



Cambodia Development
Resource Institute



Cambodia Outlook Brief

Harnessing the AEC for Industrial Development

“As we move to the achievement of AEC 2015, with the opportunities and challenges it presents, our industrial development and diversification will be a critical foundation of economic growth, prosperity, employment and further poverty reduction.”

*Samdech AkkaMoha Sena Padei Techo HUN SEN
Prime Minister, Kingdom of Cambodia*

Policy Priorities for Government from the 2015 Cambodia Outlook Conference

1. Open a dedicated “help desk” with sector-specific, practical information for companies about (1) ASEAN Economic Community (AEC) impacts and opportunities and (2) industrial development policy. This entity could be based at the Council for the Development of Cambodia.
2. Implement laws and regulations that strategically diversify industrial output by incentivising (1) multinational corporations to base operations in country, (2) SMEs to engage in secondary industries that link with the production networks of multinational companies and (3) Cambodian business to link into AEC production networks.
3. Increase industrial productivity by (1) creating forums in which business can shape industrial policy to address its needs, (2) extending TVET programmes to boost labour productivity and (3) extending affordable electricity coverage to reduce production costs.
4. Develop governance mechanisms that ensure sustainable industrial development, including (1) urban master plans, (2) acceptable minimum wage policies and (3) balanced trade union laws.
5. Rebrand Cambodia as a global business destination by (1) implementing laws that protect emerging Cambodian brands, for example, quality control and anti-counterfeiting measures, (2) strengthening the capacity of anti-corruption institutions and (3) addressing human rights issues, particularly land grabbing.

AEC in the context of rapid industrialisation

This year Cambodia joins other South-East Asian nations to form the region’s first single market, the ASEAN Economic Community.

The agreement brings together the economies of ASEAN as one of the most significant trading blocs in the global economy: a single market with a combined GDP of

USD2.4 trillion and intra-regional trade of USD600 billion and home to 625 million people, including a rapidly growing middle class of consumers (Table).

Achieving the AEC in 2015 is the latest act in a trend of strengthening relations between Cambodia and other economies. This process began with accession to

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the WTO in 2004 and progressed through a number of bilateral and multilateral trade agreements with major economies in Asia, Europe, North America and Australasia.

Table: Key ASEAN Indicators in 2013

Indicator	Unit	Amount
Total population	Thousand	625,091
GDP	USD million	2,395,253
GDP growth	Percent	5.2
Total Trade	USD million	2,511,517
exports	USD million	1,271,128
imports	USD million	1,240,388
Total FDI	USD million	122,377
Intra-regional trade	USD million	608,558
Intra-regional FDI	USD million	2132

Source: ASEAN statistics

Entering the AEC, the Cambodian government takes economic integration a crucial step further to become part of a single ASEAN market. This will entail a five-pronged strategy to achieve regional economic liberalisation: enabling the free flow of goods, services, investments, capital and labour.

The AEC comes at a crucial juncture in Cambodia's economic development. Over the past two decades, the economy has rapidly industrialised; the industrial sector accounted for 26 per cent of GDP in 2013.

Sustainable growth of the sector is increasingly important for the overall health of the economy and a key aspect of the government's strategy to keep long-term GDP growth high. This year, the government launches its new Industrial Development Policy, which provides the regulatory tools to power the next stage of industrial development.

The AEC presents tremendous opportunities for Cambodia's industrial sector. Cambodian businesses—both big and small—will gain preferential access to a large and growing ASEAN market, benefit from increased intra-ASEAN investment, integrate into regional production networks and move up the value-added chain. Moreover, through alignment with a global economic powerhouse, the AEC will afford Cambodian companies better access to global markets.

For opportunities to become realities, government must facilitate the private sector. Policy makers should provide the regulatory and institutional environment to enable Cambodian business to increase its productivity,

diversify its production base and, in so doing, thrive in the AEC.

Closing the gap between policy and practice

The Cambodian government is one of the regional leaders in implementing reforms requisite for the AEC. These reforms have progressively removed barriers to intra-regional trade and investment over a sustained period. As a consequence, there are already trade and investment frameworks in place through which Cambodian companies can gain preferential access to ASEAN markets. However, these formal channels are underutilised by the private sector because of constraints on flows of information between government and business regarding their usage.

Currently there is no dedicated institution to bridge the knowledge gap between AEC policy frameworks and Cambodia's business practice. To close the gap, government must provide companies with practical information pertaining to the benefits and procedures of conducting transactions through AEC frameworks. For example, businesses need to be aware of AEC non-tariff barriers (NTBs) relating to their specific product and target market, which can offset the benefits of using AEC trade frameworks.

Tailored advice on how to access AEC frameworks easily without incurring NTBs would increase AEC usage and reduce transaction costs for businesses.

Cambodia is far from the only economy in which private sector knowledge of relevant international agreements is limited. Recently, South Korea opened a bespoke "help desk" to assist businesses to access the China-South Korea Free Trade Agreement. This kind of service would be of great benefit to Cambodian business seeking to engage with markets through the AEC.

Increasing awareness of the government's industrial policy is also important if Cambodia's industrial strategy is to synergise with AEC integration. It is crucial that government utilise effective platforms to communicate how new industrial policies will affect the private sector, and listen to the concerns of businesses. Such platforms may include the internet and social media.

Government must extend this service-oriented approach to all sections of the private sector—from big business to SMEs—and provide platforms to access all levels of government. Effective engagement between the government and private sector will foster a symbiotic relationship in which policies needed by business are mainstreamed into industrial development strategies.

Diversifying Cambodia's industrial sector

Changing global conditions mean that the economy must diversify its industrial base if export-led growth is to remain strong.

It is expected that there will be oversupply of low-skilled labour and slowing demand from advanced economies for labour-intensive manufactured products, such as low-cost garments. Therefore, Cambodia must transition from a site of low-cost labour-intensive production to more value-added light manufacturing and high-tech industries if industrial growth is to continue.

Industrial diversification can be achieved only by strategically implemented policy. To achieve this goal, Cambodia can draw lessons from other economies that have successfully industrialised.

In South Korea, one of the few low-income economies to join the OECD, government selectively directed FDI to industries that fitted with its long-term industrial strategy. In Cambodia, this would include high value-added industries that provide good opportunities for up and down linkages and stimulate a diverse array of secondary industries.

In tandem, government needs to encourage SMEs to engage in secondary industries that link with the production needs of large, high-tech, multinational businesses, such as automobile companies. The presence of secondary industries, coupled with Cambodia's favourable geographical location for trade, would encourage multinational business to base operations in country.

The presence of ever more multinational companies in Cambodia would necessitate the proliferation of a variety of secondary industries. This would catalyse a cyclical process of industrial development and stimulate increases in technology and productivity that would drive the country's industrial sector up the value-added chain.

With the imminent realisation of the AEC, it is important to place industrial diversification in the regional context. Industrial policy must push diversification into sectors that complement rather than compete with regional producers. In doing so, Cambodian companies will be better able to integrate into regional production networks.

For SMEs to fill a role as drivers of diversification, they must be supported by government and provided with information about prevailing market conditions and how best to respond to them. In addition, government

must develop mechanisms to monitor the performance of SMEs and address the sector's structural deficiencies with targeted policies.

Diversifying industry requires diversifying the skills of Cambodia's labour force—particularly important in the context of oversupply of low-skilled labour in the global economy. Government must address the current skills mismatch and ensure that the country's education system provides the skills required by the private sector to diversify industrial output. This will require mobilising public and private sector resources to scale up technical and vocational education and training institutes.

More broadly, it is important that the needs of the private sector be represented throughout the curricula. This process ranges from greater numeracy at primary level to the provision of high-quality technical courses, such as engineering degrees, at higher education institutions.

Sustainable industrial development

Sustainable industrial policy nurtures productivity increases in core sectors while diversifying into new sectors. With the AEC a few months away, it is crucial that government strengthen Cambodia's core industries so they will fare well against regional competitors. In particular, increasing the productivity of the garment sector is important. The industry is a significant contributor to GDP, employment and remittances for rural households.

Currently, high transaction costs for Cambodian producers limit the capital available for investment and render their products more expensive than regional alternatives. The government has already made considerable gains in reducing some transaction costs, notably by improving transport capacity. According to the World Bank's Logistics Performance Index, logistical capacity has improved markedly: Cambodia moved 46 places up the world LPI rankings between 2013 and 2014 to 83rd out of 160 countries.

There has been significant upgrading of road and rail infrastructure, notably as part of the Asian Development Bank's Greater-Mekong Sub-region umbrella programme, and associated soft infrastructure, such as customs procedures. These initiatives must continue and be implemented in a timely and effective manner.

The most significant production constraint for Cambodia-located business is low-capacity electricity infrastructure. Around 40 per cent of Cambodia's power is imported from Vietnam and Thailand, meaning that electricity in much of the country remains expensive and unreliable.

The government is working to increase investment in hydropower, coal-fired and biomass plants to reduce costs and increase the reliability of electricity to the private sector. These efforts are crucial to increase productivity in the economy's core sectors and their competitiveness in the AEC.

Another important component of sustainable industrial growth is urban planning. Cambodia's industrialisation has been accompanied by rapid urbanisation. However, planning mechanisms such as land use zoning, infrastructure planning and housing policies have been lacking.

The foundation of sustainable industrial development is social stability. Therefore, industrial development policy must balance the need for increased industrial productivity and social harmony. Crucial in this respect are fair trade union laws and wage policies that safeguard livelihoods and provide decent living standards for industrial workers.

Positioning Cambodia as a global business destination

If Cambodia's private sector is to embrace industrial development policy, modernise and excel in the AEC, there must be a paradigm shift in business practice. Government must encourage business that is conducted according to global norms and standards, and not through informal networks and payments of "unofficial" fees. It is only when business has made this transition that Cambodian companies will succeed on the global stage and the country will become a global business hub.

An emerging generation of entrepreneurs is increasingly utilising "global standard" business technologies and management techniques. This group has the potential to invigorate the private sector and bring Cambodian business into the global era. The government must develop mechanisms to ensure that the voices of this nascent business community are well represented in industrial policy.

From a business perspective, promoting the Cambodia brand is important for the country's international reputation with both consumers and potential investors. The Cambodia brand must be synonymous

with products and services of global standard quality. Policy makers have a crucial role in strengthening the Cambodia brand by enforcing quality standards.

A good example of effective government support of the private sector in this way is the resurrection of the Kampot Pepper brand, which was once a global marker of quality pepper. Recently, in a bid to reinvigorate the brand, the Ministry of Commerce has begun certifying Kampot Pepper that meets its quality criteria. After decades in the wilderness, quality-assured Kampot Pepper is in the process of reclaiming its position as a global premium brand.

The most pressing constraint on Cambodia becoming an international business destination is pervasive corruption. Cambodian companies must be induced by the law to conduct business in a transparent and fair manner with their foreign counterparts; otherwise the country's reputation will become tarnished among international investors. Cambodian businesses would also benefit from the robust, equitable and transparent application of laws pertaining to the protection of property rights and the resolution of disputes.

Access to clear information on institutions and laws related to business and trade for foreign companies is also important in attracting foreign business. The Council for the Development of Cambodia provides such information, and numerous chambers of commerce represent the interests of companies from around the world. The government must look into how these institutions can be better supported.

Finally, the government must address human rights issues, such as land grabbing, that bring negative headlines to Cambodia. Many global companies that adhere to stringent due diligence policies will be reluctant to invest in economies associated with violations of individual rights—particularly property rights. It is these companies—those that operate in a transparent manner and that are held accountable for their business transactions—that Cambodia must attract if it is to foster a global standard business environment.

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