

Chapter 8

Trade Policy Reforms to Improve Competitiveness

Cambodia has achieved some successes in its efforts to reform its economic system and integrate itself into the region and the world economy. Achievements in economic growth in the past decade have come, thanks to inflow of FDI and expansion of trade. International trade has become one of the engines of growth. Total trade volume surpassed the GDP in 2003, according to an estimate by the Economic Institute of Cambodia (EIC). Recently, the National Assembly and Senate ratified the agreement for Cambodia to join the World Trade Organization (WTO), membership of which is being seen as an opportunity for wider market access for Cambodia's exports.

In response to the growing importance of trade and the need to remove obstacles to its development, the government has incorporated trade policy reform in its NPRS 2003 – 2005. Three main issues have been laid out: a) Improving the trade environment, through economic integration of Cambodia with its AFTA member states and the world through WTO; b) Trade facilitation, by enhancing Cambodian firms' ability to export competitively through low-cost, efficient trade facilitation which is harmonized with trade partners; and c) Export diversification; that is, reducing Cambodia's dependence on GSP exports and preparing for full trade liberalization⁵².

8.1. Economic integration of Cambodia

Cambodia joined the Association of South East Asian Nations (ASEAN) in 1999, which meant an automatic accession to the ASEAN Free Trade Area (AFTA). Entering AFTA, Cambodia has therefore agreed to essentially eliminate tariffs on all ASEAN products by 2015. Under these agreements, the tariff regime was substantially reformed in April 2001. High rates were reduced, from 120 percent down to 35 percent. And the system was simplified, with numbers of bands being reduced from 12 to 4. Despite these adjustments, there is still a cascading tariff structure with the highest rates applying to processed goods and lowest rates on raw materials. Moreover, the Law on Investment (LOI) provides exporters with exemptions on import goods for export production. Cambodian trade policies show that the Cambodian trade legal framework is gradually paving the way for the country's integration into the region as well as in the world, *see matrix 8.1 for recent developments*.

⁵² Royal Government of Cambodia (2003), *National Poverty Reduction Strategy 2003-2005*. p. 159

Matrix 8.1: Economic integration of Cambodia into AFTA and WTO

Reforms Agenda^(a)	Measures Taken^(b)
• Complete legal and judicial requirements of WTO accession, including sanitary and phytosanitary issues, sector regulation, intellectual property rights, and due process rights	- National Assembly (31/08) and Senate (06/09) have ratified the agreement for Cambodia admission to WTO. - Signed and ongoing negotiations on FTAs with major trade partners
• Build capacity in government and private sector to analyse trade policy and conduct social impact assessments of trade policy reforms	- Unidentifiable.
• Implement MIME action plan for technical barriers to trade through enactment of Law on Industrial Standards	- Unidentifiable.
• Establish WTO-consistent customs valuation procedures	- Finalize the draft Law on Customs (LOC) which meets international standards and best practices. The Council of Ministers approved the draft LOC on 27 December 2002 and submitted to the National Assembly on 15 January 2003 for adoption.
• Simplify and reduce tariffs in line ahead of AFTA commitments	- Completed tariff restructuring by lowering unweighted average rate to 14.9%. The import duty of some categories of goods has been brought further down. However, the rates of excise tax for certain commodities have been increased or imposed to offset import duty reduction
• Deepen transportation linkages with Thailand, Laos and Vietnam	- On going infrastructure reconstruction projects

Source: ^(a) Selected from National Poverty Reduction Strategy (NPRS) 2003-2005.

^(b) EIC compiled from WB, IMF and Government Sources.

As part of its commitment to market liberalization, the Ministry of Commerce has lifted all restrictions on foreign companies and allows them to freely engage in trading activities. Foreign companies need only to register with the Ministry of Commerce and pay the required tax. Previously, only Cambodian-owned companies (51% shareholding owned by Cambodian nationals or Cambodian entities) were allowed to engage in import and export activities.⁵³ With its accession to the World Trade Organization (WTO), Cambodia needs more regulations and institutions to prevent potential negative effects of that membership, including a new law on bankruptcy, mortgages and property rights, new law on dispute settlement, a law to control excessive movement of capital, and establishment/reform of commercial courts.⁵⁴

⁵³ Prakas N° 017/PRK of January 25, 2000 on Trading Activities of Commercial Companies

⁵⁴ EIC Economic Review, Volume 1, n°2, Nov-Dec, 2003

In October 2004, Cambodia became the official 148th member of WTO, after many rounds of negotiations and political turbulence⁵⁵. Additionally, Cambodia also is currently very active in negotiating bilateral trade agreements⁵⁶ with many countries to get Generalized System of Preferences (GSP) and Special Preferential Tariff (SPT) on top of the Most Favored Nations (MFN) status it can enjoy from all WTO member countries. The successful integration of Cambodia to the world's economy will pave the way for wider market access. However, whether the country can really turn these opportunities into concrete benefits is largely dependant on the degree of its success in its efforts to embark on better trade facilitation and export diversification.

8.2. Trade Facilitation

Recently, the government established Sub-Steering Committees for Private Sector Development, consisting of a Sub-Steering Committee on Investment Climate and PPI (Private Participation in Infrastructure), on Trade Facilitation, and on SME (Small and Medium Enterprise). These sub-committees will work on policy and strategy mechanisms for the private sector development. The committees have laid out 12 action points to be taken to improve investment climate and trade facilitation, the World Bank report (2004)⁵⁷.

The amended Law on Investment, two Laws on Industrial Management, and a Law on Industrial and Export Processing Zones have been submitted to National Assembly for approval. Once adopted, they will provide legal incentives and protection conducive to investment attraction. The Ministry of Commerce (MoC) also has issued a guideline on New Procedure for the Issuance of Commercial Invoice (C/I), Certificate of Origin (C/O), and Export License (E/O), through which export document processing is simplified and less time-consuming. Moreover, to encourage the formalization of new business establishment, the MoC has cut down the cost of business registration to fixed level of US\$ 177⁵⁸, *see matrix 7.2 for recent developments*. These measures have produced a positive impact on the reduction of transaction costs and lead times for exporters and the private sector as a whole.

⁵⁵ http://www.wto.org/english/news_e/news04_e/cambodia_148members_13oct04_e.htm

⁵⁶ For detailed list of countries offer MFN/GSP to Cambodia is available at:

http://www.moc.gov.kh/econo_intergration/mfn-gsp_cambodia.htm

⁵⁷ The World Bank (2004), Cambodia: Seizing the Global Opportunity: Investment Climate Assessment & Reform Strategy, p.86-89.

⁵⁸ Prakas N° 159/MOC/M2004 of August 19, 2004, and Prakas N° 162/MOC/M2004 of August 23, 2004.

Matrix 8.2: Enhancing Cambodia's firms' ability to export competitively through low-cost, efficient trade facilitation which is harmonized with trade partners

Reforms Agenda^(a)	Measures Taken^(b)
- Rationalize overlapping administrative responsibility for border inspection	- A Trade Facilitation Reform Team is Established to work under the guidance and leadership of the Sub-Steering Committee of Trade Facilitation - Prakas No. 159/ MOC/M2004 dated August 19, 2004 on New Procedure for the Issuance of Commercial Invoice (C/I), Certificate of Origin (C/O), and Export License (E/O). - Prakas No 162/MOC/M2004 of August 23, 2004 on Fixed costs on Business Registration.
- Reform and computerize customs compliance procedures	- Complete evaluation and clarification of IT proposals. Final documents have been prepared and submitted for consideration and approval.
- Harmonize customs and trade facilitation procedures with neighbors within GMS framework.	- Completed preparation of the ASEAN Harmonized Tariff Nomenclature (AHTN) which based on the WCO HS-2002 version, and contained 10689 tariff lines. The AHTN was put in place for implementation from 1st January 2004. - Expanding multilateral and bilateral relations. Participation in WTO accession process, works of the World Customs Organization, ASEAN, GMS and development of bilateral cooperation relationship with customs administrations of neighboring countries - Development and implementation of streamlined customs clearance procedures to enhance trade facilities and improve effectiveness of operations.

Source: ^(a) Selected from National Poverty Reduction Strategy (NPRS) 2003-2005.

^(b) EIC compiled from WB, IMF and Government Sources.

However, the same World Bank report reveals that inefficient trade facilitation – e.g., high costs of corruption and long delays for clearances procedures – is still a critical issue for Cambodia in its efforts to attract FDI, and that in fact FDI has been decreasing in recent years. Inefficiencies also are affecting export expansion. Each step in the import and export process is characterized by delays, formal costs and unofficial payments. Unclear and superfluous procedures have caused confusion and overlapping responsibilities of government agencies, thereby hindering chances for smooth flows of goods. These inefficiencies not only cost money to the business community, but also increases the stress and anxiety of any businessperson trying to operate in Cambodia.

The report suggests that the government implement comprehensive reform actions to address transaction costs in exports and imports, streamline roles and responsibilities of its various ministries and agencies in their management of the trade process, increase the visibility and predictability of that process, and comply with international commitments.

8.3. Export Diversification

Currently, Cambodia makes very few types of products for export. In fact, 80 percent of its exports are garments. The garment industry is the single most important industry in Cambodia, providing jobs to 250,000 workers. A lack of capital and technology investment has kept the country from developing a better-diversified production base. Moreover, the prospects for business expansion have been hindered by many impediments.

Matrix 8.3: Reducing Cambodia's dependence on GSP exports and preparing for full trade liberalization

Reforms Agenda ^(a)	Measures Taken ^(b)
- Execute market creation and capacity-building activities for non-traditional industry, including tourism, high value agribusiness, and light manufacturing	- Unidentifiable.
- Promote MOC/MSALVY/private sector cooperation in labor policy development, in line with ILO analysis.	- Applying ILO Labor Compliance.
- Identify and carry out a program of sector support for those firms and employees most impacted by trade reform to facilitate adjustment (including current exports and those potentially impacted in increased imports)	- Unidentifiable.

Source: ^(a) Selected from National Poverty Reduction Strategy (NPRS) 2003-2005.

^(b) EIC compiled from WB, IMF and Government Sources.

Export diversification is still a daunting issue as it is closely linked with a better investment climate and efficient trade facilitation. Without dramatic achievement in these two areas, there is little chance for an upsurge in diversification. Fiscal policy is particularly discouraging. Tax discrimination of domestic enterprises has suppressed the potential further investment, and inappropriate taxations on fuels and utilities have also pushed the costs of doing business in Cambodia higher. Due to dollarization, it is impossible for the government to use its exchange rate policy as a tool to promote its exports through effective rate devaluation.

Therefore, improving the investment climate and favorable trade facilitation (12-point actions) must be in the forefront of the government's trade policy reforms. And it must be done quickly and in an organized fashion; otherwise, export diversification will never be realized.

Guiding Principles for Trade Reforms

1.	Ease the burden on business: a shift from a culture of control to a culture of facilitation.
2.	Empower markets and competition.
3.	Do not go beyond the limited capacity of the public institutions.
4.	Focus on reforms that are empirically shown to relate to improving competitiveness and productivity.
5.	Use private institutions to integrate rural and informal sectors.
6.	Focus on institutions that reduce risk and transaction costs.
7.	Focus on institutional learning, given the early stage of private sector development.
8.	Introducing greater accountability in policy formulation and performance.

Source: The World Bank (2004), Cambodia: Seizing the Global Opportunity: Investment Climate Assessment & Reform Strategy, p.69-70.