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20 Years of FDI in Cambodia:

Towards Upper Middle-Income Status and Beyond

Simona Iammarino, Muth Sumontheany
and Nith Kosal

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Table of contents

List of figures, tables, and maps iv

Acknowledgements v

Acronyms and abbreviations vi

Abstract viii

1. Introduction 1

2. Insights from the literature 2

- 2.1. FDI, GVCs and economic development 2
  - 2.1.1. Overview 2
  - 2.1.2. Definitions and key concepts 2
  - 2.1.3. General trends in the past 20 years 4
  - 2.1.4. The impact of FDI in developing economies 4
- 2.2. Policy principles for FDI and economic development 8
- 2.3. FDI, GVCs and economic development in Asian economies 10
  - 2.3.1. Overview 10
  - 2.3.2. FDI in Cambodia: Empirical evidence in the literature 11

3. Cambodia's policy framework for FDI 14

- 3.1. Regulatory framework for FDI 14
- 3.2. Investment activities in Cambodia 14
- 3.3. Key actors 15
- 3.4. Procedures for obtaining QIP status 15
- 3.5. Investment incentives 15
- 3.6. Investment protection and guarantees 16
- 3.7. Special economic zones 16
- 3.8. Other national policies 16

4. FDI in Cambodia: Trends over the two decades 2003-2022 17

- 4.1. Inward FDI: Cambodia in the Mekong sub-region 17
  - 4.1.1. General trends 17
  - 4.1.2. FDI sectors and GVC stages 19
  - 4.1.3. Geography of origin 24
  - 4.1.4. Geography of destination (Subnational distribution) 27
- 4.2. Outward FDI from Cambodia: Emerging trends 29

5. Policy recommendations 31

- 5.1. A SWOT analysis for FDI in Cambodia 31
- 5.2. Policy implications of the study 34

References 39

Appendices 47

CDRI Working paper series 53

List of figures, tables and maps

Figure 1: Benefits and costs of inward FDI 7
Figure 2: Investment value and estimated number of jobs, Cambodia, 2003-2022 18
Figure 3: Investment value and estimated number of jobs, Cambodia, Vietnam and Lao PDR, 2003-2022 18
Figure 4: Yearly FDI value from EU, USA, China and RoW to Cambodia, 2003-2022 19
Figure 5: Investment value by sector (top 25), Cambodia, 2003-2022 20
Figure 6: Investment value by sector (top 25), Vietnam and Lao PDR, 2003-2022 20
Figure 7: Number of jobs by sector (top 25), Cambodia, 2003-2022 20
Figure 8: Number of jobs by sector (top 25), Vietnam and Lao PDR, 2003-2022 21
Figure 9: Investment value by sector, Cambodia, 2003-2012 and 2013-2022 21
Figure 10: Number of jobs by sector, Cambodia, 2003-2012 and 2013-2022 22
Figure 11: Investment value by GVC stage, Cambodia, 2003-2022 23
Figure 12: Investment value by GVC stage, Vietnam and Lao PDR, 2003-2022 23
Figure 13: Estimated number of jobs by GVC stage, Cambodia, 2003-2022 23
Figure 14: Investment value by GVC stage, Cambodia, 2003-2012 and 2013-2022 24
Figure 15: Number of jobs by GVC stage, Cambodia, 2003-2012 and 2013-2022 24
Figure 16: Investment value by source country (top 25), Cambodia, 2003-2022 24
Figure 17: Investment value by source country (top 25), Vietnam and Lao PDR, 2003-2022 25
Figure 18: Estimated number of jobs by source country (top 25), Cambodia, 2003-2022 25
Figure 19: Investment value by source country (top 20), Cambodia, 2003-2012 and 2013-2022 26
Figure 20: Number of jobs by source country (top 20), Cambodia, 2003-2012 and 2013-2022 26
Figure 21: Investment value by source country and sector, Cambodia, 2003-2022 26
Figure 22: Investment value by destination province, Cambodia, 2003-2012 and 2013-2022 28
Figure 23: Number of jobs by destination province, Cambodia, 2003-2012 and 2013-2022 28
Figure 24: Investment value by destination province and sector, Cambodia, 2003-2022 28
Figure 25: Investment value by destination province and GVC stage, Cambodia, 2003-2022 28
Figure 26: Outward FDI value by sector, Cambodia, 2003-2022; 2003-12 and 2013-22 30
Figure 27: Outward FDI value by country of destination, Cambodia, 2003-2022; 2003-12 and 2013-22 30
Figure 28: Outward FDI value by GVC stage, Cambodia, 2003-2022; 2003-12 and 2013-22 30
Figure 29: Outward FDI from Vietnam, investment value and number of jobs, 2003-2022 31
Figure 30: Outward FDI from Vietnam, destination countries, 2003-2012 and 2013-2022 31

Table 1: Investments in R&D (GVC stage), Cambodia, 2003-2022 29

Map 1: Geographical subnational distribution of inward FDI across provinces, Cambodia, 2003-2022 27
Map 2: Geographical subnational distribution of inward FDI across provinces, Vietnam and Lao PDR, 2003-2022 27

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Acronyms and abbreviations

AI	Artificial Intelligence
ASEAN	Association of Southeast Asian Nations
BRI	Belt and Road Initiative
CDC	Council for the Development of Cambodia
CDRI	Cambodia Development Resource Institute
CIB	Cambodian Investment Board
CSEZB	Cambodian Special Economic Zones Board
EQIP	Expanded Qualified Investment Project
EU	The European Union
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
GNI	Gross National Income
GPNs	Global Production Networks
GTOI	Graduated Tax on Income
GVCs	Global Value Chains
ICT	Information and Communications Technology
LoI	Law on Investment
M&A	Mergers andAcquisitions
MNEs	Multinational Enterprises
MPIS	Municipal-Provincial Investment Sub-Committees
MSMEs	Micro-, Small and Medium-sized Enterprises
OECD	Organisation for Economic Cooperation and Development
OEM	Original Equipment Manufacturer
OFDI	Outward Foreign Direct Investment
PTOI	Prepayment of Tax on Income
RCEP	Regional Comprehensive Economic Partnership
R&D	Research and Development
RoW	Rest of the World
QIP	Qualified Investment Project
SEZs	Special Economic Zones
SDGs	Sustainable Development Goals
SMEs	Small- and Medium-Sized Enterprises
STI	Science, Technology and Innovation

SWOT	Strengths, Weaknesses, Opportunities, and Threats
TNCs	Transnational Corporations
TOI	Tax on Income
TVET	Technical and Vocational Education and Training
UNCTAD	United Nations Conference on Trade and Development
USA	The United States
VAT	Value-added Tax
WTO	World Trade Organization

Abstract

Although Cambodia has a strong ambition to become an upper middle-income nation by 2030 and a high income by 2050, it faces various challenges in achieving these goals. This study investigates Cambodia's progress and potential in this regard by analysing its position and trajectory relative to Greenfield Foreign Direct Investment (FDI) inflows and outflows – where foreign firms establish new operations in Cambodia and Cambodian investors set up businesses abroad. This study also provides preliminary insights on Cambodia's integration into Global and Regional Value Chains (GVCs), always using FDI as a proxy, considering sectoral, functional, and geographical trends and comparing them with those of its neighbouring countries – Lao People's Democratic Republic and Vietnam – over the 20 years between 2003 and 2022.

The research employs a desk review, SWOT analysis, and descriptive statistics by using academic literature, policy documents, stakeholder policy dialogues, and the fDiMarkets database by Financial Times. The analysis shows that FDI has been instrumental in reshaping Cambodia's economic structure, significantly contributing to economic development and job creation. Key sectors attracting FDI include real estate, financial services, and alternative/renewable energy, while textiles, real estate, and consumer products are notable for generating employment opportunities. However, most FDI projects are concentrated in the capital and coastal areas, and have focused on low-tech manufacturing, which offer limited opportunities for spillovers and industrial upgrading. Cambodia's outward FDI began in 2008, mainly targeting ASEAN countries.

This paper highlights that Cambodia has developed a robust policy framework to attract and re-orient inward FDI, including a provision of various incentives for Qualified Investment Projects. Recent FDI inflow trends indicate growing interest in sectors such as alternative and renewable energy, rubber, automotive OEM, leisure and entertainment, food, tobacco, beverages, and paper, printing, and packaging industries. These sectors could be pivotal for Cambodia's future growth.

While Cambodia is making progress in addressing business challenges, there is a critical need to accelerate efforts to fully leverage FDI and support local firms' development. This paper offers policy recommendations to address these challenges and maximise the potential benefits of FDI and regional GVCs, supporting Cambodia's economic transition towards its income targets.

Keywords: Foreign Direct Investment, Global Value Chains, Inward FDI, Outward FDI, Cambodia

1. Introduction

This paper investigates the trajectory and current position of Cambodia with respect to Foreign Direct Investment (FDI) flows, their connections with Global and Regional Value Chains (GVCs), sectoral, functional, and national and subnational development paths. The paper considers Cambodia within the context of the Mekong sub-region and provides an analytical framework and empirical evidence to help Cambodia identify opportunities and challenges for achieving upper middle-income status by 2030 and high income by 2050 through internationalisation.

The paper presents some key concepts found in various streams of academic literature to show the complementarity between FDI, GVCs, and the role of business firms, particularly multinational enterprises (MNEs). It elaborates a broad analytical and policy framework linking FDI and economic development to support the design of more effective internationalisation and development policies.

The paper discusses insights from a wide review of the relevant academic literature, summarises the government policy context for FDI and internationalisation in Cambodia, and presents key facts and figures on inward and outward greenfield FDI flows over the 20 years 2003-2022 at national, subnational, industry and functional level.[1] It situated Cambodia's FDI position also with respect to the two neighbours of the Mekong sub-region, Vietnam and Lao People's Democratic Republic (Lao PDR). In addition, the findings of this paper were presented and discussed in the occasion of the 1-day Workshop organised by the Cambodia Development Resource Institute (CDRI) on "20 YEARS OF FDI IN CAMBODIA: Towards Upper Middle-Income Status and Beyond", held in Phnom Penh on 8 February 2024. The workshop's main objectives were as follows: 1) Sharing the findings of the CDRI research and paper with both public and private sectors' stakeholders; 2) Collecting inputs from these key stakeholders to validate and complement the analysis; 3) Discussing policy recommendations to promote FDI into and from Cambodia and, more widely, its integration in regional and global value chains and production and innovation networks.

The paper is structured in 5 Sections. The following Section 2 provides an overview of key definitions, insights and lessons from the most prominent literature on FDI, with particular reference to developing and emerging economies, the Asian and Cambodian contexts, and the transition to higher income levels. Section 3 briefly summarises Cambodia's policy framework for FDI and its evolution over time. Section 4 describes in detail and in a comparative fashion the structure and trends of both inward and outward greenfield FDI in/from Cambodia and its subnational regions over the two decades 2003-2022. Section 5 – which relies also on the insights and crucial inputs gained during the Workshop held on the topic on 8 February 2024 – concludes with a summary of the current strengths, weaknesses, opportunities, and threats faced by Cambodia in relation to its attractiveness towards foreign investors and internationalisation of its own domestic firms, presenting recommendations for government policy.

1 Greenfield FDI is a type of investment where a company establishes new operations or facilities in a foreign country. In a greenfield investment, the company set up new production plants, offices, or other business facilities rather than acquiring assets or merging with a foreign company.

2. Insights from the literature

2.1. FDI, GVCs and economic development

2.1.1. Overview

This section presents the main definitions, concepts and reflections on empirical evidence gathered from academic and policy literature on the relationship between FDI, GVCs and economic development, with reference to developing economies and the specific case of Cambodia. In the context of Cambodia's ambition to achieve upper middle-income status by 2030 and high income by 2050, it focuses on the direct opportunities for strengthening internationalisation through the attraction of FDI, and indirect opportunities for the integration of small- and medium-sized enterprises (SMEs) within GVCs. Beyond key concepts and empirical findings from the literature, this section also identifies the main lessons (both "good" and "bad") that could be of relevance to Cambodia's Government in developing policies for FDI attraction and further integration into regional and global production networks. Following definitions and a description of major trends, this section of the paper will focus on the following areas:

- key concepts and insights from the scholarly literature useful as a reference framework for the analysis of FDI, GVCs and economic development in Cambodia
- strengths and weaknesses of attracting FDI and integrating in the global economy through FDI, and basic framework conditions (e.g., local productive structure, infrastructure, and institutions)
- general lessons in terms of policy intervention and governance drawing from cross-country experiences and relevant implications.

2.1.2. Definitions and key concepts

Income Status: According to the (World Bank 2024b): "lower-middle-income economies are those with a [Gross National Income] GNI per capita between USD1,136 and USD4,465; upper- middle-income economies are those with a GNI per capita between USD4,466 and USD13,845; [while] high-income economies are those with a GNI per capita of USD13,846 or more." Cambodia is currently classified as a lower-middle-income country (World Bank 2024c).

Foreign Direct Investment: In the context of Asian economies, attracting FDI has long been seen as providing a significant boost to economic development potential and integration within value chains and global production networks (e.g., Thorbecke and Salike 2011). The Organisation for Economic Cooperation and Development (OECD 2008,17-20) provides the following definition of FDI:

> FDI is a category of cross-border investment in which an investor resident in one economy establishes a lasting interest in and a significant degree of influence over an enterprise resident in another economy. Ownership of 10 per cent or more of the voting power in an enterprise in one economy by an investor in another economy is evidence of such a relationship. FDI is a key element in international economic integration because it creates stable and long-lasting links between economies. FDI is an important channel for the transfer of technology between countries, promotes international trade through access to foreign markets, and can be an important vehicle for economic development. The indicators covered in this group are inward and outward values for stocks, flows and income, by partner country and by industry and FDI restrictiveness.

21. Deregulation of markets, technological innovations and cheaper communication tools have allowed investors to diversify further their participation in competitive markets overseas. In consequence, a significant increase in cross-border capital movements including direct investment has become a key factor in international economic integration, more generally referred to as globalisation.

22. By the very nature of its motivation, FDI promotes stable and long-lasting economic links between countries through direct access for direct investors in home economies to production units (businesses/enterprises) of the host economies (i.e. the countries in which they are resident). Within a proper policy framework, FDI assists host countries in developing local enterprises, promotes international trade through access to markets and contributes to the transfer of technology and know-how. In addition to its direct effects, FDI has an impact on the development of labour and financial markets and influences other aspects of economic performance through its other spill-over effects.

Global value chains: Seric and Tong (2019), on the background of global economic integration, define GVCs as follows:

[GVCs refer to] the full range of activities (design, production, marketing, distribution, and support to the final consumer, etc.) that are divided among multiple firms and workers across geographic spaces to bring a product from its conception to its end use and beyond.

Countries can participate in GVCs by engaging in either backward or forward linkages. Backward linkages are created when country A uses inputs from country B for domestic production. Firms in country A can source inputs from country B through direct as well as indirect imports, i.e. inputs are either supplied by local affiliates of TNCs [i.e. transnational corporations] from country B or by locally owned firms that import inputs from other countries. Being able to source foreign inputs is particularly advantageous if the inputs required for production are either not available locally or available but deficient in some aspects (e.g. quantity, quality, and price).

Forward linkages are created when country A supplies inputs that are used for production in country B. The goods produced in foreign countries may be final products (for local consumption and investment) or intermediate products which are exported further elsewhere for use as inputs. Being able to produce and supply inputs for production to firms in other countries can be especially important for developing countries seeking entry into new industries that are in the process of learning how to produce goods (however simple) for export markets. These inputs are, however, equally important for industrialised economies that supply complex, specialised, and high value inputs.

From the various strands of the vast literature that have engaged with FDI and GVCs, and more generally internationalisation processes, FDI and trade in GVCs are complementary phenomena that need be taken into account when trying to capture the geographical and functional dimension of global production networks (GPNs). Furthermore, by carrying out different forms of investment abroad, MNEs are considered key actors behind global and regional economic integration of countries and regions worldwide, being them also critical players in international trade flows. "While often described as "two sides of the same coin", (Krugman 2007), trade and investment seem to be intertwined in a more complex manner within GVCs" (OECD 2008,31). Following Comotti, Crescenzi, and Iammarino (2020), in this paper, FDI inflows and outflows are used also as a proxy of GVC participation.

2.1.3. General trends in the past 20 years

Since the 2000s, there have been rapid and drastic shifts in the global productive capital flows from the global North to emerging and developing economies in different parts of the world (e.g., Padilla-Perez and Gomes Nogueira 2016; UNCTAD 2018), which has reversed and possibly ended once-and-for-all the supremacy of investors from the global North. A major shift has been the rise of 'regional value chains' in which cross-border FDI flows span neighbouring economies, rather than being genuinely global transactions, therefore slicing up and recombining GVCs into smaller groups of activities that are 'unbundled' (Baldwin 2011) primarily across groups of neighbouring economic systems (e.g., Rugman 2005; Guy 2009; UNCTAD 2017). A significant example is the rise of Chinese FDI in the Mekong sub-region which has significantly altered patterns of trade and investment in countries such as Cambodia (e.g., Frost 2004; Santasombat 2015; Panthamit and Chaiboonsri 2020).

Additionally, over the last three decades, FDI has increasingly shifted from greenfield investment to mergers and acquisitions (M&A), from capital-intensive to high-tech manufacturing and then to knowledge-intensive services, from production to R&D activities, from sectoral to functional specialisation. For instance, approximately two-thirds of global FDI stocks are now in service industries: it is undeniable that changes in FDI composition reflect growing complementarity between manufacturing and service industries. The shift to Industry 4.0 – the current industrial revolution based on automation and data exchange in manufacturing technologies – together with the connected modularity and separability of production stages in GVCs allowed by technological progress, are rendering industry boundaries increasingly blurred: the current knowledge economy is more likely to be classifiable in terms of activities and functions, and so are notions of comparative advantage (Iammarino 2018; Comotti, Crescenzi, and Iammarino 2020).

In the wake of the Covid-19 pandemic, there have also been significant alterations in FDI trends. While some world regions have recovered well from the pandemic, others have seen changes in investment patterns reflecting transformations in both domestic and regional economies (e.g., Kowalski 2020; Al-kasasbeh, Alzghoul, and Alghraibeh 2022). This has further deepened shifts to the worldwide global division of labour, and it is paramount to take them on board whatever the economy under observation, especially if the ultimate aim is to identify suitable instruments in the policy domain. Attractiveness of a country or subnational region towards FDI inflows, active internationalisation and GVC participation, and dynamic processes of specialisation and diversification, all interact to reconfigure – for better or worse – local economic and institutional advantages, strictly depending on both absolute and relative positions of the economy in wider production and innovation networks (Iammarino et al. 2023).

2.1.4. The impact of FDI in developing economies

Inward FDI and its impact on local economies have been hugely investigated by scholars working in the areas of economics, international business and management, innovation studies, economic geography, sociology, etc., where both theoretical and empirical perspectives have been deployed to assess whether MNEs and their investments abroad are overall advantageous or disadvantageous to the recipient economies. The relationship between FDI and economic development depends on the host economy's endowments and structure, such as availability of natural resources, labour, physical and human capital, and institutions; while type of FDI – whether factor-seeking, market-seeking, or market/technology-seeking – also matters (Ozawa 1992). As Lipsey (2002,1) comments on the benefits and costs of FDI, "Much of the impact is from the transfer of knowledge of world markets and of ways of fitting into worldwide production networks, not visible in standard productivity measurements." Hansen and Rand (2006) further emphasise that much of the benefits of inward FDI depend on structural conditions of the recipient locations. The major rationale for FDI attraction has been the potential for creating new economic opportunities for developing economies, including those for improving economic integration. As Lautier and Moreaub (2012,10) explain, "FDI flows are [often] directed towards developing countries which have already a strong investment rate […and] where there is already a dynamic process of economic development." With inward FDI, scholars have highlighted benefits in terms of the emergence of new business models, production techniques to enhance productivity, increased employment prospects and skills development, alongside human and physical capital formation (e.g., Prabhakar et al. 2015; Kayani, Al-Ammary, and Sadiq 2021).

Externalities and knowledge spillovers generated and diffused in the host economy have long been discussed as potential benefits of FDI. These are often difficult to analyse because they unfold at different levels – i.e., the firm, the industry, the region, and the country as a whole – and at different paces, making it tricky, if not impossible, to disentangle them (Ietto-Gillies 2012). Spillovers in particular are linked to involuntary knowledge flows and technology transfer that directly stems from an MNEs presence in a host location. For example, FDI can increase market competition, improving allocative efficiency; create demonstration effects, pushing domestic firms to increase their level of technical efficiency (X-efficiency); and increase transfer and diffusion of knowledge, encouraging local innovation (Caves 1974). A notable literature has developed over time on knowledge spillovers from the point of view of the local economy (e.g., Blomström and Kokko 1998; Javorcik 2004; Lin and Saggi 2004; Javorcik and Spatareanu 2008; Hallin and Lind 2012; Perri and Peruffo 2016; Rojec and Knell 2018).

The literature has also emphasised different types of knowledge spillovers, namely productivity and market access spillovers. The former might result from tougher competition following the entry of foreign firms, generating incentives for local firms to introduce new technologies and organisational practices in order to cope with new competitive pressures. In addition, knowledge externalities (not necessary spillovers, see Breschi and Lissoni 2001) arise when foreign MNEs facilitate local firms access to new technologies and skills through backward and forward linkages, as well as labour exchanges. Market access spillovers arise from the experience and knowledge that MNEs have of international marketing, distribution networks, and lobbying power. MNEs also contribute to the local economy by creating opportunities for learning by doing, innovation, and technological catch-up for domestic firms involved in the value chain (e.g., Morrison and Pietrobelli 2007; Morrison, Pietrobelli, and Rabelloti 2008; Fu, Pietrobelli, and Soete 2011; Pietrobelli and Rabellotti 2011). As a result of their own operations, and as lead firms in GVCs, MNEs often pave the way for local firms to enter new export markets, due to new capital formation, infrastructure, and dissemination of information (Iammarino and McCann 2013; 2015).

The literature on FDI and local impacts also emphasises the need for proactive local actors. In FDI-led manufacturing and service industries in less advanced economies, both national and subnational, MNEs can be critical actors in the creation of capabilities since the recipient contexts normally face structural constraints in terms of knowledge, skills, finance, technology, marketing, management, and institutional governance (e.g., Berger and Diez 2004; Saliola and Zanfei 2009). On the other hand, and as already highlighted, although MNEs undoubtedly play a central role in development paths, learning and capabilities building, recipients' benefits are also strongly dependent on the characteristics of local actors – first of all domestic firms – and environments. In many cases, in the short- and even longer-term, technological and knowledge resources cannot be locally generated or upgraded without a minimum threshold of local absorptive capacity (Cohen and Levinthal 1990). The literature has stressed that the consequences of openness to FDI and the integration in GVCs crucially depend on the capacity to actually implement and govern systemic integration, involving the co-ordination of a diverse structure of 'value networks', both localised and global: which in turn requires capacity to manage institutional change (Coe, Dicken, and Hess 2008; Gereffi 2014; Rodríguez-Pose and Cataldo 2015; Yeung and Coe 2015). Upgrading within GVCs and diversification of the economic structure, therefore, also depend on coordination between lead firms, local industry, and government agencies (Pietrobelli and Puppato 2016; Pietrobelli and Staritz 2018; Crescenzi and Limodio 2021; Pietrobelli, Rabellotti, and Assche 2021).

The search for often unspecified spillovers in the economic literature on FDI has also to some extent hidden the effects of MNEs and FDI on capabilities development and skills upgrading, especially in emerging and developing economies (Iammarino and McCann 2013). Such effects take place mainly through three mechanisms:

1. backward linkages with MNE customers: domestic firms supplying intermediate inputs or services obtain technical assistance, incentives to improve product quality and/or cost reductions, and opportunities to reap economies of scale and scope;
2. imitation and adaptation of innovations generated elsewhere to the local environment;
3. skills upgrading and human capital formation, ranging from basic learning-by-doing and learning-by-using to formalised advanced technical training courses (e.g., Radosevic 1999; Padilla-Pérez 2008; Iammarino, McCann, and Ortega-Argilés 2018; Marchi, Giuliani, and Rabellotti 2018).

Importantly, the learning processes implied by all three mechanisms occur via both informal and formal collaboration. In other words, to benefit from FDI, firms, local organisations, and other stakeholders must engage in deliberate and coordinated efforts and devote substantial resources to start and sustain a gradual process of (technical, organisational, and institutional) knowledge accumulation conducive to capability building.

Despite the acknowledged benefits of FDI, there are also significant risks and costs for local economies arising from FDI-led economic development. Notably, the unbundling of GVCs has also resulted in the rise of cross-border corporate and network-based organisation of economic activity that has fostered widespread diffusion of low-tier activities and occupations (thus, not only higher value-added ones, such as R&D) towards a range of locations, mostly (but not exclusively) in the emerging global South, with overdependence on foreign MNEs and rising inequality due to power concentrations, employment and value creation in certain countries and subnational – mainly capital – regions (e.g., Athreye and Cantwell 2007; Iammarino and McCann 2013). Foreign MNEs may particularly take advantage of weak economic systems and institutions (e.g., Giuliani, Pietrobelli, and Rabellotti 2005; García, Jin, and Salomon 2013; Ning, Wang, and Li 2016; Ascani, Crescenzi, and Iammarino 2016; Narula 2019). This results in effects such as the crowding out and loss of domestic firms, poaching of qualified staff, monopolising of suppliers, diverting capital away from local forms, failure to upgrade/integrate the informal sector, rising prices, costs of production and assets (e.g., housing, business services, etc.), thus also spurring economic polarisation at both the individual and spatial level.

Extant research also provides consistent evidence on various forms of exploitative and predatory attitudes, particularly but not at all exclusively from FDI operated by MNEs based in emerging markets (e.g., Giuliani et al. 2014). Further evidence suggests that in some cases and particular industries MNEs – even from the most advanced economies – may prefer locations with more deficient institutional settings as a strategy to elude or circumvent transparent market mechanisms and regulations when investing abroad (e.g., Boddewyn and Brewer 1994; Giuliani and Macchi 2014; Ascani, Crescenzi, and Iammarino 2016; Webster and Piesse 2018). Recent literature has emphasised that such strategies may be detrimental also to the host locations' environment quality (e.g., Adeel-Farooq, Riaz, and Ali 2021; Garrone et al. 2023), and that FDI can indeed have positive and negative effects on sustainable development and on the achievement of the Sustainable Development Goals (SDGs) (e.g., Johnson 2019; Sauvant and Mann 2019).

Therefore, understanding and screening the nature, objectives, and trends of FDI inflows in relative and absolute terms in a country or region is crucial for pursuing developmental goals (Iammarino 2018). Both macro and microeconomics environments and structures, and levels of political risk, regulatory climate, supporting infrastructure and institutional capacity play significant roles in FDI attractiveness (e.g., Sekkat and Veganzones-Varoudakis 2007; Kinda 2010; Krifa-Schneider and Matei 2010; Jiang and Martek 2021), while likelihood of extreme weather events, climate-change mitigation policies, or presence of critical raw materials are emerging as crucially important factors (e.g., Gu and Hale 2023; Iammarino and Sait 2024; Li and Iammarino 2024).

Figure 1: Benefits and costs of inward FDI

FDI potential benefits	**FDI potential costs**
• Capital formation • Employment generation • Increased market competition • Demonstration effects • Technology transfer • Knowledge diffusion • Knowledge spillovers • Improved (global & regional) economic integration and participation in GVCs • Capabilities' upgrading • Diversification of domestic economic structure	• Crowding out of domestic firms • Overdependence on foreign MNEs • Poaching of human capital • Rising demand and cost of production inputs and prices of local assets • Increasing inequality and polarization at both individual and spatial (subnational) level • Exploitative and predatory actions • Inability to meet sustainable development goals due to allocation of domestic resources to MNEs • Falling into a mid-income trap

Source: adapted from (Iammarino et al. 2023).

Without the necessary (though insufficient) framework conditions, local SMEs may be unable to face the higher competitive pressure exerted by foreign firms and the development process initiated by FDI could come to a halt, pushing the domestic economy into a "middle-income trap". This concept has been mainly used to describe countries that suffer from a sharp drop in economic dynamism after a successful transition from low-income to middle-income status, preventing them from moving to a higher income level (Gill and Kharas 2007; 2015). The empirical evidence shows that, in the past century, only a handful of countries went from being low-income to high-income, whilst many economies, by contrast, moved from low-income to middle-income levels. The nature of transition from low-income to high-income is deeply structural: the economy becomes gradually more expensive than low-income competitors; labour costs rise, as well as urban land costs. At the same time, it is difficult to reach the productivity levels of high-income economies due to a lack of capacity to produce high-quality products or being on the innovation frontier: investment costs in quality, skills, innovation are high, and high-income countries have achieved scale economies in these areas that give them additional advantages (Diemer et al. 2022).

2.2. Policy principles for FDI and economic development

Some general principles for a coherent policy framework are drawn from the current scholarly literature on FDI and GVCs (e.g., Iammarino 2018; Comotti, Crescenzi, and Iammarino 2020; Crescenzi and Harman 2022a; 2022b; 2023a; Pietrobelli, Rabellotti, and Assche 2021) and recent work by Iammarino et al. (2023), as follows:

- The generation of benefits, positive externalities and sustainable linkages does not happen automatically or as a consequence of the presence of foreign MNEs, but requires a minimum threshold of local absorption capacity and involvement and collaboration of all interested stakeholders, and an aligned policy environment, where the crucial role of (different levels of) government may change over time (e.g., Chaminade and Vang 2008; Tunzelmann 2009; Marchi, Giuliani, and Rabellotti 2018).
- The effects of inward FDI depends on the embeddedness of MNEs, their linkages with local SMEs and the strength of local linkages. Foreign firms may (or may not) act as suppliers, customers, competitors, or through the employment of local workers, to transfer knowledge and skills (e.g., Iammarino, Padilla-Pérez, and Tunzelmann 2008; Ferraris 2014; Li et al. 2016).
- The integration of FDI inflows into the local economy and industry structure should be implemented through careful screening, with attention to sectoral and functional features of inward FDI and those of the location/industry targeted. The nexus sector-function in FDI and GVCs indicates that understanding the detailed structure and evolution of local-global networks must be central to development policies. A more holistic industrial and internationalisation strategy is vital for ensuring a balanced and diversified structural change at the local level (e.g., Bailey and Lenihan 2015; Crescenzi and Iammarino 2017; Marchi, Giuliani, and Rabellotti 2018).
- The quality of FDI matters more than the quantity in terms of the overall impact on development and growth (e.g., Alfaro and Charlton 2013), indicating that FDI promotion policies should particularly target industries which are likely to supply inputs to domestic firms, with positive effects in terms of quality upgrading of local exporters (Bajgar and Javorcik 2020).
- Multi-level governance and coordination are required to strike the correct balance of ‘mission oriented’, top-down, science-led approaches, and ‘diffusion-oriented’, bottom-up, capacity-building programmes, providing at the same time the necessary conditions for a ‘fairer globalisation’, or rules of law, to address negative externalities (Iammarino 2018). It is critical to pursue coherence of policy goals: Bailey and Driffield (2007) warned that incompatibility of policy goals may arise when attracting foreign MNEs to reduce unemployment or upgrade skills, without simultaneously supporting domestic firms’ growth and local networking development.
- Trade in GVCs and FDI are complementary phenomena that need to be taken simultaneously into account when trying to capture the potential for local economic development (Crescenzi, Pietrobelli, and Rabellotti 2014; Comotti, Crescenzi, and Iammarino 2020; Casadei et al. 2023). GVCs can be configured in a variety of ways depending on the strategic actions and needs of firms, resulting in changing geographic and organisational structures. The rise of macro-regional value chains and production

systems (see point below) has had significant implications for the economic and social upgrading of countries, regions, firms, and workers (Ponte, Gereffi, and Raj-Reichert 2019; Ambos et al. 2021; Gereffi, Lim, and Lee 2021).

- The development of multiple interregional linkages and connections within macro-regions of the world need to be fully exploited, together with already established global links. This implies exchanges of products, capital, labour and skills, knowledge, and technology: as said above, FDI and GVCs are particularly intense, and locally embedded, in geographical neighbouring systems (Thorbecke and Salike 2011; UNCTAD 2017).

In addition to the above general principles for ensuring the maximum benefits of FDI for local economic development while minimising costs, it is also important to note the following:

- First, financial incentives and access to capital are necessary but not anymore sufficient to support global connectivity: institutional capacity-building, technical, legal, fiscal and administrative assistance, targeted and timely communication and information on foreign markets, provision of specialised skills, all support firms' decisions to create international links through export and FDI (Malecki 2010; see also Fletcher 2001).
- Second, firm strategies to upgrade through GVCs (e.g. product/process or functional upgrading) substantially differ across sectors: firm clustering and collective efficiency are crucial in some industries but not in others, depending on the governance structure of the value chain, local strengths and institutional support (Giuliani, Pietrobelli, and Rabellotti 2005; Giuliani and Bell 2005; Devid Bailey and Driffield 2007; Phelps 2008)
- Third, FDI investment can also have a polarising effect on regional (subnational) economies, as investment concentration can distort local markets (i.e., housing, wages etc.), as MNEs may attract the best local resources to specific locations. As a result, there is a need to address increasing regional inequality within the country as a consequence of FDI and GVCs which should be accounted for in policy (Iammarino 2018).
- Fourth, on outward internationalisation strategies, most attention has been devoted to export-led, manufacturing and building territorial competitive advantages, but even more important is how to promote openness, stimulate SMEs and larger domestic firms' risk propensity for 'going global' to overcome competitive disadvantages (e.g., Child and Rodrigues 2005).
- Fifth, the growth of emerging economies' MNEs in recent years has shown some of these governments engaged in the promotion of outward FDI at the same time of implementing policies for FDI attractiveness and export growth (Crescenzi and Harman 2023a) . These emerging economic powers – e.g., China, for all – seem to have acknowledged that simplistic 'host-home economy' and 'inward-outward FDI' dichotomies have become obsolete (e.g., Wei 2013; Iammarino and McCann 2015).
- Sixth, development of active policy frameworks to promote the internationalisation of domestic firms through export and FDI, in coordination with inward FDI promotion, is vital, especially through investment promotion agencies (IPAs): their potential for policy learning has been undervalued (e.g., Davies 2010; Narula and Nguyen 2011; UNCTAD 2018; Crescenzi et al. 2023). Indeed, "place-sensitive policies" for global connectivity – unlike traditional industrial policies – require integration between the 'silos' of inward and outward FDI: support to FDI attractiveness without careful consideration of what is leaving the local economy may result in the wrong recipe for sustainable growth (Iammarino 2018).

2.3. FDI, GVCs and economic development in Asian economies

2.3.1. Overview

The case of diverse Asian economies offers different perspectives on the significance of FDI and GVCs in the process of economic development. As Har, Teo, and Yee (2008)note, governments have to balance the benefits of FDI in terms of employment, technology and skills transfer with problems such as loss of market power and competition for domestic producers. As Asghar, Nasreen, and Rehman (2011) argue, using data from a vast selection of different Asian countries, evidence on the benefits of FDI is largely mixed: while some economies have experienced evident benefits of FDI-led development, in other cases positive externalities have been harder to identify. Indeed, in many cases FDI is seen as a 'mixed blessing': it produces not only economic benefits but may also have adverse effects on societal equity (e.g., Majeed 2017; Chaudhury, Nanda, and Tyagi 2020). As recent work by Crescenzi and Harman (2022a) highlights, rather than focusing on sectors, FDI flows in Asian economies are increasingly context-dependent:

> Countries upgrade GVCs in different forms. In Asia, Vietnam represents one trajectory, its economic model led by FDI but focused on assembly tasks that depend on imports. The country shows a strong involvement of foreign MNEs in its economy. By contrast the Republic of Korea followed a different trajectory. Here the country experienced a much larger role for domestic MNEs, and the economic model is more dependent on the exports it provides others. Both, to many, are deemed successful cases of development in their own right, highlighting the multiple potentially beneficial pathways to GVC involvement in Asia.

Crescenzi and Harman's (2022a, 2023b) analysis also illustrates the variation in the ways that different Asian countries have integrated into the global economy: for example, highlighting that, relative to other cases, Cambodia has seen a decline in both its forward and backward linkages as it has focused primarily on low-cost production in the garment sector. In their report on *Climbing up global value chains: Leveraging FDI for economic development* (Crescenzi and Harman 2022b,5) they point out that Asian economies increasingly have more opportunities for opening up because:

> In [Asian economies], trade in intermediate goods and services is often more regionalized than trade in final goods. […] most Asian economies interact and participate with GVCs in different ways. Due to their economic make up, some have many forward linkages, and the exports are transformed into products further along the value chain. Others have backwards linkages and focus on assembly of goods created elsewhere.

However, a major concern remains not just attracting FDI but utilising it for developmental purposes. As Ohno (2009,21) describes, using the examples of East Asian economies, it is vital to consider strategic objectives and governance processes:

> For example, in formulating industrial strategies, Japan and South Korea in their fast-growing periods adopted the super-ministry model, in which one organisation (the Ministry of International Trade and Industry and the Economic Planning Board, respectively) with strong and broad authority orchestrated the entire industrial policy process. Malaysia drafts industrial master plans in the multiple layer model which consists of the minister-level committee, the steering committee and technical resource groups. Thailand under Thaksin Shinawatra (2001-2006), in what may be called the central coordination model, assigned newly created institutes, such as the Thai Automotive Institute and the Electrical and Electronics Institute, to coordinate among businesses, government and experts to draft

> policies and conduct supportive activities. […] In many latecomer countries including Vietnam, Laos and Cambodia, a workable model for conducting consistent industrial policies is not yet in place.

It is important and necessary to learn from past experiences and regional examples in moving up the value chain (e.g., Chhair and Ung 2013; Paus 2017; Islam et al. 2023; Hu et al. 2023; CM, Hoang, and Yarram 2024). However, it should also be reminded that the rise of Japan, South Korea and the so-called Asian Tigers occurred in totally different phases of globalisation and technological transition, where the division of labour worldwide had not reached the extent and modalities we witness today, and the ICTs revolution was unfolding, progressively allowingfor the slicing up of production stages and functions across geographies around the world. The recent disruptions of GVCs and GPNs due to the global COVID-19 pandemic, trade conflicts and geopolitical crises, coupled with the twin digital and green technological transitions, make up for a radically different and possibly more challenging economic landscape.

According to the Asian Development Bank (ADB 2020a), as a relatively late joiner to the World Trade Organization, among Asian economies Cambodia has opportunities to leverage FDI for developmental purposes as it catches up with neighbouring countries. More generally, the (ADB 2020b,25) highlights some priority areas across the wider region:

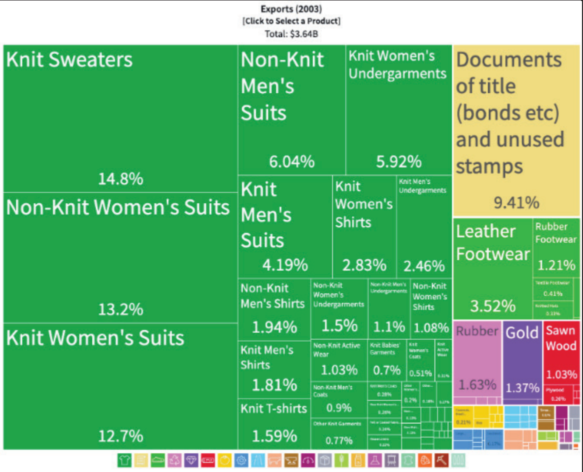
> First, governments should continue to promote open trade and investment. Governments should work toward lowering nontariff measures, harmonising standards, and applying mutual recognition. Second, as Asian economies increasingly rely on services, governments must think about how to incorporate them into their trade and growth strategies. Third, governments need to continue helping small and medium-sized enterprises access international markets by improving regulations, easing access to finance, and supporting capacity building, among others. Fourth, governments must keep abreast with rapidly changing technologies and the Fourth Industrial Revolution—which is fundamentally changing how goods and services are produced, traded, and consumed, including through e-commerce and digital trade. Finally, Asia's governments should renew efforts to support the multilateral trading system.

2.3.2. FDI in Cambodia: Empirical evidence in the literature

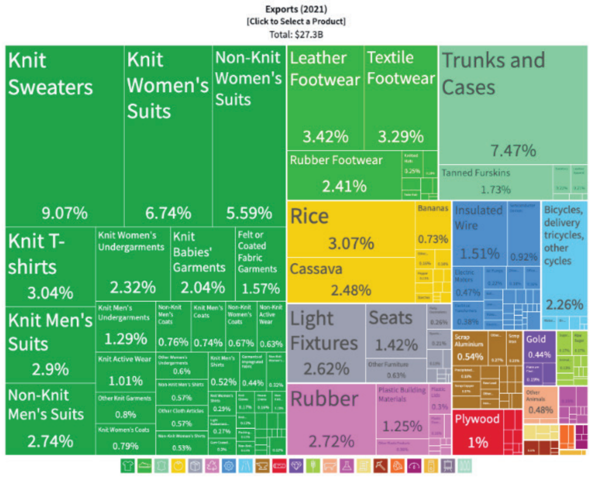
2.3.2.1. Overview

Over the last two decades, Cambodia has undergone a process of rapid industrialisation and diversification, with a contribution of the agriculture sector to GDP close to 50 percent at the end of the 1990s shifting to around 22 percent of GDP in 2019, and the role of the garment sector increasing from 17 percent to 22 percent over the same period; in the meantime, other sectors have become more dominant including food and beverage, light manufacturing and services (e.g., Yang Maria 2019). The academic literature has emphasised the crucial role that FDI has played in gradually upgrading and diversifying the export structure in Cambodia – with the top 10 products exported from 2001 to 2018 improving in both sophistication and quality, particularly low-tech secondary products to medium-tech secondary products and strengthening its role in regional and global value chains (Obashi 2022). This is also confirmed by the fact that FDI inflows to Cambodia have been the main mechanism for transforming the country's economic development from low-productivity agriculture to rapid industrialisation and growth in the service sector (Cuyvers et al. 2008; Soeng, Cuyvers, and Sok 2017). The government continues to prioritise attracting high quality FDIs to Cambodia, particularly FDI that contribute to provincial development and advanced economic growth, thus helping the country to achieve 2030 and 2050 goals of becoming a middle-income and high-income economy. Through FDI, a considerable number of people working in agriculture in rural areas have migrated to urban centres for job opportunities due to FDI-driven developments in Phnom Penh and costal area. Labour has thus shifted to other sectors, such as garment and footwear manufacturing, construction, and various servicesthat require low-- and medium-skilled workers. In addition to that, FDI plays a key role for enabling Cambodia to export goods to the international market, this[2], as shown in the exhibit below.

Cambodia exports by product, 2003



Cambodia exports by product, 2021



Source: OEC. It can be found via this link: https://oec.world/en/profile/country/khm

50 academic and policy papers were reviewed for this paper, using a mix of qualitative and quantitative research methods, to examine the varied impacts of FDI on economic development in Cambodia. Evidence covers the last three decades of FDI policy and positions Cambodia's FDI experience within the wider context of East Asian economies and ASEAN. Overall, the evidence suggests that FDI in Cambodia has played a crucial role in terms of economic development, growth, and technology spillovers (e.g., Tuck and Wong 2011; Lim and Moolio 2013; Tu and Tan 2012; Seng 2017). FDI inflows have particularly benefited exports in the garment sector, and improved productivity and competitiveness (e.g., Cuyvers et al. 2008; Tuck and Wong 2011). More recent studies have also examined FDI investment patterns, factors affecting Cambodia's overall attractiveness, and the role of Chinese FDI, highlighting how FDI inflows have continued to shape Cambodia's economic performance.

2.3.2.2. General FDI trends in Cambodia (1992-2022)

FDI investment patterns. In terms of FDI distribution, since the 1990s the vast majority of FDI investment in Cambodia has clustered around Phnom Penh, Sihanoukville, and Kandal province, constituting approximately 90 percent of the total, with about 5 percent directed toward agriculture in rural areas (Hing 2003; Cuyvers, Soeng, and Bulcke 2006). The sectoral distribution of FDI has been uneven, with manufacturing – and particularly the garment sector – attracting most inward investments. Between 1994 and 2003, Cambodia enjoyed a comparative advantage in textile exports and tourism compared to Lao PDR and Myanmar, though continuing to face comparative disadvantages relative to Vietnam, ASEAN, and the rest of the world in the garment sector (Cuyvers, Soeng, and Bulcke 2006; Cuyvers et al. 2008).

2 Complexity values are based on exports value for HS-1992 four-digit level product classification (considering in total 1241 products, which are manufacturing only, services are not included). The data is for export value (US dollar) by product and origin country, for 179 countries; see:https://oec.world/en/profile/country/khm

In agriculture, due to having benefited from land concessions, asmall volume of FDI has been invested in growing cash crops such as rubber, cassava, sugarcane, teak, acacia, and pistachio. However, these have faced problems such as land disputes, inadequate compensation for landowners, and various other harms in terms of biodiversity loss, economic instability, and the loss of cultural heritage for local communities (Hem 2012; Saing, Hem, and Ouch 2012). Several scholars have stressed the importance of Cambodia's strong trade relations and bilateral investment with other countries, resulting in increased FDI inflows[3] (Cuyvers et al. 2008; 2011; Soeng, Cuyvers, and Sok 2017). Inward FDI has been found to contribute to higher wages and increased formal employment in the manufacturing sector – though with lower wages for women – with non-garment industries having a more significant wage boost in relative terms (Helble and Takeda 2020). Macroeconomic data from the Cambodian Investment Board also highlights possible under-optimisation of Cambodia's Special Economic Zones (SEZs) to attract FDI (Tam 2019), although SEZs have been found to have positively affected both FDI inflows and economic diversification (Chuop 2022).

Factors affecting FDI attractiveness and its effects. Promoting FDI attraction has had significant benefits for both economic growth and employment in Cambodia between 1992 and 2011 (Lim and Moolio 2013). As Xaypanya, Rangkakulnuwat, and Paweenawat's (2015) macroeconomic analysis highlights, using UNCTAD and World Bank data, Cambodia has seen significant positive effects of infrastructure investment and levels of openness in the Mekong sub-region, alongside negative effects of inflation on FDI inflows. Meanwhile, Seng's (2017) paper, using UNCTAD data from 1980 to 2014, concluded that while manufacturing and gross fixed capital formation significantly contribute to long-term growth, inward FDI does not solely explain increased economic growth. Compared to other ASEAN countries, Cambodia's political stability and proactive policy have been primary factors in shaping increased FDI attractiveness, while higher unskilled labour supply, institutional and deadlocks have had short-run negative impacts on FDI inflows (Masron and Nor 2013; Hor 2016; Soeng, Cuyvers, and Sok 2017). Indeed, as both Masron and Nor (2013) and Seng (2017) suggest, adhering to core principles of fairness, equity, rule of law, and having mechanisms for international dispute resolution, clear laws governing earnings repatriation, and generally a robust commercial code to protect intellectual property rights, remain vital for Cambodia. Factors such as market size, inflation rate, openness, real effective exchange rate, and labour force have also influenced FDI inflows in Cambodia relative to some of its neighbours (Kueh and Soo 2020). As Dang and Nguyen (2021) note, market factors like economic growth, tax burden, and economic freedom have been pivotal to FDI attraction across ASEAN countries, with a need for flexible policies to adapt to transformations in the global economy.

Significance of Chinese FDI inflows. China emerged as the largest source of FDI in Cambodia following the 2008 global financial crisis, through support from the Chinese government and the Belt and Road Initiative (BRI), aided by Cambodia's competitive production costs, low labour rates, investment-friendly policies, growing local market demand, stability and other trade preferential measures which made it an appealing FDI destination (Chap 2010; Kowattanawaranon 2019). As Ung Khemara Bormeychan's (2023) analysis notes: "Cambodia captured fixed-asset investment from China worth USD2.32 billion in 2021, up 67 percent from USD1.39 billion in 2020. China continued to be Cambodia's top foreign investor, contributing 53.4 percent of the total investment of USD4.35 billion authorised by the kingdom in 2020." As Tu and Tan (2012) illustrate, China's FDI in ASEAN countries including Cambodia, has

3 FDI activities in Cambodia appear to involve the imports of raw materials, semi-finished goods, and machinery from MNEs' home countries for use in final production within Cambodia. The resulting final output is then exported to third markets, specifically the US and the EU (Soeng, Cuyvers, and Sok 2017).

generally required lower educational thresholds, has generally brought positive technological spillovers, and helped to address unemployment issues. However, there have been concerns over human rights, good governance, transparency, natural resource management, labour standards and practices, wage discrimination, and environmental consequences, including damage to forests, endangered species, water pollution, and loss of the primary sources of income for local communities (Chheang 2017; Po and Heng 2019; Kowattanawaranon 2019). From a geopolitical standpoint, Chheang's (2017) work suggests that China's economic presence in Cambodia also has political implications. Firstly, it offers forms of legitimacy in terms of economic growth and job creation. Secondly, China serves as a balancing power against Cambodia's neighbours, particularly Thailand and Vietnam. Chheang recommends that Cambodia should strategically align with China's interests, provided these do not directly compromise its national interests.

3. Cambodia's policy framework for FDI

3.1. Regulatory framework for FDI

Since Cambodia's first Law on Investment (LoI) was promulgated in 1994, the Council for the Development of Cambodia (CDC) has played the role of "Etat-Major"[4] in implementing Cambodia's FDI regulatory framework. Amendments in 2003 introduced 'Qualified Investment Project' (QIP) status[5] and various incentives[6]. Sub-Decree No. 111 issued in 2005 clarified the status of QIPs and introduced a "Negative List" with ineligibility criteria. Sub-Decree No. 33 ANK.BK in 2019 further provided tax exemptions for existing QIPs and expanded investment promotion activities. In 2021 a revised LoI was promulgated updating Cambodia's FDI practices in response to global developments. This updated investment law aims to identify gaps that hinder potential FDIs in high tech industries from investing in Cambodia, and to address challenges faced by local and international businesses operating in the country. One of the main objectives of this law is for the government to reassess certain regulations, and investment sectors that qualify for QIPs, as well as to restructure incentives and tax exemptions. At the same time, the updated law is aligned with new policies for economic recovery following the global pandemic and is part of the broader strategy to achieve middle-income and high-income status. The law updated the CDC's role; established governance at the municipal-provincial level; updated registration and implementation processes, investment guarantees and protections, incentives, acquisition, sale or merger procedures, processes for project nullification, dispute resolution, and implementation procedures. In June 2023, a sub-decree was issued applying to FDI projects that solicit investment through the CDC and Municipal-Provincial Investment Sub-Committees (MPIS).

3.2. Investment activities in Cambodia

Cambodia has three types of investment activities: prohibited activities; activities eligible for incentives provided by CDC; and activities not eligible for incentives. The first category includes bans on the production/processing of: (1) psychotropic/narcotic substances; (2) poisonous chemicals, agriculture pesticides/insecticides and other goods using chemical substances

4 This included all major aspects of investment decision-making and evaluation, rehabilitation, development and investment project activities, the procedures involved in investing, as well as investors' entitlements, incentives, and priority sectors.

5 As for the definition from Cambodia's investment law, QIP refers to an investment project that has received a registration certificate from the CDC or a Municipal-Provincial Investment Sub-Committee.

6 These include automatic tax holidays, tax exemptions on imports, and investment protections including non-nationalization guarantees and extended land concession leases of up to 99 years for agricultural purposes (ODC 2021).

prohibited by international regulations or the World Health Organization; (3) electrical power generated using waste imported from a foreign country; and (4) forestry exploitation prohibited by Cambodia's Forestry Laws. Foreign investors are generally permitted to invest in nearly all economic sectors without discrimination, except their land. Foreign investment can only access land through concessions, permanent leases or limited short-term leases7. This extends to joint ventures where non-nationals are limited to a 49 percent stake. However, in 2010 rules permitted foreign individuals to possess 'strata-titles' for condominium complexes above ground level. Not all investment projects are eligible for CDC incentives. The 2021 LoI categorises 13 investment activities ineligible for incentives8, and a further 18 sectors that are eligible for QIP status9 provided they meet minimum capital investment thresholds.

3.3. Key actors

Depending on the investment, different key actors are involved in registration and licensing processes. If a project does not qualify for incentives, registration involves standard interactions with the Ministry of Commerce, General Department of Taxation, and Ministry of Labour and Vocational Training. However, if a project falls within a prioritised sector and meets capital investment criteria, it can obtain QIP status (see section 3.4). For QIPs with a capital investment below USD5,000,000, oversight falls under the MPIS10. QIPs with capital investment exceeding USD5,000,000 are supervised by the Cambodian Investment Board (CIB). If the investment is situated within SEZs, the Cambodian Special Economic Zones Board (CSEZB) plays a central role. There are also instances where the CDC must seek approval from the Council of Ministries, particularly for projects with specific characteristics11: capital investment above USD50 million; politically sensitive issues; exploration/exploitation of mineral resources; potential negative environmental impact; long-term development strategy infrastructure projects.

3.4. Procedures for obtaining QIP status

To obtain QIP status, investors must submit a written application to the CDC or MPIS. Their Investment Project Application should be accompanied by the information specified in the Sub-Decree. The CDC is responsible for reviewing and deciding on the application through the One Stop Service mechanism. If an FDI project is in a priority sector and meets the minimum capital requirement, the CDC issues a Registration Certificate within 20 working days, following which the investment can be implemented automatically pending all relevant permissions.

3.5. Investment incentives

Chapter 6 of the 2021 LoI classifies investment incentives into three types: basic, additional, and special incentives (see also Tables A1, A2 and A3 in Appendix 1). QIPs are offered basic incentives through tax on income (TOI) exemptions or accelerated depreciation[12]. The first

7 Permanent leases have a duration of between 15 to 50 years and can be renewed for additional 50 years.

8 Annex 1 of Sub-Decree No. 139 on the Implementation of the Law on Investment.

9 These are identified on the basis of high-value-added, social, and sustainable development, defined under Article 24 of the 2021 Law on Investment.

10 Article 3, "Sub-Decree No.120 on the Organization and Functioning of the Provincial/Municipal Investment Sub-Committees".

11 This is defined by Article 11, "Sub-Decree No.149 on the Organization and Functioning of the Council for the Development of Cambodia".

12 Investments are classified in three groups receiving different incentives: High-tech investment activities; Intermediate-tech adoption investment activities; and Low-tech adoption investment activities. EQIPs also enjoy PTOI exemption and minimum tax exemptions provided that they have externally audited financial statements.

gives investors TOI exemptions followed by Graduated TOI rates (GTOI) for six years. The second allows investors 40 percent depreciation for capital expenditure, and 200 percent deduction rate for expenses related to workforce skills. Both include minimum tax, prepayment of tax on income (PTOI), export duty exemptions, and exemptions from production costs including customs duty, specific taxes, and VAT. Additional incentives include zero-rating for VAT on locally produced inputs; deductible expenses of 150 percent for R&D, human capital investment, welfare promotion, etc.; and customs duty, specific tax, and VAT exemptions for imports for constructing worker facilities. Expanded QIP (EQIP) also enjoys TOI exemptions[13]. Investment activities with high potential to contribute to Cambodia's development may receive further special incentives[14].

3.6. Investment protection and guarantees

Chapter 5 of the 2021 LoI specifies guarantees and protections to investors. This includes refraining from implementing nationalisation policies, avoiding price fixing, protecting intellectual property, and facilitating unrestricted purchase and transfer of foreign currency, including royalty remittances, management fees, profits, and repatriation of invested capital. The law also permits investors to hire foreign nationals as managers, technicians, and skilled workers, provided that the required skills are not available in Cambodia. It additionally grants benefits to facilitate individuals' employment and residency. Both investors and foreign employees are entitled to work permits, employment books, and temporary long-term stay permits for themselves, spouses, and children. The law additionally guarantees investor protection against discrimination when pursuing legal remedies against losses incurred due to conflict, civil disturbances, or emergencies. It ensures fair treatment, restitution, or compensation.

3.7. Special economic zones

SEZs are areas strategically designed to generate economic benefits, with accessible transport. To establish an SEZ in Cambodia, operators need at least 50 hectares of land, must establish roads, and supply of utilities such as electricity, water, and internet services. They must also provide *One-Stop, On-Site Services* including administrative support for import-export (CDC 2023). Cambodia's first SEZ was established in 2005 to promote diversification, urban-rural economic linkages, and industrial investment outside Phnom Penh (World Bank 2012). SEZs in Cambodia are almost entirely privately-owned, with the exception of Sihanoukville Port SEZ, a public-private partnership financed by a Japanese Industrial Cooperation Agency loan. Firms locating in SEZs are contractually required to purchase utilities from the operator (Warr and Menon, 2015). Additionally, service costs are met by the zone operator, who charges a fee for services provided. The Open Development Cambodia database (ODC 2023) identifies 51 SEZs, of which 24 are operational[15], with 561 investments, and 160,000 jobs (CDC 2023).

3.8. Other national policies

Related to FDI attraction, Cambodia's 'Pentagonal Strategy' for national development and Industrial Development Policy 2015-2025, respectively, promote growth, employment, equity,

13 This includes product diversification, new technologies enhancing productivity or environmental protection.

14 Eligible sectors and activities are to be set out in the Law on Financial Management.

15 These are distributed as follows: Banteay Meanchey (3), Kampong Cham (1), Kampong Chhnang (1), Kampong Speu (2), Kampot (2), Kandal (4), Koh Kong (8), Kartie (1), Phnom Penh (2), Preah Sihanouk (12), Pursat (1), Rathank Kiri (1), Svay Rieng (11), and Takeo (1). See also Figure A1 in Appendix 1.

efficiency, and sustainability for achieving high-income status and economic resilience, and diversify labour-intensive industries, manufacturing, and specialisations based on sciences, technology, and innovation (RGC 2015; 2023). Meanwhile, Cambodia's Digital Government Policy 2022-2035 promotes concepts of *digital citizenship, digital government, and digital business, and the once-only principle* for data collection (RGC 2022). Cambodia also aims to integrate into regional and global production networks and value chains, taking advantage of economies of scale by way of attracting FDI within the ASEAN Economic Community framework, developing the Greater Mekong sub-region economic corridors, and linking its economic poles – Phnom Penh, Sihanoukville and Koh Kong – and border areas to industrial centres including Bangkok and Ho Chi Minh City. Overall, these policies are crucial to enable general improvements in Cambodia's FDI attractiveness.

4. FDI in Cambodia: Trends over the two decades 2003-2022

4.1. Inward FDI: Cambodia in the Mekong sub-region

This section of the paper focuses on inward and outward greenfield[16] FDI flows for Cambodia. Information comes from fDiMarkets, a database created and maintained by the Financial Times, monitoring cross-border greenfield investments for all countries and sectors worldwide and covering the period between 2003 and 2022. Each entry is a project: the database is carefully updated each year to check whether projects have been 'completed' or not, and, if not, they are deleted from the database. The accuracy and robustness of fDiMarkets and its coherence with official statistical sources has been tested and confirmed by a consolidated literature (e.g., Crescenzi, Pietrobelli, and Rabellotti 2014 for Europe; Amighini, Rabellotti, and Sanfilippo 2013 for China; Crescenzi and Limodio 2021 for Africa)[17]. fDiMarkets offers detailed information on both sector and business function pursued by each investment, i.e. it specifies whether a particular new investment project is a production site vis-à-vis, for example, a R&D unit or a regional headquarter. By following Crescenzi, Pietrobelli, and Rabellotti (2014) and Sturgeon (2008), it is possible to associate each investment project with a particular stage of the GVC. In addition, through geo-localisation of the information contained in the dataset, fDiMarkets traces individual investment projects down to their sub-national geography. It furthermore allows coherent international comparisons: in what follows, the focus is on Cambodia and the two neighbours in the Mekong sub-region, Vietnam and Laos PDR. Further statistics for this Section 4 are reported in Appendix 2.[18]

4.1.1. General trends

The following plots show inward FDI flows into Cambodia in terms of investment value (in million dollar) and estimated number of jobs created over the 20-year period 2003-2022; as a comparison to Figure 2, Figure 3 reports also the neighbours of the Mekong

16 "Greenfield FDI relates to investment projects that entail the establishment of new entities and the setting up of offices, buildings, plants and factories from scratch. (…) Greenfield FDI involves capital used for the purchase of fixed assets, materials, goods and services, and to hire workers in the host country" (UNCTAD 2005).

17 The accuracy and robustness of the information reported in fDiMarkets has been checked in the literature using different methodologies. Investment flows have been compared, among others, with UNCTAD information on FDI flows at the country level; cross-checks based on different independent data sources confirm the reliability of the fDiMarkets database on the spatial distribution of greenfield FDI (Crescenzi, Pietrobelli, and Rabellotti 2014: p. 1065).

18 In Cambodia, when it comes to research on FDI, most data sources used are from theCDC and the National Bank of Cambodia (NBC). CDC data has some limitations because it only reports FDI investment projects that have obtained QIPs, while it lacks data on FDI investments that do not receive QIPs. NBC data is comprehensive; however, it does not include information on job creation or company profiles.

sub-region, Vietnam and Lao PDR. Cambodia has been attracting considerable inward FDI over the two decades: the trends reported in Figure 2 in terms of both investment value and number of jobs created also illustrate – despite the usual volatility of such flow indicators, particularly in correspondence to major global crises – the recovery trend after the COVID-19 pandemic.

The trends observed across the three countries mirror by and large each other for both variables, although the magnitude of FDI in Vietnam is clearly far greater. The peaks and troughs experienced in Cambodia and Lao PDR appear to perfectly coincide in some key years (e.g., in 2015 in terms of investment value), while for Vietnam these occur at slightly different times. As a comparison (Figure 3), in 2022 Vietnam had more than 60000 estimated jobs created by FDI, against less than 2000 in Cambodia and a few hundred in Lao PDR.

Figure 2: Investment value and estimated number of jobs, Cambodia, 2003-2022

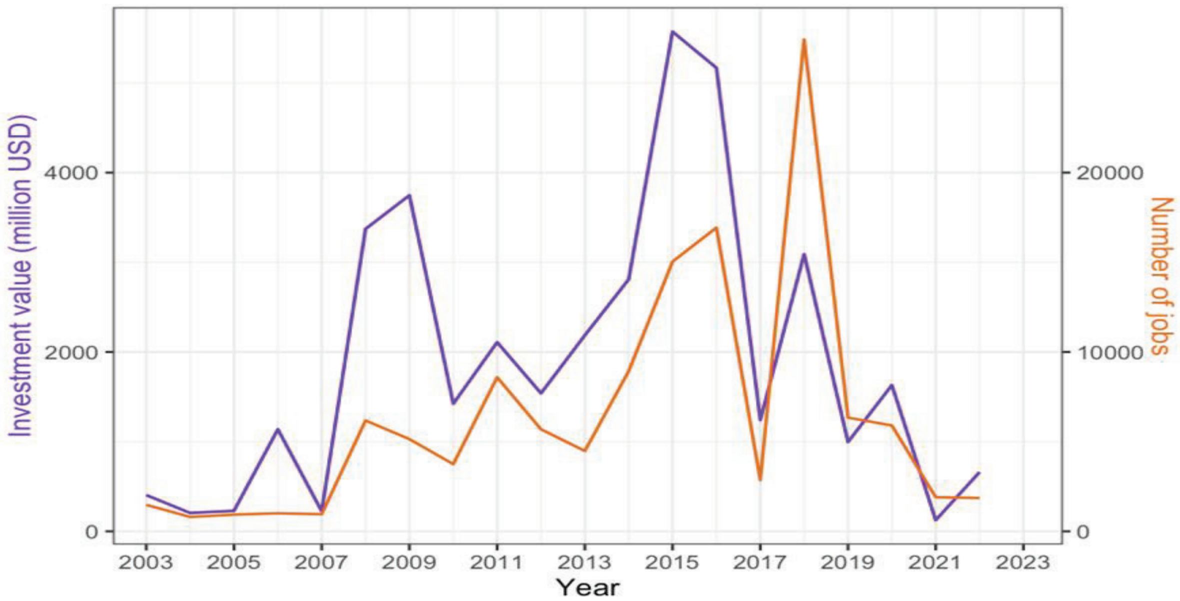


Figure 3: Investment value and estimated number of jobs, Cambodia, Vietnam and Lao PDR, 2003-2022

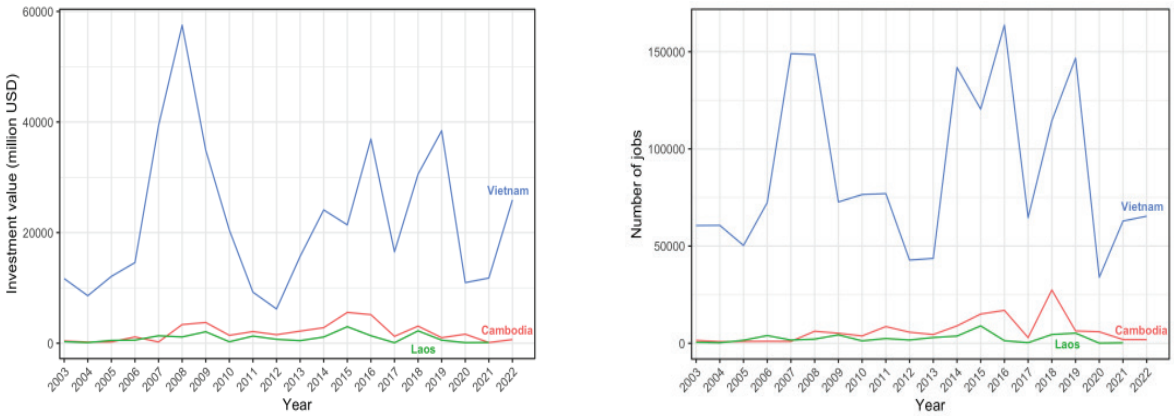
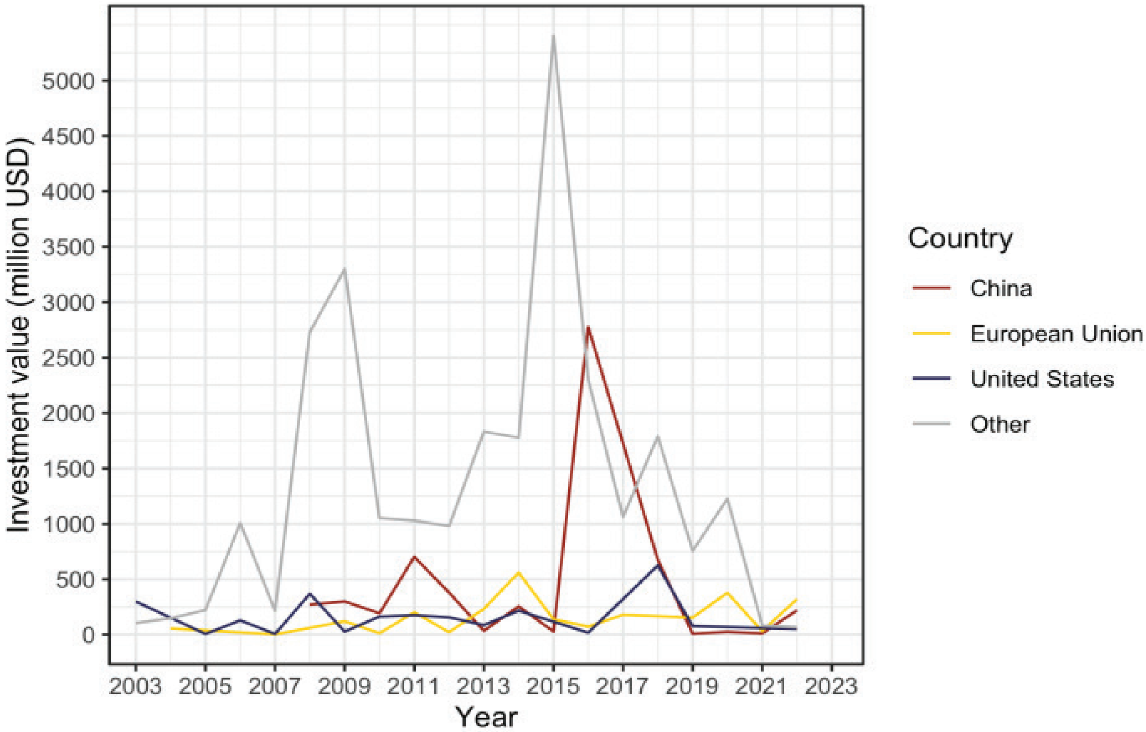


Figure 4 shows yearly FDI in Cambodia from major investor areas (i.e. China, the European Union (EU), the United States (USA) and the rest of the world (RoW)). While FDI from the USA is present right from the start of the period of observation, China's investment begins in 2008; some increases are recorded in the last decade for FDI inflows from the EU countries. The impact of the great economic and financial crisis in 2009 is clearly visible particularly for investors from the rest of the world. A sharp spike is recorded in 2015-2016 in inward FDI from China and other world areas, steadily decreasing to near zero in 2019-2021, an effect due to the Covid-19 pandemic: Cambodia's attractiveness seems to recover in the last year observed, 2022.

Figure 4: Yearly FDI value from EU, USA, China and RoW to Cambodia, 2003-2022



4.1.2. FDI sectors and GVC stages

Figures 5-8 below present the top 25 sectors in terms of aggregate FDI flows value and number of jobs created in the three Mekong sub-region economies over the 2003-2022 period. Some common patterns emerge in terms of amount invested in the top attracting sectors (Figures 5 and 6): importantly, Alternative/Renewable Energy is in the top 3 across the three countries, while Real Estate features in the top 5. Whilst Coal, Oil & Natural gas, Metals, and Financial Services are important recipients in all three economies – with the first industry accounting for the largest cumulative amount of FDI in Vietnam; the latter country features a much bigger value of inward FDI in higher value-added manufacturing sectors such as Electronic Components and Chemicals. The weight of foreign investment in Cambodia's Textiles over time (similarly to Vietnam) strikingly appears – as expected, given the labour-intensive nature of the sector – in terms of estimated number of jobs generated (Figures 7 and 8): Textiles is the largest recipient, followed by Real Estate, Financial Services and Food & Tobacco.

Figure 5: Investment value by sector (top 25), Cambodia, 2003-2022

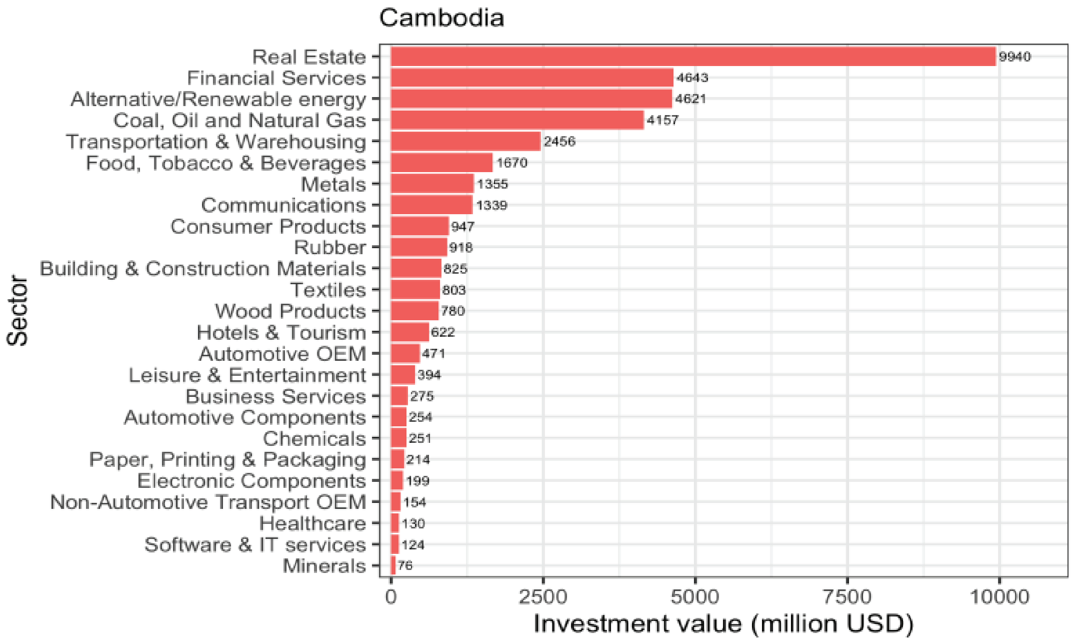


Figure 6: Investment value by sector (top 25), Vietnam and Lao PDR, 2003-2022

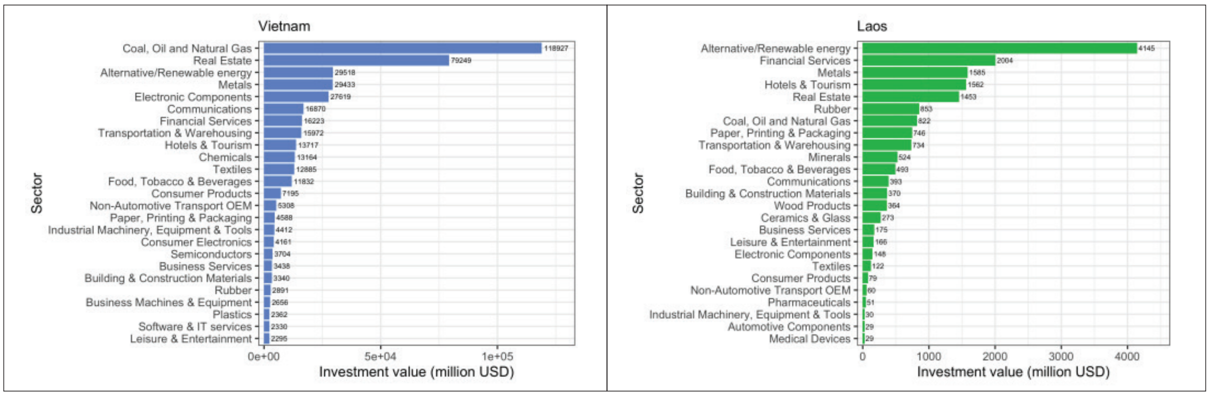


Figure 7: Number of jobs by sector (top 25), Cambodia, 2003-2022

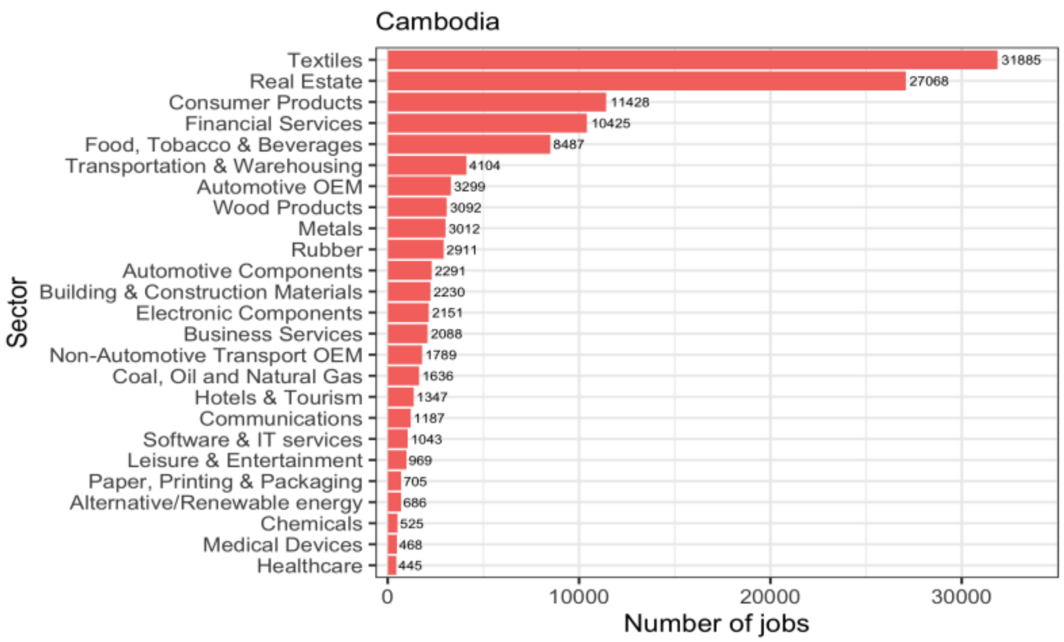


Figure 8: Number of jobs by sector (top 25), Vietnam and Lao PDR, 2003-2022

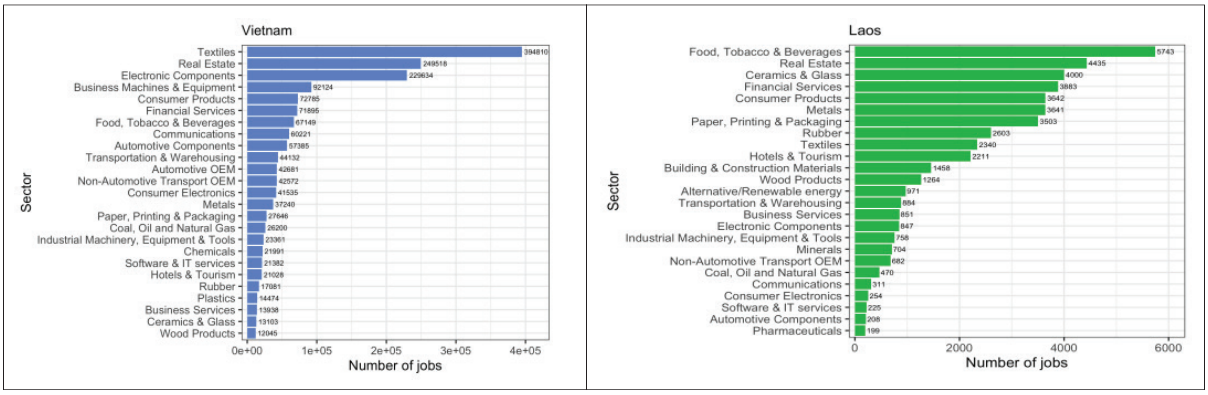


Figure 9: Investment value by sector, Cambodia, 2003-2012 and 2013-2022

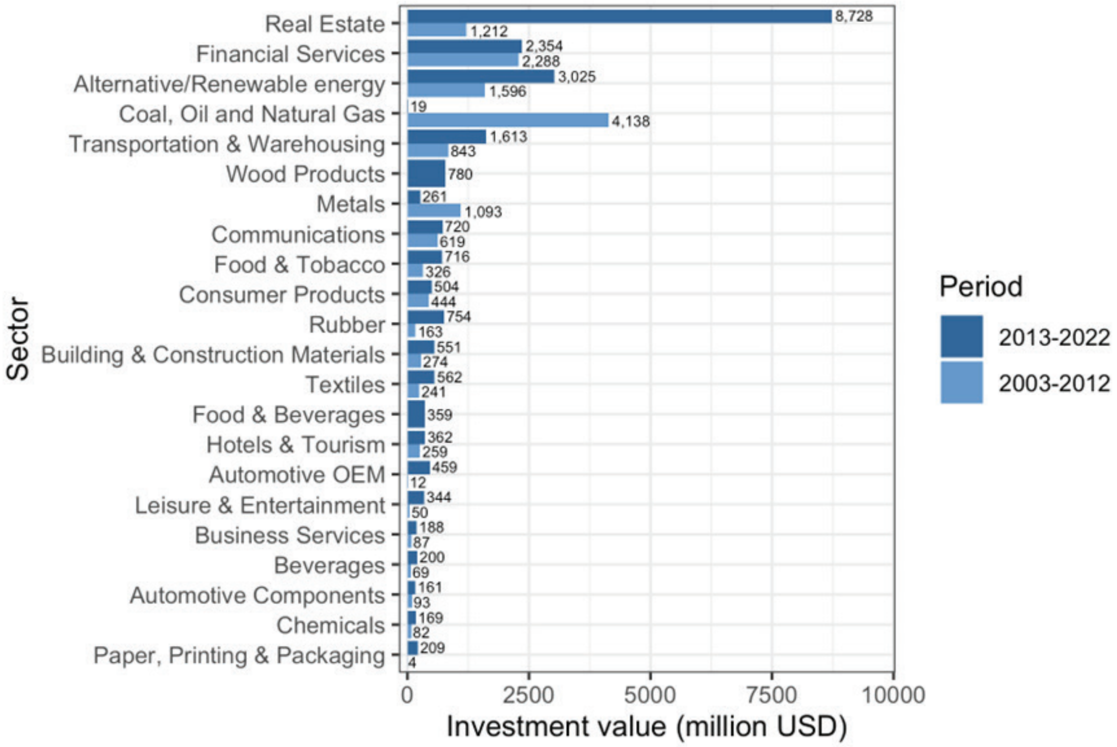
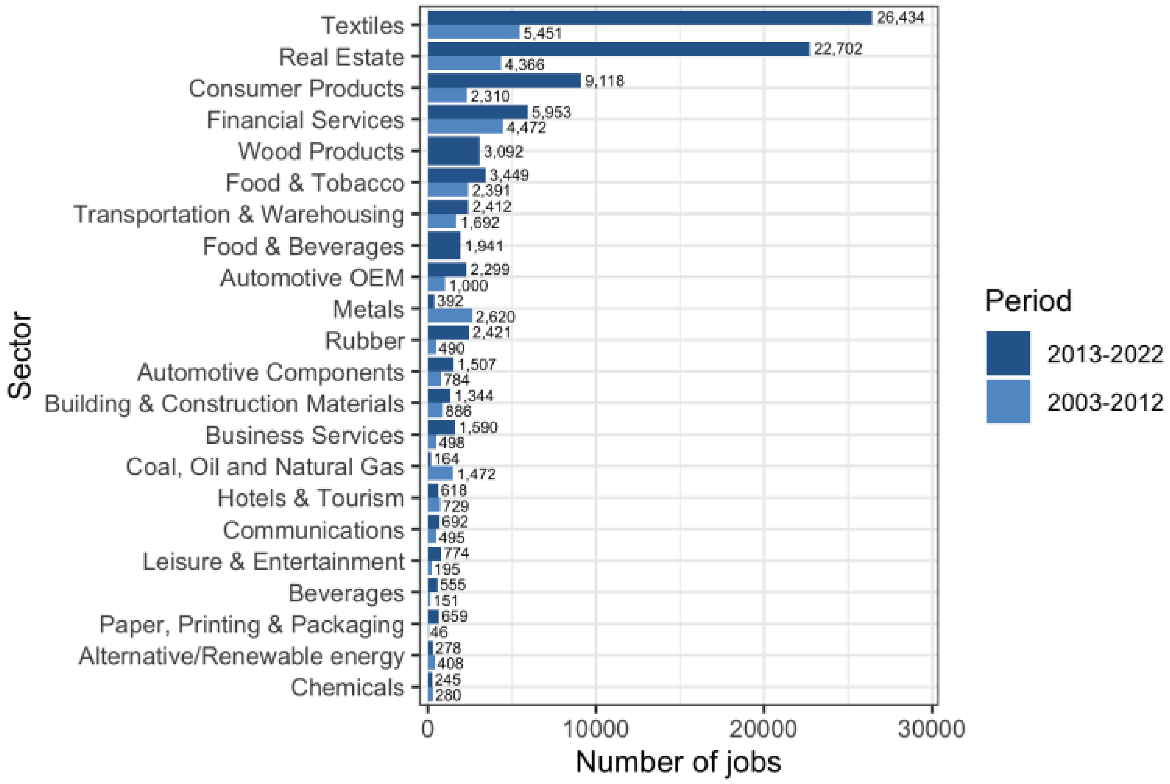


Figure 9 shows aggregate FDI inflows value in each sector and in two sub-periods, corresponding to the decade 2003-12 and 2013-22, for Cambodia. In the figure, only the sectors that had a total investment over USD200 million over the entire 2003-2022 period are considered (equivalent plots for Vietnam and Lao PDR are reported in Appendix 2). Figure 10 displays the same for FDI job creation: in this case, the sectors are ordered in descending order by number of jobs created in the full period. A major shift toward services is observed, in line with global trends. The real "winner" sector has been Real Estate, becoming by far the most attractive to foreign investors in the second period, followed by Financial Services, which however shows stability across time in terms of aggregate FDI value. The other main recipient sectors registering substantial growth in the indicator are Alternative/Renewable energy and Transportation & Warehousing, both witnessing doubled FDI values between the two decades. Notable increases – though for much lower dollar amounts – are recorded in Rubber, Automotive OEM, Leisure & Entertainment, Food, Tobacco & Beverages, and Paper, Printing & Packaging. Interestingly, although Textiles show relatively modest greenfield inward FDI values, as mentioned above its labour-intensive nature emerges in terms of estimated number of jobs, for which it remains the first FDI recipient in Cambodia in both decades, growing fivefold in the most recent period (over 26,400 jobs generated in 2013-2022); in terms of job creation, this growth is rivalled only by Real Estate (22,700 estimated jobs in 2013-22). On the contrary, the largest recipient sector in value terms in the 2003-2012 decade – Coal, Oil & Natural Gas – lost its appeal in the most recent years for both invested amount and employment creation, reflecting internal reforms to move away from fossil fuels; a huge drop is also observed in FDI in Metals. Overall, the distribution by sector of FDI in Vietnam tends to be more stable across the two periods than in Cambodia and Lao PDR (see Appendix 2).

Figure 10: Number of jobs by sector, Cambodia, 2003-2012 and 2013-2022



Turning to GVC stages, Figures 11 and 12 show how FDI value is split among the five functions, or Global Value Chain stages, for each country, over the whole observed period. Not surprisingly, across all three economies, the Production stage (GVC stage 4) is the dominant one; this is particularly striking in the case of Vietnam, where it accounts for 87.5 percent of cumulative FDI value. In comparison, Cambodia manages to attract relatively more FDI in GVS stages 3 and 1 (Sales and Headquarter), with 13.1 percent and 11.5 percent of the total value respectively; however, the share of FDI in R&D and innovation function (GVC stage 2) is the lowest, with only 0.2 percent of the total, against 1.1 percent for Vietnam and 0.4 percent for Lao PDR. Figure 13 reports the GVC stage in terms of the number of jobs only for Cambodia (for the other two Mekong countries see Appendix 2), which follows similar patterns as for the value of investment, with a slightly higher share of the R&D function on the total (0.6 percent, or 777 jobs for the whole period); the latter, however, is still below those of both Vietnam (1.9 percent) and Lao PDR (0.7 percent).

Figure 11: Investment value by GVC stage, Cambodia, 2003-2022

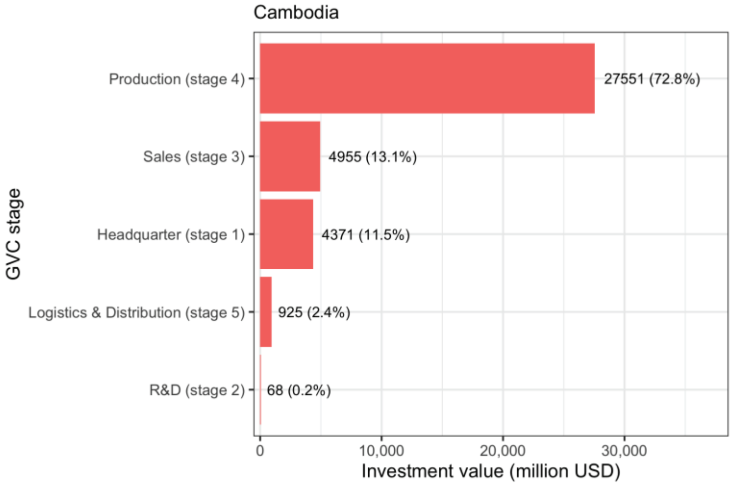


Figure 12: Investment value by GVC stage, Vietnam and Lao PDR, 2003-2022

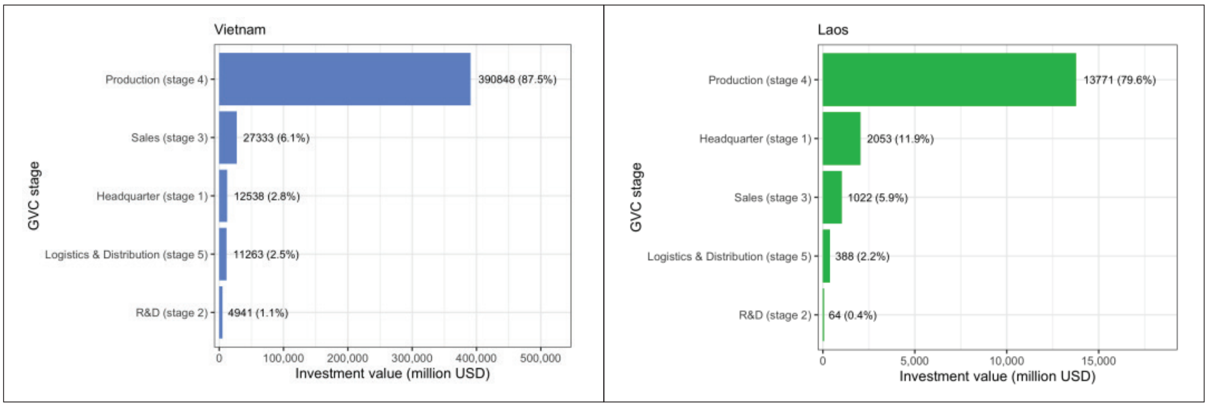
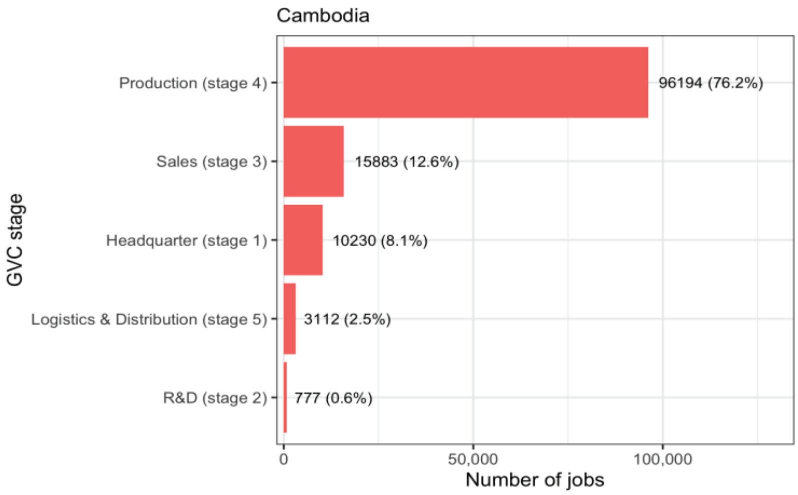


Figure 13: Estimated number of jobs by GVC stage, Cambodia, 2003-2022



The two plots in Figures 14-15 highlight that the ranking of GVC stages for Cambodia remains the same between the two decades 2003-12 and 2013-22, with Production having consistently the highest shares of investment value, as well as number of jobs: both indicators saw substantial growth, going up from 66 percent to 77 percent and 65 percent to 81 percent, respectively, in the last decade. On the contrary, as noted above, R&D is the GVC stage with the lowest levels of inward FDI: worryingly, both investment value and estimated jobs creation have become even more marginal in the most recent years. This is explored in more detail in the geographical analysis below.

Figure 14: Investment value by GVC stage, Cambodia, 2003-2012 and 2013-2022

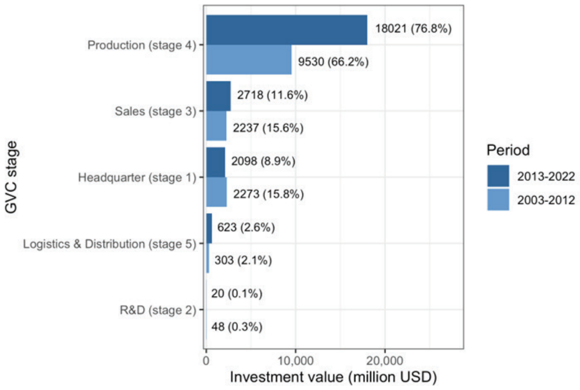
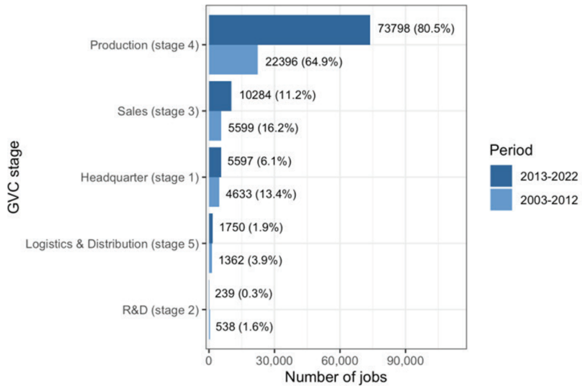


Figure 15: Number of jobs by GVC stage, Cambodia, 2003-2012 and 2013-2022



4.1.3. Geography of origin

Figures 16 and 17 show the top countries of origin of the investment in terms of value aggregated for the whole period observed. As expected, some origin countries are among the top for all three countries, such as Malaysia and Japan; Cambodia, like Lao PDR, sees a more prominent role of Chinese investors than Vietnam, particularly in terms of job creation (Figure 18; for Vietnam and Lao PDR see Appendix 2): the first country of origin for inward FDI amount in Vietnam is South Korea, followed by Japan. Overall, data shows a strong FDI integration among Asian economies, corroborating the vital importance of FDI and GVCs within macro-regions.

Figure 16: Investment value by source country (top 25), Cambodia, 2003-2022

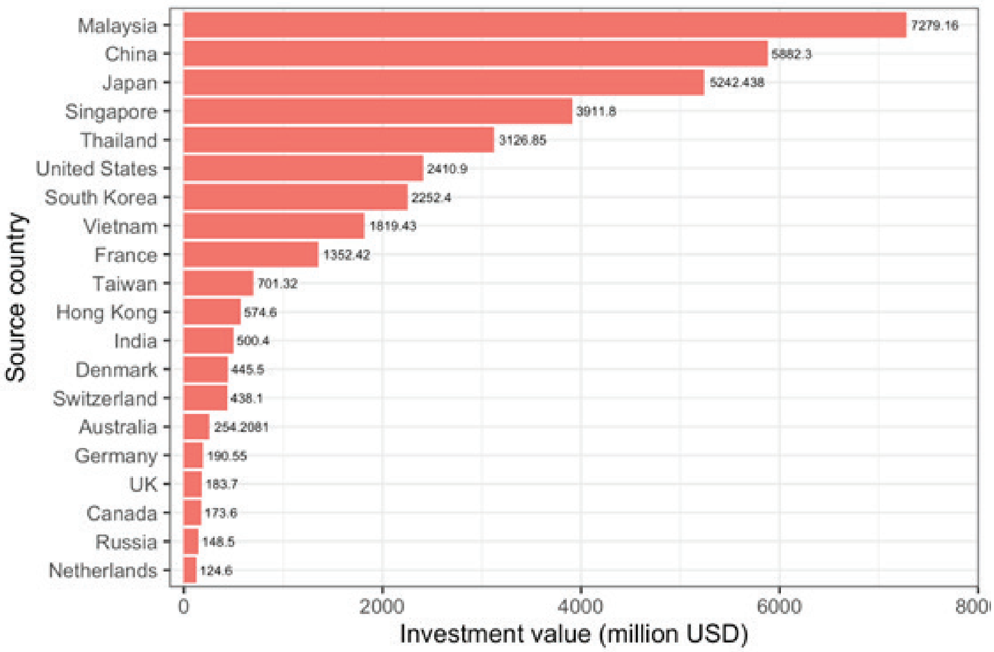


Figure 17: Investment value by source country (top 25), Vietnam and Lao PDR, 2003-2022

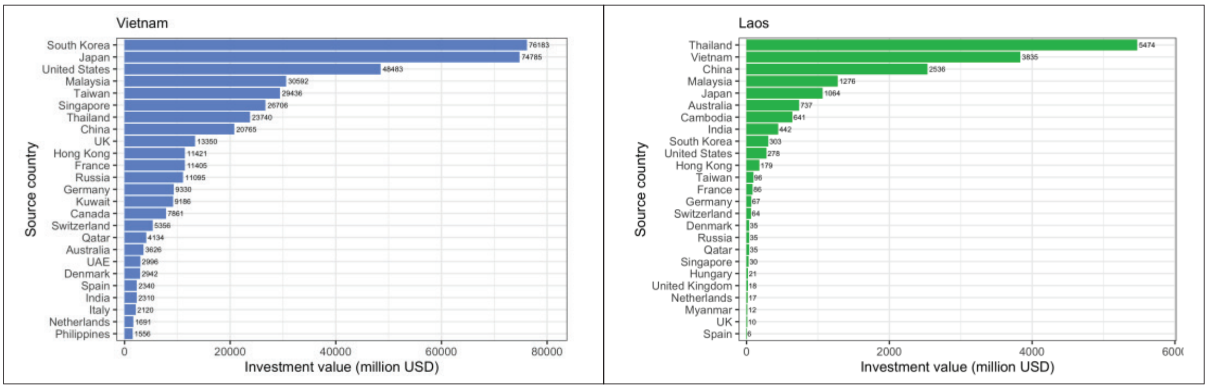
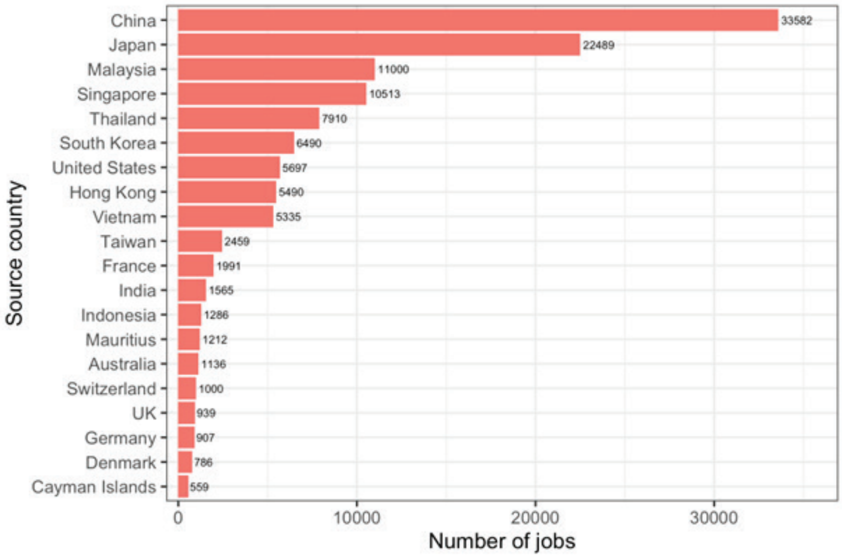


Figure 18: Estimated number of jobs by source country (top 25), Cambodia, 2003-2022



Figures 19 and 20 display the FDI value and estimated job creation for different source countries (top 20) in each decade 2003-12 and 2013-2022 (see Appendix 2 for equivalent charts in terms of cumulative FDI value for Vietnam and Lao PDR): the countries are ordered by decreasing value of total investment/estimated jobs over the 2003-2022 period. The strong and growing integration of Cambodia in the wider Asian macro-region is evident: Japan, China and Singapore record the biggest increases in investment flows to Cambodia in the second decade, all overtaking Malaysia – the largest source during the whole 20 years observed – both in terms of FDI value and job creation. With respect to the latter indicator, the role of China is particularly striking, generating by far the largest number of jobs in the second period (over 30,800 estimated jobs), with almost twice the number of jobs created through FDI from Japan (15,280 jobs), the next highest source country, and three times those generated in the same period by MNEs from Singapore (10,222 jobs).

To be noted, France exhibits a big rise in investment to Cambodia in the second decade, having had no investment in the previous one; conversely, sizeable reductions in both FDI values and jobs are recorded in the most recent years for South Korea and Vietnam, whilst USA investors register a modest decline in the amount invested, but stability in jobs generated over time. Interestingly, Vietnam experiences a large increase in FDI from South Korea, whilst both Cambodia and Lao PDR saw decreases; in contrast, investment value coming from China increased significantly for both the latter economies, while it decreased for Vietnam.

Figure 19: Investment value by source country (top 20), Cambodia, 2003-2012 and 2013-2022

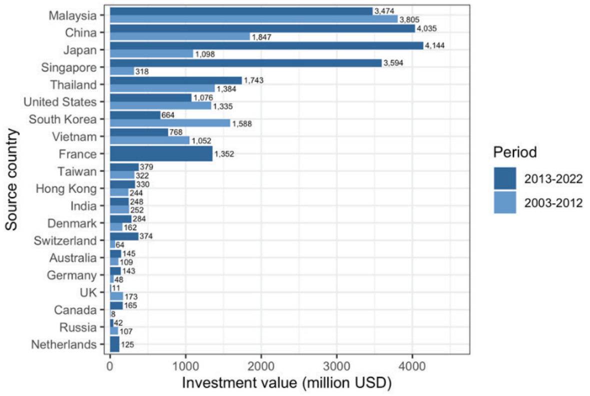


Figure 20: Number of jobs by source country (top 20), Cambodia, 2003-2012 and 2013-2022

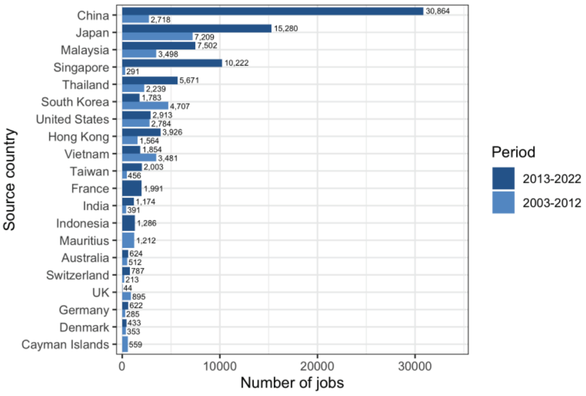
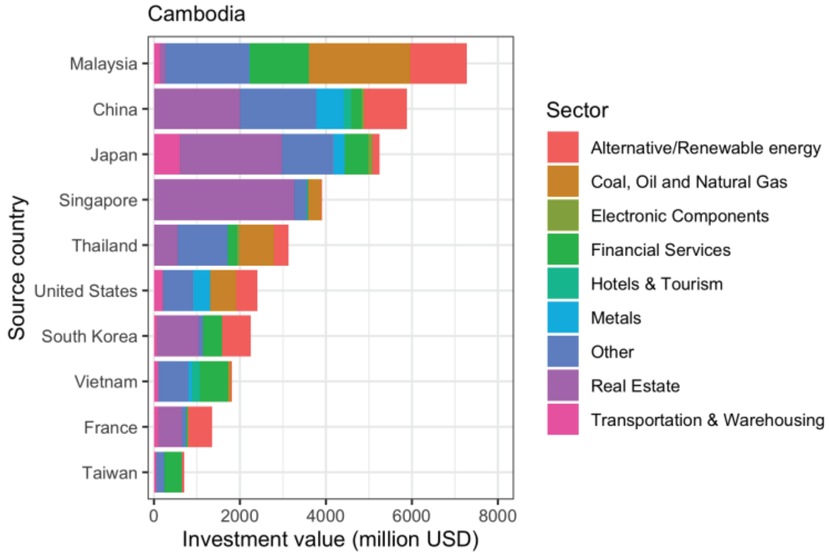


Figure 21: Investment value by source country and sector, Cambodia, 2003-2022



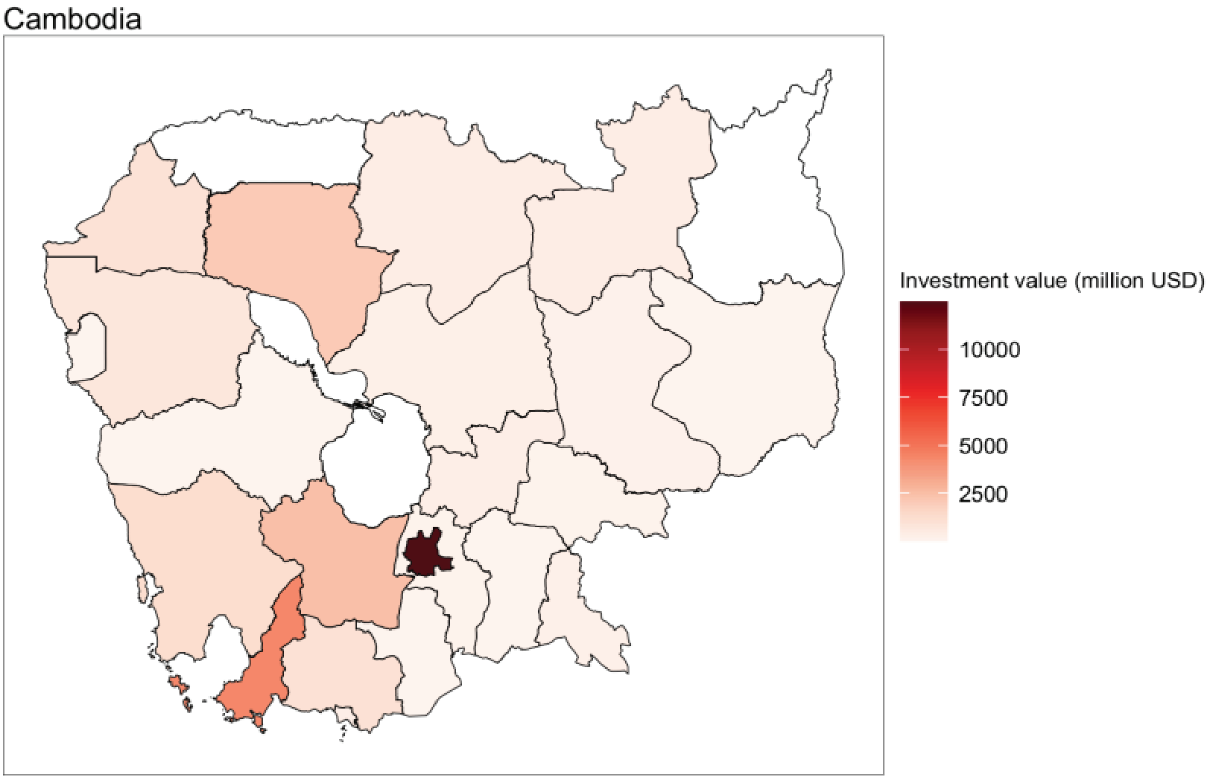
By intersecting the sectoral (top 5 sectors) and geographical source dimensions of FDI, Figure 21 reveals that investors target sectors differently. For China, Japan and Singapore, which experience the biggest increases in FDI to Cambodia over time, Real Estate is an important and prominent sector of investment, making up for the vast majority of FDI coming from Singapore. Malaysia, Thailand and the USA display significant investments in Coal, Oil and Natural Gas; at the same time, Alternative energy investment come mainly from Malaysia, China, South Korea, France – representing almost half of the recent FDI in Cambodia of the EU economy – and the USA.

When it comes to composition in terms of GVC stage (see Appendix 2 for plots for Cambodia, Vietnam and Lao PDR), as expected Production is the most important across all investing countries, accounting for the vast majority of FDI even for those source economies with the highest FDI levels. This is followed by Headquarter and Sales, which play a significant role for FDI from Malaysia. Interestingly, Cambodia displays a more diversified distribution of GVC stages across most investor countries with respect to both Vietnam and Lao PDR, showing relatively more attractiveness for Headquarter and Sales functions across geographical sources (see Appendix 2).

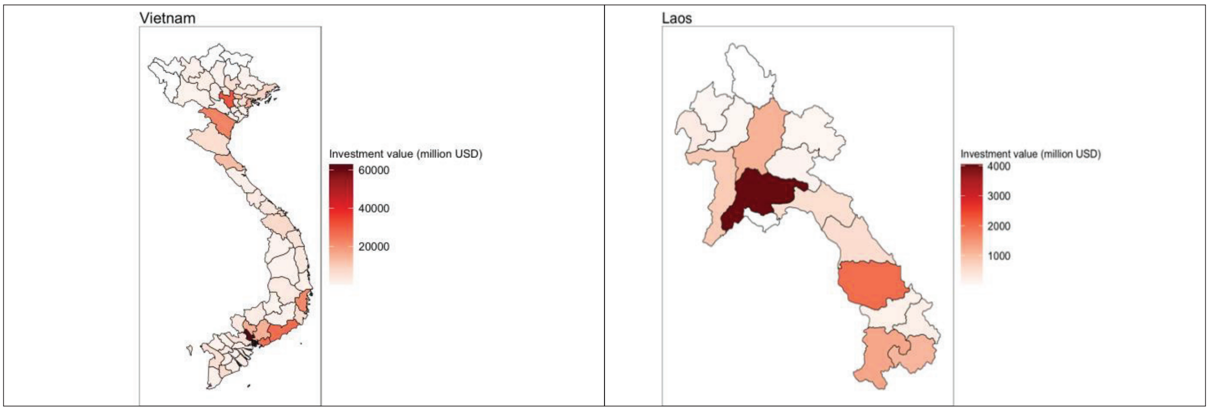
4.1.4. Geography of destination (Subnational distribution)

This section explores the geography of FDI destination within Cambodia (Map 1), focusing on the province level, comparing it with the other two Mekong economies (Maps 2 and 3)[19]. As expected, Phnom Penh has the highest concentration of aggregate inward FDI value; the same holds for the capital Vientiane in Lao PDR. However, in the case of Vietnam, the most attractive province is undoubtedly that of Ho Chi Minh City in the south of the country, with more than double the amount of FDI in US dollar than the capital Hanoi over the time considered. Overall, the concentration of FDI at the subnational level is highest in Cambodia, indicating a risk factor for balanced development through internationalisation.

Map 1: Geographical subnational distribution of inward FDI across provinces, Cambodia, 2003-2022



Map 2: Geographical subnational distribution of inward FDI across provinces, Vietnam and Lao PDR, 2003-2022



19 See also the plots for all three countries for 2003-22 in Appendix 2 (these report 25 provinces for the case of Vietnam; all subnational provinces are shown for Cambodia and Lao PDR).

In the fDiMarket dataset, some investments miss information about the detailed subnational destination. In Cambodia, this is the case for USD3,998.29 million invested in the 2003-2012 period, and USD6,468.45 million invested in the 2013-2022 period; it makes up 28 percent of the total investment. In the following plots (Figures 22 and 23), exploring the subnational patterns of investment in Cambodia between the two decades, these investments are disregarded (thus, 28 percent of inward FDI are not included in the descriptive statistics as they cannot be allocated to specific provinces: most of these probably are in the capital region).

Figure 22: Investment value by destination province, Cambodia, 2003-2012 and 2013-2022

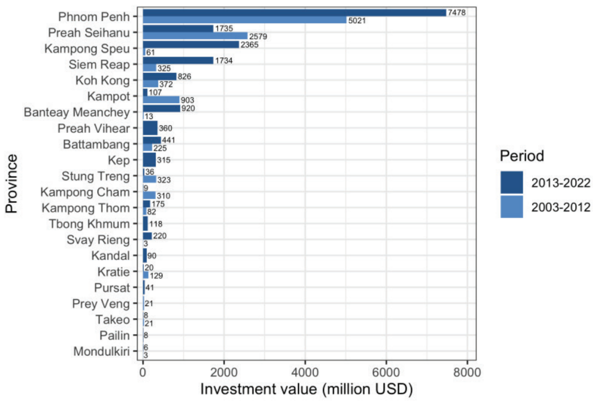


Figure 23: Number of jobs by destination province, Cambodia, 2003-2012 and 2013-2022

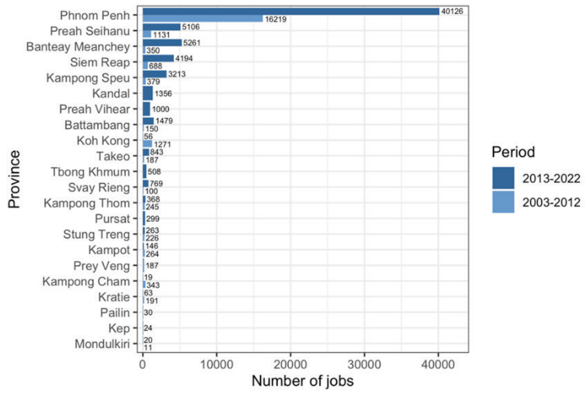


Figure 22 shows the provincial distribution of foreign investments for the two periods, while that for the estimated employment creation is reported in Figure 23. Although the dynamics of the subnational distribution of inward FDI across Cambodia's provinces confirm the strong geographical concentration in the capital Phnom Penh noted in the literature, in terms of both value and, even more, job creation, some changes are worth noting. Whilst Preah Sihanouk (ranked second on the overall period) shows a moderate decline in FDI value (though not reflected in job creation) in the most recent decade Kampong Speu, Siem Reap and Banteay Meanchey all register remarkable increases in their attractiveness to foreign investors for both indicators. Interestingly, some provinces such as Preah Vihear, Kep and Kandal emerged as brand-new locations for foreign investors in recent years, possibly indicating a starting spread of the geography of inward FDI and the potential for some territorial spillover effects over time.

Figure 24: Investment value by destination province and sector, Cambodia, 2003-2022

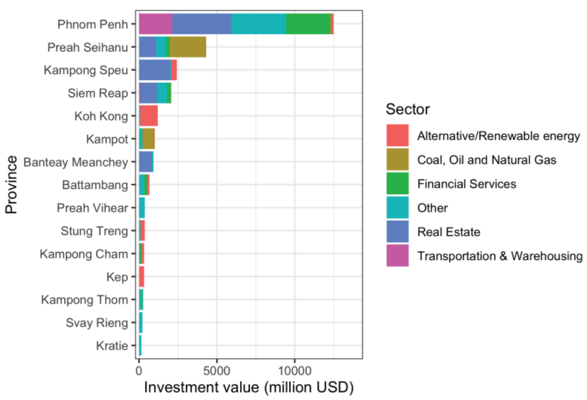
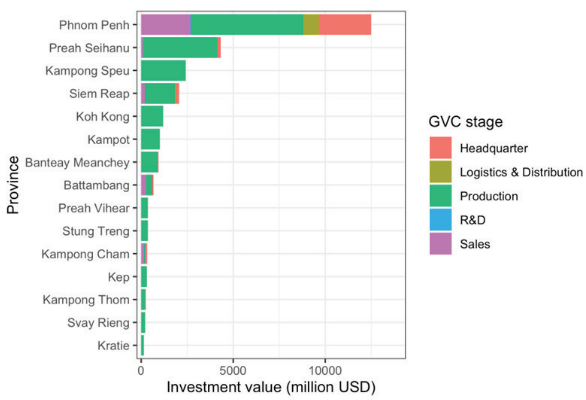


Figure 25: Investment value by destination province and GVC stage, Cambodia, 2003-2022



Figures 24 and 25 present the provincial-sectoral and provincial-GVC stage cross-dimensions, respectively, with reference to FDI US dollar value over the whole period considered: Phnom Penh, not surprisingly, shows the highest diversification in both sectoral and functional terms.

Table 1 displays the subnational destination of the R&D function, as said above extremely low: as expected, FDI in this GVC stage is exclusively located in the capital province.

Table 1: Investments in R&D (GVC stage), Cambodia, 2003-2022

GVC Stage	Destination province	Sector	Investing company	Source country	Year	Investment (mil. USD)	Number of jobs	Projects
R&D	Phnom Penh	Transportation & Warehousing	DHL Global Forwarding	Germany	2011	21.4	138	1
	Phnom Penh	Software & IT services	Dell Computer	US	2010	15.9	210	1
	Phnom Penh	Business Services	Intertek Group	UK	2010	10.4	190	1
	Phnom Penh	Business Services	SGS	Switzerland	2014	10.4	190	1
	Not Specified	Business Services	Nagoya University	Japan	2014	9.6	49	1

4.2. Outward FDI from Cambodia: Emerging trends

Little evidence exists about the recent active internationalisation strategies through outward FDI of Cambodian firms. As maintained by recent academic research, the international connectivity of Cambodia – i.e., its exposure to the assets, knowledge and expertise flows coming from and going towards the rest of the world – is of paramount importance for understanding the economic development trajectories of the country and its regions. Considering outward FDI (OFDI) from Cambodia, some key tendencies can be identified:

- OFDI started only from 2008 onward, with no investment recorded in the fDiMarkets dataset before then. All investments are classified as new greenfield investment abroad, with one exception categorised as an expansion (in 2014, to Myanmar).
- 31 OFDI projects from Cambodia, equivalent to USD917.6 million and associated with an estimate of 1,659 jobs generated abroad, are reported over the 2008-2022 period.
- All OFDI originates from the capital Phnom Penh.

Figures 26 and 27 illustrate the sector of origin and the country of destination of Cambodian MNEs, respectively. Financial services are the dominant source of outward FDI from Cambodia. Not only it represents the largest share of OFDI value over 2003-2022 (Figure 26), but it was already the main sector of outward flows in the first period (2003-2012): it represents around three quarters of total OFDI value over 2008-2022. Acleda Bank has been the first and biggest Cambodian investor abroad. Since 2013, additional sectors have emerged: Communication, with the highest investment in value of all directed to Ethiopia; Hotel and tourism and Leisure and entertainment, the latter with investments from NagaCorp, the largest gaming entertainment company in the Mekong sub-region, and one of the biggest in the world; and Business services, with VDB Loi playing a prominent role as investor in other economies of the Southeast Asia region, particularly since 2012. As shown in Figure 27, most of the OFDI projects from Cambodia, the large part from the Financial Services sector, have chosen the Lao PDR as their destination (19 projects out of 31, and almost 70 percent of invested value), targeting 13 different provinces in the host economy. With the exception of Ethiopia and Russia, all geographical destinations of Cambodia OFDI are countries in the Asian macro-region.

Figure 26: Outward FDI value by sector, Cambodia, 2003-2022; 2003-12 and 2013-22

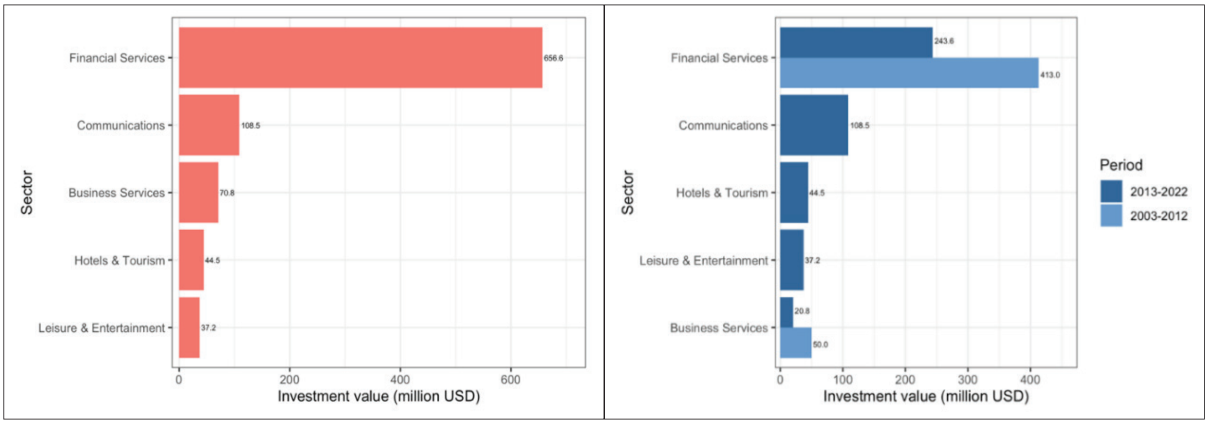


Figure 27: Outward FDI value by country of destination, Cambodia, 2003-2022; 2003-12 and 2013-22

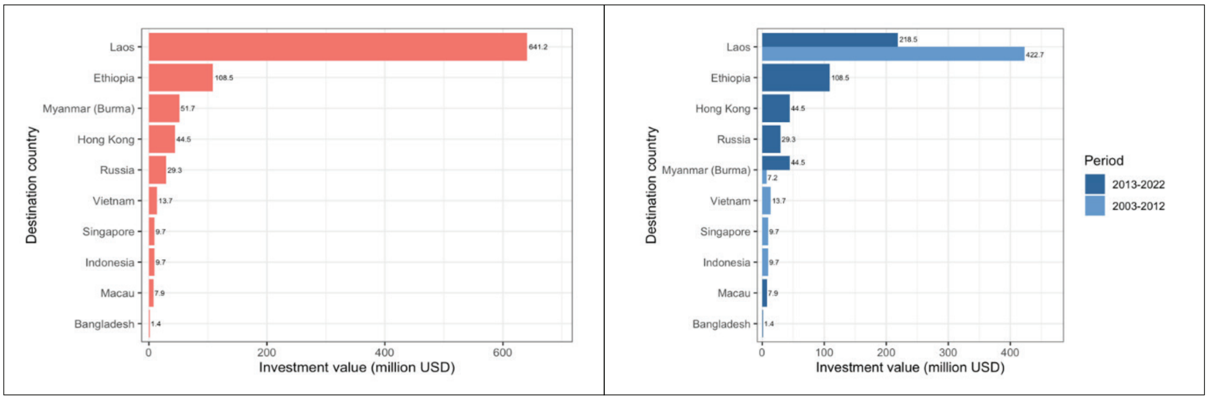
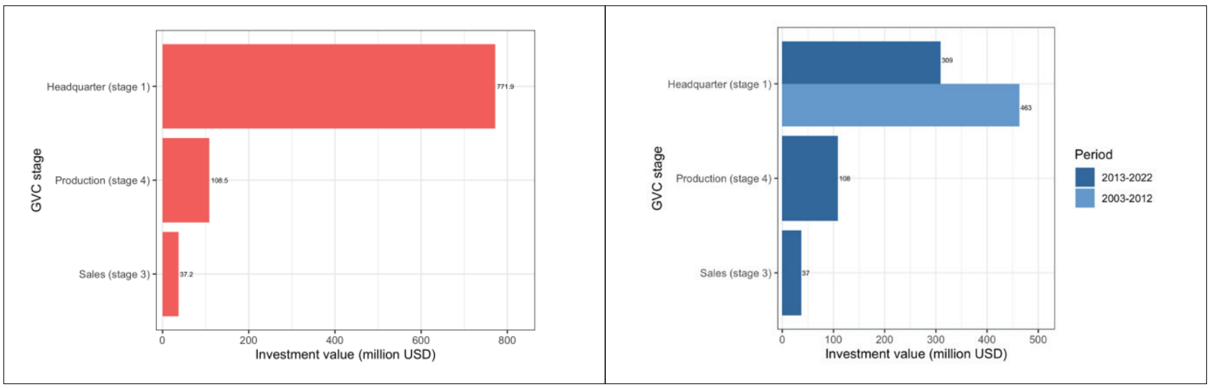


Figure 28: Outward FDI value by GVC stage, Cambodia, 2003-2022; 2003-12 and 2013-22



OFDI from Cambodia occurred across three of the five GVC stages (Figure 28). Headquarter (stage 1) overwhelmingly dominates, accounting for 84 percent of all OFDI in the years 2008-2022 and being the only stage of outward investment until 2012: this likely reflects the emergence of active internationalisation strategies from large Cambodian companies. In the last decade 2013-2022, OFDI occurred only in Production (GVC stage 4) and Sales (GVC stage 3), with shares of 12 percent and 4 percent of the total respectively, suggesting the consolidation of firms' efficiency- and market-seeking strategies.

Figure 29: Outward FDI from Vietnam, investment value and number of jobs, 2003-2022

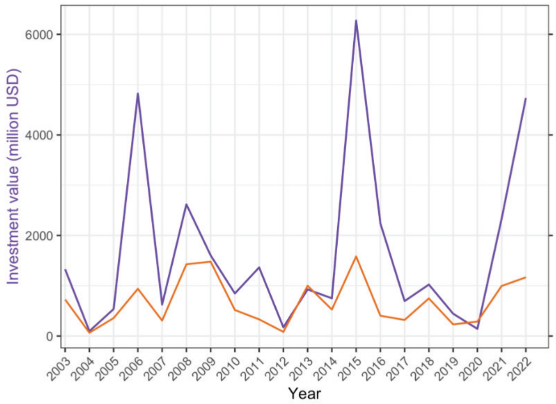
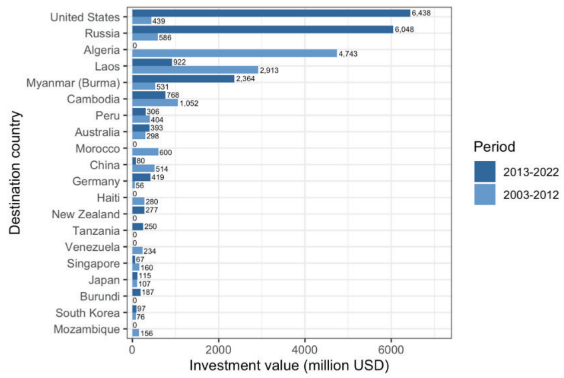


Figure 30: Outward FDI from Vietnam, destination countries, 2003-2012 and 2013-2022



In comparison with Vietnam, the active internationalisation through OFDI by Cambodian MNEs is very early stage. Figures 29 and 30 below show the much greater extent of engagement with OFDI by Vietnamese firms in terms of value and estimated number of jobs generated by outward flows, and destination countries across the two decades here considered. There is substantive outward investment from Vietnam that goes to both Cambodia and Lao PDR. As previously noted, for overall OFDI from Vietnam in the whole observed period, Cambodia is the top sixth receiving country, although it saw a small decrease in the second decade.

5. Policy recommendations

5.1. A SWOT analysis for FDI in Cambodia

The case of Cambodia illustrated in this paper offers important insights into the use of FDI as a channel for developing export sophistication, economic diversification and capabilities' upgrading. Below a SWOT analysis is presented – informed by the in-depth review of different streams of academic literature, policy and data analysis summarised in previous sections – to highlight the main Strengths and Weaknesses of Cambodia's FDI context, and to detect Opportunities and Threats for the country's internationalisation through FDI, economic development path and achievement of the middle-income status.

SWOT analysis: 20 years of FDI in Cambodia	
S	**W**
• Cambodia's internationalisation through FDI grown in the past 2 decades • Rapid economic transformation with gains from FDI & GVCs, and economic regional integration • FDI helped diversification of exports into light manufacturing and, particularly, services • Long-term FDI policy schemes and incentives to promote local ecosystem, updated over time • FDI attractiveness recovers post-Covid-19 • FDI in Alternative/Renewable energy very attractive and growing, signalling commitment to integrate renewable energy and energy efficiency into national strategies; disinvestment in Coal, Oil & Natural Gas • Modest but evident increases of FDI in Rubber, Automotive OEM, Leisure & Entertainment, Food, Tobacco & Beverages, and Paper, Printing & Packaging • New provincial locations for FDI in most recent years may signal territorial spillovers effects • Recent OFDI trends in the last 10 years indicate the emergence of active internationalisation strategies from large Cambodian companies	• Cambodia's internationalisation through FDI far lower than in other Mekong sub-regions (e.g. Vietnam) • Structural lack of skills, weak human capital and public and private research; frail domestic firms' capabilities and capacity to take advantages of niches offered by GVCs/GPNs • FDI policy framework sectorally very broad • Disproportioned, and increasing, weight of Real Estate in FDI value; Textiles highest in estimated job creation, followed by Real Estate • Higher value-added sectors still weakly attractive to FDI • Specialisation in Production GVC stage stronger over time, both in terms of value and estimated employment creation • Negligible (and decreasing) investment in innovation & R&D stage, relative to neighbours • Concentration of FDI at the subnational level, mostly in the capital Phnom Penh, highest in Cambodia even relative to the neighbours, signalling risks for balanced development • Still negligible internationalisation of Cambodia's business firms, also relative to the area (e.g. Vietnam), suggesting obstacles in regional GVC integration
O	**T**
• Exploit internationalisation and regional economic integration to achieve middle-income status and further economic development through FDI/GVCs (taking advantage of global geopolitical tensions • Creating goods and services inherently greener, and inserting in new "green" GVCs regionally and globally • Promote the use of AI & digital technologies for the global delivery of services	• Cambodia's structural disadvantage in FDI/GVCs – and particularly skills, human capital, university and education system, and R&D – may detract from its ability to attain development targets and increase risk of middle-income trap • Strong growth in the Mekong sub-region – particularly in terms of skills and research – may push Cambodia in a peripheral position • Over reliance on Chinese FDI at a time of geo-political tensions and trade wars

As mentioned in the Introduction, a 1-day Workshop was held on 08 February 2024, organised by the CDRI on "20 Years of FDI in Cambodia: Towards Upper Middle-income Status and Beyond" and aimed at facilitating a comprehensive dialogue among the research team working on the present paper and key stakeholders in Cambodia, including policymakers, government agencies, private sectors, development partners, and researchers. The fruitful discussion added further insights and inputs to the research presented in this paper, emphasising elements for the SWOT analysis and strategies to promote FDI inflows and outflows into/from Cambodia and contribute to its future's diversified and competitive economy. Indeed, the main elements emerged from the Workshops in relation to the SWOT Analysis are reported here below (and are summarised in the exhibit above):

Strengths

- **Favourable policy framework**: Besides political and economic stability, Cambodia offers a favourable investment policy framework that includes a range of incentive packages aimed at attracting both national and foreign investors without discrimination. The 2021 Law on Investment provides basic, additional, and special incentives for more than 18 sectors, which are divided into high-tech, mid-tech, and low-tech categories. As seen in Section 3 of this report, these incentives include exemptions from income tax, special depreciation allowances, customs duties, special taxes, and VAT exemptions.

- **Abundant young workforce**: Cambodia benefits from an abundant, young workforce. 65 percent of its population in 2022 is in the working age group between 15-65(UN 2024). This demographic presents an opportunity for rapid adaptation to digital technologies. As a result, the share of individuals owning a mobile phone (2019) rose to 72 percent, and the prevalence of active mobile-broadband subscriptions per 100 inhabitants in 2022 reached 102.[20]

- **International integration**: Cambodia's memberships in WTO, ASEAN, and RCEP, as well as bilateral free trade agreements with countries such as China and South Korea, reflect its economic openness and integration at both regional and international levels. This expands market access for Cambodian exports, attracts FDI, promoting overall future internationalisation.

Weaknesses

- **Lack of skilled workforce**: Despite the abundant young workforce, Cambodia is facing challenges in meeting the skill requirements of different industries. According to the stakeholders, this problem arises from both the overall education and the TVET systems, with a worrying lack of research and high-quality teaching in university education. According to the UNESCO Institute for Statistics (UIS), only 19 percentof Cambodia's adults (25 years of age and above) completed at least a lower secondary education level in 2019, which is significantly lower compared to its peers such as Myanmar (41.5 percent), Bangladesh (42.6 percent) and Vietnam (65.3 percent). In addition, a skill mismatch emerges as students tend to prefer social sciences majors over STEM majors. A study conducted by CDRI revealed that only 30 percent of tertiary students pursue a STEM major although 80 percent of upper secondary school students enrol in the science track, highlighting the ineffectiveness of the existent mechanism to motivate students toward the STEM path (Kao, Chea, and Song 2022).

- **Lack of local micro and SMEs (MSMEs) capabilities**: In connection with the point above, the limited capabilities of local MSMEs in Cambodia were highlighted, constraining their ability to integrate into the supply chains of large FDI projects.This lack of backward participation not only affects the capacity of Cambodia to implement structural change but

20 International Telecommunication Union (ITU) Data.

also acts as a bottleneck which discourages potential foreign investors from investing in the country as it translates into higher costs of production.

- **Business environment obstacles**: The ease of doing business in Cambodia has improved over recent years. Its ease of doing business score has increased from 52.9 in 2016 to 53.8 out of 100 in 2020 (World Bank 2024a). Yet, issues such as complex business procedures, compliance, unclear government auditing practices, corruption and unfair competition are still largely diffuse, as pointed out by various stakeholders in the Workshop, especially from the private sector.

- **Lack of zoning**: According to ministers' representatives, Cambodia has not yet defined and developed the classification of its land for industrial and residential use. Thus, infrastructure development tends to be cohort-based and tailored to the localisation of SEZ developers, which is very costly and inefficient.

Opportunities/threats

- **Geopolitical tension**: Trade tensions between the US and China present an opportunity for Cambodia to serve as an alternative for foreign business companies looking to diversify their production bases away from China. The emerging solar panel industry is one example of the opportunity for Cambodia to benefit from this geopolitical tension. On the other hand, Cambodia needs to position itself carefully in the political scenario between China and the Western economies to derive benefits from such intermediary roles.

- **Integrate with neighbouring Countries' production chains**: Cambodia is located between two major industrial powerhouses, namely Vietnam and Thailand. Given that labour costs in those countries are rising as their industrial development is growing, programs such as Thailand+1 and Vietnam+1 have the potential to attract foreign investors from these neighbours to Cambodia to support specific niches of their production chain. Cambodia should carefully monitor these trends to avoid being relegated to lower value-added segments in regional GVCs.

5.2. Policy implications of the study

The findings of this study offer important elements for a reflection on the policy implications of the growing interdependence of Cambodia in the current international division of labour through FDI and GVCs, and entail key issues and areas for policy and future research.As clearly emerged from the vast academic literature, most benefits of FDI depend on structural conditions of the recipient economy, among which the main important are:

- **Necessary (but insufficient) conditions:**
    - Local absorptive capacity (i.e. capabilities and skills within the business sector, education/research sector and government sector).
    - Capacity for systemic integration (i.e. coordination of a diverse structure of 'value networks' and linkages, both local and global).

- **Main mechanisms for development:**
    - Backward linkages with MNEs customers
    - Imitation and adaptation
    - Skills upgrading and human capital formation

While there is no single set of policies that will work to support Cambodia's economic development, internationalisation and achievement of middle-income status, some main recommendations can be made. Main **broad areas of intervention** are outlined below. These interventions are both horizontal (i.e. generic policies providing environments and institutions conducive to economic development) and vertical (e.g. sector- and place-sensitive), and are strongly interdependent.

- **Developing skills, human capital and the education system**

To address the critical gap in skilled labour, Cambodia must **prioritise long-term investments in education, and investment in vocational training for the short- and medium-terms**, aligned with market demands, industry, and public sector needs. Specifically, the skills and knowledge currently needed in the market are in renewable energies, electrical components, and agri-processing sectors. Cambodia needs more skilled workers capable of designing, installing, operating and maintaining systems in these sectors. Beyond such technical skills, also soft skills are needed – like, for example, communication, teamworking, problem-solving and adaptability. These sectors also require business skills and specialised knowledge from market analysis to regulation,including project management, finance, and marketing. Innovation skills are obviously crucial; and the links between business and the education and research system, particularly the National Research Agenda 2025 (MISTI 2023), are fundamental. Thus, restructuring and improving the education system should start from primary school to higher education,[21] targeting both soft and hard skills. The reform should also aim at upgrading capabilities both technically for industry and technological research, and organisationally for increasing the quality of government and institutional capacities. The Ministry of Education, Youth and Sport needs close collaboration with stakeholders to detect **skills and knowledge essential for current and future market demands, ensure alignment of academic curricula and teaching strategies, provide incentives to improve quality at all stages of education and promote internationalisation within the education system to consolidate good practices**. Examples may be offering grants and scholarships to teachers and students to study abroad in fields crucial to Cambodia's competitiveness, requiring the return to the home country to contribute to the local development. In addition, Technical and Vocational Education and Training (TVET) programs are an ideal tool for addressing job mismatches and prioritising skills for economic development. With the new direction of the government, the "TVET.1.5M" program has been launched, aiming to provide skills training to 1.5 million youth from poor and vulnerable households. While this is clearly a positive initiative, it is important to understand that this type of investment is a long-term strategy that cannot be fruitful in the short term. **Building up a national Science, Technology and Innovation (STI) System** as stated in the STI Roadmap 2030 (MISTI 2021) strictly depends on this type of long-term investment.

21 A positive trend in recent years is the government's focus on improving the education system, by allocating relatively larger shares of the national budget to the Ministry of Education. Still, in 2021 Cambodia's government expenditure on education as a share of GDP was 1.7 percent, well below the other Mekong sub-region economies (e.g. Vietnam (2.9 percent), Thailand (2.6 percent) and Myanmar (2.1 percent) (World Bank 2024c).

- **Improving monitoring and evaluating FDI, investment law and general business environment**

Cambodia has a commendable investment law that apply to both domestic and foreign firms. However, ongoing complaints are evident about applying the law, as some ambiguity has emerged among both implementers and investors regarding legal interpretation and enforcement. This ambiguity leads to misunderstandings between the parties involved. To address this issue, policymakers should provide more **comprehensive training and clear guidelines to law implementers**, particularly officers at Provincial/Municipal Investment Sub-Committees.

A transparent and predictable business environment is a key factor for attracting businesses and investors. Although Cambodia has made significant progress in the ease of doing business, there are still obstacles that need to be addressed. It is urgent, as said above, to **improve transparency in business procedures and fees, particularly taxing**, and ensure that the implementation of law and compliance is carried out fairly and lawfully by its officials. The government should establish a working group to design a **sound governance structure for monitoring, evaluation, accountability, and learning to ensure that no illegal activities are involved in the process of business regulation, administrative service, and tax collection**. Such initiatives would involve strong inter-ministerial collaboration across policy areas (e.g., the Ministry of Economy and Finance, the Ministry of Commerce, the Ministry of Justice, and Anti-Corruption Unit) and international collaboration to learn from good (and bad) practices. It should be emphasised that the government has created a Government-Private Sector Working Group, chaired by the Prime Minister. This group organises regular meetings and forums with the private sector to address issues related to business development and operations in Cambodia. Thus, it should be tapped to improve the investment environment. At the same time, **introducing digital technology and high-level technological and organisational skills in the administrative system and fighting corruption across the board** would improve transparency and accountability in government and business services.[22] The digitalisation of public goods and services at the sub-national levels is imperative, together with upgrading capabilities and training of new and existing local authorities and senior officers to equip them with such technologies.

Finally, **developing capacities to improve screening, selection and multilevel governance of FDI** and domestic firms' internationalisation, and to devise sector- and place-specific investment measures are critical. This entails, as a first and essential step to design knowledge-based policymaking, creating an **integrated information base** to monitor the potential features and evolution of both inward and outward FDI as well as the overall international integration.

- **Developing zoning and subnational regional specialisation**

Cambodia needs to **develop a zoning master plan** that identifies areas designated for residential, commercial, and industrial uses. This planning activity will simplify the process of providing infrastructure and facilities for each type of land use, particularly for industrial areas to take advantage of agglomeration economies and localised externalities, respecting the environment. In addition, **identifying, mapping and supporting the economic potential of each province** or region (based on provincial and regional development plans) is necessary to boost national development and growth.

22 A good example provided by the government so far is the financial reform in public institutions and the introduction of technology in business registration and tax collection. However, we need more of this kind of technology integrated into every public service, from the top to the bottom of the administrative system.

- **Identifying and strengthening intermediate industries and business linkages and networks**

Investment in Cambodia is often discouraged due to insufficient raw materials and inputs. This stems from the high level of informality among firms in Cambodia, which is driven by factors such as small business scale, less restrictive regulatory framework, particularly for micro-enterprises, fear of compliance/taxing, and a lack of perceived benefits (UNDP 2023). As a result, small firms tend to remain less productive, struggle to access finance and government support and fail to meet the standards required by large FDI firms, which impede their link to multinational firms. Therefore, it is crucial to encourage investment in input and intermediate providers to reduce production costs and **create backward linkages between MNEs and local firms**. Cambodia's strategy should focus first and above all on **mapping, building and strengthening domestic firms'**, particularly SMEs, and relevant local actors' capabilities. This should involve **improving access to finance, encouraging entrepreneurship, enhancing skills and human capital, and speeding up the formalization of SMEs**. This effort should capitalize on the existing institutions and policies such as the SME Bank of Cambodia, the Khmer Enterprise, the Skills Development Fund, and the national strategy for informal economic development 2023-2028.

Furthermore, support to SME innovation activities must be based on the **development of a local research and science and technology base** that helps, through high human capital formation and technology transfer, produce high-quality products and services that meet the export standard and strategies for marketing. **Supporting collaboration, networks and participation of all local stakeholders** (domestic firms, foreign and local MNEs, foreign and local researchers and education representatives, government agencies, etc.) is of paramount importance. This would also enhance ties within macro-regional areas.

Starting with small development projects and support for backward linkages and SME development, the government should prioritise these initiatives based on available resources and the sectors that will be most beneficial for Cambodia in the long term. They can allocate more financial support to SMEs for business development and provide tax exemptions for priority sectors, particularly those involved in the green transition. SMEs, and the private sector in general, will thrive and work well themselves when they have access to resources and networks in a conducive business environment.

- **FDI sectoral and geographical selection and diversification**

Policy support for investment diversification should be **selective on particular industries or groups of industries that provide opportunities to enhance the environmentally-friendly and sustainable production of existing goods and services**. According to the findings of this paper, renewable energy, electrical components, and agro-processing sectors are the potential sectors for Cambodia. Therefore, being able to rigorously monitor and evaluate MNEs' (and local firms') alignment to these sectors and SDGs is a competitive advantage. FDI companies in some sectors may negatively affect domestic firms as they have more capacity and resources than the local ones. The government should focus on **identifying the "right" FDI in sectors** that have the potential for generating expertise and linking MNEs to domestic firms that can provide raw materials and intermediate products. This would facilitate **SMEs' participation in GVCs and enable them to become greener with higher value addition**. The growing investment in solar panel manufacturing is a clear example of this trend. In this regard, Cambodia needs to identify and develop other emerging industries by improving workforce skills, creating a better business environment, developing the necessary infrastructure, and encouraging quality inward FDI.

- **Fostering economic development across subnational regions**

In addition to establishing industrial parks and economic special zones, Cambodia needs to prioritise more inclusive socio-economic development across its regions and provinces. **Territorially tailored and place-based policies** are vital to internal economic, social and political cohesion; and to supply chain participation, diffusing development. **Within-country economic diversity is an essential leverage for creating opportunities for local populations** and extracting value from local resources for business development. Rural economic activities in Cambodia largely revolve around agriculture (Nith 2024). Promoting investment and capability-building in agro-processing and facilitating access to urban markets and international exports is urgent (Nith 2020). This would concern enabling small-scale producers to produce products sustainably, at relatively low cost, and with high quality. Furthermore, it is crucial to devise long-term development plans for each province that better leverage local skills, business linkages across provinces and sectors as well as **connections to national infrastructure and administrative services**. Monitoring, on the basis of statistical and qualitative information, the intersections between geographical (i.e. international origins and subnational destinations), sectoral and functional distributions of both inward and outward FDI in and from Cambodia can provide a sounder base for policy decision-making.

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Appendices

Appendix 1 (Section 3)

Table A1: Investment activities eligible and not eligible for incentives

Investment Activities Not Eligible for Incentives Regardless Capital Investment	Investment Activities Eligible for Incentives Regardless Capital Investment
1. Living Modified Organisms-LMOs 2. Production of tobacco products 3. Service on installation, maintenance and repair of agricultural machinery 4. Postal and courier activities 5. Activities related to production or supporting production of video, motion picture and television programs, sound recording and music publishing activities 6. Commercial activities, import and export 7. Restaurants, karaoke, discotheques, massage salons, fitness centres, and markets that are not under any QIPs 8. Tourism service provider, tourism agent, tourism information and tourism advertisement 9. Gambling and betting activities 10. Currency and financial business and services, including banks, financial institutions, insurance companies and all kinds of financial intermediation 11. Activities related to newspaper and media, including radio, television, press, magazine, video production or reproduction, theatre and related activities 12. Professional services 13. Real estate development	1. High-tech industries involving innovation or research and development; 2. Innovative or highly competitive new industries or manufacturing with high added value; 3. Industries supplying regional and global production chains; 4. Industries supporting agriculture, tourism, manufacturing, regional and global production chains and supply chains; 5. Electrical and electronic industries; 6. Spare parts, assembly and installation industries; 7. Mechanical and machinery industries; 8. Agriculture, agro-industry, agro-processing industry and food processing industries serving the domestic market or export; 9. Small and medium-sized enterprises in priority sectors and small and medium-sized enterprise cluster development, industrial parks, and science, technology and innovation parks; 10. Tourism and tourism-related activities; 11. Special economic zones; 12. Digital industries; 13. Education, vocational training and productivity promotion; 14. Health; 15. Physical infrastructure; 16. Logistics; 17. Environmental management and protection, biodiversity conservation and the circular economy; 18. Green energy, technology contributing to climate change adaptation and mitigation.

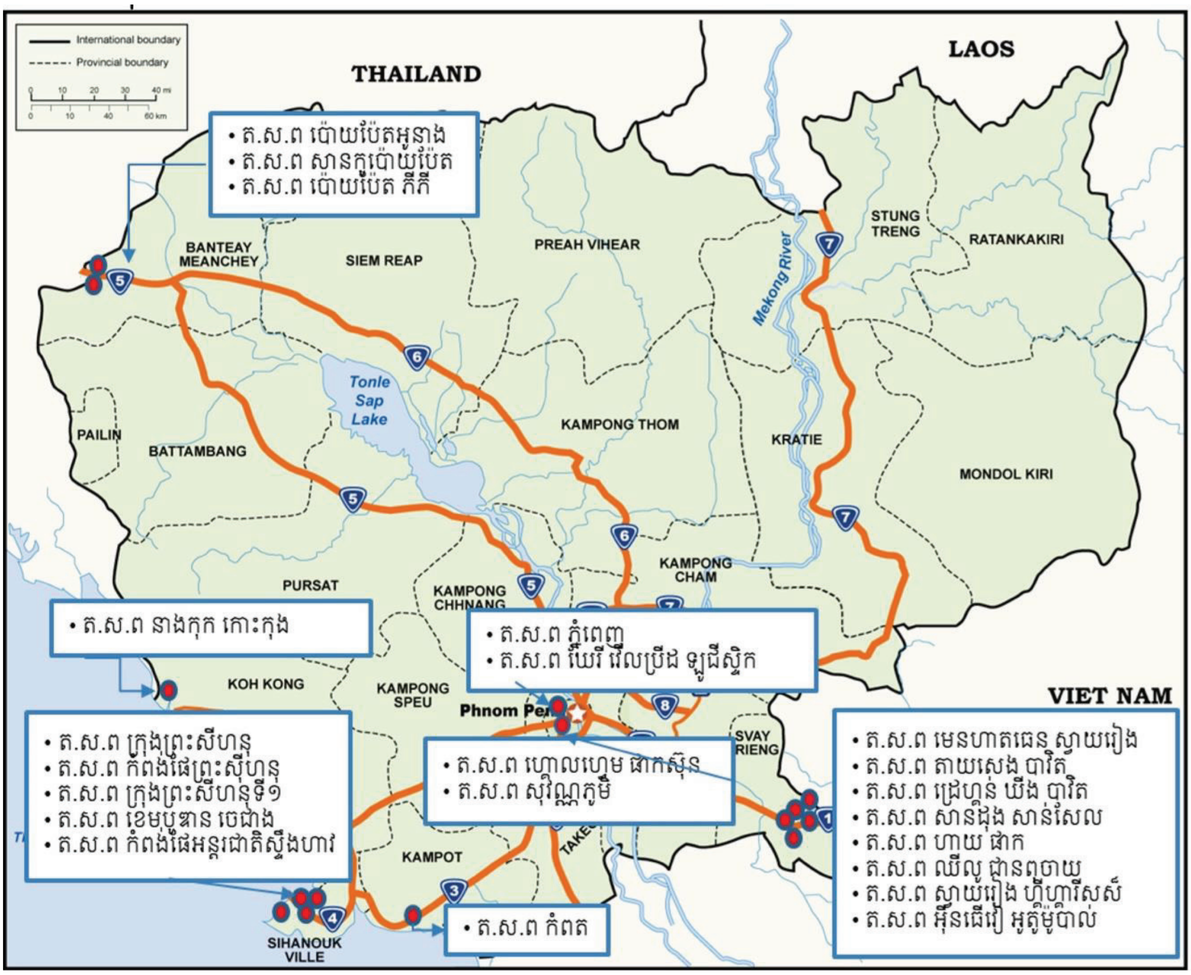
Table A2: Types incentives available under QIP status

<table>
<tr><th colspan="2">Type of incentives</th><th>Description</th></tr>
<tr><td rowspan="3">Basic Incentives</td><td>Option 1: Tax exemption period</td><td>• An income tax exemption for 3 to 9 years, depending on the sector and investment activities, commencing from the time of first earning income. The period of income tax exemption that each sector and investment activity will receive shall be determined by the law on financial management and/or the future LoI Sub-Decree.
o After the income tax exemption period has expired, the QIP's income tax will increase gradually over 6 years, at a progressive rate proportional to the total tax due as follows: 25 percent for the first 2 years, 50 percentfor the next 2 years and 75 percentfor the final 2 years.
• A Prepayment Tax exemption during the income tax exemption period;
• A Minimum Tax exemption, provided that an independent audit report has been carried out, and;
• An Export Tax exemption, unless otherwise provided for in other laws and regulations.</td></tr>
<tr><td>Option 2: Special depreciation</td><td>• Deduction of capital expenditure through special depreciation, as stated in the tax regulations in force;
• Eligibility of deducting up to 200 (two hundred) per cent of specific expenses incurred for up to 9 (nine) years. Sectors and investment activities, specific expenses, as well as the deductible period shall be determined in the Law on Financial Management and/or the Sub-Decree;
• Prepayment Tax exemption for a specific period of time-based on sectors and investment activities to be determined in the Law on Financial Management and/or the Sub-Decree;
• Minimum Tax exemption, provided that an independent audit report has been carried out;
• Export Tax exemption, unless otherwise provided in other laws and regulations.</td></tr>
<tr><td colspan="2">• Export QIP and Supporting Industry QIP are entitled to customs duty, special tax and value-added tax exemption for the import of Construction Material, Construction Equipment, Production Equipment and Production Inputs;
• Domestically Oriented QIP is entitled to customs duty, special tax and value-added tax exemption for the import of Construction Material, Construction Equipment, and Production Equipment. The incentives for Production Inputs shall be determined in the Law on Financial Management and/or the Sub-Decree</td></tr>
<tr><td>Additional Incentives</td><td colspan="2">• Value-added tax exemption for the purchase of locally made Production Inputs for the implementation of the QIP.
• Deduction of 150 percentfrom the tax base for any of the following activities:
o Research, development and innovation;
o Human resource development through the provision of vocational training and skills to Cambodian workers/employees;
o Construction of accommodation, food courts or canteens where reasonably priced foods are sold, nurseries and other facilities for workers/employees;
o Upgrade of machinery to serve the production line; and Provision of welfare for Cambodian workers/employees, such as comfortable means of transportation to commute from their homes to factories, accommodation, food courts or canteens where foods are sold at reasonable prices, nurseries and other facilities.
• Entitlement to income tax exemption for the Expansion of QIP, which will be determined in the Sub-Decree.</td></tr>
<tr><td>Special incentives</td><td colspan="2">• Any specific sector and investment activities having high potential to contribute to Cambodia's national economic development may receive specific special incentives. The eligible sectors and activities are to be set out in the Law on Financial Management.</td></tr>
</table>

Table A3: Investment group and associated tax exemption period

Group	Description	Tax exemption period (in years)
Group 1	High-tech adoption investment activities belong to the prioritised sectors of government. This includes investment activity in the development of the digital industry, manufacturing of solar systems, and SEZ development.	9
Group 2	Intermediate-tech adoption investment activities. This includes, for example, agro-processing development activities, manufacturing/installation of electrical components, services on agriculture infrastructure support	6
Group 3	Low-tech adoption investment activities. This includes, for example, textile-related development activities, paper manufacturing, manufacturing of office suppliers except computers or computer components	3

Figure A1: Map of SEZs in Cambodia



Source: Council for the Development of Cambodia

Appendix 2 (Section 4: Statistical Appendix)

Figure 1A: Investment value by sector, Vietnam, 2003-2012 and 2013-2022

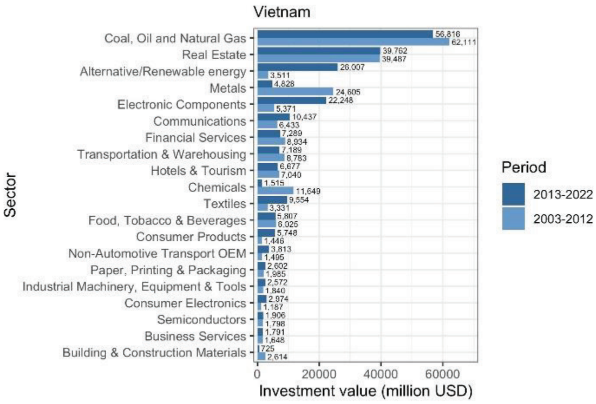


Figure 2A: Investment value by sector, Lao PDR, 2003-2012 and 2013-2022

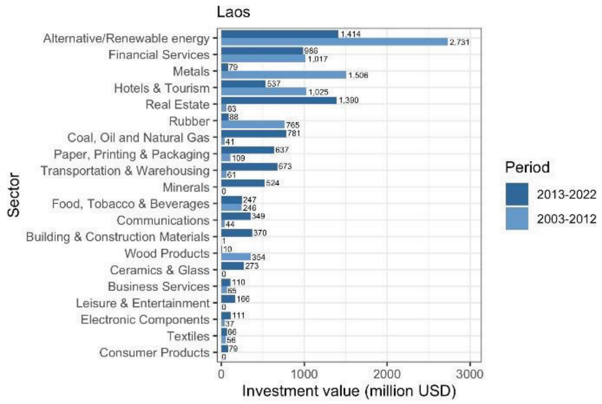


Figure 3A: Estimated number of jobs by GVC stage, Vietnam, 2003-2022

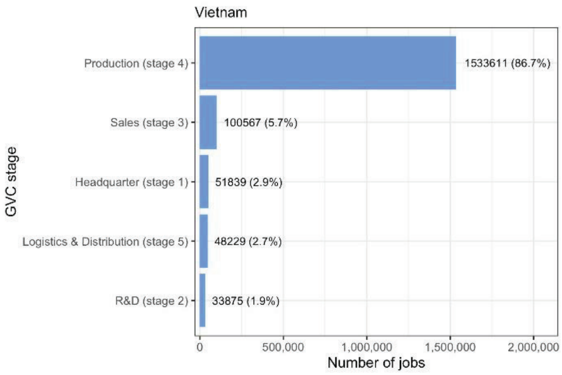


Figure 4A: Estimated number of jobs by GVC stage, Lao PDR, 2003-2022

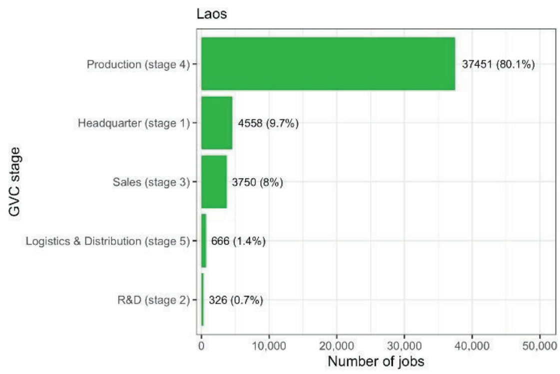


Figure 5A: Estimated number of jobs by source country (top 25), Vietnam, 2003-2022

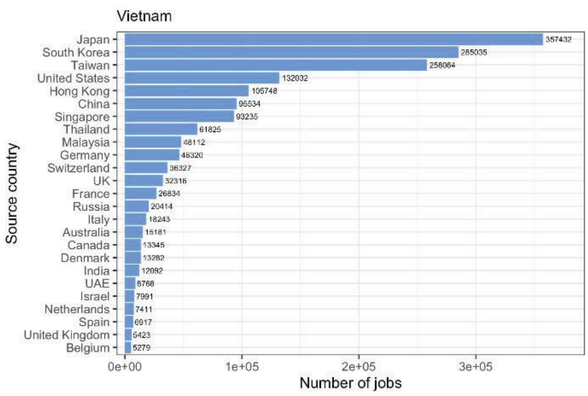


Figure 6A: Estimated number of jobs by source country (top 25), Lao PDR, 2003-2022

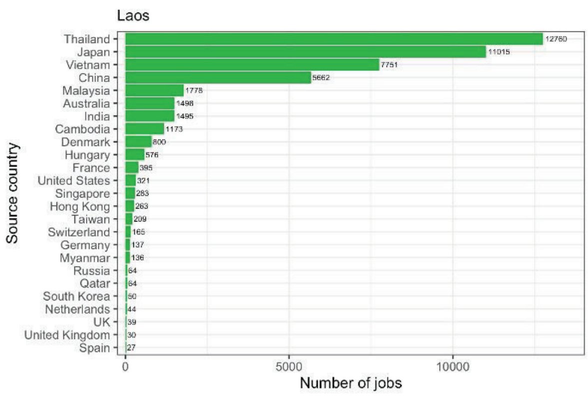


Figure 7A: Investment value by source country (top 20), Vietnam, 2003-2012 and 2013-2022

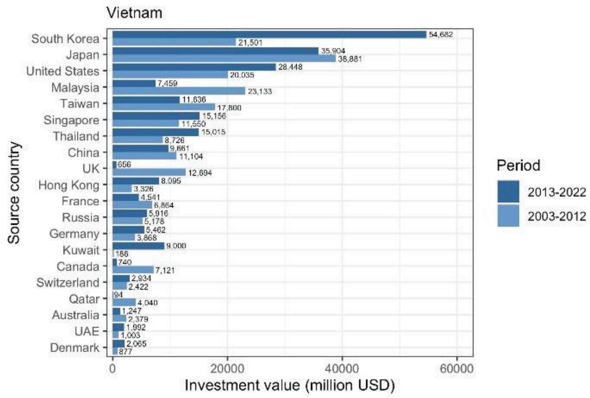


Figure 8A: Investment value by source country (top 20), Lao PDR, 2003-2012 and 2013-2022

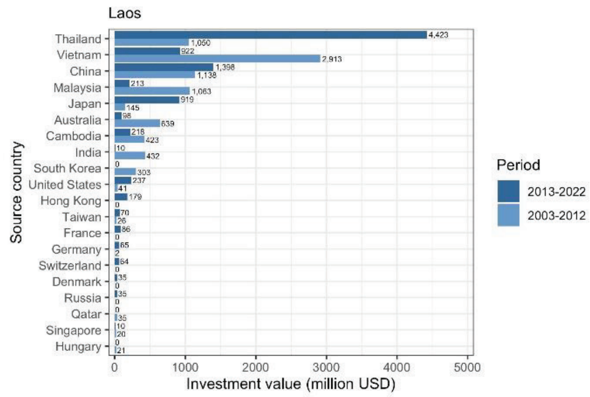


Figure 9A: Investment value by source country and sector, Vietnam, 2003-2022

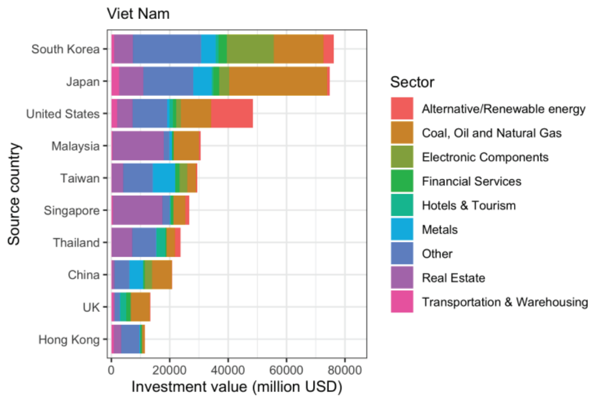


Figure 10A: Investment value by source country and sector, Lao PDR, 2003-2022

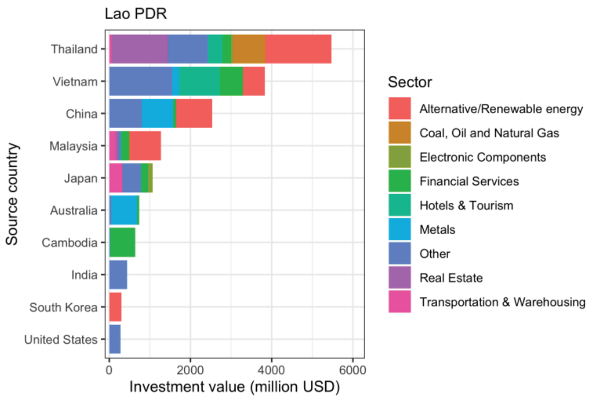


Figure 11A: Investment value by source country and GVC stage, Cambodia, 2003-2022

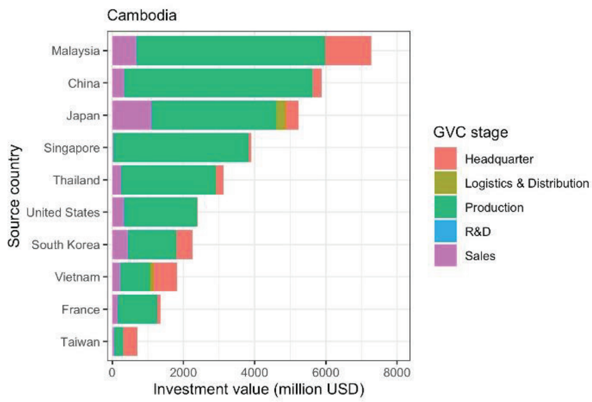


Figure 12A: Investment value by source country and GVC stage, Vietnam, 2003-2022

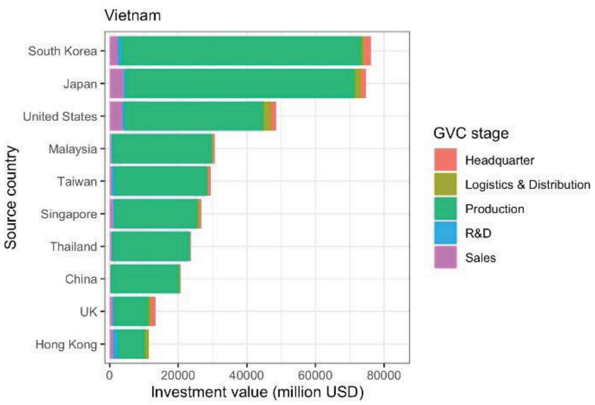


Figure 13A: Investment value by source country and GVC stage, Lao PDR, 2003-2022

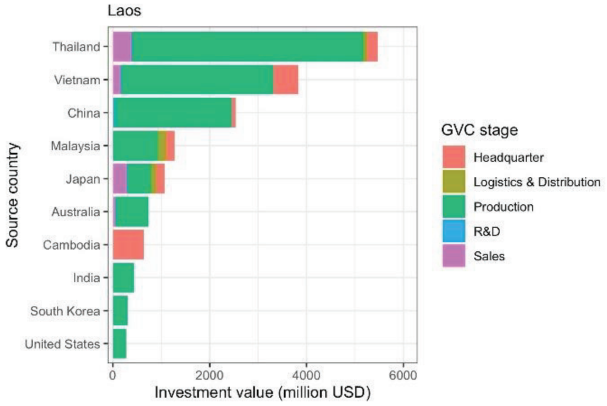


Figure 14A: Investment value by destination province, Cambodia, 2003-2022

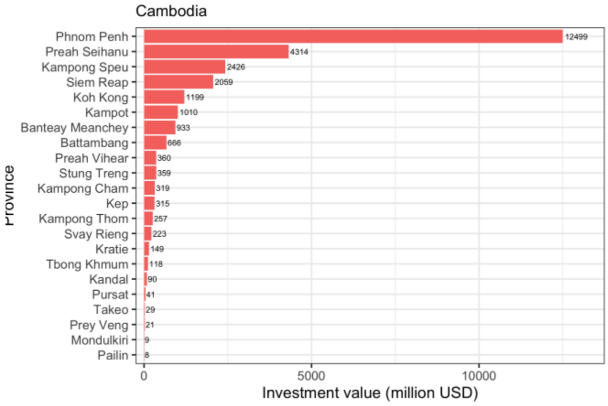


Figure 15A: Investment value by destination province, Vietnam, 2003-2022 (top 25 provinces)

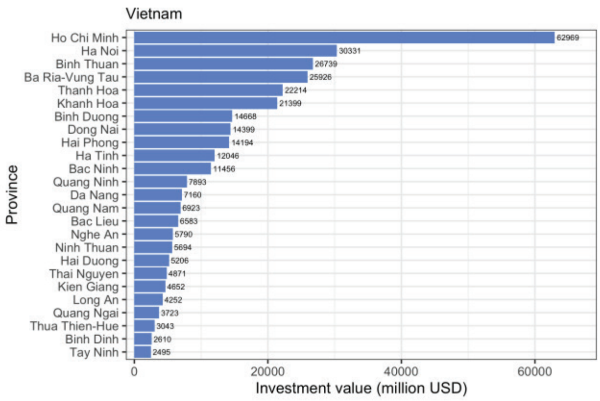
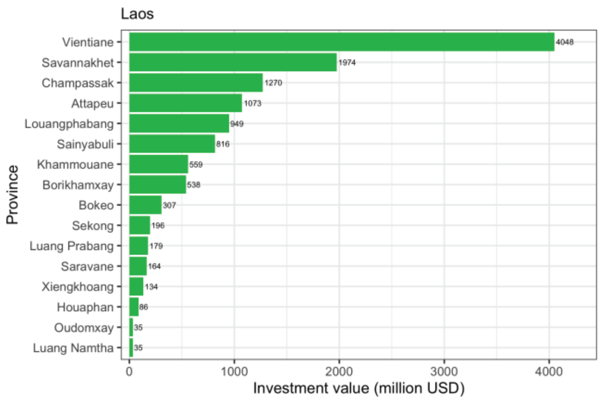


Figure 16A: Investment value by destination province, Lao PDR, 2003-2022



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