

Report on the Cambodia Mission

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GRIPS Development Forum

A GRIPS Development Forum (GDF) team consisting of Kenichi Ohno, Izumi Ohno, and Akemi Nagashima visited Phnom Penh during May 27-29, 2015 to study the features and issues of Cambodia's industrial policy. This was one of the regular research missions conducted by GDF to compare industrial policies across countries and draw lessons for developing or emerging economies including Ethiopia¹. Before and during the mission we were supported by Mr. Hiroshi Suzuki (CEO & Chief Economist) and Ms. Chea Dalin (secretary) of the Business Research Institute of Cambodia (BRIC) as well as Mr. Masayuki Ishida, Chief Advisor of the JICA SME Promotion Policy Formulation Project, to which we are very grateful. We would also like to express our appreciation to all people who kindly received us and shared valuable information with us. The mission schedule and collected documents are given in the appendix section.

1. Overview

Cambodia began economic development from the status of a post-conflict fragile state. After the mass killing by Khmer Rouge and subsequent intervention by Vietnam, peace was finally restored under UN supervision, and King Sihanouk returned to Cambodia in 1993. Initially, sheer survival was the name of the game for the new government. At that time, "we were trying to swim, keep our heads above water, and got whatever we could get" in the words of a Cambodian high official. Policy capability and organization were weak, the goal of poverty reduction was imposed from outside, and two international organizations sided with different ministries to create inconsistent policies.

From a little over ten years ago, however, the Cambodian government began to gradually regain policy initiative and ownership. The Supreme National Economic Council (SNEC), a forum consisting of top policy makers, started to concretize Prime Minister Hun Sen's vision in the Rectangular Strategy of 2004, which laid out broad directions for the nation and was revised twice subsequently. The Rice Policy of 2010 was the first sectoral master plan calling for concrete policy action to export surplus rice by processing and adding value. FDI policy (the 1994 FDI law was revised in 2003 and 2005) and SEZ law (2005), as well as the development plan of Sihanoukville, were drafted. The latest addition is the Industrial

¹ The purpose of our JICA-commissioned missions, including this one, is to collect information on industrial policy formulation in selected countries for the policy learning of other developing countries. During Phase I of Japan-Ethiopia industrial policy dialogue 2009-2011, GDF visited Singapore (August-September 2010), Korea (November 2010), and Taiwan (February 2011). During Phase II, India (September 2012), Mauritius (October 2012), Malaysia (June 2013), Indonesia (June 2014), Rwanda (August 2014), and Thailand (May 2015) were visited in addition to Cambodia. Views expressed in this report belong to the GDF team and are not necessarily the views of JICA.

Development Policy (IDP) 2015-2025, approved in March 2015, which is a key document guiding Cambodia's future industrialization (we will discuss it in detail below). To implement IDP, the Productivity Committee and the Labor Advisory Board have also been created, and more mechanisms may follow.

When GDF visited Phnom Penh previously, in 2004, the government was weak and passive, with development policies dominated by the agenda of powerful donors. Today, we can clearly see the emergence and dynamism of policy ownership and national pride, with relatively young leaders and officials taking charge. Policy evolution is in progress, and Cambodia today is a very different nation from Cambodia in the past.

Cambodia has just attained or is about to attain the lower middle income status with per capita income of \$950 in 2013 (World Bank data)². The population is about 15 million, with more than half under the age of 24. The poverty ratio declined rapidly from 50% in 2004 to 16% in 2013. The Gini coefficient also fell to a mere 0.26 suggesting that, if true, Cambodia is one of the most equitable countries in the world (this data probably needs checking). Financial deepening is also underway with bank deposits and lending reaching to 80% and 65% of GDP, respectively. International reserves are at a reasonably comfortable level of 4.5 months of import. According to the assessment of the World Bank and IMF, Cambodia's foreign debt service burden is low.

Progress is visible and expectation is rising. However, like many other latecomer countries that show high growth at first, Cambodia is still in the recovery phase from the suppressed past in which economic opening and liberalization alone can attain high growth. Up to now, the quality of industrial policy did not matter very much because ODA, FDI, and autonomous private-sector resurgence were sufficient to push the country forward. However, real achievements in productivity and competitiveness are still limited. From now on, the quality of industrial policy, and private sector response to such policy, will matter greatly if Cambodia wants to avoid a future middle income trap and climb further to upper middle income and above. In IDP mentioned above, broad directions are set more or less correctly, but concrete details must be properly installed and executed.

We are surprised and happy to see many changes in Cambodia during the last decade. Some governments are static and their policies hardly improve. But in Cambodia, rapidly changing landscape, not only in physical infrastructure but also in policy mindset and aspiration, gives us hope. However, Cambodia's starting point was low. The country has made visible progress but still has a long way to go before it is fully industrialized. Much work is required for both government and the private sector.

² According to the World Bank's latest income classification based on GNI per capita as of July 2013, Cambodia's income was \$950 per head, slightly below the threshold of \$1,045 for lower middle income countries. Other sources report somewhat higher income for Cambodia. It is highly likely that Cambodia has already joined the group of lower middle income countries by 2015.

2. Leading policy organizations

The impact of Khmer Rouge massacre is still felt in Cambodia. Experienced leaders and experts in their 50s and 60s are in serious shortage. Young dynamic leaders are emerging, but they lack practical knowledge for executing policies effectively or competing in the global market.

Presently, Cambodian policy formulation is characterized by (i) a developmental leadership of Prime Minister Hun Sen; (ii) a relatively small number of high-ranking technocrats supporting the Prime Minister; and (iii) policy competition and collaboration among such technocrat groups as well as economic ministries. Personal rapport and cooperation among such technocrats seem to be ensuring policy coherence more effectively than formal inter-ministerial coordination mechanisms. Cambodia does not have a super planning agency that stands above all ministries such as the Economic Planning Unit (EPU) of Malaysia, BAPPENAS of Indonesia, or the Economic Planning Board of Korea in the 1960s-70s. Cambodian policy making is an interactive and relatively flexible process among multiple leaders and ministries. Such policy making is perhaps suited to Cambodia at this particular development stage.

More specifically, the Supreme National Economic Council (SNEC), the Ministry of Economy and Finance (MEF), and the Council for the Development of Cambodia (CDC) are the three lead organizations at different levels that cooperate to produce and execute development policies. According to a number of officials we interviewed, this centralized mechanism is necessary for speed and coherence in key policy formulation because line ministries are too weak to draft and implement policies. Some noted the lack of policy capacity at the Ministry of Industry and Handicraft (MIH) or the Ministry of Agriculture, Forestry and Fisheries (MAFF), and at present the Ministry of Planning (MOP) is mainly responsible for statistics. This raises an interesting question of balance between central policy management versus the need for strengthening line ministries³.

SNEC, established in 2000, is the Prime Minister's think tank (or the "Brain Bank" as some official calls it) which functions as an action-oriented inter-ministerial discussion and coordination forum attended by high officials, with particularly strong representations by MEF and CDC. Its task is to produce real policies rather than just talk or formally approve. SNEC-drafted policies go to the Council of Ministers and relevant ministries. SNEC consists of about 10 minister-rank members, and is supported by a secretariat staffed with about 30 current (non-seconded) officials of various ministries and agencies including MEF, MOP,

³ Ethiopia is moving toward central management of such key policies as FDI and industrial parks. The Rwanda Development Board is similar to Cambodia's CDC as it covers wide policy issues including FDI, industrial parks, SMEs, IT industry, etc. overwhelming line ministries. In our opinion, policy centralization is acceptable and even inevitable in a latecomer country in the short run, but we also advise strengthening productive-sector line ministries so they can take over key economic functions in the future.

MOC, CDC, and NBC (central bank). SNEC, which was previously chaired by a MEF Vice Minister, is now chaired by the MEF Minister. This may be good for elevating the authority of SNEC, but there is a risk that SNEC meetings may become less frequent because the MEF Minister is usually too busy.

MEF is the key ministry for economic policy formulation in Cambodia. It oversees fiscal revenue and expenditure as well as macroeconomic balance and viability, but it also has a leading role in development and industrialization. In most countries, macro balance and industrialization are usually handled by separate ministries or mechanisms because they are not only very broad but also often in conflict over a budget constraint. It is possible to embody both functions in one ministry, such as MEF, but this will tend to create a very powerful ministry that requires high policy competency in its officials. To fulfill its role, during the last few years, MEF has been training young economists in their 20s and 30s by sending them abroad for study and hiring them for hands-on policy training at the Ministry. In our meeting at MEF, we spotted six young officials sitting beside the Secretary of State, one of whom explained to us the main thrusts of IDP.

CDC was established in 1994, initially to manage external resource inflows into Cambodia. By now, it has become a strong inter-ministerial implementation agency. CDC consists of the Cambodia Rehabilitation and Development Board (CRDB, for ODA management), the Cambodia Investment Board (CIB, for FDI administration), and the more recently (in 2005) added Cambodian Special Economic Zone Board (CSEZB, for SEZ management). While it is an implementing agency, CDC is expected to function, and actually partly functions, also as a policy proposing agency like Malaysia's MIDA or Rwanda's RDB⁴. MIH is a member of CDC but does not lead its operation. For foreign investors, CDC, which grants licenses and incentives, is the first point of contact as well as the place to raise and solve issues. IDP proposes to further enhance CDC for industrial development.

In terms of personalities, there are policy leaders in these and other economic mechanisms, ministries, and agencies who have the trust and support of the Prime Minister⁵. They collectively form the Prime Minister's advisory group and lead the nation along a development path. Their precise relations and responsibilities, how they actually compete or collaborate in policy making, and correspondence between these personalities and key bodies such as SNEC, MEF and CDC, could not be fathomed by our three-day mission.

⁴ Powerful one-window agencies such as these are often modeled after Singapore's Economic Development Board (EDB). Apparently the objective is to concentrate limited human capacities in one agency for speed and efficiency rather than spreading them over many agencies. Before adopting, however, the applicability of the Singaporean model, that works well in a small city state with very high capability in all ministries and agencies, to an average latecomer country with limited policy experience should be examined carefully.

⁵ They include Hang Chuon Naron (Minister of Education), Aun Porn Moniroth (Minister of Economy and Finance), Vongsey Vissoth (Secretary of State, MEF), Keat Chhon (Deputy Prime Minister), Sok Chenda Sphea (Secretary General, CDC), Cham Prasidh (Minister of Industry and Handicraft), Sun Chanthol (Minister of Commerce), and others.

In addition, Cambodia has a large number of committees and sub-committees at the government as well as ministerial level. They include the Economic and Financial Policy Committee, and the Committee for Private Sector Development Affairs (its subcommittees include SMEs, Investment Climate and Participation of Private Sector in the Infrastructure Development, and Corporate Governance). New committees are added as necessary, such as the Advisory Council for Development of Cambodian Industry (related to IDP). There is also the Government-Private Sector Forum which meets biannually, chaired by the Prime Minister and attended by all cabinet members, and ten working groups (e.g., agriculture and agro-industry, tourism, manufacturing/SME/services, banking and financial services). With limited time, the mission was unable to grasp the overall structure of these sub-committees, task forces, and working groups. Their functions and effectiveness must be studied separately.

In sum, Cambodia has policy-minded leaders and technocrats working jointly for policy initiatives and execution. Such a process seems healthy and appropriate as long as policy competition among different groups remains constructive and non-revengeful, and if it simultaneously achieves policy continuity and dynamism. How this Cambodian model compares with the “Flexible Structure of Politics in Meiji Japan” is another interesting topic that must be pursued on another occasion⁶.

Another critical issue is how to institutionalize good practices and mechanisms established by the current relational policy formulation, and pass them onto the next generation of policy makers with modifications and improvements as necessary.

3. Industrial Development Policy 2015-2025

Cambodia’s key policy documents for national development consist of the Rectangular Strategy (RS) for Growth, Employment, Equity and Efficiency (RS I of 2004, RS II of 2008, and current RS III of 2013), the National Strategic Development Plan as the RS’s five-year working plan (since 2006; the current one covering 2014-2018), and annual budgets⁷. For effective implementation, these policy documents need to be complemented by concrete guidelines for selected key sectors, and this need has so far been filled only partially and incompletely. The Rice Policy, FDI and SEZ policies, and the development plan for Sihanoukville are the ones that already exist, but their concreteness and implementability

⁶ Junji Banno and Kenichi Ohno, in *Meiji Restoration 1858-1881*, Kodansha Gendai Shinsho, 2010, argued that Meiji Japan pursued multiple national goals successfully by allowing a large number of policy leaders to form and re-form coalitions flexibly to both compete and cooperate, rather than by a top-down order of a charismatic leader who stayed in power for long. For English excerpts see: www.dlprog.org/publications/the-flexible-structure-of-politics-in-meiji-japan.php

⁷ Before the RS, there were two overlapping strategic documents in Cambodia reflecting donor rivalry—the Socio-Economic Development Plan (SEDP II: 2001-05) formulated by MOP with the support of ADB, and the National Poverty Reduction Strategy (NPRS: 2003-05) formulated by MEF with the support of the World Bank. The formulation of RS of 2004 and NSDP of 2006, by merging SEDP and NPRS, should be understood as a process in which the Cambodian government regained policy ownership.

vary. This year the government added Industrial Development Policy (IDP) to the list, which means that Cambodia is now becoming ready to design and execute this very important policy component.

Completion of IDP also means that Cambodia has shifted from the previous development regime where poverty reduction was the main objective to a regime where value creation and industrialization take the central stage. Even in that case, there is an ongoing debate as to whether government should provide only general support and frameworks to all sectors and firms without sectoral preference or it should work selectively and proactively with the private sector to create certain champion products. The answer to this question appears undecided at this moment in Cambodia. If industrial policy intends to go beyond just liberalization, integration, and provision of good business conditions, the Cambodian government must engage in serious policy learning—including industrial human resource, SME promotion, productivity movement, FDI marketing, strategic export promotion, and regional and corridor development—because the current policy capability of Cambodia is still low. East Asia abounds in good policy practices from which much can be learned.

Moreover, free market orientation of the past may have to be adjusted. Cambodia's policy stance has been relatively liberal, featuring open FDI policy which accepts foreign investors even in commercial, financial, telecom, professional, and other services. Although this liberalism benefited the nation by providing reasonably good financial, communication, and other services which can support industrialization, we also believe that it is possible to add selectivity and targeting in industrial policy without abandoning the liberal business environment which Cambodia has created.

SNEC began to prepare IDP in 2012 with JICA support. The final document was approved by the Council of Ministers on March 6, 2015. CDC will be responsible for managing and coordinating IDP implementation. The content of IDP, as explained to our mission by MEF officials, can be summarized as follows.

IDP's overall objectives include diversification of the industrial base, value addition, competitiveness, and meaningful participation in global and regional value chains. Currently, Cambodia's export base is narrow (mainly garment), SMEs are weak and unregistered, skills and technology are low, infrastructure services (including power) are inadequate or costly, and labor relations are tense. Cambodia aims to shift from labor-intensive to skill-based industries by 2025. Various components of IDP, which exhibit some repetition and overlaps, are summarized below.

Cambodia's Industrial Development Policy 2015-2025

Vision	From labor-intensive to skill-based industries by 2025; linking with global and regional value chain with clusters; competitiveness and productivity, marching toward modern technology and knowledge-based industry.
Targets (for 2025)	(1) GDP share: industry 30%, manufacturing 20% (2) Export diversification: non-garment 15%, agro-processing 12% (3) SME registration and proper accounting
Strategy	(1) Mobilize both large FDI and domestic investment with quality (2) Upgrade SMEs (3) Improve regulatory environment (4) Coordinate supporting policies
Priority sectors	(1) New, high-value, creative industries (2) SMEs in pharmaceuticals, construction materials, packaging, furniture, industrial equipment, etc. (3) Agro-processing (4) Supporting industries (backward or forward linkage) (5) ICT, energy, heavy industries, cultural/traditional handicraft, green technology
Approaches	- The private sector leads, government coordinates - Structural transformation - Providing support, incentives, markets linked with performance - Greenness and inclusiveness
Policy measures and action plans	- FDI attraction with improved investment climate and SEZs - Upgrade SMEs with registration, accounting, and agro-processing - Regulatory environment including trade facilitation, standards, taxes, industrial relation, etc. - Supporting policies incl. skills, STI, infrastructure, financial system, etc.

Source: Presentation slides of the Ministry of Economy and Finance, May 28, 2015, summarized by GDF.

A MEF high official further explained to us that the four pillars of IDP were (i) FDI attraction; (ii) SMEs with FDI linkage; (iii) logistics and connectivity; and (iv) legal and policy frameworks; and IDP's geographic focuses were (i) Phnom Penh; (ii) Sihanoukville; (iii) area bordering Thailand; and (iv) area bordering Vietnam. To this end, IDP specifies four key practical measures to be achieved before the end of 2018 as a milestone—reducing electricity cost and ensuring stable power supply; preparing and implementing a master plan for transportation and logistics systems; labor market management and skill training; and developing Sihanoukville Province into a model multi-purposed SEZ. In our opinion, these pillars and focuses are quite appropriate to Cambodia at this development stage—although we also feel there could be more concrete industrial targets unique to Cambodia⁸, as well as

⁸ In our preliminary opinion, a vision to become Asia's high-quality labor-intensive manufacturing leader by 2025 will not be entirely amiss for Cambodia. To attain it, numerical targets and deadlines should be set, for example, by benchmarking Vietnam for labor productivity and discipline; Thai BOI and Malaysia's MIDA for strategic FDI attraction; Thai BUILD and other Thai mechanisms for linkage policy; Malaysia and Taiwan for comprehensive SME promotion; and selected neighboring countries for logistic cost and time comparison. Productivity statistics and targets should be created by working with APO and other interested donors.

even greater stress on industrial human resource and productivity enhancement (in addition to SME support)⁹.

The Cambodian government admits that IDP is a broad policy framework only, for which detailed action plans (implementation strategies) must be created for implementation. We entirely agree with this assessment. The next important task is to create concrete plans on who will do what by when, how results should be monitored and evaluated, and how projects should be financed. New organizations and budget must be arranged, and Cambodian officials and experts must be trained, if necessary, for execution. Because it is impossible to pursue all targets, strategies, and approaches at once, implementation must be prioritized and sequenced. The matrices of policy measures and action plans attached to IDP still seem crude and general, and may have to be revised and expanded significantly to enhance implementability and gain sufficient stakeholder support. Domestic and foreign businesses, industrial experts, and relevant ministries must be deeply involved in this process. For all these purposes, policy learning based on international best (and worst) policy practices is imperative for the Cambodian government.

Recently, the Productivity Committee and the Labor Advisory Board were created to address skill, productivity, and labor market issues raised by IDP. Furthermore, to facilitate the implementation of IDP, the Advisory Council for the Development of Cambodian Industry will be established. It is also envisaged that, under CDC, the CIB function will be expanded to include coordination and monitoring of IDP implementation, and the CRDB function will be re-oriented to support industrial development cooperation. The Government-Private Sector Forum will be enhanced further. It is to be seen how these institutional details will be shaped and actually function.

According to IDP, Cambodia will graduate from labor-intensive industries into skill-based ones by 2025. We are under the impression that this time line is a bit too short given the experiences of neighboring countries and given the fact that Cambodia is still in the early stage of labor-intensive processing. A MEF official explained to us that national aspiration must be set high. This is true, but high skills can be pursued in parallel with improvements in more basic skills of Cambodian workers such as literacy, mindset, and work discipline. We believe that Cambodia's advantage in labor-intensive manufacturing should be maintained for more than a decade by steadily improving labor productivity, worker quality, product delivery, primary education, etc. Cambodia should take full advantage of labor-intensive processes before they are abandoned.

Productivity movement, perhaps including kaizen, may be introduced. High wage costs in emerging economies, AEC, China-plus-One, Thailand-plus-One, Southern Corridor links, and other dynamic trends in FDI migration should be captured with concrete targets.

⁹ For low and lower-middle income countries that can receive a large amount of manufacturing FDI, we recommend a standard policy package for *FDI-linked technology transfer* consisting of (i) strategic attraction of FDI; (ii) local enterprise capacity building; (iii) FDI-domestic firm linkage policy; (iv) efficient logistics; and (v) industrial human resource. Cambodia's IDP covers much of these grounds while industrial orientations of Vietnam and Indonesia are quite different from this model.

4. FDI attraction and SEZs

Economic liberalization has proceeded in Cambodia since the 1990s. By now, the country has a relatively open business climate for investment, foreign exchange, banking, telecom, internet services, etc. Unlike some countries that mobilize SOEs for developing certain sectors, the Cambodian economy is driven predominantly by foreign and domestic private firms. There are six (or more) domestic industrial groups in agro-business, telecom, finance, securities, insurance, property development, cigarettes, trade and distribution, tourism and entertainment, etc. Foreign-advised economic liberalization also led to the adoption of market-based provision of infrastructure services such as power. The results are not totally satisfactory, however, producing high electricity tariffs and proliferation of small-scale foreign power companies.

CIB and CSEZB under CDC are the implementation agencies for FDI and SEZ policies, respectively, and also serve as the main official one-stop service agencies for investors. The Qualified Investment Project (QIP) status, granted to most manufacturing projects and some high-value and/or large-scale service projects, is the main incentive scheme of Cambodia offering exemptions of corporate income tax (up to nine years), import duties, and value-added tax. The type and level of investment incentives in Cambodia are, by and large, standard and moderate in comparison with other countries. For Japanese investors equipped with necessary conditions, obtaining QIP status is not a big problem, and one-stop services at SEZs or business consultants can assist them if necessary. For small investors, establishing offices, shops, and restaurants is easy with little procedural hassles, unlike some countries that set minimum capital requirements for foreign investors.

Cambodia has 34 Special Economic Zones (SEZs) of which 12 are operational. They are located in Phnom Penh, Sihanoukville, and areas bordering Thailand (Poipet, Koh Kong) and Vietnam (Bavet). The largest concentration of Japanese manufacturing FDI is in Phnom Penh SEZ (PPSEZ) managed jointly by Cambodian (78%) and Japanese (22%) capital. It has one-stop service in Japanese language, water supply, waste water treatment, a power generator, a dry port, and a Japanese restaurant. In principle, CSEZB provides one-stop service at each SEZ staffed with the officials of relevant ministries and agencies (such as CDC, customs bureau, MOC, MOL). Not all SEZs have full support such as PPSEZ, however. Other than such services provided by zone operators, SEZs do not offer any additional legal privileges or incentives beyond QIP, which means that firms with QIP status can enjoy the same incentives wherever they are located. In addition, there is the SEZ Trouble Shooting Committee housed in CDC to promptly settle issues occurring in SEZs.

Japanese firms in PPSEZ (40 firms as of May 2015) are mostly engaged in labor-intensive processes in electronics, machinery, garment, leather, etc. They include Minebea (small motors and liquid-crystal display backlight panels), Sumitomo Wiring Systems (automotive wire harnesses), Ajinomoto (food processing), and Denso (automotive parts). According to

the CEO of PPSEZ, presence of even one large Japanese firm stimulates Japanese SMEs to come to Cambodia in droves¹⁰.

The JETRO Office was established in Cambodia only recently, in 2010. Earlier, JICA experts and private consultants provided necessary information for Japanese investors. JICA also supported the capacity development of CDC and established Japan Desk at CDC where a Japanese expert was assigned. The Japanese embassy, JETRO, the Japanese Business Association for Cambodia, and JICA-supported Japan Desk have collaborated closely to provide good conditions for Japanese firms. Furthermore, there are a large number of Japanese business consultants, labor-exporting agencies to Japan, and Japanese restaurants in Cambodia. Three Japanese megabanks also have representative offices in Cambodia. Aeon Mall, a large Japanese shopping center, opened in Phnom Penh in 2014.

Japan is not the largest investor in Cambodia, however. China is by far the largest with cumulative registered FDI in the past two decades of over \$11 billion (mostly real estate and energy), followed by Korea (mostly real estate), Malaysia, and the UK. Japan is No.11 with only 1,150 projects worth \$713 million (up to 2014 including cancelled projects), but it is the dominant investor in SEZs as well as in manufacturing. Japanese QIP firms are about 100 in number, and their entry is accelerating from around 2010.

Japan is the only investing country that has formal and regular investment climate discussions with the Cambodian government. Demands and requests of Japanese FDI firms are collected by the Japanese Business Association of Cambodia (JBAC), and bilateral discussions are held twice yearly to solve raised issues at the Japan-Cambodia Public-Private Sector Meeting co-chaired by the Secretary General of CDC and the Japanese Ambassador. Some of the recent issues include (i) the high cost and unreliable supply of power; (ii) rising wages and low quality of labor (see below); (iii) non-applicability of investment incentives to project expansion; and (iv) non-transparent and complicated administrative procedure including taxes and customs clearance.

5. The wage and productivity problem

Cambodia has a young and mostly rural population with 75% of the people under the age of 35, a condition generally suitable for light manufacturing. However, Japanese firms report labor-related problems regarding availability, quality, and cost.

Factory workers must often be recruited in rural areas because they are no longer easy to find in urban areas. Some firms in PPSEZ build or rent dormitories for migrant workers, and other (mostly non-Japanese) firms locate in rural areas for the ease of worker recruitment. Labor-intensive processes normally use young female labor, but job hopping is rampant among such workers in pursuit of slightly more favorable salaries or working conditions.

¹⁰ This phenomenon is called the Queen Bee effect in Singapore, and the Canon effect in Vietnam.

Footloose workers are observed in many developing countries and not unique to Cambodia.

One unfortunate feature of Cambodia is the low quality of labor. The majority of young factory workers are primary school graduates or dropouts, or people who never went to school. As a result, many are illiterate, unpunctual, and lack teamwork, discipline, and cooperative spirit. A Japanese firm in PPSEZ confided that it was surprised to discover the lack of basic attitude and mindset in Cambodian workers, which was far worse than in India, Brazil, or other locations in the world. Some factories need to train workers with very basics (reading, attitude, etc.) before they are given operational training. In contrast, in Vietnam, virtually all factory workers are high school graduates who are literate and skillful. Chinese workers are even more productive than Vietnamese workers. Cambodia has a long way to catch up in labor quality.

Another headache is rapidly rising wages in the absence of corresponding improvement in labor productivity. During the last two decades, labor productivity in Cambodia grew 3-5% per year on average according to the Asian Productivity Organization (APO)¹¹. Meanwhile, the monthly minimum wage for textile workers was revised upward from \$40 (1997) to \$61 (Oct. 2010), \$80 (May 2013), \$100 (Feb. 2014), and \$128 (Jan. 2015). Adjustments in the last few years were particularly large, with an annual average increase of 19% from Oct. 2010 to Jan. 2015. Recent wage decision was made amid labor disputes and pressure from labor unions. Wage increase has outstripped labor productivity by a wide margin. At \$128 per month, the minimum wage in Cambodia is now higher than the minimum wage in the rural areas of Vietnam¹². If such wage pressure continues, Cambodia's labor advantage will soon be lost.

The Cambodian government as well as foreign investors are alarmed. Effort to de-politicize wage setting is beginning. Previously, the government decided the minimum wage after inter-ministerial consultation led by the Labor Minister but without reference to hard facts and analysis. The Productivity Committee was established in January 2015 to collect data and propose a solution. It is hoped that the minimum wage will from now on will be based on productivity, competitiveness, and other economic factors rather than just workers' demand for better life¹³.

We heard from more than one Japanese firm that Prime Minister Hun Sen's April 2015 pledge that the minimum wage would be \$160 by 2018 (which implies an average annual increase of 8% in the next three years), if actually kept, would be highly welcome. This will impart predictability to business management.

¹¹ Average annual labor productivity growth of Cambodia, as reported in *APO Productivity Databook 2014* (p.61), was 4.3% (1990-95), 3.4% (1995-2000), 3.6% (2000-05), and 5.0% (2005-12).

¹² As of Jan. 2015, Vietnam has four minimum wages from urban to rural: \$150, \$140, \$125, and \$104. However, it should be noted that social security contribution per worker is at present much higher in Vietnam than in Cambodia.

¹³ A wage setting mechanism that reflects productivity performance is also requested by entrepreneurs in Indonesia, a country that similarly suffers from rapid increases in minimum wage. See GDF, *Report on the Indonesian Mission*, July 2014.

Given the situation above, Cambodia needs to overcome many problems to maintain the current labor advantage. First, reliable statistics on wages and labor productivity must be produced and analyzed. Second, a rational wage-setting process that balances productivity and workers' aspiration must be agreed and practiced. Third, labor productivity must be continuously improved, for which (i) benchmarking rival countries and setting numerical targets, (ii) introduction of kaizen and national productivity movement, and (iii) a social contract among government, management, and labor to jointly make effort to improve labor productivity, should be considered. Fourth, primary education and technical training must be upgraded nationwide to equip workers with basic attitude, discipline, and literacy. High skills, technology, and knowledge cannot be taught unless workers have the right aptitude.

6. SME promotion

Following the RS I, the SME Development Framework was formulated in 2005 by the SME Sub-committee with ADB support, but it was just a broad direction without implementable action plan. More recently, in March 2015, a new document (Cambodia's SME Promotion: SME's Initiative for Cambodia Brand of Quality: Policy Framework) was drafted by MIH with JICA support, to be deliberated by the SME Sub-committee. While this document provides a comprehensive policy menu referential schemes, clear prioritization and sequencing of actions must be specified in order to make it implementable. SME promotion is one of the core issues in IDP, but identifying policy details remains a future task. At present Cambodia has no SME law. Donor-supported projects have not yet been institutionalized in the Cambodian government. Up to now, we must say that there have been few effective policy measures to develop Cambodian SMEs¹⁴. SME promotion in Cambodia is in a very early stage. Much work and cooperation will be needed to implement policies effectively.

As the first step, the definition of SMEs must be given in a way consistent with Cambodia's development objectives as well as international practices. Without an agreed definition, data collection, analysis, and policy formulation are hardly possible. An SME law or a master plan that guides SME policy must be crafted. Good practices in other countries should be studied, combined, and modified to fit Cambodia's reality. The SME Sub-committee must be revitalized to do these works. Foreign technical cooperation may be sought if necessary.

Globally, standard measures for SME promotion are well-known and include: (i) legal and policy frameworks; (ii) human resource development including managers, engineers, and workers; (iii) enterprise capacity building in corporate strategy formulation, technology, marketing, export, accounting, labor management, IT, etc.; (iv) financial access; (v) building networks, forward and backward linkage, clustering, business associations, etc.; and (vi) startup support, innovation, and R&D. Within each category there are many sub-measures

¹⁴ Some measures proposed in the 2015 document, such as the lease law, credit guarantee for rice millers, and the collateral systems, have been introduced. But these still remain modest and random in view of the entire policy structure required for SME promotion.

and further items. The whole universe of SME support as practiced by such countries as Japan, Taiwan, Singapore, and Malaysia is vast and complex. A latecomer country such as Cambodia needs to be selective and modest in initiating SME promotion.

At present the main issues in Cambodia's SME policy are registration and accounting. Only 30,000 are formally registered among 514,000 SMEs in Cambodia (MOP data for 2014), which makes it difficult for government to reach out and analyze SMEs worthy of support. The proposed one-stop registration center at MOI may accelerate SME registration. But this is only a small beginning for SME promotion. After registration and accounting issues are solved, there are many more things to be done to proactively support SMEs as listed above.

Generally speaking, SME policy has two purposes: (i) job and income generation for poverty reduction, and (ii) supporting selected SMEs for value creation and competitiveness. Both are necessary for Cambodia, but high officials we met made it clear that the main objective of SME policy in Cambodia was the latter, namely the creation of competitive SMEs with FDI linkage. We believe this is an appropriate choice.

7. Development of Sihanoukville

Apart from indirect sea access through Thailand and Vietnam, Sihanoukville, situated in the southern coast, is a critically important logistic gateway to Cambodia. The government plans to develop Sihanoukville as a multi-purpose SEZ and a regional transport hub hosting manufacturing, transport, services, tourism, and residential areas. High officials we met explained to us the current status of this vision. A deep-water container port has been built with Japanese cooperation and is operational. The port has gantry and mobile cranes, stackers, storage and warehouses, etc. with the total cargo handling of 3 million tons in 2013. Bulk freight port must be added and container port capacity has to be expanded in the future.

Using Japanese yen (ODA) loans, Sihanoukville Port SEZ (SPSEZ) was also constructed adjacent to the container port and opened in 2012, with the total area of 70ha and the factory area of 45 ha (48 plots). As of now only three tenant firms came to SPSEZ. Slow sales is blamed mainly on high cost, while some also mention the lack of proper customer services, plot design, and over-specification. Separately, Sihanoukville SEZ (SSEZ) was built with Chinese cooperation at 12km from the port with a planned area of 1,113ha, and became operational in 2012.

Regardless of the current performance of SPSEZ, the critical importance of Sihanoukville, located along the Greater Mekong Subregion (GMS) Southern Coastal Corridor, for the development of Cambodia remains unquestionable. Sihanoukville is still under construction. Development must incorporate not just the city and port of Sihanoukville but entire Preah Sihanoukville Province or even beyond. A comprehensive regional development master plan and urban planning must be drawn up or revised, highways and other road links to

Phnom Penh and other locations must be built, soft components such as trouble-free customs clearance and fast handling systems must be installed, and marketing for FDI and tourism must be beefed up.

With proper design and execution, Sihanoukville has a chance of becoming a large industrial and urban area similar to the Eastern Seaboard Development of Thailand, or even better because it has non-industrial functions as well. For this purpose, a powerful high-level ad hoc coordination mechanism chaired and supervised by the Prime Minister, like the Eastern Seaboard Development Committee of Thailand in the 1980s, may prove effective.

8. Concluding remarks

Cambodia has come a long way. Starting from the position of a post-conflict fragile state dominated by donors, it recently began to regain policy autonomy and establish policy ownership. Broad directions set in IDP, as explained to this mission, are reasonable and well-focused, unlike long and unimplementable wish lists found in some countries. The mindset and collective decision making among top technocrats seem to be working for growth acceleration. We applaud the progress Cambodia has made in the last decade in the area of industrial policy formulation.

However, there is a long and winding road ahead. Broad directions must be concretized in strategies and action plans, proper staff and organizations must be prepared, financial resources must be found, and progress must be monitored and adjusted. Implementation is a challenge for all aspiring governments. We hope Cambodia will successfully solve many coming issues in the implementation process. Policy learning must be enhanced and systematized. Even after implementation, the question of how much ultimate impact the policy has had must be asked.

This is a critical historical moment for Cambodia, in which policy capacity acquired in the next stage will largely determine whether the nation will continue to march to high income in the future or become stuck in a middle income trap. Japan as an important economic partner of Cambodia, especially in manufacturing, should further align its economic cooperation and investment with IDP's priorities. In addition to discussing investment issues with CDC, Japan should start regular policy discussion with top leaders of Cambodia, set clear cooperation targets which are monitorable, invite appropriate Japanese firms and provide concrete cooperation projects to realize some of the IDP's objectives, and review their progress and make adjustments as necessary.

Japan's cooperation in the past has emphasized infrastructure, private-sector development, agriculture, governance, and social areas such as water, health, education, and land mines. It should now add kaizen and productivity, upgrading industrial human resource, soft and hard logistic efficiency along the Southern Corridor, comprehensive regional development encompassing Sihanoukville and the Southern Coastal Corridor, and other concrete

industrial support measures in line with IDP.

Attachments:

1. Mission schedule
2. Organizations/persons visited
3. List of information collected

Mission Schedule

Mission Members

Kenichi Ohno	Professor, National Graduate Institute for Policy Studies (GRIPS), Tokyo, Japan
Izumi Ohno	Professor, National Graduate Institute for Policy Studies (GRIPS), Tokyo, Japan
Akemi Nagashima	Research Associate, National Graduate Institute for Policy Studies (GRIPS), Tokyo, Japan

Mission Schedule

Date		Time	Activity	
MAY	26	Tue	PM	Flight from Bangkok to Phnom Penh
	27	Wed	AM	Supreme National Economic Council (SNEC)
			PM	Council for the Development of Cambodia (CDC)
	28	Thu	AM	Ministry of Economy and Finance (MEF)
			AM	JETRO Phnom Penh
			PM	Ministry of Industry and Handicraft
	29	Fri	AM	O&M (Cambodia) Co.,Ltd
			AM	Sumi (Cambodia) Wiring Systems Co., Ltd.
			PM	Phnom Penh SEZ Co.,Ltd
			PM	Young Entrepreneurs Association of Cambodia (YEAC)
			PM	Flight to Haneda (Transit at Bangkok)
	30	Sat	AM	Arriving at Haneda airport

Organizations/Persons Visited

Organization	Name	Position
Ministry of Economy and Finance (MEF)	H.E. Vongsey Vissoth	Secretary of State for MEF and Vice Chairman of SNEC
	Ung Luyna	Deputy Director, General Dept. /Budget for MEF and a member of SNEC
	Eng Touch	Personal Assistant to Secretary of State
	Lay Sopheak	Personal Assistant to Secretary of State
	Sieng Chamnan	Deputy Director, General Dept. /Economic and Public Finance Policy
	Heng Socheat	Officer, General Dept. /Economic and Public Finance Policy
	Khut Vanne	Officer, General Dept. /Economic and Public Finance Policy
	Choum Rottanak	Officer, General Dept. /Economic and Public Finance Policy
Supreme National Economic Council (SNEC)	H.E. Kalyan Mey	Senior Advisor for SNEC and Chairman for Royal University of Phnom Penh
Council for the Development of Cambodia (CDC)	H.E. Sok Chenda Sophea	Minister attached to the PM/Secretary General
	Lim Visal	Deputy Director, Dept. Public Relations and Promotion of Private Investment
	Unvoanra Nut	Assistant to Minister attached to the PM/Secretary General
	Yuji IMAMURA	Advisor for CIB and CSEZB Japan Office
Ministry of Industry and Handicraft (MIH)	H.E. Heng Sokkung	Secretary of State
	Son Seng Huot	Under Secretary of State
	Peou Vorleaks	Director General, General Department of SME and Handicraft
	Yea Bunna	Deputy Director General, General Department of SME and Handicraft
	Soem Nara	Director General and Board Chairman of General Department/Industry Phnom Penh Water Supply Authority (PPWSA)
	Masayuki ISHIDA	JICA SME Project Leader
Young Entrepreneurs Association of Cambodia (YEAC)	Oknha Sok Piseth	President for YEAC and CEO & Co-founder of G-Gear Co.,Ltd
	EK Sopheara	Managing Partner, BDtruS Research & Business Consultancy
Phnom Penh SEZ Co.,Ltd	Hiroshi UEMATSU	CEO
O&M (Cambodia) Co.,Ltd	Junichiro TOMIZUKA	President
Sumi (Cambodia) Wiring Systems Co., Ltd.	Takahisa WAKISAKA	President
	Kenichi ONOGI	General Manager, General Affairs Department
JETRO Phnom Penh	Masashi KONO	Chief Representative

List of Information Collected

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Council for the Development of Cambodia (CDC)	Presentation Documents: Three Key Points for Investment in Cambodia, June 2011 (Japanese)	Mr. Yuji Tanzaki, JICA expert at CDC Japan desk
	Presentation Documents: Investment environment in Cambodia, March 2015 (Japanese)	Mr. Taro TANZAKI, JICA expert at CDC Japan desk
	Guidebook for Cambodia investment, 2013	CDC (Translate by JICA)
	Brochure: Sihanoukville Port SEZ (Japanese)	Sihanoukville Port SEZ and JICA
	Brochure: Investing in The Heart of Dynamic Southeast Asia	CDC
Ministry of Industry and Handicraft (MIH)	Industrial Development Policy 2014-2024 (First Draft as of 11 March 2014)	MIH
Phnom Penh SEZ Co.,Ltd	"Welcome to PPSEZ -Communicated to the future PPSEZ" (Japanese)	PPSEZ
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