

***Cambodia Country Report  
by Dr. Hing Thoraxy  
Cambodian Investment Board  
Council for the Development of Cambodia  
Foreign Direct Investment:  
Opportunities and Challenges for Cambodia, Laos and Vietnam  
Hanoi, August 16-17, 2002***

Mr. Chairman,  
Distinguished Delegates,  
Ladies and Gentlemen,  
All participants,

I would like, first of all, to thank the organizers for giving me the opportunity to participate in this important conference: Foreign Direct Investment: Opportunities and Challenges for Cambodia, Laos and Vietnam. It is a great honor and pleasure for me to brief you about the FDI flows, the opportunities and challenges for Cambodia.

For the first time in our recent history, Cambodia stands at threshold of making a transition to a period of sustainable economic growth that will enable it to achieve durable poverty reduction. Peace, stability and security in the entire country and for all of our people are the most important pre-requisite conditions for sustainable development. The Royal Government is strongly committed to strengthening political stability, security and social order throughout the country, to build a safe and stable environment for our people and to foster business confidence. This is the first side of the Triangle Strategy.

The second side of the Government strategy is to integrate Cambodia into the region and normalize relationships with the international community. After the formation of the new Government, Cambodia succeeded in regaining the seat at the United Nation and became the 10<sup>th</sup> member of the association of South East Asian Nations. The relationships with international financial institutions and other international organizations have been normalized and Cambodia and the process of joining the World Trade Organization are well going on.

The third side of the strategy is to promote the economic and social development and it is our largest challenges. The Government recognizes that achieving sustainable socio-economic development does not depend only on the effective implementation of the reform programs, but also on the pace of the implementation, to move the country to a high economic growth platform.

Cambodia has followed and made significant progress since 1999 in implementing a macroeconomic framework aimed to achieve equitable long-term economic growth and sustainable development. The framework focuses on maintaining macroeconomic stability, strengthening the banking and financial institutions, implementing fiscal measures, ensuring a sound management of public property, and increasing public and private investment to develop the physical and social infrastructure and human resource.

The overall economic performance in 2001 has been buoyant despite the terrorist attacks and global slowdown. Following the September 11 terrorist attacks in the US, some sectors were hard hit, particularly the tourism sector and, to some extent, the garment industry. The potential indirect attacks - on consumer sentiment and spending, on business confidence, and risk aversion - are likely to be significantly more important. In general the impact of 9-11 attack has led to slower growth to garment exports and the tourism sector in the last quarter of 2001. By this reason the Government has taken steps to promote tourism and the garment sector. Along with that, we try to improve the agriculture sector that was hard hit by last year's floods and drought.

In recent years, the Government has been quite successful in maintaining macroeconomic stability. We have maintained the annual average growth rate of 7% during the last three years, from 1999-2001. The real GDP growth was 6.9% in 1999, 5.4% in 2000 and 5.3% in 2001, despite the devastating effects of the floods in recent years. Although Cambodia suffered from difficulties in 2002, we still able to achieve our forecasted rate growth of 5.5%. Furthermore, inflation rates of the last three years subsequent years were close to zero and the exchange rate has remained firm.

The monetary and fiscal policies over the last 12 months have remained prudent with a focus on fiscal consolidation. However, the Cambodian economy remains vulnerable to domestic political developments. The elections scheduled for 2003 will be crucial to improving the investment climate for domestic and foreign investors alike. Long-term political stability is needed to ensure an enabling environment for economic growth.

The agriculture sector contributes about 43 % of GDP and provides direct employment to nearly 80% of the labor force. Since 85 % of population lives in rural communities and 75% of the poor are farmer-headed households, the performance of this sector remains a key element for achieving sustained economic growth, poverty reduction, and the development of the rural economy. The development of the agriculture sector is principally constrained by low productivity, inadequate transportation and irrigation infrastructure, lack of agriculture inputs, inefficient marketing and consistent institutional support.

The years of 2000 and 2001 were the time of continued growth and transformation with the sector recovering rapidly from the 1997-1998 domestic political and regional financial crises. The industrial sector consists mainly of manufacturing enterprises of 73.5% and construction activities 18.8%. It is still minimal for mining activities. The garment manufacturing and food processing comprise mostly the value added in manufacturing, they display a remarkable dynamism. The share of industrial sector in percentage of GDP came up from 12.7 % in 1993 to 18.4% in 1999, 22.7% in 2000, and 24.4% (preliminary) in 2001. The overall thrust of the Second Five-Year Socio-Economic Development Plan (SEDP2) is the reduction of poverty among Cambodian people. Crucial to the reduction of poverty is the accelerated creation of the employment, therefore, it is a key aspect of industrial policy of the Government to give priority to the development of other labor-intensive industries such as toy-making, footwear and assembly of electrical and electronic appliances.

TABLE 1: SELECTED MACRO-ECONOMIC INDICATORS

<i>Indicator</i>	1993	1994	1995	1996	1997	1998	1999	2000	2001 Preliminary
GDP in billions of Cambodian Riels (at current prices)	5,970	6,185	7,597	8,325	9,149	10,543	11,646	11,923	12,932
GDP in million US\$ (at current prices)	2,173	2,406	3,079	3,153	3,059	2,794	3,054	3,090	3,296
Real GDP Growth (in %)	4.1%	6.3%	8.4%	3.5%	3.7%	1.5%	6.9%	5.4%	5.3%
Real GDP % share (at current prices)									
• Agriculture (in %)	40.9%	41.9%	46.2%	41.7%	42.2%	41.9%	40.4%	35.6%	31.9%
• Industry (in %)	12.7%	13.0%	13.0%	14.6%	16.0%	17.2%	18.4%	22.7%	24.4%
• Services (in %)	43.5%	39.9%	36.6%	38.7%	37.4%	36.6%	37.0%	37.7%	43.6%
Per Capita GDP (in US\$)	229	242	294	286	263	227	241	238	286
Population (in Millions)	9.474	9.954	10.470	11.034	11.640	12.280	12.663	12.961	13.300
Inflation in Cambodian Riels ( % year average)	75%	-0.5%	7.8%	7.2%	8.0%	14.7%	4.0%	-0.8%	-0.6%
Inflation (in % quarter to quarter)	41.1%	17.8%	3.5%	9.0%	9.1%	12.6%	0.0%	0.5%	-1.3%
Net Foreign Reserves (in US\$ million)	62	70	110	164	197	323	349	410	467
Gross Foreign Reserves (in US\$ million)	71	100	182	234	262	390	422	482	550
Gross Foreign Reserves (Months of Imports)	1.5	1.5	1.7	3	3.3	3.5	3.3	2.8	3
Total Savings (as % of GDP)	15.7%	18.0%	21.0%	25.6%	20.5%	21.3%	20.1%	20.9%	21.5%
Reil/US\$ parity (year average)	2,747	2,570	2,467	2,640	2,991	3,774	3,814	3,859	3,900
Reil/US\$ parity (end of year )	2,350	2,593	2,560	2,720	3,400	3,800	3,775	3,906	3,900
<b>Total Investments (in US\$ million)</b>	<b>303</b>	<b>429</b>	<b>614</b>	<b>800</b>	<b>623</b>	<b>612</b>	<b>635</b>	<b>682</b>	<b>769</b>
Public Investments	84	131	208	238	151	166	191	229	263
• of which domestic financed	2	31	23	23	32	24	59	80	51
• of which foreign financed	82	100	185	215	119	142	132	149	212
Private Sector Investments	219	299	406	562	472	447	444	453	506
• of which domestic financed	165	209	255	322	322	327	314	323	356
• of which foreign financed	54	90	151	240	150	120	130	130	150
<b>Total Investment as % of GDP</b>	<b>13.9%</b>	<b>17.8%</b>	<b>19.9%</b>	<b>25.4%</b>	<b>20.5%</b>	<b>21.9%</b>	<b>20.8%</b>	<b>22.1%</b>	<b>23.6%</b>
• of which Public Investment	3.9%	5.4%	6.8%	7.5%	4.9%	5.8%	6.3%	7.4%	8.1%
• of which Private Investment	10.0%	12.4%	13.1%	17.9%	15.6%	16.1%	14.5%	14.7%	15.5%

Sources: Ministry of Economy and Finance; National Bank of Cambodia; National Institute of Statistics/Ministry of Planning

The Foreign Direct Investment is still hopeful despite slowdowns over the last four years. The Cambodian Investment Board (CIB) / Council for the Development of Cambodia (CDC) approved a total of 62 new investment projects in 2000 with the fixed assets of US\$220.0. In 2001, 39 new investment projects were approved by CIB/CDC. These projects have US\$197.7 million of fixed assets and could create 16,408 jobs. The FDI approvals by CDC declined by 10% from 2000 levels, but some new private investments, which did not apply for incentives, have been established through agreements with relevant sectoral ministries / agencies. The new projects were in the areas of garments / textiles, food processing, plantations / agro-industry, telecommunications, tourism and infrastructure construction. About 90% of FDI is in light industry, services and infrastructure construction. More investments in manufacturing activities are now taking advantages of special trading rights under the Most Favored Nation and Generalized System of Preferences that has now been extended to Cambodia by many industrial countries. The fixed assets of proposed industrial sector projects, mainly garment factories, accounted for 44% of CDC

investment approvals in 2001, while new tourism projects accounted for 37%, infrastructure for 11% with the balance in agriculture/agro-industry. The 14 new garment factories projects and 12 expansions are approved by CDC in 2001. These garment projects will create 12,457 jobs, accounting for 78% expected jobs (16,408 jobs) to be created.

Table 2: Investment Projects by Sector in Cambodia  
from 1994-2002

Year	1994	1995	1996	1997	1998	1999	2000	2001	2002 1 <sup>st</sup> semester	Total
<b>Agri/Agro.Ind</b>										
Number of Projects	2	6	26	24	4	12	5	1	2	82
Capital Investment	559,815	6,041,768	118,495,570	65,577,452	51,609,320	63,884,623	9,758,839	400,000	3,654,000	319,981,387
<b>Industry</b>										
Number of Projects	20	82	130	168	125	66	41	28	11	671
Capital Investment	76,805,679	299,484,392	411,833,633	512,464,298	647,582,145	161,474,723	61,450,195	85,926,761	26,958,633	2,283,980,459
<b>Service</b>										
Number of Projects	3	22	17	6	6	10	8	4	2	78
Capital Investment	396,973,000	424,754,912	112,491,804	124,939,800	39,113,550	50,763,791	69,059,034	37,627,832	17,965,180	1,273,688,903
<b>Tourism</b>										
Number of Projects	1	14	16	7	8	3	8	6	0	63
Capital Investment	23,690,000	1,512,609,301	119,067,153	41,529,010	111,950,883	171,798,132	79,817,230	73,755,822	0	2,134,217,531
<b>N. of Projects Total</b>	<b>26</b>	<b>124</b>	<b>189</b>	<b>205</b>	<b>143</b>	<b>91</b>	<b>62</b>	<b>39</b>	<b>15</b>	<b>894</b>
<b>Capital Inves. Total</b>	<b>498,028,494</b>	<b>2,242,890,373</b>	<b>761,888,160</b>	<b>744,510,560</b>	<b>850,255,898</b>	<b>447,921,269</b>	<b>220,085,298</b>	<b>197,710,415</b>	<b>48,577,813</b>	<b>6,011,868,280</b>

Source: CIB/CDC (adjusted)

The improvement of the business climate and creation of an enabling environment for private sector development are key prerequisites for fostering growth and achieving sustainable economic development in Cambodia. Challenges for the development of private sector include: weaknesses in legal system, costs of and access to finance, inadequate market information on consumer trends, shortages of skilled labor, inadequate infrastructure that restrict access to markets and raw materials, the quality of the port, the high cost of essential services namely electricity, water supply, and telecommunication services. Land issues for agriculture investment projects remain an obstacle for Cambodia to be surmounted. Agriculture sector that has real potential for growth cannot be developed if the focus remains only on food production utilizing traditional methods and technique. The Government intends to consider a fiscal stimulus package, and will formulate policies and strengthen the legal framework for SMEs to create an enabling business environment for these enterprises.

It is true that there are for Cambodia much more to be done to create the most favorable conditions conducive to investment and business. Such measures include: improvement of the quality and capacity of services of Sihanoukville international port; development of industrial zone in Sihanoukville and Koh Kong; establishment of

economic corridors; rehabilitation of key physical infrastructure; reduction of the costs of transportation, electricity and telecommunications; ensuring the safety of workers; enforcement of signed contracts; training; maintenance of competitive wages; keeping transaction cost low; ensuring fair competition, and overhauling the legal and judicial system.

The Government recognizes that the above factors are indispensable conditions in order to encourage domestic business and attract foreign investments to our country, and also enable Cambodia to engage as an equal partner in the domestic and international trading system. Through international trade and with the domestic capital, Cambodia will attract more FDI, facilitate the transfer of technology, create jobs and integrate the economy into the region and the world. By this way the international trade will be an effective instrument in our struggle for economic growth, poverty reduction, and sustainable development. In this meaning, the Government is pushing for adoption of the Law on Industrial and Export Processing Zones and take measures to establishing infrastructure and high quality services in the 3 growth poles; the corridor along National Road 4; the area of Phnom Penh, Sihanoukville, Koh Kong, the coastal areas along Road 48 and Banteay Meanchey. The creation of the industrial and export processing zones in the border and coastal areas will reduce the costs of transportation and develop the economy of those coastal areas.

Completing these policies and programs in support of competitiveness is more intensive attention to the promotion of tourism opportunities. In this regard, the Government works closely with the private sector to develop tourist destinations. Much attention is given also to the improvement of sanitation and health services in Siem Reap, to ensure the sustainability and continuing beauty of the monuments and the City. We have also devoted more attention to the development of tourism potentials of areas other than Siem Reap, we should promote attractions that enable greater tourist traffic in underserved areas, as well as longer stays and increases spending by tourists. In this meaning the government encourages the development of access to ecotourism destinations such as Mondulkiri and Ratanakiri provinces, beach tourism in our sea access to the South, upgrading of the Kang Keng airport in Sihanoukville and the promotion of initiatives such as night market.

**Table 3: Top Ten Countries investing in Cambodia 1994-2002**

No	Country	Investment Capital	Percentage %
1	Malaysia	1,862,432,052	31.21
2	Taiwan	493,630,670	8.27
3	USA	434,201,401	7.28
4	China	267,064,156	4.48
5	Hong Kong	235,576,213	3.95
6	Singapore	224,592,946	3.76
7	Korea	208,708,623	3.50
8	Thailand	198,674,735	3.33
9	France	192,764,327	3.23
10	United Kingdom	94,083,532.34	1.58

*Source: CIB/ CDC (up to January 2002)*

Several countries in the region have taken bold measures to attract investment; the Investment Law of the Kingdom of Cambodia is still generous in comparison with the investment regimes of other countries in the region. We recognize that tax incentives alone without an overall environment comprising adequate political stability, physical

security, social order, legal and institutional frameworks, infrastructure (water, electricity, road), human resources and external markets-cannot attract investments. The Government has been vigorously implementing revenue-enhancing measure by tightening and rationalizing incentives to generate additional resources to strengthen government institutions, increase investment in infrastructure, human resources, security, social order and market expansion research.

Along with these initiatives, a review of investment incentives has been undertaken in conjunction with the removal of the 1 percent minimum tax on business turnover, which was considered distortion. The Ministry of Economy and Finance and the CDC working closely with the Foreign Investment Advisory Services (FIAS) of the World Bank Group as well as with other international Financial Institutions and private sector have completed the review of the Law on Investment and the draft Law was passed the Council of Ministers and now is awaiting adoption from the Parliament. This Law will ensure the maintenance of balance between the need for increased revenue and Cambodia's competitiveness with countries in the region. Thus, the draft amendment to the Law on Investment while rationalizing the investment incentives provides a simplified and transparent mechanism to automatically qualify investment projects for incentives. The amendment of the Law on Investment, includes provisions for:

- a- Eliminating the special 9 percent corporate tax rate for all new investments and phasing the 9 percent rate out to the standard 20 percent under the Law on Taxation for the next five years for existing, approved and operational projects;
- b- Eliminating tax free reinvestment of profits and introducing an appropriate investment allowance in the Law on Taxation applicable to all qualified investment, new or expanded, irrespective of source of finance, without evaluation;
- c- Repealing the current tax holiday provisions and introducing a new formula of Tax holiday: trigger period ( $\leq 3$  years from business date) + 3 years + n to be mentioned in yearly financial Act, conditional on annual certification of compliance, to all qualifying new investment, without evaluation; the use of a tax holiday will deny the tax payer any benefits available under the Law on Taxation during the tax holiday including the initial investment allowance as well as accelerated depreciation allowance; all current tax holidays provided under the Law on Investment will be "grand-fathered";
- d- Eliminating the right to tax-free repatriation of earnings and other incomes by approved enterprises.

We expect that the amendment of the Law on Investment will increase the confidence of investors, make Cambodia more attractive to investment, and also increase budget revenues. The expected amendment to the Law on investment will facilitate investment by streamlining and fast-tracking procedures for the application and approval of investment projects. The procedure of import and export of equipment for investment projects will be also restructured. It is encouraging that many positive changes have taken place. To this end, we will continue to work on a broad range of policies aimed at reducing transaction cost and removing impediments to effective competition. In fact, we acknowledge that the transport and container handling cost, electricity and water tariffs and telecommunication cost in Cambodia are high compared to our neighboring countries. Therefore the

Government should focus on the solution of these concerns immediately and into the medium-term.

Besides, the Law on Investment amendment will cut down and simplify paperwork and make rules and requirements transparent and predictable. Even before its adoption by the National Assembly, the processing of investment projects subject to the approval by Executive Committee of CDC will take only 7 working days. The approval process of investment projects in the “One-Stop-Service “ is taking only least than 14 working days.

In addition to improve the investment climate the Law on Corporate Accounting, Audit and the Accounting Profession entered into force on July 8, 2002. This law strengthens corporate governance, especially in terms of adoption of international accounting and auditing standards.

Furthermore, the Government has enabled a mechanism that allows taxpayers to discuss the draft Law on Taxation with authorities. Tax collection and the rules related to such is usually the exclusive prerogative of the authorities. That participation demonstrates that the Government is committed to partnership with the business sector and is prepared to take such a humble position in the common pursuit of the development of private enterprise. The Council of Ministers will review the amendment to the Law on Taxation in the near future and it will pay close attention to the suggestions made by the private sector.

Moreover, for increasing State revenues and attracting more FDI, the Government has strengthened fiscal and economic management by focusing especially on the management of budget, strengthening tax and customs administrations and the national treasury. It has also shortened the length of approval process of new investments by simplifying administrative procedures.

The private enterprises and the private sector are the engine of growth of Cambodia, and the economy’s basic foundation for sustainable growth. This declaration is contained in the Second Five-Year Socio-Economic Development Plan (SEDP2) launched on 29 July 2002. The Government-Private Forum is organized regularly in six months, during this gap period there are 7 Working Groups conducting the meeting every month. The partnership between the Royal Government of Cambodia and the private sector has become a culture, an establishment tradition, and a regular mode of work. This is the practice of true partnership – fulfillment of a basic tenet that constitutes one of the basic principles of good governance.

Reform of the education and training system is required to build such a labor force. Such reforms leading to improve quality of education are being pursued through the following key initiative: increase focus on professional skill and language skill, especially in English language skill for students; greater utilization of information technology as a learning tool; and increase the capacity of the trainers/teachers. Therefore, we has strongly encourages companies to give priority to the training of their employees. Companies are also encouraged to set up on-the-job training facilities so that they are assured of labor that meets their specific requirements. A liberal policy with regard to private sector training and education are also taken so

many private schools and institutes have emerged to respond to the demand for labor and the deep hunger among our people for skills for employability, growth, and advancement.

Furthermore, the development of micro and small-scale enterprises is at the heart of our plan to promote industrial development. This strategy we will apply particularly in the areas at outskirts of Phnom Penh, and in Sihanoukville, Bantey Meanchey, and Koh Kong. In this areas the Government will enable the provision of micro-finance and marketing services, streamline procedures, provide some training on production techniques, management and the liberal supply of crucial information.

Cambodia still has vast untapped resources and potentials in agriculture and livestock, particularly in high-value products and processed foods. The Government should all cooperate to develop these potentials in a sustainable manner. The agricultural sector can provide jobs for so many of our labor force if we develop the rural sector in a rational and sustainable manner. To achieve this momentum, the resolution of land issues and the establishment of roads and irrigation systems are priorities of the Government in the next several years.

In addition, the Government will focus on the proposed industrial and export processing zones in order to attract private investment. In this zones, priority attention will be focus on completing the roads network, system for power and water supply, ensure waste management and environmental protection, provide education and vocational training, upgrade health services, the establishment of warehouse and reduction of custom procedures, etc.

The improvement of Cambodia's international competitiveness is crucially depend on success in the upgrading of basic physical infrastructure-including water, power, telecommunications and information. However, we cannot supply all these public goods all at once and in all parts of the country as we are under tough budget constraint. We only have limited resources, and so we have to prioritize and carefully manage and allocate these resources for investment in those projects and areas with the highest economic returns.

Therefore, the establishment of industrial corridors or centers concentrated in the key areas is the right solution for Cambodia. We strongly believe that the private sector as potentially the heaviest users of the entire system of infrastructure, is in a good position to share with the Government regarding their vision and recommendation, their advice and guidance in the management and allocation of these scare public resources for investment in the common interest.

To ensure that the private sector can play its crucial role in development, the Government has taken enormous steps to improve the investment and business climate. By creating a climate for profitable, long-time enterprise, the Government is at the same time promoting the reduction of poverty, ensuring economic development and enhancing Cambodia's competitiveness among other countries in this increasingly globalized world.

Those points that I have raised above are just the points of the policy and strategy that are the basis guideline for the investment in Cambodia.



Finally, on behalf of the Cambodian delegation, I would like to thank once more the organizers for this nice welcome and reception.

Thank you for your kind attention