

CHAPTER 9

Industrial Development Policy and Intermediate Goods Trade in Cambodia

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CHAPTER 9

INDUSTRIAL DEVELOPMENT POLICY

AND INTERMEDIATE GOODS TRADE IN CAMBODIA

Chap Sotharith

INTRODUCTION

After decades of civil war and political strife, Cambodia's first general election was held in May 1993 under the auspices of the United Nations Transitional Authority in Cambodia (UNTAC), after which Cambodia enjoyed national reconciliation and relative political stability. After the election, the Constitution of the Kingdom of Cambodia was promulgated in September 1993. Since then, Cambodia has been transformed from a centrally planned economy to a free market economy. The Royal Government of the Kingdom of Cambodia has been implementing macroeconomic and structural reform, and has achieved some significant success in stabilizing the macroeconomic foundation. The economy has grown rapidly since the first half of the 1990s, while inflation has been dramatically reduced.

Apart from advances in peace, stability and social order, Cambodia is now becoming increasingly integrated into the region after joining ASEAN and other regional and sub-regional mechanisms, with participation in activities including successfully hosting the ASEAN summit in 2002 in Phnom Penh. The Royal Government of Cambodia has signed trade agreements with many countries in Asia to

loosen access to outside markets. Globally, an important milestone was finally reached when Cambodia was admitted as the 148th member of the WTO on 13 October 2004. Cambodia is the second LDC (least-developed country) after Nepal to join the WTO through the full working party negotiation process.¹ With limited human resources and expertise in international trade, the WTO membership has imposed on Cambodia greater responsibility to adhere to strict protocols and standards. However, it has equally opened up tremendous opportunities for trade with the world at large on a competitive basis.

Following the implementation of favorable policies of trade development and foreign direct investment (FDI), Cambodian industry has grown rapidly. Manufacturing in Cambodia in the past was conducted mostly on a very small scale, informally where food processing, brick making and timber processing played leading roles. Cambodia, nevertheless, went through a great deal of structural changes in the past decade or so after declaring a market economy.²

The key strategy of the Royal Government of Cambodia with its industry policies is to expand the economic linkage between agriculture and industry to improve the industrial sector and lessen its dependence on the only prime sector, the textile industry. The government continues to provide the necessary physical infrastructure and highly qualified support services to enhance the investment climate, promote transfer of technology, increase professional training, and establish industrial zones or special economic zones (SEZs). The legal framework is also being strengthened to ensure

¹ On 22 July 2003, Cambodia submitted its Acceptance of the Terms and Conditions of WTO Membership and it was approved by the Ministerial Conference on 11 September 2003 in Cancun and was subject to ratification. Source: http://www.wto.org/english/thewto_e/acc_e/a1_cambodge_e.htm.

² JICA (2002), p.45.

efficiency and transparency in the implementation of laws and regulations.

Upon starting to rebuild the country barehanded from the ground up, Cambodia also commenced rebuilding its economy in defense against the return of the Khmer Rouge regime. The following is a chronological outline of the changes in Cambodia's industrialization.

(i) Starting from 1989: Radical reform was launched to accept private ownership of land and real estate. Privatization and acquisition of state-owned enterprises was introduced and FDI was warmly welcomed.

(ii) Starting from 1993: There was a complete changeover from a centrally planned economy to a market economy. The economy became highly dependent on the external assistance provided by international aid agencies.

(iii) After 1995: The economy showed steep growth led by labor-intensive industries, especially garment manufacturing and tourism-related industries.

(iv) After 1997: The economy was affected by political unrest and the fallout from the Asian financial crisis. However, Cambodia still could overcome this with positive growth, and industry in the country survived mainly due to strong demand in the garment sector.

(v) After 1999: Integration into the regional economy took place by admission in ASEAN. FDI in manufacturing started to flow in.

(vi) After 2003: Integration into global trade took place by admission in the WTO. The garment sector still dominated industry and Cambodia's trade continued to grow rapidly.

This research is going to analyze industrial policy and make an assessment on Cambodia's intermediate goods trade with some case studies.

1. INDUSTRY DEVELOPMENT POLICY IN CAMBODIA

1.1. Historical Background

Most of Cambodia's industrial establishments are in the form of small and medium-sized enterprises (SMEs). Industry started to develop in the 1960s after the country gained full international recognition and prestige. Later, the sector faced an uphill battle to survive due to many changes in leadership and regimes that resulted in destruction and stagnation.

Industry accounted for only 5 percent of Cambodia's GDP in 1985, down from 19 percent in 1969. Industrial activity continued to be concentrated in the processing of agricultural commodities, mostly rice, fish, wood, and rubber. Manufacturing plants were small, and they employed an average of fewer than 200 workers. These plants aimed to produce enough consumer goods (soft drinks, cigarettes, and food items) and household products (soap, paper, and utensils) to satisfy local demand.³

The extent of Cambodia's industrial rehabilitation could be gauged by a comparison of enterprises in prewar and in postwar times. In 1969, the last year before the country was engulfed in the war sweeping Indochina, a census disclosed 18 large industries countrywide (13 public and five mixed as public-private) and 33,000 privately owned SMEs. About half of the factories operating in 1969 were rice mills, or were otherwise engaged in rice processing. In 1985, the government news agency Sarpodamean Kampuchea announced that 56 factories had been renovated and had been put back into operation. In the capital itself, about half of Phnom Penh's prewar plants had reopened by 1985. Most industries were producing at far below capacity

³ Source: US Library of Congress, <http://countrystudies.us/cambodia/66.htm>.

because of frequent power cuts, shortages of spare parts and raw materials, and the lack of both skilled workers and experienced managers. Industrial revival continued to be difficult and extremely slow because it was based mainly on the use of limited local resources.

In early 1986, the major industrial plants in Phnom Penh included the Tuol Kok textile factory, the largest of six textile factories in the city (the factory was idle three days a week, however, because of power shortages). There were also four power plants, a soft drink plant, a tobacco factory, a ferro-concrete factory, and some other enterprises that produced consumer goods.⁴

In the municipality of Sihanoukville (or Kampong Som) and in neighboring Kampot Province, rice mills, lumber mills, small brick and tile factories, power plants, an oil refinery, a tractor-assembly plant, cement and phosphate factories, and a refrigeration plant for storing fish were reported to be in operation. In the important industrial center of Ta Khmau, Kampot Province, there was a tire factory (possessing its own generator, but lacking rubber and spare parts), several mechanical workshops, and warehouses. Batdambang Province had shops for repairing farm implements, a cotton gin and textile mill, a jute-bag factory, an automobile and tractor-repair plant, and a phosphate-fertilizer plant. In Kampong Cham Province, the former center for tobacco growing and for cotton garment making, there was a cotton-spinning textile factory, some silk-weaving operations, and an automobile tire and tube plant.

Small family-run businesses and private enterprises specializing in weaving, tailoring (silk sampot and sarongs, the Cambodian national dress), and small manufactured products grew more rapidly than public industries, and they contributed

⁴ Ibid.

significantly to economic recovery. According to an official estimate, the output value of local and of handicraft industries together amounted to 50 percent of the value of production in state industries in 1984. In Phnom Penh alone, there were 1,840 handicraft shops whose output value raised from 14 million riels in 1981 to 50 million riels in 1984.⁵

In 1989, while Vietnam conducted its “Doi Moi” reforms, Cambodia also started to reform its economic management system from a centrally planned economy (or socialist economy) to a market-oriented one. This was initiated by the recognition of private property in real estate, the reform of state-owned enterprises, and the welcoming of FDI. The reforms laid a foundation for the industrialization of Cambodia.

Industrial development was promoted by the investment policy of the Royal Government of Cambodia. The policy encouraged local production and international trade by opening the free market to all investors and partnerships to invest in the country without any discrimination and restriction. The exception was the requirement that land ownership is by natural persons holding Cambodian citizenship or by legal entities in which more than 51 percent of the equity capital is directly held by natural persons or legal entities with Cambodian citizenship.

Starting from 1994, the Royal Government of Cambodia began privatizing small and medium-sized state-owned enterprises, especially those that did not make a profit such as engineering, rice mills, soft drinks, textiles, and wine breweries. In 2009, the Cambodia Royal Railways was privatized to an Australian company named TOLL. So far, only a few strategic enterprises remain as 100 percent state-owned enterprises,

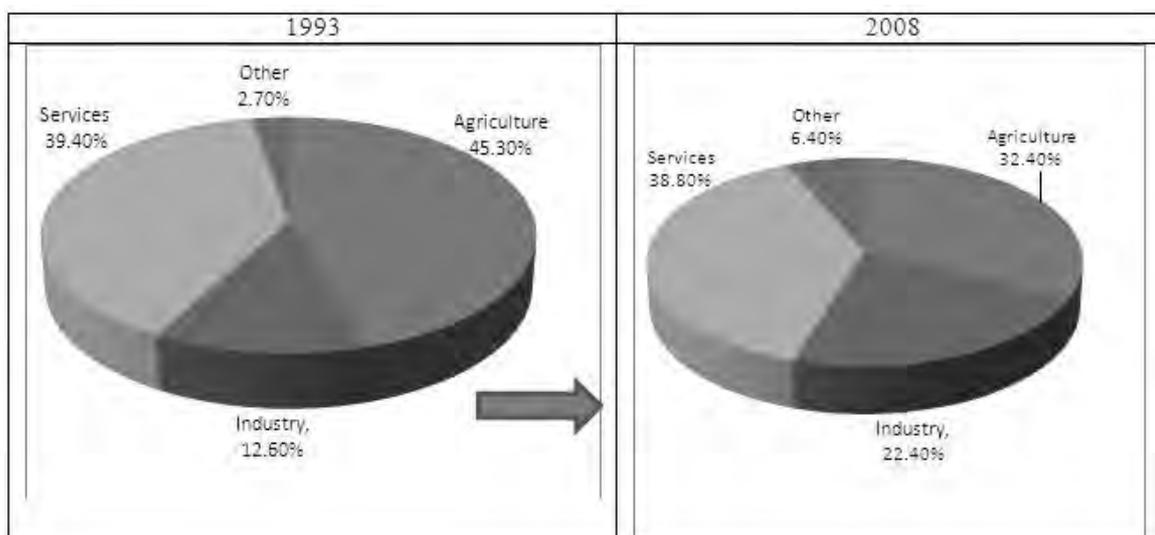
⁵ Ibid.

including ports, electricity, and water supply, or even as partly state-owned such as airlines and air traffic control.

1.2. Trend in Industrialization

Industrialization in Cambodia has been achieved through many changes in economic policies, especially the reform from a centrally planned economy to a free market economy in 1993. Starting from 1993, due to attractive FDI policies, industry has grown rapidly. As a result, the industrial sector has developed from 12.6 percent of the GDP in 1993 to 22.4 percent in 2008 (see Figure 1).

Figure 1: GDP by Sectors



Source: Royal Government of Cambodia (2010) NSDP Update (2009-2013).

The Royal Government of Cambodia's Industrial Development Action Plan (1998-2003) had two goals: the development of export-oriented industries, and the development of import-substituting production of selected consumer goods. Those goals were thought to be achieved by promoting: (i) labor-intensive industries, (ii) natural resource-based industries, (iii) SMEs, (iv) agro-industries, (v) technology transfer and upgrading the quality of industrial products, (vi) establishment of industrial zones, and (vii) development of import-substituting production of selected consumer goods.⁶

Two key features of good economic performance in recent years have been the increasing diversity of the sectors that are contributing to economic growth, and the robust contribution to economic growth by the agriculture sector in particular. This performance is underpinned by the strong support extended to agriculture, the garment sector, and active promotion of the tourism sector by the Royal Government of Cambodia. The expansion of the economy resulted in rapid growth of the construction sector, facilitated by the availability of increased domestic credit to the private sector. During 2003-2005, domestic credit to the private sector grew at an average annual rate of 31 percent. It grew by 52 percent and 76 percent in 2006 and 2007, respectively.

Over the period of implementation of the National Strategic Development Plan (NSDP) 2006-2010, the highlights of the changes in the sectoral composition of the economy were as follows:⁷

- The agriculture sector's share of the GDP increased from 30.7 percent in 2005 to 32.4 percent in 2008.

⁶ Ministry of Industry, Mines and Energy (1997), Industrial Development Action Plan (1998-2003).

⁷ RGC (2010) NSDP Update.

- The industrial sector's share declined from 25.0 percent in 2005 to 22.4 percent in 2008. Within the industrial sector, the shares of:
 - textile and garment sub-sector declined from 12.3 percent in 2005 to 10.3 percent in 2008;
 - mining sub-sector did not change from 0.4 percent between 2005 and 2008; and
 - construction sub-sector declined slightly from 6.3 percent in 2005 to 6.1 percent in 2008.

- The services sector's share declined slightly from 39.1 percent in 2005 to 38.8 percent in 2008. Within the services sector, the shares of:
 - tourism and hotel sub-sector increased from 4.3 percent in 2005 to 4.5 percent in 2008;
 - transportation and communications sub-sector did not change from 7.4 percent between 2005 and 2008;
 - financial sub-sector increased from 1.1 percent in 2005 to 1.3 percent in 2008; and
 - real estate sub-sector declined from 6.6 percent in 2005 to 6.4 percent in 2008.

Table 1: Macroeconomic Indicators, 2003-2008

	2003	2004	2005	2006	2007	2008
Real GDP (% growth)	8.5	10.3	13.3	10.8	10.2	6.7
-Agriculture (% growth)	10.5	-0.9	15.7	5.5	5.0	5.7
-Industry (% growth)	12.0	16.6	12.7	18.3	8.4	4.0
-Services (% growth)	5.9	13.2	13.1	10.1	10.1	9.0
GDP per capita in US\$	356	402	468	534	623	738
National savings (% of GDP)	16.3	16.4	17.3	23.1	23.8	16.9
Central administration savings (% of GDP)	0.8	1.6	1.7	1.0	3.1	3.0
Private savings (% of GDP)	15.6	14.8	15.6	22.1	20.7	13.9
Domestic investment (% of GDP)	12.2	11.8	11.1	11.2	11.1	11.3
Public investment (% of GDP)	6.5	5.8	5.3	5.9	6.2	6.5
Private Sector investments (% of GDP)	12.8	12.9	16.3	16.9	20.4	18.0

Source: National Institute of Statistics, Ministry of the Economy and Finance, National Bank of Cambodia, IMF.

The outward-oriented industrial development strategy is given priority for four reasons. First, the small size of the domestic market in terms of population and purchasing power limits the opportunities for efficient production. Second, Cambodia does not have sufficient financial resources or managerial expertise to fully utilize its natural resource base. Third, access to technological innovations that underpin increased efficiency and wider consumer choice can only come from integration with regional and global economies. Fourth, no country has a comparative advantage in producing everything, and all countries can therefore benefit from cooperating and trading with others.⁸

The promotion of labor-intensive manufacturing will continue to focus on the textile and garment sectors where the ready supply of mostly female workers supports cost-competitiveness. However, the government recognizes that retaining and

⁸ Sau (2007).

increasing market share in an increasingly competitive international environment requires upgrading product quality and boosting productivity through improvements in technology and management.⁹ It is essential that better industrial relations within the established legal framework are developed and ways of increasing the multiplier effect of garment manufacturing are investigated. Currently, most garment manufacturers operate on a cut, make, and trim basis. They import fabrics and accessories (zippers, buttons, thread) and avail themselves of local services such as transportation and freight clearing, construction, and utility-type services to run and build factories.

The promotion of natural resource-based industry will focus on identifying and exploiting opportunities in processing natural resources, including non-metallic mineral resources, timber, and fisheries. The development of animal- and fish-breeding facilities may permit their supply as a raw material for reprocessing factories. However, the main prospects in this area are in the use of non-metallic resources for manufacture of construction materials.

In regard to small-scale industry and handicraft production, the government intends to give priority to the promotion of traditional arts and crafts for the tourist market in both rural and urban areas. Another area with potential for expansion is the small-scale tobacco producers who can contribute to increasing the supply of raw materials to the large manufacturers. However, in order to succeed it will be necessary for these enterprises to ensure sustained product quality. In addition, because they do not have access to credit other than from high-cost moneylenders, they will need to be provided micro-finance credit facilities.

The core strategy for agro-industry development is to grant concessional land plots

⁹ Ibid.

to both domestic and foreign companies on a long-term basis, and to encourage the participation of local small landholders through contract growing for processing factories in the area. The development of agro-industry initiatives will require close coordination between the Ministry of Industry, Mines and Energy, the Ministry of Agriculture, Forestry and Fisheries, and the local authorities, as well as technical assistance in the full assessment of development potential. Strengthening the economic linkage between agriculture and industry within the context of sound environmental management is seen as essential to the creation of income and employment.

The promotion of technology transfers and the upgrading of products will require the Ministry of Industry, Mines and Energy to design and implement a quality control system for export products that sets internationally accepted standards. In addition, the transfer of technology will require the Royal Government of Cambodia to develop an appropriate legal and regulatory framework covering copyrights, trademarks, and so on.

The promotion of import-substitution of selected consumer goods will be undertaken only after a careful analysis of whether or not there is a genuine prospect of a proposed venture becoming internationally competitive.

In general, the government will support broad-based industrial development by: (i) encouraging expansion of the SME sector, especially through provision of medium and long-term finance, (ii) improving the performance of state-owned enterprises through corporatization and privatization, (iii) stemming the flow of illegally imported products, (iv) reducing barriers to export such as export taxes and inefficient provision of trade facilitation services (e.g. licensing), (v) reducing barriers to importation of business inputs, (vi) providing infant-industry protection in carefully selected instances, (vii)

enhancing the linkage between SMEs and between SMEs and large industries, (viii) promoting a national productivity center that will assist small and medium-size firms in increasing productivity and reducing production costs, (ix) establishing a national institute of standards that will ensure product quality matches regional and international standards, (x) setting up a national laboratory with the technical capacity to undertake physical, chemical, microbiological, and mechanical analyses of products in order to establish the quality and other specifications of these products, (xi) establishing an industrial property rights bureau that would protect new products, designs, and technologies from illegal copying, (xii) promoting vocational training domestically and overseas, and (xiii) upgrading the legal framework in the areas of factory law, industrial zone law, patent and industrial design law, weights and measures, and industrial safety.

Private sector organizations will play a key role in identifying industrial development opportunities and constraints, participating in the policy formulation and monitoring processes, and promoting domestic and foreign private investment.

1.3. Special Economic Zones

The creation of industrial zones is aimed at facilitating export development and generating employment by providing the high-quality infrastructure and utilities needed to encourage investment. Zones in suburban Phnom Penh and Sihanoukville would provide transport and communications, power and water, waste management, education and health facilities, and shopping complexes, along with minimal customs formalities and duty-free importation of business inputs. The spatial concentration of export-oriented enterprises would provide a business incubator environment in which

ideas and experiences could be exchanged, and would also permit better control of the environmental impact of specific business activities. Other possible regions for industrial/export processing zones include Koh Kong, Battambang (near the Thai border), and Banteay Meanchey (the most populous province). The government, with external assistance, conducted feasibility studies during SEDPII (Second Socio-Economic Development Plan 2001-2005) and, where feasibility was established, proceeded to full project formulation and implementation.

The Royal Government of Cambodia recognizes that SEZs are the foundation for industrialization, trade promotion, and economic development because they bring infrastructure, jobs, skills, enhanced productivity, and the prospect of poverty reduction in rural areas. The government has since approved a total of 21 SEZs, located along the border with Thailand and Vietnam, at Sihanoukville, and at Phnom Penh. Of the 21 zones, six have commenced operations (see Table 2). Aiming to attract more investors, the SEZs offer one-stop service for imports and exports, with government officials stationed on-site providing administrative services. Applications to establish factories within the SEZs are dealt with on-site, as are all administrative clearances and permits.¹⁰

To date, only about 30 percent of total SEZs listed in Table 2 are operational or partly in operation. There are many challenges for SEZ development in Cambodia. The first challenge is land speculation and the second is lack of funding. Some of them, after receiving licenses, are very slow in implementation due to many reasons. Some SEZs developed by local companies were only for land speculation. The owners invest so little (just dirt roads and divided plots of land), and they wait for the payments from

¹⁰ <http://www.investincambodia.com/default.htm>.

tenants to rent or buyers to buy the plots of land. Some are unable to start due to financial problems from a lack of funding.

Table 2: List of Special Economic Zones in Cambodia

	Name	Locations	Area (ha)	Ownership	Capital (\$ mil)	Status
1	Koh Kong SEZ	Koh Kong	336	Mr. Ly Yong Phat (Cambodian)	n/a	Licensed in 2002, Operational
2	Suoy Chheng SEZ	Koh Kong	100	Mrs. Kao Suoy Chheng (Cambodian)	14	Licensed in 2002. Not yet operational
3	N.C SEZ	Koh Kong	150	Mr.Kong Triv (Cambodian)	14	Licensed in 2002. Not yet operational
4	Stung Hav SEZ	Sihanoukville	192	Ms. Lim Chhiv Ho (Cambodian)	14	Licensed in 2002. Not yet operational
5	N.L.C SEZ	Sray Rieng	105	Ms. Leang Vouch Chheng (Cambodian)	13	Licensed in 2005. Not yet operational
6	Manhattan (Svay Rieng) SEZ	Sray Rieng	571	Mr. Clement Yang (Taiwan)	15	Licensed in 2005. Operational
7	Poipet O'Neang SEZ	Banteay Meanchey	467	Mrs. Van Ny (Cambodian)	15	Licensed in 2005. Operational
8	Doung Chhiv Phnom Den SEZ	Takeo	79	Mr. Doung Chhiv (Cambodian)	28	Licensed in 2006. Not yet operational
9	Phnom Penh SEZ	Phnom Penh	350	Ms. Lim Chhiv Ho (Cambodian)	68	Licensed in 2006. Operational
10	Kampot SEZ	Kampot	145	Mr. Vinh Huor (Cambodian)	15	Licensed in 2006. Not yet operational
11	Sihanoukville SEZ 1	Sihanoukville	178	Mr. Lav Meng Khin (Cambodia)	100	Licensed in 2006. Not yet operational
12	Tai Seng Bavet SEZ	Svay Rieng	99	Mr. Ly Hong Shin (Cambodian)	37	Licensed in 2007. Operational
13	Oknha Mong SEZ	Koh Kong	100	Mr. Mong Rithy (Cambodian)	40	Licensed in 2007. Not yet operational
14	Goldfame Pak Shun SEZ	Kandal	80	Mr. Chan Ji Kvang (Korean)	34	Licensed in 2007. Operational
15	Thary Kampong Cham SEZ	Kompong Cham	142	Chhorn Thary (Cambodian)	69	Licensed in 2007. Operational
16	Sihanoukville SEZ 2	Sihanoukville	1688	Mr. Lav Meng Khin (Cambodian)	n/a	Licensed in 2007. Operational
17	D&M Bavet SEZ	Svay Rieng	117	Ms. Men Pheakdey (Cambodian)	52	Licensed in 2007. Not yet operational
18	Kiri Sakor Koh Kong SEZ	Koh Kong	1750	Mr. Ly Yong Phat (Cambodia)	110	Licensed in 2008. Not yet operational
19	Sihanoukville Port SEZ	Sihanoukville	70	Mr. Lu Kim Chhun (Cambodian)	34	Government owned. Licensed in 2008. Not yet operational
20	Kampong Saom SEZ	Sihanoukville	255	Mr. Kith Meng (Cambodian)	190	Licensed in 2009. Not yet operational
21	Pacific SEZ	Svay Rieng	107	Mr. Chea Eavmeng, Mr. Gau Hieckhuor, Mrs. Yin Phanny	70	Licensed in 2009. Not yet operational

Source: http://www.investincambodia.com/economic_zones/sezs.htm, accessed on 7 July 2010.

1.4. Development of the Energy Sector and Electricity Network

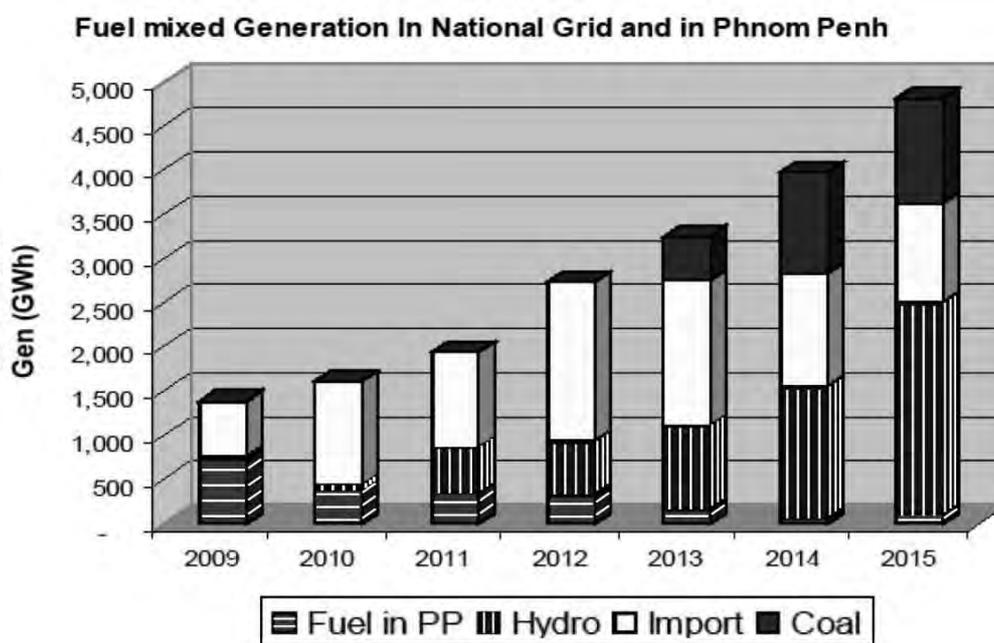
Industrialization cannot be done without building a good source of energy. So far, industrial development in Cambodia is facing constraint from the high price of electricity and lack of electricity supply. Electricity is only available in the capital and provincial towns. In order to “top up” the supply, Cambodia imports electricity from Thailand and Vietnam. Even so, only 20 percent of the population has access to electricity. In remote rural areas, people make do with diesel generators, car batteries, kerosene lamps, and candles.

As Cambodia has no national grid, the provincial towns and cities have their own power generation plants and distribution networks, with little interconnection. The power plants are small and are mainly fuelled by imported diesel, and prices reflect this.

The average price of electricity in Cambodia is \$0.16 per kilowatt/hour, and prices are as high as \$0.90 per kilowatt/hour in remote rural areas. In fact, electricity prices in Cambodia are the highest in the ASEAN region. The price of power is a major deterrent to foreign investors and undermines Cambodia’s ability to compete with neighboring countries such as Thailand and Vietnam.¹¹ Reliable, affordable electricity is a prerequisite to economic success and the welfare of the people. Without it, businesses have two choices: buy a generator or shutdown production every time there is a power cut. At present, the sale of generators in Cambodia is a thriving business.

¹¹ <http://www.investincambodia.com/power.htm>.

Figure 2: Energy Plan (2009-2015)



Source: Hang (2010).

In order to develop the energy sector, significant progress has been made in increasing the available supply of electricity and the expansion of the electricity network. Toward developing the energy sector for meeting increased demand from households and industrial establishments, the Energy Sector Development Plan 2005-2024 has been prepared.¹² A Rural Electrification Master Plan focusing on the use of renewable energy has also been prepared and is being implemented. Some of the major improvements so far include:

- A 115kV transmission line from the Thai border to supply electricity to Banteay Mean Chey, Siem Reap, and Battambang provinces has been completed and is already fully operational.

¹² Source: Ministry of Industry, Mines and Energy.

- Two 370kW micro hydropower stations (O Romis and O Mleng) and a reserve 300kW diesel-powered generator are now fully operational to provide electricity to the provincial town of Mondulhiri.
- A 230kV transmission line (110 kilometers) from Cambodia-Vietnam to Phnom Penh, and the Takeo sub-station have been fully operational since early in the second quarter of 2009.
- A 115kV circuit of 23 kilometers was added to Phnom Penh and a sub-station was installed in the western part of Phnom Penh in 2009.
- To implement the Rural Electrification Policy, the government has established a Rural Electrification Fund in promoting equal access to electricity supply services and encouraging private sector investment in rural power services in a sustainable manner. In particular, this encourages the use of new technologies and renewable energy.
- To enhance regional cooperation within the framework of the Greater Mekong Subregion (GMS), Cambodia has been participating in the implementation of the GMS Power Trade Plan; and within the framework of ASEAN, Cambodia is participating in implementation of the ASEAN Power Grid.
- An electricity generation plant using coal at Sihanoukville is relying on private sector investment under the build-own-operate mode to produce 270MW in the first phase, expanding later to 700MW.

Although significant progress has been made, the energy sector also faces many daunting challenges, which include:

- How to ensure efficiency and sustainability of production, supply, and proper maintenance in the power infrastructure across the whole country.
- How to lower the current high cost of electricity generation not only to support private sector development but also to make it affordable for the poor.
- How to attract private sector investment and participation to expand the power infrastructure and meet the growing demand for electricity, particularly in the rural communities. As of 2008, only about 10 percent of rural households had access to electricity, while in urban centers about 75 percent of homes had access.

1.5. Small and Medium Enterprise Development Framework

The Royal Government of the Kingdom of Cambodia has embarked on an ambitious program of development and reform to meet the needs of its people. A primary goal is to reduce poverty. In the fight against poverty, the government recognizes that SMEs play a significant role in promoting economic development and creating sustainable employment and income. Therefore, the SME Development Framework has been designed to improve and coordinate the government's efforts in promoting SME activity in a market economy. In doing so, it incorporates and elaborates the government's key SME policies, including those set out in July 2004 in the so-called "Rectangular Strategy."¹³

¹³ Ministry of Industry, Mines and Energy at: http://www.gdi.mime.gov.kh/index.php?option=com_content&view=article&id=15%3Asmall-and-medium-enterprise-development-framework&catid=31%3Apolicystrategy&Itemid=181&lang=en, accessed on 18 October 2010.

The SME Development Framework is intended to serve the government as a road map for the development of the SME sector. In doing so, it should be seen as a “living document” which will be amended as conditions faced by SMEs and the government’s capacity to deliver services change. The framework also provides a focal point around which government and donor discussions and activities can be coordinated.

The SME Development Framework is divided into five interrelated chapters and one appendix. Chapters 1 and 2 provide background information and identify the major issues faced by SMEs. Chapter 3 provides the policy context and institutional structure for the SME Development Framework. Chapters 4 and 5 set out a strategy for dealing with each of the major issues identified. It divides the strategy into two phases and by issues. The appendix provides a summary road map of action needed to be taken.

Despite a lack of information, it is possible to recognize that Cambodia is dominated by SMEs and that the largest numbers of these are found in the rural sector. Moreover, there is a lack of a formal definition based on employment.

An analysis of the SME sector shows that the major obstacles for its development relate, first, to an inadequate legal and regulatory framework. Thus, many of the necessary institutions, laws, and regulations needed for an efficient private sector are missing or currently being developed. Furthermore, some of the existing institutions and regulations need reforming to improve the enabling environment for business. Second, there is limited access to finance. The primary causes of poor access to finance are the lack of suitable collateral, uncertain land titles, the lack of a comprehensive legal framework, poor contract enforcement, and the lack of diversity in financial institutions. Third, there is a lack of support services in the form of private sector business development services and the provision of public goods and services.

Given these constraints, the framework sets out a vision for the Inter-Ministerial SME Sub-Committee that promotes an environment conducive to business. This will lead to a competitive SME sector, contribute to the creation of quality employment, and improve the range of goods and services available for drawing on the experience of other countries, particularly those in the region facing similar problems.

In order to give force to the vision, and the strategy, the Inter-Ministerial SME Sub-Committee was established, with private sector representation. The committee has a secretariat located in the Ministry of Industry, Mines and Energy to support its function and coordinate activities. Implementation of the road map will also require the government to coordinate with donors, as well as support the development of and coordination with business associations.

In order to implement the government's Rectangular Strategy and achieve an environment conducive to business, the SME Development Framework focuses on three key areas: (i) the regulatory and legal framework, (ii) access to finance, and (iii) SME support activities. Several issues are identified and discussed within each of these three key areas. The discussion includes background information and the constraints and objectives faced by SMEs. For each sub-topic, the discussion then shifts to actions to be taken in two phases (Phase I in 2005-2007 and Phase II in 2008-2010).

In regard to the regulatory and legal framework, a significant issue is the need for streamlining and reducing the cost of company registration. Currently, this represents one of the highest cost and time expenditures in the region. A second priority is establishing a regulatory review process and a recourse mechanism. This would focus on the numerous and overlapping licenses issued by most ministries, a situation that imposes a severe burden on SMEs. Third, the need for establishing a commercial legal

framework is highlighted as an important part of the strategy. As of mid-2005, the commercial legal framework remained incomplete.

The second key area in the strategy is improving access to finance. Access to finance is a critical issue for all businesses and remains a problem particularly for SMEs. Among the issues the strategy addresses are: (i) collateral and land titling, (ii) leasing, (iii) credit information sharing, (iv) simplified accounting for SMEs, and (v) non-bank financial institutions. Addressing these issues is seen as critical for improving SME access to credit.

Finally, the third key area is improving support activities for SMEs. In the delivery of support services, there is a role for the government to play in addition to that played by the private sector. Where public goods and services are involved or there is market failure, the government should take the initiative, either by itself or in partnership with the private sector. Where private sector Business Development Services (BDS) markets do not exist, there is a role for the Inter-Ministerial SME Sub-Committee to work with donors and business associations to stimulate demand and develop private sector supply. In particular, support activities should focus on improving access to markets, upgrading technology and human resources, and developing linkage.

The SME Development Framework requires significant effort by the committee and its secretariat. It also requires the cooperation and coordination of donors, business associations, and other stakeholders. Moreover, the framework should be periodically reviewed and revised to reflect changing conditions and priorities for Cambodian SMEs.

The development of SMEs in Cambodia is facing many challenges:

- The electricity tariff remains high compared to neighboring countries, and is

a big obstacle in strengthening Cambodia's competitiveness as well as attracting investment and improving livelihoods. Access to electricity in rural areas is still limited.

- The shortages of technicians and skilled workers are a major obstacle to accelerating SMEs in both urban and rural areas.
- There is a lack of support from the government in human resources development, market information and market access, and technological innovation.

2. CAMBODIA INTERMEDIATE GOODS TRADE

Cambodian industry has emerged from having no foundation to becoming export-oriented. However, due to a limited production base, the country imports raw materials and intermediate goods to produce finished products.

As shown in Table 3, Cambodia's exports depend heavily on textile, garment and apparel products, which cover about 70 percent of total exports. Pulp and paper is No.2 in exports, covering about 20 percent of the total. Although Cambodia is based on agriculture, where about 85 percent of the population is living on agriculture in rural areas, the exports of its agro-products are limited, as shown in the same table. Agro-products (Harmonized System sector 01-16) make up only about 0.3 percent of total exports. This can be interpreted as indicating that the country has not used its full potential of agricultural development for exports. It can be explained in another way that agricultural products, especially rice, rubber, and other products, were traded across borders to neighboring countries without recording through customs or with

poor data entry.

Due to the urgent need for reconstruction of its economy and the booming private sector, Cambodia imports more raw materials or intermediate goods such as cloth and related unfinished textile products, which cover about 35 percent of imports. Other main import items include vehicles (both new and secondhand ones in Chapters 86-89), machinery and electrical appliances (Chapters 84-85), and mineral resources including oil and gas (Chapters 25-27). These make up 13 percent, 11 percent, and 10 percent of imports, respectively (see Table 4).

Table 3: Exports by Product in 2008

Chapter	Section	Export Value US\$	% of Total
1-5	Live Animal	2,426,563.62	0.06
6-14	Vegetable Products	9,648,310.68	0.22
15	Fats and Oils	8,951,496.67	0.21
16-24	Prepared Foodstuffs	9,458,443.41	0.22
25-27	Mineral Products	117,687,756.88	2.70
28-38	Chemicals	968,564.99	0.02
39-40	Plastics	34,398,196.80	0.79
41-43	Hides and Leather	863,504.14	0.02
44-46	Wood and Wood articles	3,558,391.53	0.08
47-49	Pulp and paper	903,851,658.00	20.74
50-63	Textiles and apparel	3,025,351,504.39	69.40
64-67	Footwear	93,912,377.29	2.15
68-70	Stone/Cement/Ceramics	1,295,743.88	0.03
71	Gems	11,239,364.59	0.26
72-83	Base metal and Metal articles	16,509,529.97	0.38
84-85	Machinery and Electrical Appliances	6,978,053.91	0.16
86-89	Vehicles	97,946,760.38	2.25
90-92	Optical, precision & musical instruments	2,950,386.65	0.07
93	Arms	83,462.41	0.00
94-96	Miscellaneous Manufactured articles	6,805,703.19	0.16
97-98	Antiques and works of art	4,130,390.62	0.09
Total		4,359,016,164.00	

Source: Author computing based on Ministry of Commerce Database 2008.

Table 4: Imports by Product in 2008

Chapter	Section	Import Value US\$	%
1-5	Live Animal	6,127,890.60	0.14%
6-14	Vegetable Products	37,366,927.06	0.84%
15	Fats and Oils	6,895,474.83	0.16%
16-24	Prepared Foodstuffs	258,217,650.37	5.83%
25-27	Mineral Products	454,908,915.03	10.26%
28-38	Chemicals	202,128,457.20	4.56%
39-40	Plastics and Rubber	124,380,959.45	2.81%
41-43	Hides and Leather	29,927,420.17	0.68%
44-46	Wood and Wood articles	2,427,069.93	0.05%
47-49	Pulp and paper	214,470,780.57	4.84%
50-63	Textiles and apparel	1,563,560,144.57	35.28%
64-67	Footwear and Headgear	26,430,183.24	0.60%
68-70	Stone/Cement/Ceramics	59,569,529.19	1.34%
71	Gems	35,952,583.94	0.81%
72-83	Base metal and Metal articles	216,507,025.76	4.88%
84-85	Machinery and Electrical Appliances	505,134,534.47	11.40%
86-89	Vehicles	577,765,817.84	13.04%
90-92	Optical, precision & musical instruments	42,536,254.53	0.96%
93	Arms	66,655.97	0.00%
94-96	Miscellaneous Manufactured articles	66,010,491.78	1.49%
97-98	Antiques and works of art	1,720,125.16	0.04%
Total		4,432,104,891.65	100.00%

Source: Author computing based on Ministry of Commerce Database 2008.

2.1. Case Study of Garment Industry

The garment industry is Cambodia's biggest industrial employer, and it is now struggling against stiffer global competition and slowing demand. For years, many Chinese and Korean companies have maintained a presence in Cambodia. Today, more than 10 Chinese-owned factories have moved to cheaper markets, leaving hundreds of thousands of garment workers from the provinces facing destitution, as reported in the Phnom Penh Times in early 2008.

The garment industry accounts for 80 percent of Cambodia's foreign exchange earnings and employs an estimated 350,000 people in more than 300 factories. The industry began to grow after the country passed new labor laws encouraging labor unions and allowing the International Labor Organization to inspect factories and publish its findings. In turn, the United States agreed to cut tariffs on Cambodian garment exports, buying 70 percent of all of the country's textiles in the 1990s. Cambodia maintained its higher working conditions after the deal expired in 2005, and garment-making has made the national economy one of the fastest growing in the region.

The World Bank reported that the industry grew only 8.0 percent in 2007 compared to growth of up to 20 percent previously. Cambodia's Ministry of Commerce said that apparel exports have declined since October 2007, mainly due to the U.S. economic slowdown. Exports to the United States slipped 1.44 percent in the first quarter of 2008, compared with the same period in 2007.

A study revealed that a quarter million Cambodians are employed in the garment industry, and a multiple of that number is employed in supporting sectors. Workers are

mainly women from rural villages; their remittances back home sustain an estimated 20 percent of the country's population (USAID 2005).

Garment exports have grown dramatically over the past decade, from US\$26 million in 1995 to US\$1.6 billion in 2004. Apparel now accounts for nearly 80 percent of the country's merchandise exports. Most factories belong to foreign owners, largely from mainland China, Hong Kong, Taiwan, and Korea. All garment production is sold for export. The United States, which buys roughly two-thirds of Cambodia's exports, and the European Union, which buys most of the rest, are Cambodia's primary export markets. As much as one-third of Cambodia's garments are manufactured for one brand label client, The Gap. Other brands also figure prominently in Cambodia's production for export.

The 1999 U.S.-Cambodia Bilateral Textile Agreement linked quota access in the U.S. market to factories' compliance with international labor standards, as monitored by the International Labor Organization. Cambodia has subsequently earned a reputation among buyers as a socially responsible manufacturing platform from which to source garments.

In the post-quota environment, however, filling the social-responsibility niche cannot compensate for a lack of competitiveness on other fronts. To remain in the pool of acceptable suppliers, Cambodian factories must stay competitive. Working with authorities to address the costs of administrative red tape and corruption, estimated by a recent Cambodian government report to amount to 7 percent of total sales value, is part of the answer. Toward this end, Cambodia is committed to improving the investment climate by introducing streamlined trade facilitation procedures.¹⁴

¹⁴ USAID (2005), p.vi.

According to a study, the main feature of the export-oriented garment industry in Cambodia is that most firms do not produce fabrics and instead specialize in making garments from imported fabrics (Yamagata 2006). The study shows that 87.4 percent of the sample firms engaged in only sewing fabrics and making final products.

A study also indicated that the degree of technological and managerial sophistication among garment companies in Cambodia varies widely. It was found that although some companies are improving technically, the majority of garment factories in Cambodia require both technical and managerial training. Another finding was that productivity is low at all stages of garment manufacturing in Cambodia. Although the country's factories produce mostly basic garments, productivity is well below 70 percent. (Compare this rate to those of the best-organized and best-controlled production units in the world, which can achieve productivity of 85-90 percent.)¹⁵

By using the 8-digit nomenclature of the Harmonized System codes (HS codes) of imported goods in 2008, the study classified HS codes 50 to 63 as total garments and apparel, HS codes 60 to 63 as finished products and HS codes 50 to 59 as intermediate goods. The calculation reveals that Cambodia's garments and apparel imports totaled US\$1.564 billion, of which finished products accounted for US\$982.4 million and intermediate goods US\$581 million.¹⁶ Intermediate goods imports covered about 37 percent of total garment and apparel import (see Table 5).

¹⁵ USAID (2005), p.19.

¹⁶ Based on the author's calculation.

Table 5: Import of Garments and Apparels

Nomenclature	Items	Customs Values
50-63	Garments and Apparels	1,563,560,144.57
60-63	Garment and Apparel (finished)	982,471,416.75
50-59	Garment and Apparel (Intermediate)	581,088,727.82

Source: Database of Ministry of Commerce 2008.

2.2. Case Study of Intermediate Goods Trade with China

Trade between Cambodia and China has increased dramatically, especially after Cambodia became a full member of ASEAN in 1999. In 2007, China-Cambodia trade rose to US\$933 million, a 72-fold increase compared to 1992. Both countries are committed to increasing trade, which resulted in a rise in trade volume to US\$946 million in 2008, of which Cambodia exported only US\$12.9 million to China and imported US\$933.43 million.

China provided tax exemption for 418 items or tariff lines for Cambodian products entering China. However, Cambodia is still unable to maximize the benefits from this cooperation due to its lack of resources, quality products, information on markets, and means. Every year, Cambodia posts a trade deficit with China, ranging from US\$104.57 million in 2000 to US\$920.50 million in 2008 (see Table 6).

Table 6: Cambodia-China Trade (2000-2008)

	Unit million US\$								
	2000	2001	2002	2003	2004	2005	2006	2007	2008
Export	59.49	34.8	24.55	26	29.93	27.31	15.72	51.07	12.93
Import	164.06	205.61	251.56	294.65	451.77	536.03	541.44	882.93	933.43
Balance	(104.57)	(170.81)	(227.01)	(268.65)	(421.84)	(508.72)	(525.72)	(831.86)	(920.50)

Source: BRC Report No.1 (2009), p.27 and Ministry of Commerce.

As indicated in Table 7, Cambodia's exports to China reduced from US\$15.72 million in 2006 to US\$12.93 million in 2008. The main exported products are textiles and garments, which cover about 68 percent of total exports. Although the Early Harvest Program within the framework of ACFTA provides opportunity for Cambodia to export to China, Cambodia has not used China as the main export market yet. So far, Cambodia has exported practically nothing to China, especially in agro-products.

The volume of Cambodia's exports to China is very low. In 2008, Cambodia exported US\$8.9 million worth, of which 95 percent (US\$8.4 million) was for finished goods and only about 5 percent for intermediate goods (see Table 8).

In 2008, Cambodia imported about US\$933 million from China, of which the main imports were textiles and garments, and machinery and electronics, covering 62.5 percent and 17.42 percent of total imports, respectively (see Table 9).

In 2008, Cambodia imported US\$583.45 million worth of garments and apparel from China, of which finished products accounted for US\$376.84 million (or 64.59 percent) and intermediate goods US\$206.60 million (see Table 10).

Table 7: Export to China in 2006-2008 by Products

Chapter	Section	2006 (US\$)	%	2008 US\$	%	Change
1-5	Live Animal	514,372.75	3.27	386,854.05	2.99	-33%
6-14	Vegetable Products	145,783.33	0.93	14,894.01	0.12	-879%
15	Fats and Oils	28,142.39	0.18	107,679.71	0.83	74%
16-24	Prepared Foodstuffs	90,245.70	0.57	269,068.97	2.08	66%
25-27	Mineral Products	10.16	0.00	6,409.84	0.05	100%
28-38	Chemicals	-	-	-	-	
39-40	Plastics	34,321.95	0.22	156,419.05	1.21	78%
41-43	Hides and Leather	141,054.53	0.90	9,251.39	0.07	-1425%
44-46	Wood and Wood articles	2,306,608.28	14.67	933,767.17	7.22	-147%
47-49	Pulp and paper	14,214.56	0.09	7,745.24	0.06	-84%
50-63	Textiles and apparel	10,050,216.59	63.91	8,917,201.09	68.95	-13%
64-67	Footwear	159,566.03	1.01	98,898.04	0.76	-61%
68-70	Stone/Cement/Ceramics	-	-	197.24	0.00	100%
71	Gems	-	-	61,084.17	0.47	100%
72-83	Base metal and Metal articles	91,680.59	0.58	4,730.67	0.04	-1838%
84-85	Machinery and Electrical Appliances	1,481,731.84	9.42	85,486.45	0.66	-1633%
86-89	Vehicles	460,767.51	2.93	275,585.12	2.13	-67%
90-92	Optical, precision & musical instruments	-	-	-	-	
93	Arms	-	-	-	-	
94-96	Miscellaneous Manufactured articles	205,274.11	1.31	6,673.27	0.05	-2976%
97-98	Antiques and works of art	1,382.32	0.01	1,590,647.42	12.30	100%
Total		15,725,372.63	100.00	12,932,592.90	100.00	-22%

Source: Author computing based on Ministry of Commerce Database 2006 and 2008.

Table 8: Export of Intermediate Goods of Garments and Apparels to China in 2008

Items	Value (US\$)	%
Cambodia export Garment & Apparels	8,917,201.09	100.00%
Cambodia Export Finished (60-63)	8,479,067.10	95.09%
Cambodia export intermediate goods (50-59)	438,133.99	4.91%

Source: Author's computing based on Ministry of Commerce Database 2008.

Table 9: Import from China 2006-2008 by Products

Chapter	Section	2006 US\$	%	2008 US\$	%	% Change
1-5	Live Animal	1,100,706.20	0.21%	219,549.85	0.02	-401.35%
6-14	Vegetable Products	1,893,912.59	0.36%	4,641,074.37	0.50	59.19%
15	Fats and Oils	17,998.11	0.00%	189,834.87	0.02	90.52%
16-24	Prepared Foodstuffs	4,579,160.46	0.86%	8,577,476.56	0.92	46.61%
25-27	Mineral Products	229,843.49	0.04%	2,986,659.24	0.32	92.30%
28-38	Chemicals	11,827,091.69	2.23%	15,304,185.24	1.64	22.72%
39-40	Plastics	6,873,310.64	1.29%	10,307,937.56	1.10	33.32%
41-43	Hides and Leather	2,847,443.74	0.54%	1,195,396.93	0.13	-138.20%
44-46	Wood and Wood articles	281,856.03	0.05%	885,362.72	0.09	68.16%
47-49	Pulp and paper	5,704,361.83	1.07%	7,202,960.97	0.77	20.81%
50-63	Textiles and apparel	357,982,861.61	67.36%	583,452,128.57	62.50	38.64%
64-67	Footwear	1,354,902.38	0.25%	2,053,247.05	0.22	34.01%
68-70	Stone/Cement/Ceramics	24,238,429.32	4.56%	35,171,189.84	3.77	31.08%
71	Gems	1,331.56	0.00%	17,141.28	0.00	92.23%
72-83	Base metal and Metal articles	12,849,130.53	2.42%	29,883,145.13	3.20	57.00%
84-85	Machinery and Electrical Appliances	78,773,485.89	14.82%	162,666,186.35	17.42	51.57%
86-89	Vehicles	10,269,386.30	1.93%	41,967,158.89	4.50	75.53%
90-92	Optical, precision & musical instruments	1,191,029.79	0.22%	12,463,463.10	1.34	90.44%
93	Arms	82,315.98	0.02%	-		
94-96	Miscellaneous Manufactured articles	9,341,471.79	1.76%	14,328,528.94	1.53	34.81%
97-98	Antiques and works of art	0.00	0.00%	40,468.80	0.00	100.00%
Total		531,440,029.93	100.00%	933,553,096.27	100.00	43.07%

Source: Author's computing based on Ministry of Commerce Database 2008.

Table 10: Import of Intermediate Goods of Garments and Apparels to China in 2008

Items	Value (US\$)	%
Cambodia Import Garment & Apparel	583,452,128.57	100.00%
Import finished Garment & Apparel (60-63)	376,848,199.57	64.59%
Import intermediate goods (50-59)	206,603,929.00	35.41%

Source: Author's computing based on Ministry of Commerce Database 2008.

3. CONCLUSION

Cambodia's industrial development was carried out by the Royal Government of Cambodia's Industrial Development Action Plan (1998-2003), which had two goals: the development of export-oriented industries, and the development of the import-substituting production of selected consumer goods. Those goals were to be achieved by promoting labor-intensive industries, natural resource-based industries, SMEs, the agro-industry, technology transfers and upgrades in the quality of industrial products, establishment of industrial zones, and development of selected import-substitution production.

Due to many reasons, including the impact of the global financial crisis, the share of the industrial sector declined from 25.0 percent in 2005 to 22.4 percent in 2008. Within the industrial sector, the share of the textile and garment sub-sector declined from 12.3 percent in 2005 to 10.3 percent in 2008, the mining sub-sector did not change at 0.4 percent throughout the period, and the share of the construction

sub-sector declined slightly from 6.3 percent in 2005 to 6.1 percent in 2008.

Cambodia's trade consists largely of exporting its finished garments and pulp and paper, and importing finished products for daily consumption, petroleum, and vehicles.

Trade in intermediate goods also plays an important role in production in the country. The country imports finished and intermediate products from all over the world but finds it difficult to export both finished and intermediate products to global markets, especially to neighboring countries and elsewhere in Asia.

The main challenges of trade in intermediate goods are poor industrial policy, lack of technical skill, high production costs, and poor infrastructure.

4. RECOMMENDATIONS

There are three sets of recommendations:

For the Government

1. The industrialization policy should include a master plan for regional hubs of industry and poles for the country's industrial zoning. Special promotion of industrial zones at different provinces is recommended.

2. The government should formulate a technology transfer policy to promote technical skill and encourage the FDI companies to invest in R&D in Cambodia.

3. The government should strengthen standards and quality control to restrict the import of poor-quality products, while at the same time promoting the quality of local products to improve competitiveness.

4. Investment and trade promotion should be conducted more in Cambodia, and

4. Investment and trade promotion should be conducted more in Cambodia, and also abroad, so that the government could attract FDI for producing intermediate goods in the country. Special incentives should be provided in SEZs for selected industries such as electronics and food processing that use local raw materials for manufacturing and export.

For the Private Sector

1. The private sector should work together more strongly to promote professional associations, entrepreneurship, and innovation.

2. The private sector should find foreign partners to work with in order to share experiences and learn technical knowledge from them. The partners should work together with honesty, shared interests and mutual respect.

For Development Partners

1. Development partners should provide scholarships to Cambodian students for study in selected industries that the country needs to develop, such as oil and gas, mines, energy, and telecommunication.

2. Official Development Assistance (ODA) should be provided to increase industrial productivities and to promote quality of local products. The concepts of “one village, one product” should be further realized.

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