level playing field. Revenue lost through smuggling that would otherwise be used for public services has to be found elsewhere and it is the businesses that operate legitimately in Cambodia, which ultimately subsidize these smugglers. The private sector noted that due to Cambodia’s high input/production costs it is not possible to compete with smuggled goods. “Production costs for farmers in general are high in Cambodia. This makes the cost of local produces more expensive and thus it is difficult to compete with illegally imported products.” K. Speu, Diversified Agriculture Sector. To be competitive against smuggled goods domestic products are required to win on price. Though smuggling was identified as the leading cause for the agro sector slow-growth recommendations to combat and overcome this issue were few. For the intermediate term actions focused on tightening border controls and reducing the cost of doing business so that domestic products can be competitive.

4. CONCLUSION

The growth of the private sector in Cambodia over the past decade has been remarkable in light of the destruction wrought by years of conflict, market constraints, policy and administration barriers, and has proven that investment in the private sector and open trade can create jobs at wage levels that can reduce poverty. However, this growth has been narrowly based, focused heavily in the garment and tourism sectors, has lacked integration and linkage to the broader economy, and has failed to reach the majority of the population. Moreover, with the garment sector increasingly subject to international competition, this growth is at risk.

Aside from the garment sector, employment and the absolute number of enterprises is concentrated agriculture and agro-industry, and the vast majority of employment is in rice farming. The challenge facing the RGC is to create an enabling environment in which more firms operate at the high productivity levels, which characterize the manufacturing sector. In turn this will simultaneously address concentration in agricultural employment. Whilst many countries have pursued development strategies that rest on shifting labor from agriculture to assembly line and low-tech manufacturing, including through the use of export processing zones, the World Bank report identifies a potential comparative advantage in agro-industry in rural areas. But since prevailing income levels in rural markets are low, this will require integration – bringing the rural non-farm enterprises into the formal economy. In this way diversification is synonymous with integration.

The global marketplace, of course, will not make exceptions for Cambodia because of its past. With the Government committed to greater stability and openness to the world, Cambodia business is set for inevitable and substantial change. In particular, domestic producers are clearly set to experience a significant rise in competitive pressures.

Cambodia’s first wave of entrepreneurial pioneers has shown great ingenuity and perseverance in succeeding against all odds in the difficult present environment. There is therefore, good reason for optimism that, given fair access to basic commercial resources, they and those soon to follow will continue to adapt and broaden their success within the evolving framework of more global, rules-based markets.

A country needs not to conspire to create a large SMEs sector to generate economic growth. Rather, a healthy growing economy is characterized by a healthy small business sector, where impediments to growth – which usually lie in the policy and regulatory environment – regulations and procedures so obtuse that an entire army of high rent-seeking’ officials and unscrupulous middlemen spring up to expedite (more like extract) the processes be eradicated.

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Cambodia completed the first country Diagnostic Trade Integration Study (DTIS).
Annex ‘A’ IV

Trade would help break the vicious cycle of poverty!!!!

Rapid population growth

Rapid labor force growth

Trade

More jobs opportunities

Increased incomes

Insufficient employment creation

Low growth in per-capita income level

Low per-capita income level

Cambodia’s Integrated Framework Approach

Cambodia’s:
- Opportunities facing households
- Resources available to households
- Policies for education, health and social security

Changes in conditions of market access by other countries:
- EU – US – ASAN

Case studies:
- Cane products – Rice – Tourism
- Fisheries – Handicrafts
- Agriculture – Labour services

Implications for policy and supportive TA

Cambodia’s Integrated Framework Approach

Cambodia’s:
- Past economic and export performance
- Macroeconomic policies

Changes in Cambodia’s:
- Trade policies
- Trade facilitation
- Regulatory environment for investment

Impacts on:
- Economic growth
- Incomes and
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TAKED

ADD

ACKED

DRAW

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DRAW
Opportunities and Constraints facing Cambodian Households

Household dominated economic activities

36% of households in poverty
- Most poor households are in rural areas
- 64% of people are in agriculture

Their opportunities are constrained

- Farming: Rice - Others
- Labor: Cambodia - External
- Fisheries:
- Housework:
- Handicrafts - Cash
- Services: Construction
- Manufacturing: Garments, etc.

Their access to resources is limited

- Land: Small areas - Land disputes - Land mines - Inaccessibility
- Credit: Weak banking system - Land collateral
- People: Low literacy - Little English - Poor health and many disabled
- Infrastructure: Poor roads and communication
- Legal: Weak regulatory environment

Expand and diversify opportunities
- Remove obstacles
- Build institutions

Enhance resources:
- Land market
- Labor market
- Infrastructure
- Banking
- etc.