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Chapter

The New Investment Environment

Most Cambodian business people give the same list of reasons when asked why they do not invest more for export: they cannot get credit on reasonable terms to finance investment; the infrastructure in Cambodia is too poor to offer reliable, timely delivery to customers; the hidden costs of administrative demands, and the bribery of officials are too high for domestic production to be competitive; the costs and complications of buying capital equipment from abroad are excessive; power and fuel prices are much higher than in neighboring countries; Cambodia lacks an efficient, non-corrupt legal system; there are not enough well-educated and well-trained workers; and, many already have a comfortable niche in the domestic market.

The issues are similar for potential investors from abroad, many of whom look into Cambodia and walk away: poor infrastructure; lack of local finance; high power costs and unreliability; lack of regulatory transparency; absence of a commercial court and a respectable judiciary; a corrupt administrative bureaucracy; smuggling of competing products, and complications and high costs associated with getting inputs into the country and exports out. Some overseas firms take the minimal risk approach of opening a representative office and sourcing supplies from local firms. With the exception of the garment industry, however, major firms prefer other locations for significant capital investment.

Many will admit that things are improving, but Cambodia's potential investors, and in some cases its existing investors, are nervous. Approval of investment projects fell from $832 million in 1998 to $217 million in 2004. Agribusiness investment approval fell even more, from 23.15% of the total to 8.63%. Foreign Direct Investment (FDI) rose to $243 million in 1998, and then dropped progressively to $141 million in 2004.

The failure to generate investment from abroad or among domestic firms is not a reflection of a lack

Box 9: The WTO and labor standards

The relationship between WTO rights and the recognition, by its members, of international labor standards has been a long-standing issue in the organization. Initiatives to secure a formal, legally enforceable, link have failed, largely because many developing countries saw them as a disguised means of protecting markets in industrial countries.

Thus, the only exception, written into GATT, provides for measures against the exported products of prison labor. Other than that, there is no legal basis on which WTO members can discriminate, with respect to their WTO obligations, against countries that fail to enact or live up to International Labour Organization (ILO) standards. Nor can they discriminate in favour of those that do. For preferential agreements it is another matter; the US and EU commonly use labor standards as a criteria for coverage.

In 1996, WTO ministers rejected the use of labor standards for protectionist purposes, but agreed to "renew" their commitment to the observance of those standards. They confirmed that the ILO was the competent body to set and deal with such standards. The WTO has no more than a cooperative relationship with the ILO.

of assets. Cambodia has many positive characteristics. While Cambodia may be a small market, its neighbors are large. It is a member of an important trade grouping, AFTA. It has natural resources. It can offer high-quality agribusiness products, and has the space and fertility to produce much more. It has a vast, young workforce capable of learning new skills. Labor costs are still low, and Cambodia has earned a positive reputation for complying with international labor standards (See Box 9 on the previous page). It is an ideal place for US and European buyers to diversify away from an over-reliance on China as a supplier. It could be a location for the outsourcing of manufacturing tasks by Thai, Chinese and, eventually, Vietnamese firms, as costs increase in those countries.

An important question is: How can Cambodia's accession to the WTO help amplify the nation's investment assets and dismantle its handicaps? It is important to remember that the WTO can only make a contribution. WTO membership will not build roads or schools, directly create jobs, or distribute cheap medicines. It cannot require any company to invest. It can merely help Cambodia create an environment for investment.

As discussed in Chapter 5, the initial impact of the WTO will be on the regulatory environment. If overseas companies can look at Cambodian institutions - notably the courts, government ministries, and provincial administrations - and have confidence, then other elements of the WTO agreement will become relevant.

Developing Support Services

It is the commitments made by Cambodia in the area of services that may attract investors the most. While, as its name implies, the WTO is largely an agreement about trade, not investment, the rules covering services are almost entirely about investment. After all, to trade in services like banking, insurance, telecommunications, and construction, the client and the services firm have, for the most part, to be in the same country. It is the terms, under which foreign services firms can establish themselves in Cambodia that were the object of the accession negotiations in the WTO.

Box 10, on the next page, provides a brief outline of how the General Agreement on Trade in Services (GATS) works, while Box 11, on the following page, illustrates some of the more important commitments made by Cambodia. Negotiators were pressured to make commitments to GATS, but many aspects of Cambodia's services economy are untouched by the WTO; the government made clear its reservations in some key areas. Generally, countries negotiate new commitments in services over time, as they have negotiated to progressively reduce their import duties, in some cases over five decades.

In the long-term, the opening up of the services sector in Cambodia should benefit almost all Cambodian firms, especially those in the manufacturing and agricultural sectors. From efficient and competitive financial services, to advanced telecommunications and transport infrastructure, improved services will support the enhancement of the industrial base and the competitiveness of Cambodian exports.

WTO Commitments give Investors Confidence

Investors in the services sector need to feel confident of the minimum conditions that will attach to their operations in Cambodia. The government may chose to offer better conditions than those agreed in the WTO; but they cannot impose worse. That is a means of establishing some security for investors.

Annexes E1 and E2 look specifically at how financial and construction services may be affected by GATS. Clearly, these two sectors are crucial to the future development of productive and competitive industries in Cambodia. They are part of the fundamental business infrastructure, without which little else will move forward. Other services that will need to play a bigger role, and where meaningful WTO commitments were made, include: telecommunications, education, health, legal, accountancy, and passenger transport services.

It is sometimes erroneously claimed that by making commitments to open services sectors, governments give up their right to regulate those services; for instance, in the interests of public health and safety, or to safeguard the banking and insurance industries through prudent regulation. Governments maintain an absolute right to regulate; even, in some instances, to discriminate between domestic and foreign-owned firms. Nor is it the case that GATS

Box 10: How the WTO Services Agreement Works

Effectively an investment agreement, the General Agreement on Trade in Services (GATS) has few obligations that all members must accept. For the most part, countries take on only those obligations they wish to, and in the services they are willing to open up. Investors have the guarantee that they will benefit from treatment at least as favourable as those listed in each WTO member's "services schedule". This does not mean that governments cannot offer even more favourable conditions; they often choose to do so, but such conditions may be insecure and unenforceable.

Two key GATS obligations that all members must fulfil are:

- Transparency of services regulation; Cambodia must, for instance, establish an enquiry point where foreign services companies can get information on applicable rules and laws.
- MFN (see Chapter 4), or non-discriminatory treatment among foreign services providers. Exemptions from this rule are possible and Cambodia has taken some.

However, market access and "national treatment" (the treatment of foreign services providers on an equal basis with domestic providers) are both matters for negotiation and specific national commitments.

Cambodia, like all other WTO members, has a services schedule attached to its accession agreement that indicates, sector-by-sector, whether commitments have been made and, if they have, any restrictions that apply with respect to national treatment and market access.

The schedule covers, for each service activity, and for both national treatment and market access, all four possible modes of delivery of services recognized in the GATS. The four possibilities are:

1. Cross-Border Supply ("Mode 1") in which the service does cross borders; for instance, international telephone calls or on-line medical diagnosis.
2. Consumption Abroad ("Mode 2") in which the consumer must cross borders; for instance, tourism.
3. Commercial Presence ("Mode 3") in which a foreign-owned services firm physically establishes itself in the market; for instance, retail bank services or chain stores.
4. Presence of National Persons ("Mode 4") in which services are delivered directly in the market by foreigners; for example, consultants, pop singers and football players.

forces the privatization of essential publicly-owned services. If governments wish to maintain complete sectors or specific service activities under public ownership, they may do so. That is the case, for instance, for many education, health, and water supply services in Europe.

Investment Incentives

As a WTO member, Cambodia will be affected by many disciplines concerning the use of subsidies. These are set out principally in the WTO Agreement on Subsidies and Countervailing Measures (see Chapter 8). As a poor country, it is unlikely to use direct subsidies as a tool to push industrial investment.

The reduction, or remission, at the border, of import duties and VAT on inputs into products that are later exported, may be seen as an export subsidy in the WTO. This might lead to disputes, though it is most unlikely in the case of Cambodia. Alternatively, it could lead to additional, or countervailing[3], duties being imposed on Cambodian products in Cambodia's export market.

It was pointed out during the WTO accession process that the remission scheme currently in place was "highly complex, lacking in transparency, and prone to abuse". Further, the danger of possible countervailing action in export markets detracted from the security and predictability sought by investors and buyers of Cambodian products. A

[3] A countervailing duty is an additional import duty that is set at a level to offset the value of a subsidy.

Box 11: Cambodia's Commitments in Services

Much of what Cambodia agreed to in the WTO merely reflected policy reforms already enacted or expected. Nevertheless, the security of "scheduling" will ultimately be of great importance to investors. In some instances, Cambodia insisted on reserving aspects of its current policies that place restrictions on foreign services providers.

Among reservations of broad, or horizontal, application are:

- Protection of the *current* rights and conditions of *existing* foreign service suppliers. This means that foreign services companies that have operated in Cambodia for some time will not lose advantages from which they already benefit (even if they are advantages that new investors will not receive).
- Continuation of the prohibition on non-Cambodians owning land.
- The obligation on investors seeking investment incentives to provide training to Cambodians, including for managerial positions. Without this reservation, the obligation might be challenged in the WTO.
- The conditions for foreign nationals who wish to work in Cambodia. These cover business visitors, persons responsible for setting up a commercial establishment in Cambodia and intra-corporate transferees (executive, managerial, and specialist staff of foreign firms working in Cambodian branches, subsidiaries, and affiliates).
- Various exemptions from MFN treatment in the audio-visual and transport sectors. This means Cambodia can continue to have special arrangements with neighboring countries in the land transport, Mekong river navigation, and maritime sectors. In the audio-visual sector, it means film co-production agreements and international audiovisual support programmes will be protected from WTO challenge.

At the sectoral, or vertical, level:

- The following services are largely open, with the exception of conditions on the movement of foreign personnel:
  - Professional services
  - Computer, rental/leasing, and other business services
  - Construction and engineering (see Annex E2)
  - Distribution and retail services
  - Education
  - Environmental services
  - Hospital services
  - Recreational, cultural and sporting services

- Legal services: current restrictions on foreign law firms are maintained including the ban on direct representation of clients in court.
- Telecommunications: courier services, mobile, and value added, fixed-line services are open; basic fixed-line services are subject to Telecom Cambodia monopoly until 1 January 2009.
- Insurance services: largely open except for cross-border coverage. Licensing requirements are as for national firms. 20% of reinsurance risk must be placed with Cambodia Re until 31 December 2008. Cover amounting to $500,000 or less to be reinsured locally until 31 December 2008. (See Annex E1)
- Banking services: most commercial banking services are open, including acceptance of deposits, lending, and payments/credit card services. Foreign companies must meet licensing requirements. (See Annex E1)
- Tourism and travel: largely open. The right to establish applies to 3-star hotels or higher only. The issuance of restaurant permits will continue to take account of local characteristics.
- Transport services. Road transport: largely open. International maritime services: no commitments except to permit to maritime suppliers "reasonable and non-discriminatory access" to normal support services. Air transport: commitments only to open aircraft repair and maintenance, marketing of air services, and computer reservation systems. Pipeline transport services: can only be provided on the basis of state-granted concessions.

duty drawback system would provide a more stable and WTO-safe approach. In other words, rather than the imported inputs being exempt from duty or VAT when they enter Cambodia, those costs could be claimed on the exported product. Cambodia's negotiators stated at the WTO that the country does not currently possess the administrative resources necessary to operate a full drawback system. They were given until 2013 to resolve the problem.

Similarly, Cambodia will need to observe disciplines under the WTO's Agreement on Trade Related Investment Measures (TRIMs). This agreement prohibits a number of practices where investment conditions potentially distort international competition. For instance, measures that tie investment incentives to the use of local inputs, or to specific export targets, are outlawed. These are believed to distort international trade. Cambodia has removed one potentially offending measure in its Investment Law, which made import duty exemption dependent on the export of 80% of production, and has assured the WTO that it will not introduce any incentives that contravene the TRIMS agreement.

Both the rules of TRIMS and the subsidies agreements in the WTO would be applicable in the development of Special Economic Zones. Many other members have established these zones without having difficulties within the WTO.