

Implications of General Agreements on Trade in Services on the Cambodian Economy

The opening of Cambodia for trade in services may bring about cheaper prices for local consumers, but not all will benefit, especially in the short run. Local service providers may face bankruptcy, unless somehow they become competitive.

The internationalization of trade in services is the heart of the economic globalization process, since services industry has expanded rapidly and has come to play an increasing role in the national and international economy over the past two decades. Services represent 60 percent of the global economy, 40 percent of total employment, and 20 percent of global trade. The increase in share of services in the economy has happened not only in developed countries, but also in developing and least developed countries. In some developing countries, such as Cambodia, the services industry constitutes about 50 percent of economic activity, significantly more than traditional sectors, such as agriculture.

After years of war and conflicts, and in order to accelerate its economic integration into the world economic system, Cambodia applied in 1994 for membership of the World Trade Organization (WTO). It was finally approved in September 2003 at the Cancun Ministerial Meeting. This membership requires Cambodia to make a large number of commitments to liberalize its trade in services under the General Agreements on Trade in Services (GATS), which is one of the WTO agreements that came into effect in 1995. Cambodia has committed itself to implementing this agreement no later than 1 January 2009.

The empirical evidence shows that the Cambodia's services industry is de facto liberalized, especially in areas that have experienced high growth, such as business services, air transportation, health, and education. Therefore, it seems that GATS has come to regulate the already opened market; it covers a wide range of services from business to legal to technology to social issues, and potentially affects every individual and organization.

The goal of this paper is to draw the attention of policy makers to one of the major agreements under the WTO, which has not been widely and sufficiently discussed in public.

The service industry in Cambodia

Thanks to many reforms enacted by the government after the first general elections in 1993, Cambodia's economy reacted quickly to absorb the foreign direct investment (FDI) that flowed into the region. As a result, foreign investment has boosted a rapid development of some emerging industries, such as garment, wood, telecommunications, and tourism. The services industry - including construction, tourism, transportation, and telecommunications - absorbed more than 50 percent of FDI in the country in 2003.

Cambodia's services industry grew very fast during the last decade. Its share in total GDP increased from about 35 percent in early 1990s to about 50 percent in 2003. The industry employs about 1.2 million people, representing 20 percent of the total labor force. The economic value added of the industry is thus very high, compared to that of the agriculture which employs more than 70 percent of the total labor force but has an output of less than 30 percent of the GDP.

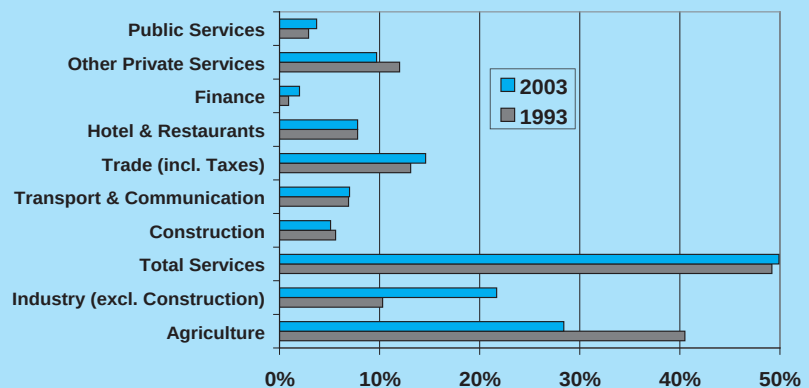
The services industry remains very informal, and dominated by the private sector. Foreign entities have a significant share in the formal area that includes air transportation, courier,

and banking services.

The structure of services was also changing from 1990 to 2003. All services increased slightly on average by 1 or 2 percentage points, but hotels and restaurants increased dramatically from a growth rate of 1 percent in 1990 to 8 percent in 2003. It is apparent that there are only a few traditional services, tourism and related services, that have grown dramatically in the past several years, while there has been only a slight increase in new and dynamic area such as technology and telecommunication. The tourism makes up the biggest share in services export, and its trade surplus represents almost the same amount as that of the garment industry. However, services export is only a small part of the total export that has been dominated by the garment products.

By the current trade practices, the services industry has already been privatized, and liberalized in all kinds of supply mode (Box 2). Cambodia is basically very open for cross border supply (Mode 1) and consumption abroad (Mode 2); and it is quite difficult to regulate these supply modes as well. Cambodians prefer foreign services through Mode 1 and 2 in a number of areas, such as health, education, and banking. Effectively, there is nothing to prevent Cambodian consumers

Figure 1: Share of Services in the Cambodia's Economy



Source: EIC, Compiled from various sources

from accessing the services abroad or cross border supplies. Indeed, in education service, many Cambodian students go to study in countries such as France, the United States, Australia, Japan, New Zealand, Singapore, and Thailand. Actually, it is only a difficulty in obtaining visa from developed countries that has effectively blocked local consumers from acquiring those services abroad.

Locally, foreigners with their direct investment also have their business operations in certain areas of services industry, such as private hospitals, schools, hotels, restaurants, airlines, banks, and business services. In the telecommunications industry, multinational corporations operate their branches or subsidiaries in Cambodia. In early 1990s, the Ministry of Post and Telecommunications (MPTC) received an approval from the Government to establish joint venture companies with foreign entities to provide and operate mobile cellular services.

The movement of natural persons across borders (or Mode 4) is the most restrictive, which distorts the liberalization all over the world. There are, however, foreigners with different backgrounds who work in various industries in Cambodia. Many experts work on contracts with multinational organizations, non-government organizations, and donor countries. There are a lot of low skill workers who are employed in construction services, food processing, and commercial sex. Most of them come to Cambodia illegally.

Potential Costs of Liberalization

While the GATS may contribute to increased competitiveness and efficiency, there are concerns about its implications on equity, costs, distribution, availability of services, human development, and the sovereignty of government objectives and priorities in the services industry. These concerns are predominantly in social services such as health and education where there are past market failures, and government is heavily involved as regulators, providers, and distributors of such services.

The air transportation industry is indeed de facto liberalized; there

have already been foreign airline companies operating their businesses in the country. Currently, Cambodia has four main direct air routes to Bangkok, Hong Kong, Singapore, and Hanoi. Most of the flights to Phnom Penh and Siem Reap are through Bangkok. The industry is so concentrated that competition is rather limited; consumers are unlikely to benefit in terms of prices and service quality. Each flight route is serviced by only one or two airline companies, even there has been in place an open sky policy. Cambodia needs to liberalize its air service industry to the extent that there will be some level of acceptable competition.

The industry experienced some decline in the number of tourists visiting Cambodia in earlier of 2003, due to the January riots against Thai interest in Cambodia. Potential Thai visitors were concerned for their safety, and Thai owned airline companies were temporarily suspending their flights to and from Cambodia.

It is necessary that the country have some control over strategic capital assets. Most of these major assets - including aircraft, hotels, resorts, and restaurants - are currently foreign-owned; therefore, the benefit to the local economy from the tourism growth in the past few years has rather been limited. These foreign companies take a large chunk of more than 80 percent of the tourist expenditures back to their home countries, leaving only a small balance for local workers and businesses.

Currently, Cambodia is not ready to benefit from liberalizing the

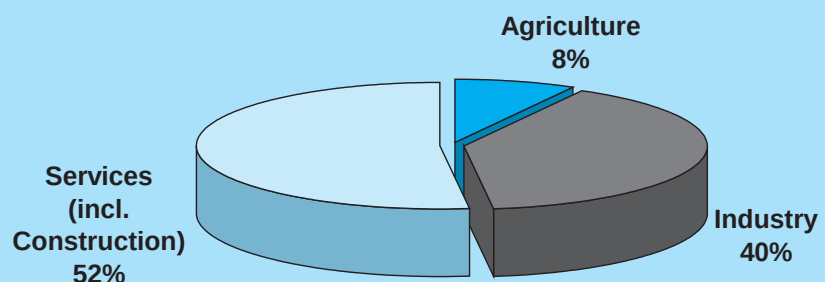
trade in services. It does not have sufficient capacity to export most of services in the services industry, especially the new dynamic and emerging services such as new technology, software, telecommunication, distribution, and transportation. Hence, a major concern of trade liberalization under such circumstances is that there will be no reciprocity of benefits for some time, even though tourism continues to be potentially a growing industry in the foreseeable future.

Moreover, the services trade liberalization will open the local market for foreign competition that may just suffocate local small and medium enterprises. There will always be industries in which foreign competitors are more efficient than domestic producers. When import barrier is lowered, the foreign producers will be able to attract domestic consumers with lower prices and better quality. Domestic competing firms in those markets will face pressure on their sale and profit, which can lead to lower wages, job losses, and perhaps bankruptcy. Even in the tourism and related services - hospitality, restaurant, tour operators, guide, etc - where domestic service experiences and skill have been improving due to the industry growth in the last few years, the local may not be able to match for quality and price those foreign companies that have decades of experiences.

Potential Gain of Liberalization

The motive for trade in services is not different from that for tan-

Figure 2: Share of Stocks of FDI in the Economy



Source: EIC, Compiled from various sources

gible goods. Cambodia will be able to increase their exports of services, and gain access to services not available domestically. The country will reform its regulatory environment, and develop necessary human and physical capitals. Being seen as a supplier of specific services such as tourism and related areas, Cambodia will somewhat gain from the access to a larger market and perhaps better prices. Cambodian is regarded as a consumer of most services in the services industry, especially new and emerging services. In this perspective, Cambodia will gain because they get access to both a wider variety of services and imported services at competitive prices.

Liberalization of trade in services will drive down the price for two reasons. First, GATS calls for a gradual reduction of tariff barriers and an elimination of the non-tariff barrier that is embedded in price of the services. Second, when the country is opening up, the demand may remain constant while the supply increases as foreign suppliers enter the markets. This will lead to a competition between the service suppliers, which should drive the price down. The price decrease will also occur for substitute services.

According to the investment climate report of the World Bank, 250,000 youngsters enter job market each year. In the current situation, the Cambodian economy cannot create enough jobs to absorb the new entrants. Cambodia has thus a labor surplus, especially among low-skilled workers. In fact, some of them have already been, legally and illegally, exported to Malaysia, Thailand, and Korea. Cambodia can reduce the unemployment rate and the gap in income distribution by sending their surplus workforce abroad. The outflow of natural persons, not only increases the revenue for their home country when they send back their savings, but will transfer know-how upon their return home at the end of their work contract.

Liberalization is, of course, about expanding exports; it helps domestic producers gain access to more efficient and diversified world markets. Liberalizing trade in services

can result in increased competitiveness because services somehow are complementary to each other, and they often are inputs for production of goods.

In addition, services such as transport, finance, and communication, play a vital infrastructure role in the economy, and can have major multiplier effects on competitiveness in both goods and services. With rapid advances in information technology, knowledge-based services have become increasingly important for international competitiveness and for Cambodia's ability to adopt, acquire, and use new technologies.

Concluding Remarks

It seems all costs will occur immediately after the trade liberalization, and the benefits will come later. The Cambodian economy may be worse off in the short run; but in the medium to long term, the gains from liberalized trade will outweigh the short-run adjustment costs. It is necessary, however, that Cambodia have a political will to make real reforms in regulatory environment, and develop human and physical capitals.

Obviously, the quality and implementation of the regulations can be the key to determining the success of policy reform. It will be a big challenge for Cambodia to regulate the current practices while lacking human resources and skillful people who clearly understand implications of any service reform.

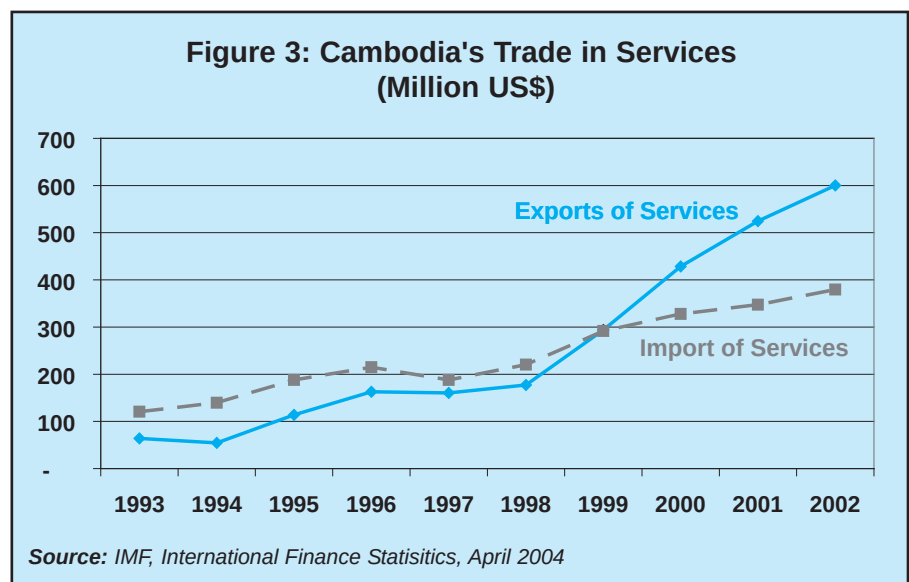
Cambodia may benefit from the liberalization on two fronts - consumer gain and increase in competitiveness. In order to benefit much more from GATS, it needs to strengthen the production capacity that leads to accumulation of the foreign exchanges.

In the current practice, trade in services is very open and largely unregulated in almost all areas. The GATS may come to regulate those services for the better, and may bring about some benefit in terms of increasing overall income, equitable income distribution, and generating employment for local people.

One major downside is that there are foreigners who illegally come to take jobs from local workers, especially in construction, wood processing, and many other services areas. Thanks to the commitment that Cambodia has made in the national schedule that deals with movement of natural persons (Mode 4), it gives some flexibility to the country to control the downside. The control does not necessarily prohibit foreigners from temporarily remaining and working in Cambodia. It can, however, segregate those who are in legally and those who are illegal.

Overall, the GATS presents Cambodia an opportunity to regulate its services industry that has been largely unregulated to the country's detriment.

Chea Samnang



Cambodia's Commitments under the General Agreements on Trade in Services

In September 2003, Cambodia was accepted to become a member of the World Trade Organization (WTO). Under this accession, Cambodia is committed to open up not later than early 2009 a large portion of its services industry to other WTO members. Cambodia's government also intends to extend this liberalization to all ASEAN countries.

Cambodia imposes horizontal restrictions on land ownership, and offers various incentives conditional upon satisfying training performance requirements. Non-Cambodian natural and juridical persons may lease but not own land. There is no specific distinction in the commercial presence for foreign investors. However, they are obliged to provide adequate and consistent training to Cambodian staff, including opportunities for promotion to senior positions.

The presence of natural persons is unbound, except for measures concerning the entry and temporary stay. An entry visa for business visitors is valid for a period of 90 days for an initial stay of 30 days, which may be extended. Temporary residency and work permits are required for natural persons falling under the category of intra-corporate transferees. Such permits are issued for an initial two years, and may be renewed annually until reaching a maximum of five.

In addition, Cambodia has committed itself to providing MFN exemptions that cover national treatment measures based upon co-production bilateral and multilateral agreements in audiovisual services, land, maritime, and internal waterway transport.

Under its accession to WTO, Cambodia has been committed to liberalizing its services industry with certain exemptions.

This article is compiled from a study on "Liberalization of Trade in Services in ASEAN", under the ASEAN Economic Forum project, sponsored by the World Bank Institute.

Business Services

Legal services

Foreign lawyers can operate freely in Cambodia, for the most part. The only requirement is a commercial association with a Cambodian lawyer, and a restriction that they may not directly represent clients in court.

Specialized medical services

These services are limited to orthodontics, oral surgery, and other specialized dental services. Provision of services is permitted through a joint venture with Cambodian juridical persons. Foreign equity participation is based on negotiation between parties concerned.

Computer and related services

There is no restriction applied in these sub-sectors; the market is fully open, except for Mode 4 that subjects the number of foreign employees working in a firm to the Cambodian Labor Law. There are currently no licensing or qualification requirements for offering computer and related services in Cambodia.

Advertising services

It is unbounded until 1 January 2009. After that date, the services will subject to legislation in force.

Communication Services

Courier services

These services are limited to the provision of services on a contract basis for the delivery of letters, packages, and parcels. A number of foreign companies, such as DHL, TNT, OCS, UPS, and FedEx, have already provided courier services in Cambodia. Although this market is not yet regulated, these operators are required, in principle, to obtain a

license from the Ministry of Post and Telecommunication (MPTC).

The MPTC owns and operates the national postal system. The tariffs for main types of service are established by the MPTC on the basis of the Consumer Price Index and the convention of Universal Postal Union (UPU). There are 40 post offices in Cambodia: one Postal Department and 6 post offices under its supervision; 23 provincial and town bureaus and 10 district post offices. The post offices in Phnom Penh provide a wide range of postal services. Six provincial bureaus provide, as well as letter services, Express Mail Services (EMS) and parcel services within and outside the country; the remaining bureaus provide only letter services. A monopoly in providing postal services is granted to Cambodia Post for all mail weighing 500 grams or less.

Box 1: Classification of Service Sectors under GATS

There is no clear definition of services in GATS. Based on the United Nations Central Product Classification (CPC) system, GATS identifies 11 basic service sectors - plus a twelfth category for miscellaneous services. These sectors are subdivided into some 161 sub-sectors or separate service activities:

1. Business services
2. Communication services
3. Construction services
4. Distribution services
5. Educational services
6. Environmental services
7. Financial services
8. Health-related and social services
9. Tourism and travel-related services
10. Recreational, cultural, and sporting services
11. Transport services
12. Other services not elsewhere included

Not covered are "services provided in the exercise of governmental authority", i.e. services that are supplied "neither on a commercial basis, nor in competition".

Source: B. Copeland and A. Mattoo, *The Basic Economics of Services Trade*, April 2004.

Telecommunication services

Cambodia has committed itself to opening its market for telecommunication services starting no later than 1 January 2009, with a requirement that local shareholding be up to 49 percent. However, Cambodia undertakes the obligations contained in the Telecom Reference Paper upon accession.

Communication services have grown exponentially in recent years, with an expectation of a continued rapid growth. The mobile telephone market has undergone a remarkable transformation that is leading to a growing selection of services and products for businesses and individuals. Currently six operators, including Cambodia Telecom, are providing mobile service in Cambodia. Growing competition among them forced one operator, Tricelcam, to withdraw from the market in 2000. It was replaced by a new operator, S Telecom. It seems another company, Camtel, is struggling to survive.

Cambodia, as a young economy, is seeking to create a good business climate for potential investors in order to encourage long-term investment. Presently, the legislative base in the area of telecommunications is under preparation. In the absence of legal provisions governing licensing procedures for the establishment of new operators, each application is being reviewed on a case-by-case basis, taking into account the needs for further development of the network, infrastructure, the expected coverage, the customer base, and other factors.

Construction and Related Engineering Services

With huge potential benefit that could be extracted from the construction business in the future, Cambodia has committed itself to allowing foreign firms to establish themselves in these services without restriction. The services across border, however, are prohibited. The number of foreign employees working in a firm is also subject to the Cambodian Labor Law.

Distribution Services

Cambodia will formally open its distribution services market from 31 December 2008, even though the market is currently de facto open.

Educational Services

Cambodia will formally open its market for education services from 31 December 2008. Similar to the distribution services, the market is practically liberalized.

Environmental Services

In all areas of environmental services as classified under the GATS, Cambodia welcomes foreign investment and services. However, making the sector commercially viable is not feasible given the low earning capacity of the population. In such a situation, the government is compelled to provide services with its limited resources and on a non-commercial basis. The legislation and regulations are well developed in the area of environmental protection; they include the Law on Environmental Protection and Natural Resources Management, sub-decree on Environmental Impact Assessment Process, sub-decree on Water Pollution Control, sub-decree on Solid Waste Management, and sub-decree on Air and Noise Pollution Control.

Financial Services

All insurance and insurance-related services

Insurance activities are regulated by the Insurance Law adopted in 2000 and the Insurance Sub-Decree adopted in 2001 for the implementation of the Insurance Law.

There is no life insurance market in Cambodia to date. None of the insurance companies that have applied for a licence in the area of insurance has applied for the provision of life-insurance services.

Cambodia made a commit-

ment only for Mode 3 where the establishment of commercial presence with 100 percent foreign ownership is allowed. The services must be provided through an insurance company. Cross-border supply is unbound except for marine, aviation, and transport insurance which will be allowed from 1 January 2009, or once a law has been passed.

Some provision has been made for reinsurance. All insurance company must reinsure 20 percent of their total risks with a national reinsurance company called "Cambodia Re." until 31 December 2008. Insurance contracts less than or equal to US\$ 500,000 must be reinsured locally until 31 December 2008. Insurance companies are free to choose where and with which company to reinsure all other risks.

Banking and other financial services

In addition to commercial banks, specialized banks, and insurance companies, a number of micro-finance institutions are currently operating in Cambodia. Some NGOs (about 90 of them to date), which started their operations as humanitarian activities, also provide some sort of financial services though issuing credit and promoting savings, especially among their members. There is

Box 2: Mode of Supply

- **Mode 1:** Supply of a service from the territory of one Member into that of another, i.e. supplier and consumer interact over distance ('cross-border trade').

- **Mode 2:** Movement of the consumer of one Member into the territory of the supplying Member ('consumption abroad').

- **Mode 3:** Services are sold by foreign suppliers that are commercially established in the territory of the Member concerned ('commercial presence').

- **Mode 4:** Services are supplied by foreign natural persons, either employed or self-employed, who currently stay in the territory of the Member concerned ('presence of natural persons').

Source: WTO - GATS

no specific law/regulation to govern non-bank financial institutions. So far, no non-bank financial institution has either approached Cambodian officials or applied to provide such services. Perhaps this is due to the fact that the financial sector in Cambodia is still in its early stage of development and under reform process.

A government regulation, called Prakas, on Licensing of Rural Credit Specialized Banks came into effect in January 2000. During 2002, with the aim of strengthening micro-finance institutions and specialized banks, two more Prakas were issued on "Loan Classification and Provisioning Applicable to Specialized Banks and Licensed Micro-Finance Institutions", and on "Onsite/Offsite Inspection Procedures". The former is aimed at classifying different types of loans and establishing the necessary credit provisions. The latter addresses procedural aspects relating to the examination of banking activities in terms of their compliance with relevant provisions of laws and regulations.

A draft law on capital market was prepared in 1997. In accordance with the financial sector development strategy, "Financial Sector Blueprint 2001-2010", the Asian Development Bank is expected to provide technical assistance to review and finalize this draft.

As of 30 September 2002, the banking sector in Cambodia included 13 commercial banks. One was State-owned, nine were privately-owned, and three were foreign-owned (two of which were subsidiaries). The Law on Banking and Financial Institutions (LoBFI) and subsequent regulations guarantee foreign banks rights and obligations equal to local banks. There is no restriction regarding foreign ownership of banks.

The scope for the operations of banks and financial institutions are set out in the LoBFI, which includes among others, leasing, guarantees and commitments under signature, etc... However, at the moment banks are mainly focusing on the areas of

acceptance of deposits and lending.

A financial institution can be locally incorporated in Cambodia, or can operate as a branch of a foreign bank. There are no separate regulations to govern foreign bank branches. Both local banks and foreign banks are subject to the same prudential and supervisory procedures.

The LoBFI has no specific provision regarding the supply of financial information and advisory services. So far there has been no request from banks to carry out these services.

Health Related and Social Services

The Law on Hospital Services has been adopted, and the sub-decree has been passed. However, a number of specific questions on the establishment and operation of hospitals needs further clarification. The general approach is towards opening the market access to direct ownership and management, and operation by contract of such facilities on a "for fee" basis.

However, primary objectives of the Government are to achieve access to health care for the poorest populations and to improve and ensure the quality of medical services. The private market for hospital services is very small, with only 3 private hospitals operating in Phnom Penh catering for a population of more than 1 million. The consumers purchasing power is very low, and the burden of providing medical services rests on the public establishments. Public hospitals has been trying to adopt a so-called cost recovery system, which is yet to function smoothly.

Tourism and Travel Related Services

Tourism is one of the key economic sectors in terms of its contribution to value added in GDP and employment. It is the second most important source of foreign currency in the economy. Cambodia has only recently prepared a draft national plan, with assistance from ADB, on

policy and strategy for sustainable development of the tourism sector. The government is also preparing a draft law on tourism. Among expected provisions of this draft law will be the establishment of conditions for conducting travel agencies and tour operations. The overall policy in Cambodia is to help and encourage business initiative and local investment in the area of lower-end hotels and guesthouses, and to support the development of the network of travel agencies that would provide important employment and business opportunities to locals.

There is no restriction on foreigners in operating 3-star/or higher hotel businesses except that the number of foreign employees working in a firm is subject to the Cambodian Labor Law. Foreign equity participation is limited to 49 percent for travel agencies, and Cambodian nationality is a necessary requirement for being tourist guides.

Transport Services

Cambodia has drafted a law on maritime and merchant shipping to regulate maritime services activity, which is basically free in the meantime. Concerning air transport services, Cambodia applies only one restriction limiting foreign capital to 49 percent.

In regard to road transport services, Cambodia applies only a restriction on cross border supply by requiring commercial presence in the country.

The road transportation activity is dominated by numerous small and medium companies that are contributing to the creation of employment. It is important to continue to provide local service providers scope for business opportunities. At the same time, technology and knowledge are crucial, and the establishment of joint ventures with participation of foreign capital could facilitate attainment of this objective.

**Chea Samnang, Sarin Denora,
and Sok Hach**