

**SUMMARY OF CHAPTER 5**  
**Governance for Private Sector Development**

Private enterprises operating in Cambodia understand the need for improvements in governance. The top ten business constraints they cite are all directly, or indirectly, governance-related. Issues that any objective observer would recognize as urgent, such as the cost and availability of credit, the cost of energy, the quality of inputs, the availability of roads, the skill and education level of workers do not make the list of top ten. This is because so long as governance remains weak, businesses lack the certainty that they need to take long-term risks. While some may view bribes as a cost of doing business, they raise costs and make it difficult for firms to break even and survive, particularly in cost-competitive industries. Corruption also robs government of much needed revenues which gets passed back to businesses through the higher costs of transport and self-generated power.

The Protocol of Accession for Cambodia's landmark entry into the World Trade Organization requires 98 separate legal and policy reforms on an accelerated schedule, improvements in the regulatory framework for foreign direct investment and taxation and a framework for open consultations with the private sector on investment climate issues. Areas needing attention include:

- Improving the regulatory environment: Administrative controls are a heavy burden on Cambodia's private sector: it has the most annual inspections the highest costs to register businesses and the second highest time cost of management to deal with officials. Overlapping administrative mandates add uncertainty, discretion and high fees to the process of trading goods. Moreover, excessive regulation and corruption forces firms to stay informal.
- Establishing Credible Market Supporting institutions: Lack of property rights, contractual rights and agreed standards make Cambodia's investment climate unattractive. Legal and judicial reform and informal institutions are all needed. The private sector also needs to be better organized to help in the development of such institutions and to conduct a dialogue with government.
- Transparency and Competition in Public Private Partnerships: Laws and regulations do not provide for a coordinated process or establish clear, transparent procedures. As a result the process lacks transparency and competition and the benefits to the nation are not realized.

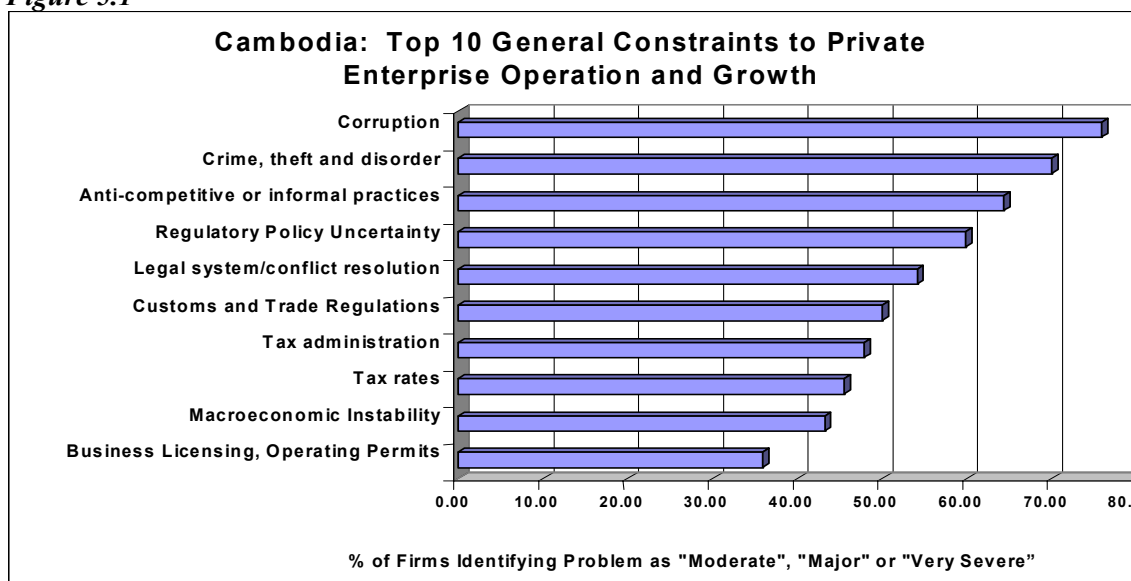
The Reform plan, devised by the Government to reduce the cost of doing business, would inter-alia, streamline and overhaul the trade facilitation process, introduce an overall risk management strategy to consolidate and rationalize inspection requirements, rationalize fees and charges, and streamline and rationalize the registration, licensing and taxation of companies. The private sector, on its part, will be encouraged to adopt a code of ethics and improve corporate governance. And it will join the Government in monitoring progress on reforms proposed based on a set of transparent performance measures.

## CHAPTER 5: Governance for Private Sector Development

1. The Rectangular Strategy states that “The Royal Government considers the private sector as the engine of growth, while the government plays its role as the strategist in creating an environment conducive to enhanced private enterprise” (Royal Government of Cambodia, “Rectangular Strategy”, 2004). Governance is at the heart of this objective. The infrastructure development, capability building, and institutional investment needed for broad-based sustainable growth with equity constitutes a long and difficult agenda. Such broad based growth is central to poverty reduction in Cambodia. But without, a fundamental improvement in governance, such an agenda stands little chance of succeeding.

2. Private enterprises operating in Cambodia – both foreign and domestic – understand this intuitively. When asked about the constraints they face, the top ten issues they cite are all directly or indirectly governance-related (Figure 5.1).<sup>1</sup> The cost and availability of credit, the cost of power, the quality of inputs, the availability of roads, the skill and education level of workers – all issues that any objective observer of the business environment in Cambodia would recognize as urgent – do not crack the top ten. What matters to the private sector is improving governance.

**Figure 5.1**



*Source: The World Bank, Cambodia Productivity and Investment Climate Survey 2003.*

**A. Why Governance Matters**

3. Governance matters for two core reasons essential to any business: risk and reward. So long as governance remains weak, officials may be bribed not to enforce a law or regulation, and businesses cannot have the certainty provided by law necessary to take long-term risks. So long as the “rules of the game” are not certain, no long-term investment can be certain, and the only viable investments are short-term, speculative or depend on unique assets or monopolies. Without long-term investments, particularly in building skills and capabilities, there can be no long-term competitiveness. So long as governance remains weak, bribery and corruption become the rules of the game rather than fair competition. In terms of rewards and incentives to perform, an investment climate characterized by corruption penalizes those who would rather invest in improving their products and services than pay bribes, and rewards those who spend their available time and resources on obtaining favors from the state.

4. To some who think they can prosper in such an environment, bribes are just another cost of doing business like a tax. However, bribes are paid from “top line” revenue which raises fixed costs and makes it more difficult for firms to break even and survive. They undermine any capacity to compete in cost-competitive industries and, unlike a tax, are paid to intermediaries or individuals. This robs the state of official revenue needed to deliver the public services – electricity, roads, telecommunications, health, education – that are needed for long-term competitiveness. Such costs are then passed on to firms themselves, in the form of self-generated power or higher transport costs. Firms that bear such costs themselves stand little chance of being competitive unless labor costs are dramatically squeezed. Short term gains from paying bribes or accepting them always comes at the expense of a competitive, growing marketplace characterized by efficient public services, credible policy and decent wages.

5. Private enterprises require a measure of certainty and predictability in order to undertake long-term investments. As well, business now operates in a global marketplace that rewards competitiveness. As a result, and as the Government recognizes, Cambodia has little choice but to strengthen governance and reduce corruption. All stakeholders have a vested interest in the success of this bold direction: policymakers who have risked their credibility on this strategy; public officials who deserve the dignity of a wage that can support their family; workers who deserve the opportunity to put their educational investments to work; and above all, entrepreneurs who need not special favors but a chance to compete on a level playing field and the space to focus on improving their businesses. If Cambodia cannot provide such an environment, they will move to environments in which they can flourish.

6. This transformation must start with a fundamentally different vision of the role of government from an institution that controls private activity to one that facilitates its growth through competitive markets. As the country leaves the conflict that characterized its past behind, the heavy burden of checking and regulating – which may

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have made sense in the past – must also be left behind in favor of market-supporting tools to achieve the same goals. It is already clear that the Government understands that a vibrant private sector is in their interest; indeed a central part of its strategy. This commitment needs to manifest itself in a change in the governance culture from one that imposes registration, licenses, inspections and fees at each stage to one that encourages markets to work by targeting public interventions only where risks are greatest.

7. It is important to recognize the landmark step Cambodia has taken toward this objective by entering the World Trade Organization. As H.E. Cham Prasidh described in a recent speech, the Protocol of Accession requires the Government to undertake 98 separate legal and policy reforms on an accelerated schedule, improvements in the regulatory framework for foreign direct investment and taxation, and a framework for open consultations with the private sector on investment climate issues. WTO is an institution that derives its strength from the commitment of its members to managing trade with a common set of values: openness, transparency, predictability, non-discrimination/multilateralism and a rule-based dispute resolution. These are the same values that Cambodia is trying to instill throughout its economic and social development. Joining WTO improves market access, and also sends a strong signal to trade and investment partners about Cambodia's future direction. But WTO is not a panacea. Leveraging the benefits of market access will require substantial reforms, which entail shift from a culture of control to a culture of facilitation. From this basic premise flows four key strategies.

- (a) Improving the regulatory environment for business, including trade facilitation;
- (b) Establishing market-supporting institutions to facilitate competition;
- (c) Transparency and accountability in public-private partnerships; and
- (d) Development of key institutions including codes and standards of private sector governance.

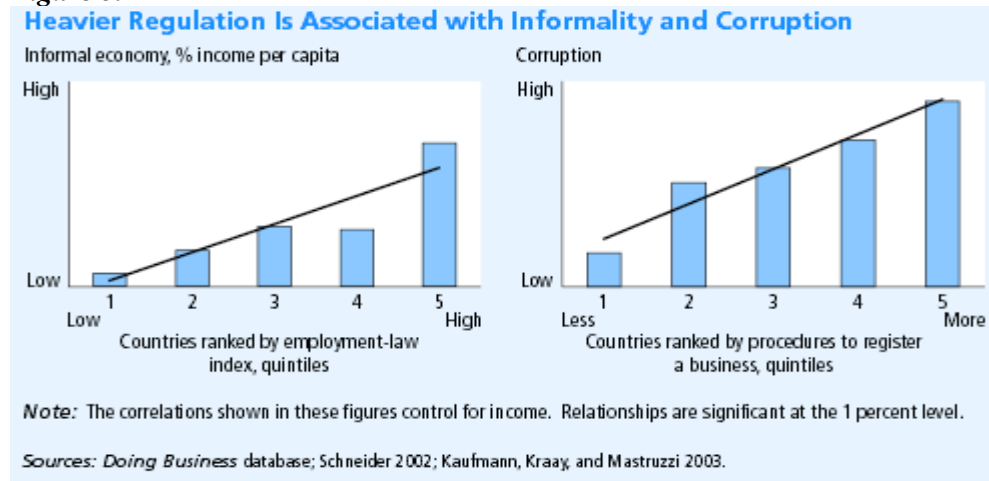
### **B. Improving the Regulatory Environment**

8. Excessive regulation of firms and markets contributes to informality, corruption, and undermines the tax base (Figure 5.2). The impact of the regulatory governance breakdown is to reduce the size and scope of the formal private sector, limit productivity, and therefore reduce the impact the private sector has on poverty. A credible reform strategy must be based on replacing overlapping and sometimes discretionary administrative controls with a program that intervenes based on risk, removes overlapping mandates, and empowers markets through clear rules of the game.

9. Regulation, in this instance, refers to the use of state power to control the functioning of markets. Markets often require regulation to protect consumers, workers and the environment; to ensure efficient markets; and better balance the public interest with that of profit-seeking firms. The challenge for policymakers is not whether or not

to regulate, but rather how to design regulations that achieve social goals while still providing a conducive environment for investment.

**Figure 5.2**



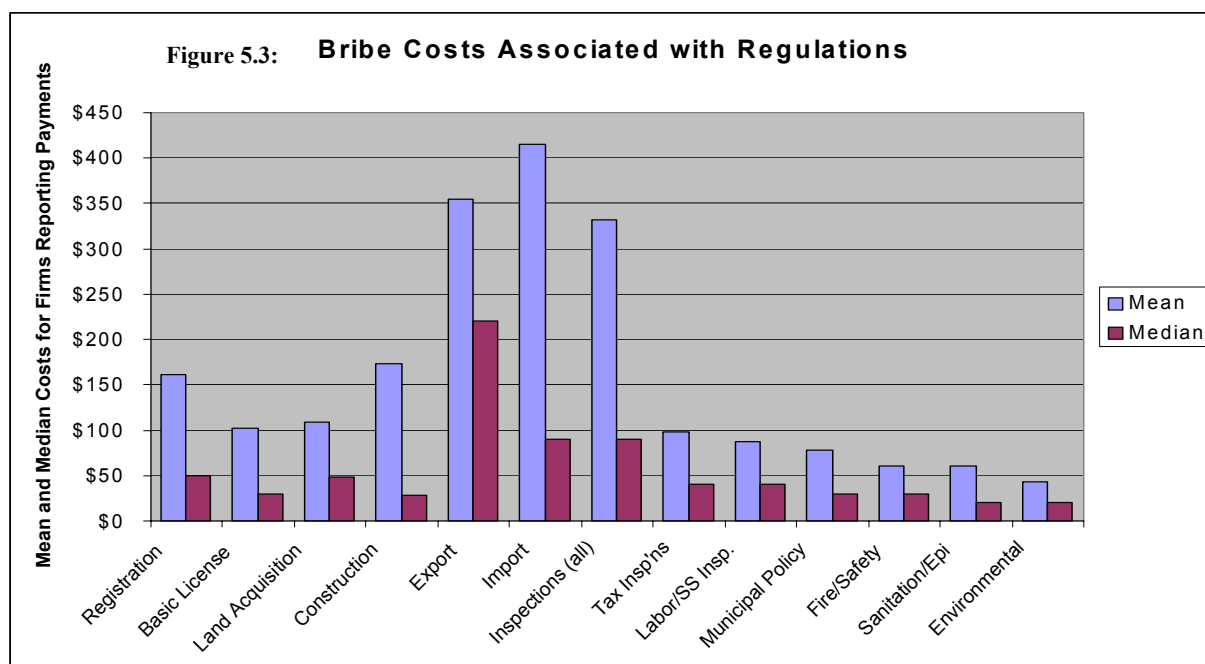
10. Poorly designed regulation can undermine the benefits of free trade. There is growing evidence that openness and trade do not produce growth in business environments that are heavily regulated (Bineswaree Bolaky and Caroline Freund, 2004). Heavy regulation limits the flexibility of markets and thereby prevents the deployment of factors – skilled and unskilled labor, capital equipment – in ways that would produce the productivity gains normally associated with trade. There is also substantial evidence that poorly-designed or excessive regulation is closely associated with both informality and with corruption.

11. Administrative controls are a heavy and costly burden to Cambodia’s private sector. The 2003 Investment Climate Survey revealed that Cambodia compares unfavorably with countries with which it competes in a number of regulatory issues. It has the most annual inspections, the highest cost per capita to officially register businesses, and the second highest “time cost” of management to deal with officials (after China). Trade facilitation practices are particularly constraining, with the second longest clearance times after Pakistan. In contrast with Cambodia’s reputation as a liberal environment, in several key respects Cambodia appears to be a restrictive market due to the cumulative impact of multiple agencies operating in an uncoordinated fashion. According to the *Doing Business Database*, (World Bank: *Doing Business: Understanding Regulation*, 2003) it takes 94 days to start a business in Cambodia - 30 days longer to start than in Vietnam, and 52 days longer than in Thailand. Cambodia has one of the slowest and most expensive systems for business entry in the East Asia region on a per capita basis.

12. These administrative measures create frequent interaction between public officials and firms, and therefore enable corruption to take place. Most firms

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acknowledge that payments to public officials are frequently, mostly, or always required to “get things done” (Figure 5.3). Our survey of 500 urban firms revealed that bribe paying is very frequent. Of the 447 firms that answered the question, 82% reported that they pay bribes, and 71% of large firms suggest such payments are frequent. These payments amount to a reported average of 5% of firm sales, but increase with firm size and formality, exceeding 6% of total sales for large firms.



Source: *The World Bank, Cambodia PICS 2003*

13. These overlapping administrative mandates add uncertainty, discretion and high fees to the process of trading goods. Among the major hurdles reported by trading firms are customs clearance, Ministry of Transportation border authorization or border police, veterinary and phytosanitary inspection, and CAM control. Each involves delays, management time, formal costs and informal payments. Customs clearance by itself imposes substantial delays and great variation, and hence, unpredictability. On average, firms report that imports take 6.5 days to clear customs, while exports take 4.5 days. However, this timing is variable, and firms report that in the last year they have had to wait an average of over 11 days for at least one shipment, and 16 days to clear an export shipment. Total costs of clearing goods also varies.

14. As a result of both excessive, unpredictable regulation and the frequency of bribe payments associated with regulations, firms react by staying informal (Figure 5.4). According to the Asian Development Bank, of the 27,000 firms operating in Cambodia, only 9,000 are registered. The strategy of remaining informal appears to make short-term sense: informal firms as well as rural firms are less constrained. In the long-term such a strategy is costly, as the informal sector has a reduced capacity to trade with the

formal sector, to obtain credit and to grow. Overall, the result appears to be a negative cycle in which firms remain small and informal, denying the Government the revenue base needed to improve public performance, which in turn contributes to weaknesses in the investment climate.

Figure 5.4

15. The key exception to the common response of staying informal is the garment sector, which has grown in an environment of a unique, non-competitive asset: quotas. The garment sector has proven its ability to export and grow, but it

Estimated % of Income Reported for Tax											
Large or Foreign:	61%	SMEs:	53%	Micros:	40%	Urban- Informal:	2%				
Unofficial payments as a share of sales revenue											
Foreign:	6.9%	Large:	6.1%	SMEs:	5.5%	Micros:	4.0%	Urban- Informal:	2.3%	Rural Non-farm:	1.3%

now faces the prospect of lower prices and therefore the need to increase its efficiency. Like garment exporters throughout the world, Cambodian firms must contend with the liberalization of garment trade at the end of 2004. Through the WTO Agreement on Textiles and Clothing, the US has given Cambodia a quota in its protected market, the volume of which depends on labor practices. Such agreements will be replaced by competition in 2005. There is a possibility that corporate social responsibility practices will become a source of competitive advantage, but Cambodia competes in high-volume segments where demand is likely to be cost-sensitive. The evolution of price behavior in Cambodia's non-quota exports to the US suggests declining margins. As the global industry consolidates to reap economies of scale, Cambodia's industry is at risk. The focus on improving regulation is perhaps even more urgent in the garment sector to allow some of the 240,000 workers to remain employed.

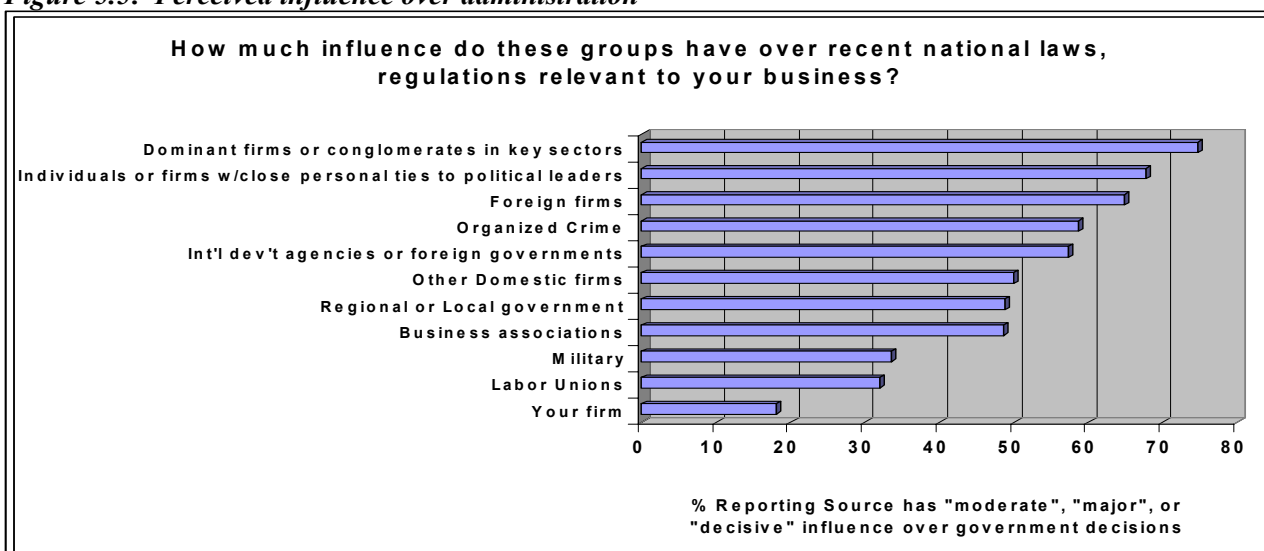
### C. Establishing Credible Market-Supporting Institutions

16. Many of the investment climate issues, particularly outside of the garment and tourism sectors, result from the lack of key institutions, including property rights, contractual rights, and agreed standards. The value of such rights depends on the presence of an effective judicial system. The functioning of markets, like any competition, depends on clear rules effectively and fairly enforced. This requires that the administrative power of the state be used not to intervene at all stages of the game, but to resolve disputes and enforce penalties for violations of rules to which competitors subscribe. Where those rules are clear and enforcement is credible, markets perform many of the functions intended by administrative control. This entails a shift of power and accountability from administrators to market participants.

17. Part of the process of establishing clear rules is to insulate the "referees" from influence by market participants through an independent judiciary (Figure 5.5). But few have confidence in the judiciary (Overview for a fuller discussion). Simply put, the

Judiciary will need substantial reform to build up a track record of impartial and effective judgments before this perception is changed. Meanwhile, there are important roles that can be played by the private sector and civil society.

**Figure 5.5: Perceived influence over administration**



18. Cambodia has made substantial progress in drafting new laws particularly associated with WTO accession, and needs to make equally rapid progress in building the capacity to enforce these regulations. An effective Civil and Commercial Code is particularly important since it encourages arm’s length transactions.

19. The institutional development agenda goes well beyond legal reform. Informal institutions, such as product standards, trading rules, information systems and out-of-court mechanisms to resolve disputes all play a role in creating a market environment that supports fair competition. Even as Cambodia’s parliament undertakes the legislative agenda, there will be substantial work for the private sector to both change its behavior in light of new laws, and build other non-formal systems. As Douglass North explained in his Nobel lecture, “it is the admixture of formal rules, informal norms and the enforcement characteristics that shapes economic performance. While the rules may be changed overnight, the informal norms usually change only gradually.”

20. In many instances the private sector can undertake reform without public intervention. This includes self-regulated industries such as professional services, and those that are partially self-regulated such as construction. The private sector, particularly the domestic and rural private sector which accounts for the bulk of employment in Cambodia, needs to play a more active role in establishing institutions. Since Cambodia is at early stage of formalization and specialization the most important consideration may be the ability of local institutions to learn – to acquire information and experience that is an essential part of the process of technology adoption. The

Cambodian private sector has few institutions that can facilitate a dialogue on the “rules of the game” aside from the successful garment manufacturer’s association. The private sector needs to be better organized in order to help in the development of such institutions, to raise awareness among market participants of those rights, and to hold the state accountable to fair enforcement of those rights.

21. The Government-Private Sector Forum, designed as a bi-annual meeting of the Cabinet of the Royal Cambodian Government and representatives of the private sector, is a useful start, but more needs to be done to build the “voice” of the private sector – particularly in rural Cambodia. Social capital, networking and information sharing among the private sector can be facilitated by business associations, or business membership organizations (BMOs). BMOs are intermediary, networking, and self-regulative bodies.<sup>2</sup> As such, they represent an increasingly important form of participatory development in countries such as Cambodia. Because of their size, BMOs have extensive outreach capabilities and can contribute to improving the framework conditions for the private sector through facilitating a common understanding of the formal rules of commerce, taking collective action, delivering central services, and networking among members and other stakeholders. It is this unique combination of strengths that makes them effective tools to increase the growth of firms in a given country. Business associations can facilitate exchange by improving information flows and by facilitating learning through policy advocacy, through facilitation or direct provision of demand-driven services, and through advocacy aimed at creating a better business environment.

22. This will require investments in raising awareness and policy monitoring and advocacy capacity. No party has a larger stake in a successful reform than the private sector, which is directly affected by the quality of the investment climate. As such, building local capacity to monitor reform is more likely to be sustainable, and more consistent with a strategy that calls for maximum use of private, non-state resources.

#### **D. Transparency and Competition in Private Public Partnerships**

23. Cambodia’s Rectangular Strategy places an important priority on improving delivery of public services, which were particularly weakened by years of conflict and neglect. Because needs are so acute and resources so limited, the state will inevitably need to yield a substantial role for delivery of public services to the private sector. Because of its resource constraints, Cambodia has in fact been a center of innovation in public-private partnerships for delivery of services, including health, water, rural electricity provision, and even the introduction of labor protection standards linked to trade (Table 5.1). In the water sector, the RGC undertook private participation initiative which involved the use of competitive, output-based contracting of connections to the public water system that ended saving 30% relative to public provision.

**Table 5.1 PPI Transactions in Cambodia and Form of Contract**

<i>Sector</i> Project	Public Entities	Form of PPI contract /	Value US\$ mn
<b><i>Municipal Services</i></b>			
Waste management	APSARA Authority	Concession for Angkor Wat garbage collection with a private sector firm	N/A
	PP Municipality	Concession for Phnom Penh garbage collection with a Cintri Company	n/a
<b><i>Water</i></b>			
Rural	Various agencies		
	MIME, MRD, MOWRAM, MPWT	Ten rural systems privately negotiated MIME Six rural systems directly negotiated with MRD-MIME-PGs	< 0.25 < 0.1
<b><i>Transport</i></b>			
Roads	MPWT	National Route 4 negotiated with CoM	n/a
	Provinces	Rural concessions negotiated with provincial governors	n/a
Ports	MPWT	Oil terminal and dry ports negotiated with CoM	n/a
Airports	CoM, SSCA	Concession with Vinci subsidiary SCA for development of Pochentong Airport, Phnom Penh (PNH) negotiated with CoM	30.0
	CoM, SSCA, MPWT	Concession with Vinci subsidiary SCA extended to include Siem Reap International Airport, based on international exclusivity clause in PNH concession	n/a
	SSCA MIME, CoM, EDC, EAC	Air navigation services negotiated with CoM	23.0
<b><i>Electricity</i></b>			
Urban	MIME	Power Purchase Agreements for IPPs negotiated with MIME in cooperation with CoM in the presence of EdC as offtaker	n/a
Rural	MIME, EDC EAC (regulator)	Battambang and Siem Riep negotiated with MIME-EdC Licensing of (existing) small rural electricity providers >50kW	n/a 12.0
<b><i>Telecoms</i></b>			
Inter-national gateway	MPTC	Joint venture agreement with RTI	n/a
2nd fixed line network	MPTC	Joint venture agreement with Indosat for Camintel	n/a
Mobile Services	MPTC	Joint venture agreements with 4 operators: Mobitel, Samart, Camtel, Shiniwatra negotiated with MPTC/CoM	n/a
VOIP	CoM, MPTC	One License for Voice-Over-Internet Protocol (VOIP) granted to BCC, negotiated with CoM	n/a
<b><i>Internet</i></b>	MPTC	Licenses to Internet Service Providers	n/a

24. Increased private participation in infrastructure (PPI) in Cambodia, under an appropriate institutional and regulatory framework, is likely to provide opportunities for

augmenting budget resources and for improving efficiency. The benefits of the latter can be substantial, particularly when accompanied by pro-competitive reforms (or even monopolistic activities operating under an appropriate regulatory framework). Public-private partnerships need to be seen as part of a strategy to increase the efficiency of service delivery. To ensure the best outcomes for Cambodia's citizens and to support the NPRS service delivery goals, the Government would need to introduce the principles of transparency, competition, accountability and rational design in all transactions with the private sector.

25. But the practice of private participation in infrastructure in Cambodia is frequently characterized by a lack of competition and transparency, which denies the country the efficiency benefits that are the most important reason to involve the private sector. Because of the nature of public services, most of these efficiency gains can only be captured at the point of transaction. The process is sufficiently "broken" as to require firms to circumvent it to secure transactions – a process that denies Cambodia most of the benefits of private participation. In the absence of an appropriate legal, institutional, and regulatory framework, many of the benefits associated with PPI have not been secured. This also has severe adverse consequences for budgetary revenues.

26. In the telecom sector, each private license or cooperation agreement has been in a joint-venture between the operator and the Ministry of Post and Telecommunications (MPTC). The Ministry thus shares in the ownership of all mobile services, the fixed line network, and the international gateways. It also sets telecommunications policy and acts as the regulatory agency. The sector is characterized by a lack of transparency in the process for awarding licenses, forced large-scale revenue sharing between private operators and the MPTC, and very little price competition between service providers. In the transport sector too, it is difficult to determine whether the RGC and/or users are getting value for money from the airports, toll roads, and air traffic control concessions, since all the contracts were directly negotiated and the details regarding performance obligations and risk allocation are not publicly available.

27. The chain of accountability is broken at several levels. Policy-making, planning and project identification isn't closely aligned with the budget or with sector strategies. Current laws and regulations do not provide for any effective, coordinated process for agreeing policy on development of PPI, nor for setting priorities across projects or sectors. There is considerable institutional muddle, including cases where the allocation of roles and responsibilities between institutions is unclear. The existing laws do not clearly identify which governmental entity has the power to enter into negotiations and take decisions on all types of infrastructure projects, notably with confusion existing between the powers of the Council for the Development of Cambodia (CDC), line ministries, the MEF, and the Council of Ministers (CoM), and between these of the central government, the provinces, and the communes.<sup>3</sup>

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28. The sectoral laws also do not set out clear procedures for awarding and negotiating PPI projects. In several sectors there are multiple agencies providing oversight, licenses, and permissions to operate, but there is no or limited coordination between them. Government agencies tend to compete with each other to enter into concession negotiations with private sector investors. In some instances officially designated roles and responsibilities have been over-ridden by more senior individuals, departments, and ministries in government

29. Consumers ultimately pay, but have no avenue for redress. The consequences of these problems include:

- *non-bankable projects*, with investors to date completely unable to secure limited recourse or non-recourse project financing for infrastructure projects in Cambodia – all investments have been fully equity financed, which drives up required returns and hence the prices to consumers;
- *lack of information* on the value-for-money received by the public from infrastructure projects due to the inability of the public or third parties such as international development banks and agencies to assess the full value set of risk and the distribution of revenues and profits in concessions, and
- *limited protection of the public interest* – the lack of transparent, predictable, and enforceable laws and administrative procedures contributes to an environment where decisions can be made in an arbitrary or improper manner without due regard to the economy, efficiency, the long term sustainability of the project, or the interests of consumers and the wider public.

30. Citizens, service providers, and governments would all gain from increased accountability and transparency. With easy access to published concession contracts, citizens would be better able to determine which party has responsibilities for a particular aspect of the project, such as maintaining service quality, improving infrastructure, collecting fees, connecting and disconnecting service, and a variety of other daily operations. This would enhance the accountability of both service providers and governments to respond to citizens' issues and concerns. In many cases of troubled projects, governments and concessionaires simply exchange accusations through the press without allowing citizens to directly establish liability.

31. The Ministry of Economy and Finance and the Council for Development of Cambodia (CDC) are undertaking a program of reform that will establish a clear policy framework, an enabling law to supercede Anukret 60, and build institutional capacity with the support of the World Bank, UNDP, and PPIAF. The draft Law on Concessions and the Draft Implementing Regulations need to be finalized and adopted urgently.

## **E. Developing Codes and Standards**

32. Improving governance cannot rest on public action alone. Any strategy to fight corruption, build better institutions, introduce transparency in public contracting must also rest on efforts to strengthen codes of ethics and standards of governance that are developed and enforced by the private sector itself. A culture of facilitation in the public sector must be encouraged by a culture of respect for legitimate “rules of the game” and regulations that protect the public interest when fairly enforced. For many foreign investors, bribe paying in foreign countries is a punishable offense.<sup>4</sup>

33. Forms of governance that the private sector can lead include corporate governance, codes of ethics, and selected instances of self-regulation and use of supply chains to promote good corporate behavior. Corporate governance in Cambodia is in its infancy, with the early focus primarily on establishing accounting standards as a basis for transparency. As long as financial markets remain in their infancy, the role of banks in disciplining the private sector will be limited. However, the development of a Civil and Commercial Code will stabilize such key issues as corporate structure, the role of boards of directors, and key corporate transactions. Shareholders, and regulators of markets, will be in a position to enforce standards of ethics as a function of their role as stakeholders to enterprises.

34. Self regulation makes sense when the collective interests of a private sector profession are sufficiently aligned with the public interest that the enforcement power of peers makes public sector enforcement unnecessary. Development of standards in most industries is first the responsibility of the private sector. Public enforcement is unnecessary because standardization of components across an industry is in the private sector’s interest: it enhances efficiency, reduces costs, improves the ability of firms to collaborate and lowers barriers to entry. At this point in Cambodia’s development, it appears that the garment industry, rice sector, and to an extent construction are the only sectors that have advanced significantly in the development of codes and standards due to their exposure to international trade. There is a large scope for further potential international collaboration in establishing standards. In construction, such standards organizations as ISO, and the British Standards Institute, the International Conference of Building Officials, the International Code Council, and the Australian Building Codes Standards Board can assist in the development of an internationally-compatible set of codes in Cambodia. Similar efforts can be undertaken in the customs brokerage industry.

35. Beyond owners as stakeholders, buyers and sellers as supply chain partners can insist on a degree of adherence to ethical conduct as a condition of doing business. The corporate social responsibility movement has proven that trade can be used to ensure compliance with Core Labor Standards and the environment, among other key public goals. Supply chains are effective at strengthening corporate governance due to their networking effect and the sustained feedback it enables.

## **F. From Control to Facilitation: Key Elements of Reform**

36. The success of the transition depends heavily on three key elements: credibility, transparency and accountability. The specific reforms cited above, such as streamlining regulation, building market institutions and introducing competition in public private contracting, are essential to reduce opportunities for corruption and creating a more efficient business environment. None, however, can simply be undertaken as “stroke of the pen” reforms and be expected to have impact.

37. Credibility is necessary for all stakeholders to begin forgoing short-term behavior and begin investing in long-term competitiveness. Through the Rectangle Strategy, Public Sector Reform Strategy and WTO, the Government has established a clear vision.<sup>5</sup> But to for this vision to be credible, it is essential to establish a track record of successful implementation that is visible to all stakeholders, which in turn requires approaches that consider the incentives to adhere to the reforms in both the public and private sectors. This includes policies that reward compliance and penalize non-compliance, as well as meritocratic rules for public sector employees that offer a living wage in return for successful policy implementation.

38. Transparency reduces the chances for, and perception of, corruption. In Cambodia, many projects that were negotiated through closed, non-transparent concessions are the subject of frequent allegations of corruption, and are also often the subject of calls for renegotiation of tariffs paid by users. A norm of publication could reduce the suspicions that sometimes surround the awarding of contracts. This would be very valuable when projects are unsolicited and/or contracts are directly negotiated. With this in mind, the Mexican Government recently passed a Transparency and Access to Public Government Information Law making government contracts available to requesting citizens within 20 days. The new Mexican law also dictates that federal agencies must place contracts on government websites by mid-2003. Although transparency laws like Mexico’s will not prevent all corruption, both government officials and companies would be less likely to engage in unethical behavior during the awarding phase if they know that their contracts will eventually be made publicly available.

39. Donors who fund infrastructure and other PSD projects can insist on transparency and competition in any sector where their funds are applied, since donors funds compensate in part for inefficiency. Publication of contracts could facilitate the evolution of standards in infrastructure transactions. Governments could obviously benefit from access to privatization agreements from other municipalities, agencies, and countries. Widespread availability of contracts would also make it easier for consumers to benchmark tariffs and other service obligations with similar systems in other jurisdictions.

40. It is ultimately citizens and businesses that must demand performance from Governments as voters and taxpayers. Governments that deliver against their commitments to achieve growth and successfully carry out reforms should be rewarded, through the mandate of citizens and by being entrusted with their tax revenues. The typical democratic cycle, however, is too broad and infrequent to target specific issues. Citizen report cards have been used effectively in India and other countries to monitor specific institutional and policy reform and can play a role in Cambodia. Citizen report cards can be used to ensure that public services are delivered. To ensure performance in areas relevant to private sector development, this depends crucially on the definition, for each institution or regulatory change, of clear and monitorable indicators of government performance. Many of these have been defined within Government projects and in donor documentation, but need to be converted to more effective use by citizens and business associations. It is important that citizens understand these indicators and that other stakeholders, particularly the media, make them public.

## **G. Conclusion**

41. Recognizing some of these factors, the government has made a beginning, and developed a plan of action which would aim at reducing the cost of doing business in Cambodia and improving corporate governance. Under the plan, the government intends to, inter alia, establish a system of transparency performance measurement which would be monitored by the private sector and development partners. It would also streamline and overhaul the trade facilitation process, including licensing, documentation and overlapping and unnecessary approvals leading to a Single Administrative Document. An automated Single Window for trade facilitation at Port Sihanoukville would be set-up. The Government would also introduce an overall risk management strategy to consolidate and rationalize all inspection requirements of the different control agencies, rationalizing fees and charges, and streamlining and rationalizing the registration and licensing of companies. The private sector, on its part, will be encouraged to adopt a code of ethics and improve corporate governance. The private sector will join government in monitoring progress on the proposed reforms.

42. These are welcome developments. An energetic and dynamic reform process will now need to be quickly developed that can show results within a reasonable time period. This is another area where there are many quick wins that the government could achieve. The government needs to move energetically so that investor confidence improves quickly and gives a boost to the considerable scope for diversification away from the current heavy and risky dependence on one subsector: garments exports. Over the medium term, as described in the Overview, sustaining progress will depend on developing the legal and judicial system, on reform of the civil service. It will also depend on more broad-based development within the private sector of their ability to participate in, and hold the government accountable, for reform of the investment

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climate. The potential for growth and hence employment generation and poverty reduction is significant.

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<sup>1</sup> *Towards a Private Sector Development Strategy for Cambodia: Investment Climate Assessment*, World Bank (2004). The perception data are based on the Cambodia Productivity and Investment climate Survey, conducted in February through August 2003.

2 BMOs have to be defined as non-profit and democratically guided membership organizations that finance themselves by a mix of membership dues, service fees, as well as subsidies from government or donors. There is no law regarding the regulation of business enterprises associations in Cambodia. With the exception of a few BMOs, such as the Chamber of Commerce, which has been established by law, most BMOs simply declare their existence with the Ministry of Interior.

3 The Law on Investment (LOI, 1994) established the Council for the Development of Cambodia (CDC) as the ‘one-stop’ service organization for investors and supposedly the sole responsible organization for evaluating and making decisions on all investment projects, both rehabilitation and new. However, numerous contracts, including the National Route 4 Highway; the oil terminal and dry ports; and the airport concession were each negotiated directly with the CoM. Similarly, power purchase agreements with independent power producers in Phnom Penh and electricity projects in Battambang and Siem Riep were each negotiated with the Ministry of Mines and Energy (MIME) and the CoM in the presence of *Électricité du Cambodge* (EdC).

<sup>4</sup> Firm liability for bribe paying is an increasing trend in OECD countries, backed by both codes and laws, such as the US Foreign Corrupt Practices Act.

<sup>5</sup> H.E. Keat Chhon, Sr. Minister of Economy and Finance, *A Vision of Growth and Governance*, and H.E. Cham Prasidh, Sr. Minister of Commerce, *Converting WTO Accession to Poverty Reduction*. Speeches at Government-Bank Workshop presenting “Seizing the Global Opportunity: Investment Climate Assessment” August 12, 2004.