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EXPANDED BUSINESS ENABLING ENVIRONMENT STRATEGY FOR THE CAMBODIA STRENGTHENING MICRO, SMALL, AND MEDIUM ENTERPRISES PROJECT

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ABBREVIATIONS

AusAID	Australian Agency for International Development
BEE	business enabling environment
DTIS	Diagnostic Trade Integration Study
G-PSF	Government-Private Sector Forum
IF	Integrated Framework
IFC	International Finance Corporation
MAFF	Ministry of Agriculture, Forestry and Fisheries
MPDF	Mekong Private Sector Development Facility
MIME	Ministry of Industry, Mines, and Energy
MoC	Ministry of Commerce
MSME	micro, small, and medium-sized enterprise
PBES	Provincial Business Environment Scorecard
RGC	Royal Government of Cambodia
SEA-CLIR	Southeast Asia Commercial Law and Institutional Reform and Trade Diagnostic for Cambodia
Trade SWAp	Trade Sector Wide Approach
UNCTAD	United Nations Council on Trade and Development
UNDP	United Nations Development Programme
USAID	United States Agency for International Development
WTO	World Trade Organization

INTRODUCTION

Over a five-week period in November and December 2007, the Cambodia Strengthening Micro, Small, and Medium Enterprises project (Cambodia MSME) brought two consultants from the DAI home office to develop an expanded business enabling environment (BEE) strategy. The objectives of the assignment were to identify specific project-facilitated activities to support rural economic growth through effective regulatory and administrative reforms, processes, and dialogues. The short-term (one-year) focus of the assignment is to identify specific reform-related activities oriented to the needs of the swine, aquaculture, and clay tile sectors. More generally, the activities seek to improve the provincial and national business environments and become the base for future support that can be promoted by private sector and government stakeholders, as well as other development partners. This expanded BEE strategy report is divided into five sections:

- Section A: Background
- Section B: Challenges
- Section C: General Strategy
- Section D: Detailed Strategy
- Section E: Recommendation for Future Support to Improved BEE

A. BACKGROUND

A1. COUNTRY CONTEXT

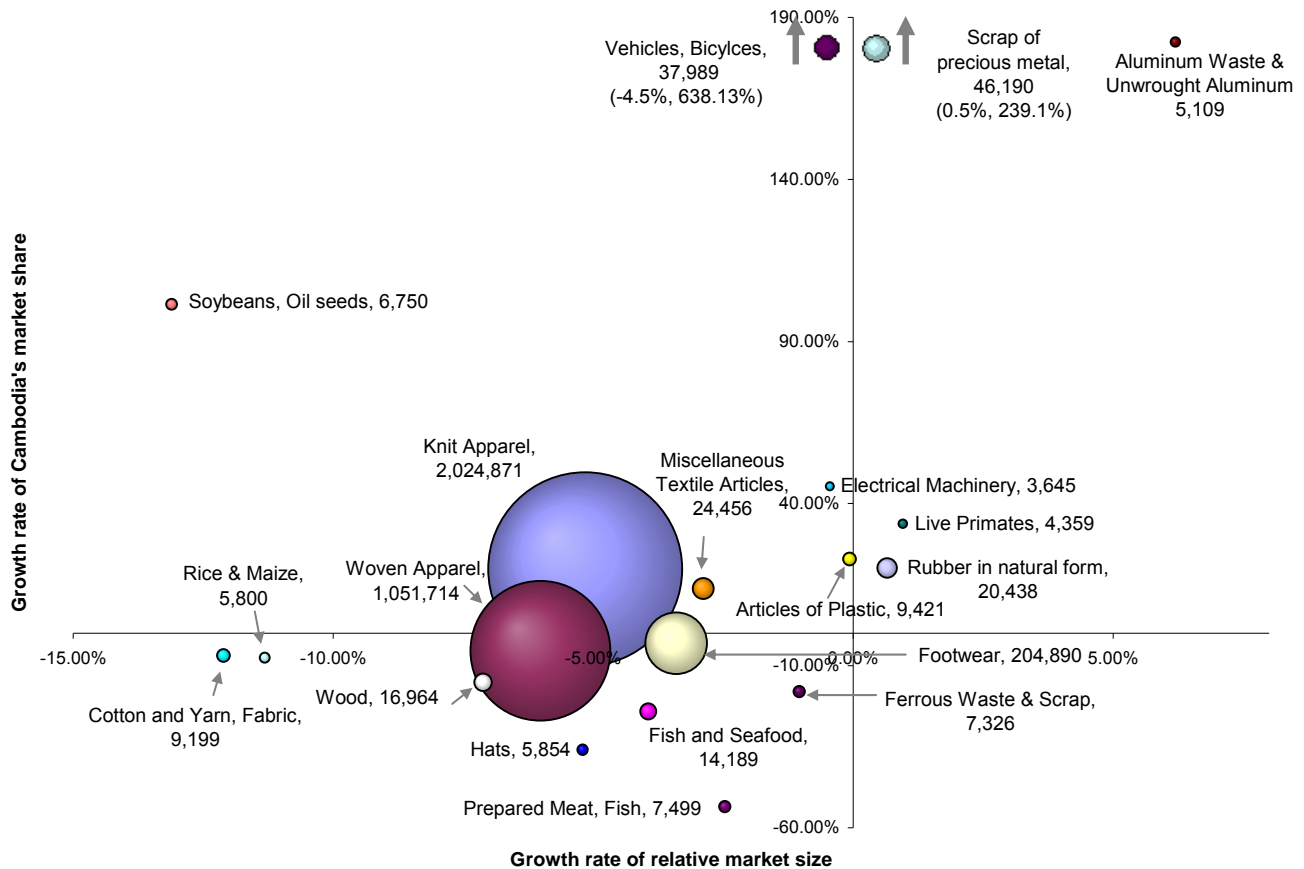
The Royal Government of Cambodia (RGC) joined the Association of South East Asian Nations (ASEAN) in 1999 and the World Trade Organization (WTO) in 2004, taking proactive steps to ensure the continued growth of the garment industry and increased involvement in the global market. International trade preferences for Cambodian garments, as well as a tourism boom and growth in the mining sector, have since supported high rates of growth in Cambodia—real gross domestic product growth was more than 10 percent in 2006. However, Cambodia’s export profile is extremely limited, with garments comprising more than 95 percent of exports to the world in 2006.

Figure 1, which uses data on reported imports from Cambodia’s major trading partners, illustrates the dynamic trends in competitiveness of Cambodian goods in the world market. Cambodia’s exports are highly concentrated in the garment sector, which showed stable performance over the last three years in terms of both market share (Y-axis) and demand for garments in the world market (X-axis). Not shown on this chart, because equivalent data for services trade are not available, is the dramatic growth in the tourism sector that Cambodia has experienced in recent years.

Although Cambodia has not seen strong performance in exports of agricultural goods that would be its natural exports—such as fish and seafood and prepared meat and fish—Cambodia’s strong performance in the garment sector suggests that the country has the capacity to capitalize on existing comparative advantages should supportive international and domestic policies be put in place.

Because of the highly concentrated nature of exports and growth in Cambodia, the vast majority of Cambodians are not seeing their benefits. An estimated 85 to 90 percent of the Cambodian population lives in rural areas and is engaged in agricultural production—often at a subsistence level—and light manufacturing. At this stage of development, improvements in competitiveness are needed simply to maintain and gain market share in the domestic market, with export-readiness a longer-term goal. Under the current regulatory regime for small and medium-sized enterprises (SMEs) however, the costs of formalization and risks to investment are too high for the average producer. As a result, the very industries that should form a basis for strong and sustainable economic growth are unduly constrained by an unsupportive regulatory environment.

FIGURE 1: CAMBODIA'S PERFORMANCE IN THE WORLD MARKET, 2004–2006 (US\$000)



Source: Global Trade Information Systems, Global Trade Atlas. Because Vietnam does not report trade data, mirror data are not available for that market. Cambodia-reported exports to Vietnam in 2006 were worth \$42,408,950, of which \$29,448,753 was earned from exports of natural rubber in raw form.

A2. BUSINESS ENABLING ENVIRONMENT

The BEE refers to the institutions, laws, and regulations that determine the cost of doing business and the ability of businesses to compete in both domestic and international markets. Free and open access to information about markets and regulations; ease of entry and exit of firms; access to factor markets; and protection of property are broad categories governed by the BEE and there are many ways to measure the level of efficiency in these areas.

The World Bank's *Doing Business* report measures the time and cost to start, run, and close a business in Cambodia based on the assumption of a limited liability company. Because this type of company is a rarity in Cambodia, the results refer to only a small percentage of firms. However, it is still useful to note that even with recent improvements in the cost of starting a business and dealing with licenses from 2006 to 2007, the costs in Cambodia remain far higher than in other countries of the region. Furthermore, it takes twice as long to complete all of the requirements to start a business in Cambodia than in the East Asia and Pacific region on average. Overall, Cambodia ranks 145 out of 178 countries ranked. Smaller

firms typically choose to remain outside the formal registration process altogether, as discretionary charges necessary to do business are less onerous than going the official route.

A Cambodia-specific index, the Provincial Business Environment Scorecard (PBES), was prepared for the first time in 2007 by The Asia Foundation with International Finance Corporation-Mekong Private Sector Development Facility (IFC-MPDF) and Australian Agency for International Development (AusAID) funding. This document does not compare Cambodia to other countries; rather, it compares provinces and autonomous municipalities to one another. Although Cambodia is not a highly decentralized country, large differences in the business climates were found between the 10 provinces measured in the first year. Kampong Cham was the strongest performer on the scale, while Sihanoukville municipality, home to Cambodia's principle seaport, was found to have the least supportive environment for doing business.

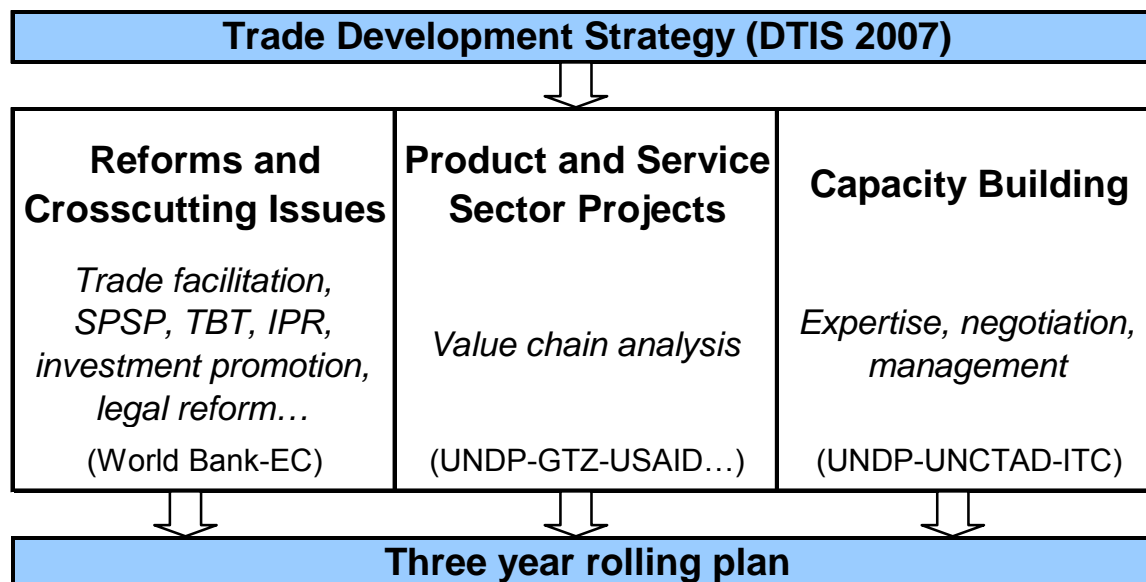
The recent U.S. Agency for International Development (USAID)-funded Southeast Asia Commercial Law and Institutional Reform and Trade Diagnostic for Cambodia (SEA-CLIR) report assessed the progress of legal and regulatory reform in Cambodia in great detail, finding large gaps in developing and drafting laws and the development of the subdecrees and "prakas" required for actual implementation and administration of reforms. Additional analysis has shown that implementation at the provincial level is further constrained by lack of information and capacity among provincial leaders.

While the results of these analyses reflect a challenging reality, Cambodia has embarked on a large number of reforms as part of WTO accession commitments. For example, the SEA-CLIR report found strong progress in some areas, including company registration procedures and banking reforms, and drafting and passage of laws related to commercial activities. Meanwhile, with a few exceptions, the legislative development process has been transparent and is being undertaken with broad support from donors and local law firms. Through public forums, the private sector is regularly given the opportunity to comment on draft laws before they are put before the Council of Ministers for passage.

A3. TRADE SECTOR WIDE APPROACH (TRADE SWAP)

The Trade Sector Wide Approach (Trade SWAp), a Ministry of Commerce (MoC) Department of International Cooperation-led and multidonor-funded initiative to organize trade facilitation efforts, offers an important new framework for USAID-funded activities in the area of economic growth and trade-related policy reform. The Trade SWAp program will support systematic reforms along three pillars: reforms and crosscutting issues for trade development; product and service sectors export development; and capacity building and management for trade development (see Figure 2).

FIGURE 2: TRADE DEVELOPMENT STRATEGY



Within the first Trade SWAp pillar, Cambodia MSME can support reform and implementation of regulations in the areas of the BEE, decentralization, business registration, and trademarks. Under the second pillar—a natural extension of the Cambodia MSME project’s successful work in value chain support— assistance can be provided to draw attention to the policy constraints to investment in value chains and improved capacity in trade promotion. For the third pillar, Cambodia MSME can support ministries and departments to coordinate trade-related value chain and business enabling activities to strengthen linkages between trade objectives and provincial economic growth.

Providing the analytical framework on trade issues for the Trade SWAp, the recent Diagnostic Trade Integration Study (DTIS) 2007 identified 19 priority sectors, or value chains, which cover 12 products already exported plus seven services and products not yet exported. Products, or value chains, include garments and a wide range of agricultural products, as well as tourism, light manufacturing, and labor services. Cambodia MSME’s proven value chain methodology offers an excellent platform to expand the project’s BEE reform activities to those described below in Section D. The expanded activities will support all three of the Trade SWAp pillars, with greatest support to pillar 2, products and services.

A4. USAID: ILLUSTRATIVE RESULTS FRAMEWORK AND NEW ECONOMIC GROWTH STRATEGY

USAID’s objectives in Cambodia are to fight corruption, strengthen political rights and civil liberties, strengthen national health systems and the health of Cambodians, improve basic education through grade nine, and improve private sector competitiveness and the enabling environment for investment. In the area of economic development, improving private sector competitiveness has focused on strengthening the productivity of the micro, small, and medium-sized enterprises (MSMEs) that employ a majority of the population and on the garment industry. Current USAID-supported initiatives include value chain and

workforce development, labor dispute resolution, and efforts to build private sector demand for policy and regulatory reforms.

At a global level, the new Foreign Assistance Framework puts economic growth at the focal position in the U.S. foreign assistance program. In turn, USAID/Cambodia's Office of General Development strategy for economic growth directly supports the USAID/Washington Economic Growth priorities highlighted in the new draft Economic Growth strategy document released by USAID in September 2007. Under the draft strategy, the two overarching economic growth priorities are to improve the competitiveness of firms toward the goal of poverty reduction and to improve business environment growth enablers. Special attention is given to improving microeconomic growth enablers such as the regulatory regime for doing business.

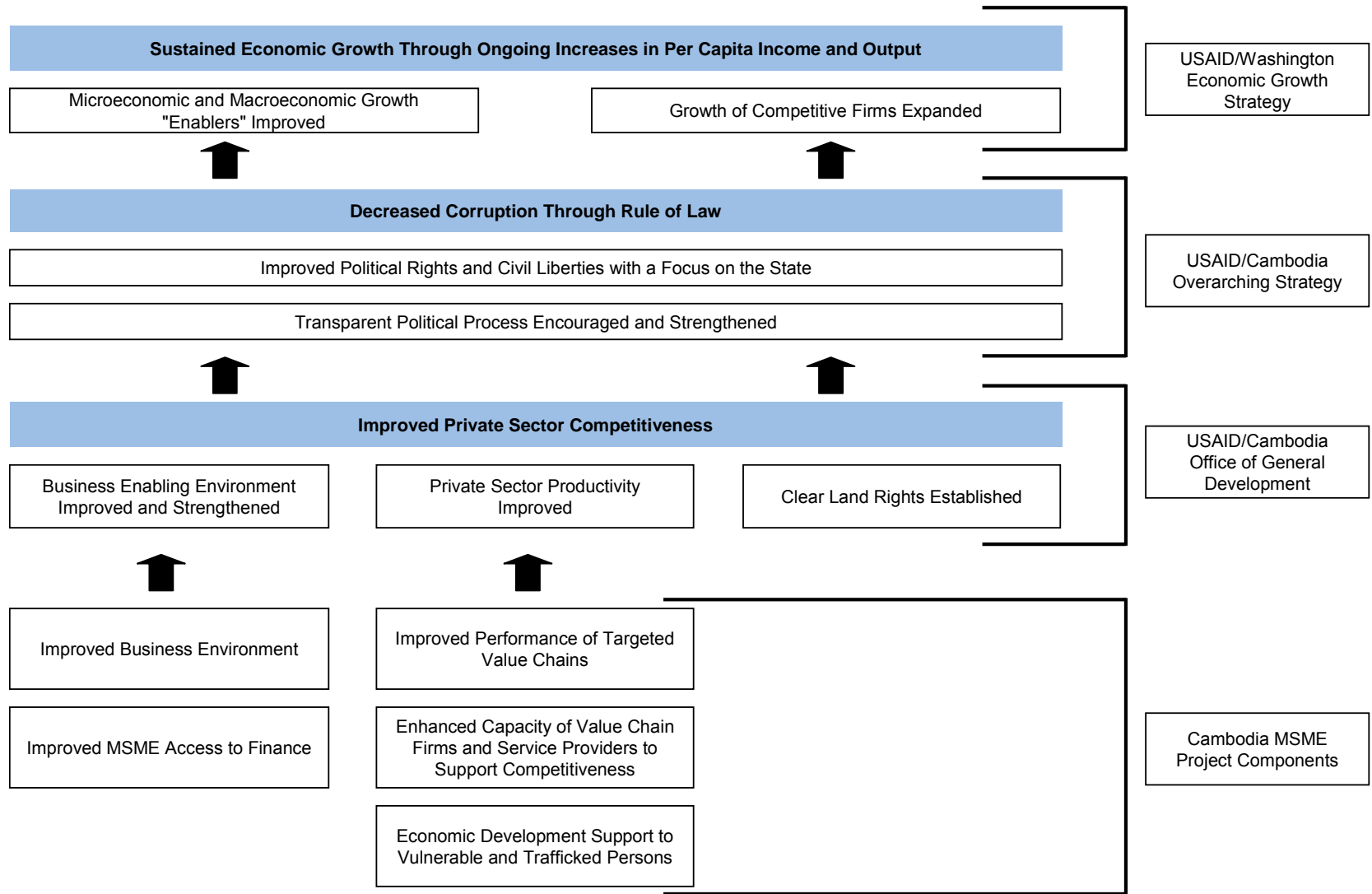
USAID has applied this two-pronged strategy first to generate productivity growth, crucial to the future of transforming countries such as Cambodia. The intent is to foster the country's ability to turn its resources into ever-greater amounts of goods and services over time. Seeking profit and motivated by competition, entrepreneurs and producers in functioning markets naturally strive to increase sales and reduce costs. Productivity growth—and the investments that feed and sustain it—takes place at the level of the firm, which includes producers in all sectors and of all sizes, from the street vendor with a handcart to the largest global corporation.

As regards the second part of its economic growth strategy, USAID recognizes that producers' decisions are strongly influenced by the incentives and disincentives created by government policies and regulations, as well as the capacity of government to enforce these regulatory requirements transparently and fairly across sectors and firms. A key regulatory factor controlled by government involves sound macroeconomic policy and its impact on overall economic stability; however, these macroeconomic issues have largely been addressed in most developing countries. Therefore, systematic attention is now being given to microeconomic policies such as tax regimes, "doing business" regulations, the enforcement of property rights, and the system for resolving economic disputes.

USAID Economic Growth Strategy: Core Principles. Of particular importance to the USAID/Cambodia program and the expansion of the Cambodia MSME project's work in BEE, the USAID economic growth strategy's core principles emphasize that programs should seek large and systematic impacts by focusing on improvements that affect all businesses within a sector or country. However, in the case of countries such as Cambodia where systematic reform has not been achieved even with accession to the WTO, the strategy encourages catalytic impact through demonstration approaches and project interventions such as Cambodia MSME's value chain activities. These activities have a multiplier effect on the number of firms that adopt changes without subsidies. Through policy work and support to both public and private reform-minded leaders, Cambodia MSME has also demonstrated clear success in stimulating institutional and policy changes that affect a far larger group of people than direct project beneficiaries. In the Cambodian environment, where change is extremely slow and many policy issues appear intractable, the Cambodia MSME project has made great strides in rebuilding the most basic human and economic relationships among farmers and firms in selected value chains. As USAID begins working directly with the RGC, it will be important that the economic growth work to date be leveraged creatively to motivate further change at the local and national levels.

Figure 3 illustrates the causal links from Cambodia MSME project-level activities to USAID/Washington's global economic growth strategy.

FIGURE 3: RESULTS FRAMEWORK



A5. CAMBODIA MSME PROJECT POLICY WORK TO DATE

In Cambodia MSME's early years, policy reform efforts were focused on issues arising from implementation of activities in each of the project's three value chains. In the two years that the project has been actively engaged in value chain policy work, a great deal of progress has been made. In particular, Cambodia MSME was instrumental in raising the issue of pig smuggling from neighboring countries from the provincial to the national agenda. With project support, advocacy by pig producers through the Government-Private Sector Forum (G-PSF) Agriculture Working Group has now put issues related to pig health onto the national Agricultural Working Group Agenda and is strengthening public-private sector coordination at the provincial and local levels. Additionally, efforts to collaborate with the provincial departments of commerce and departments of agriculture to develop and distribute information on official registration and licensing requirements are under way.

With the October 1, 2007, change in U.S. Government policy now enabling direct bilateral interaction and aid to the RGC, Cambodia MSME has rapidly expanded its activities in Component 4: Reform of the Policy Environment, with increased funding and resources dedicated to these efforts. These initiatives include developing the strategy contained in this report for expanding and establishing new project activities in support of better regulation and improvements to the BEE. As detailed further below, the strategy outlines new activities for the project at both the national and provincial levels. Strategy activities focus on *implementing* national policies under WTO-related legislation that has already been passed, increased trade and investment at the provincial level, and improved information dissemination and policy dialogue between the public and private sectors and between the national and provincial levels.

B. CHALLENGES

During the preparation of this expanded BEE strategy for the Cambodia MSME project, five critical challenges became apparent, each of which is addressed in detail below:

B1. OVERCOMING A CULTURE OF DISTRUST

With the stunning tourism experience offered by Angkor Wat and the wide range of restaurants available in Phnom Penh, it is easy to overlook Cambodia's violent past amid the beauty of the country. Yet Cambodians have certainly not forgotten. Speaking out or drawing attention to oneself during the reign of the Khmer Rouge, and even under the leadership that followed, could mean imprisonment, torture, and death. Anyone who offered advice to the government was implicitly suggesting that the system was not infallible. Intelligence was seen not as a virtue but as a threat, and college students, teachers, and doctors were particularly targeted. Although the Khmer Rouge has collapsed, suspicion, fear, and distrust among Cambodians constitute an ongoing undercurrent in public interactions today.

It is not surprising, then, that Cambodians remain reluctant to speak out in public, preferring instead to work quietly outside of the attention of authority or to sit silently at public events such as donor-funded workshops. Any donor-supported project must explicitly address this culture of distrust in program design, recognizing that real progress will take great effort and significant time at both the national and local levels. For example, as experienced by Cambodia MSME during project implementation at the local and provincial levels, swine producers have been extremely reluctant to work together through producer associations; they do not understand or believe that such organization will benefit—and not threaten—their survival. At the national level, the G-PSF marks the first real success in facilitating public-private dialogue on private sector issues. However, the G-PSF took more than two years to establish and is often still largely donor-driven. A few of the subcommittees do not meet regularly, the private sector voice on committees and at meetings is weak, and issues from the provinces remain virtually unrepresented or unknown.

However, although the cultural legacy of institutionalized and individual distrust of the last three decades continues to hamper progress, it is evident that change is taking place. Through the Cambodia MSME project, for example, government leaders at the provincial level are beginning to appreciate the need to engage with business, while businesses are becoming more assertive and willing to advocate for their interests. This process is slow, but bit by bit the common goal of economic growth is supporting change in mindsets and behavior throughout Cambodia.

B2. MOVING FROM LEGISLATIVE DEVELOPMENT TO POLICY IMPLEMENTATION

National-level efforts in the area of legislative and regulatory reform, including legal compliance with WTO requirements and the streamlining of the BEE, are moving slowly forward. However, even as many of the necessary legal reforms are taking place, actual implementation of these new laws, including the drafting and implementation of the subdecrees and prakas needed to implement them, lags behind. This is due in large part to a lack of coordination among line ministries to develop matching implementing subdecrees and delays resulting from resistance to change, but it is also a result of an implementation gap

between the national and provincial levels of government. When guidelines governing the administrative implementation of new regulatory policies are produced, the written guidance often goes out to provincial leaders and departments without implementation resources, guidelines, training, or oversight. As a result, implementation procedures vary widely among provinces and are subject to a great deal of local discretion.

B3. INSTITUTIONALIZING EFFECTIVE NATIONAL-PROVINCIAL COMMUNICATION

Somewhat obvious, but by no means simple, the first step in improving the BEE is through information dissemination and harmonization across provinces and ministries. Communication and information dissemination are essential to effective policy making, but remain weak among policy makers and ministries in Cambodia, especially between the national and provincial levels. Improved communication can demonstrate policy makers' accountability for the policies they develop and for the way those policies are implemented. Where policy reforms are controversial, dissemination of information on the results or impacts of the reforms can help broaden support for reform, catalyze public-private dialogue, and lay the groundwork for subsequent reforms.

Ineffective flow of information between national and provincial governments worsens the policy implementation challenge. It has a broadly negative impact on provincial and national development in terms of accountability, transparency, and policy performance. The Cambodia MSME project's efforts to bring local and provincial policy issues in the swine value chain to the national level represents one of the first policy dialogues initiated from the ground up. Until very recently, there was no institution or mechanism in place to support such communication, and early efforts remain weak. Thus, the challenge of institutionalizing and then broadening an effective communication process addressing a wide set of BEE issues between the national and provincial levels is large.

B4. FOSTERING MEANINGFUL PUBLIC-PRIVATE DIALOGUE

Public-private dialogue in Cambodia is similarly weak. Both groups maintain long-held distrust of and biases against the other, and getting members to come together to discuss issues of common interest can be difficult or impossible. For example, during a recent Cambodia MSME-supported exposure trip to Vietnam, participants in each group insisted on attending separately, in part because neither private sector or public sector members knew quite how to position themselves hierarchically in a single integrated public-private sector group. Yet improvements in this area are critical: good policy decisions and effective rule of law depend upon awareness and vigilance from lawyers, firms, and the public at large.

As mentioned, the pre-eminent mechanism for public-private dialogue in Cambodia is the G-PSF, which has eight technical working groups or subcommittees. The subcommittees most relevant to improving the BEE and working with the Cambodia MSME project are the Agriculture and Agro-Industry Working Group and the Subcommittee on Trade and Trade-Related Investment. In the past, the G-PSF and the work of the subcommittees has been critiqued for not serving the needs of smaller enterprises, because large firms are on the G-PSF board and have more access to leadership. A mechanism for effectively including the MSMEs that dominate the private sector in Cambodia into the higher-level G-PSF dialogue has not been established, and government is not eager to duplicate this mechanism at the provincial level.

Other efforts to foster public-private dialogue are under way at the local level and are showing early success. For example, the USAID-funded PACT program is supporting local administrative reform through the Local Administration and Reform Program operating in eight provinces and soon expanding to nearly 400 communes. This program is working to build both demand for access and accountability from citizens and civil society and supply from elected commune counselors. Additionally, The Asia Foundation has established public-private forums in targeted provinces, with varying degrees of success.

The Cambodia MSME project has initiated value chain-specific dialogues between the public and private sectors in its targeted provinces and has begun to see results, although the challenges in simply getting individuals from the public and private sectors to talk to one another are daunting. Private sector advocacy is playing a stronger role, but expectations must be managed because of the limitations of a three-year program. Efforts to catalyze effective public-private dialogue at both the national and provincial levels should be leveraged by the Cambodia MSME project and the expanded BEE strategy wherever possible, recognizing that efforts will often have to focus on very basic aspects of changing behavior and ingrained cultural interactions.

B5. DONOR COORDINATION

Donor coordination in Cambodia is relatively good; however, with so many actors functioning independently, it is also complex. To support improvements in the BEE, especially related to WTO accession, trade facilitation, and investment, USAID and the Cambodia MSME project must establish a national-level role on issues that have already had extensive donor engagement over the last decade. The situation presents an operational and a diplomatic challenge for USAID and its implementing partners as they begin working directly with national government counterparts for the first time, where other donors have long-established relationships. For example, in 2000, Cambodia was designated one of three pilot countries in the Integrated Framework (IF) program, a multi-agency, multidonor program that assists least-developed countries to expand their participation in the global economy while enhancing their economic growth and poverty reduction strategies. The IF program was first mandated by the WTO Singapore Ministerial Conference in December 1996; the participating agencies are the International Monetary Fund, International Trade Centre, United Nations Council on Trade and Development (UNCTAD), United Nations Development Programme (UNDP), World Bank, and WTO. Later, Cambodia was the first country to complete a DTIS in 2002, updated in 2007. In support of these activities, UNDP and UNCTAD have had resident advisors with offices in the MoC for over five years, the Asian Development Bank has two advisors in the Ministry of Industry, Mines, and Energy (MIME), and AusAID has an advisor in the Ministry of Agriculture, Forestry and Fisheries (MAFF).

For trade-related issues, WTO accession, and the BEE in Cambodia, the main government counterpart in the implementation of the IF and the DTIS activities is the MoC. However, many other ministries are involved and one of the key donor challenges to supporting the implementation of trade-related reforms and improvements has been interministerial cooperation. In response, the Trade SWAp for trade facilitation was formulated to provide a single framework for donor support to the sector and for trade-related and BEE reforms. Such reforms affect the regulatory regimes of multiple ministries and must be jointly implemented by ministries involved in WTO and other trade-related policy reforms. Currently, two of the three “shepherds” (pillar leaders) for the Trade SWAp sit in the MoC; the third is the World Bank representative in-country. Moving forward, a critical challenge for USAID and the Cambodia MSME project will be to establish an effective and respected role within the Trade SWAp framework, with each of the relevant ministries, and with other donors.

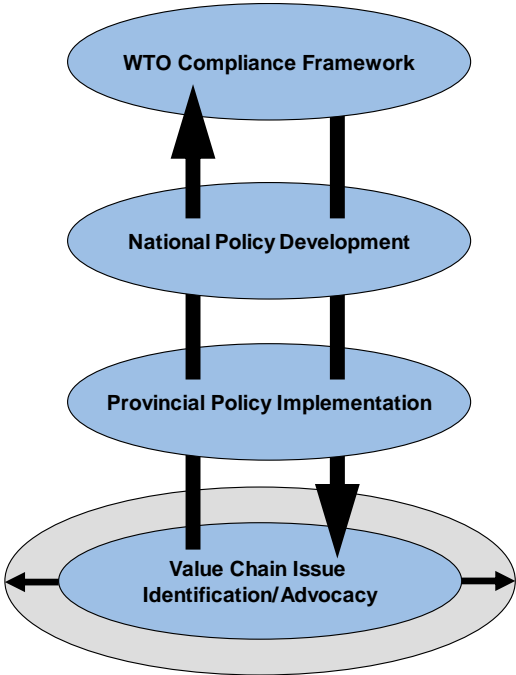
C. GENERAL STRATEGY

C1. BUILDING ON YEAR 3 POLICY WORK

The Year 3 BEE strategy for Cambodia MSME is expanding public-private sector communication by capitalizing on the new ability to work directly with the RGC and catalyzing interaction between different levels of government. Advocacy on the part of the swine value chain members in particular has seen results through improved communication with the pig association and the tangible impacts of cross-provincial and international exposure trips. Returnees from the trips are immediately putting new techniques into practice—improving the productivity of their farms in the case of SME attendees, and lowering costs and improving service provision in the case of public sector attendees. Further broadening the project’s influence, BEE workshops with People’s Communes in each province are planned for Year 3 and provincial trade fairs will heighten the profile of locally produced goods and feed directly into investment promotion activities.

The expanded BEE strategy ramps up efforts to define priorities, strengthen existing and nascent coordination mechanisms, and identify and communicate incentives for reform. The activities described in the strategy seek above all to capitalize on relationships developed within value chains. This will be done by establishing and strengthening effective bottom-up, top-down, and horizontal approaches to identifying priorities and strengthening the ability of leaders to support the competitiveness of private sector firms while catalyzing demand-driven and WTO-led improvements to the business enabling environment (see Figure 4).

FIGURE 4: EXPANDED BEE STRATEGY



C2. EXPANDING PROJECT IMPACT

As illustrated in Figure 4, the Cambodia MSME project will expand its impact in three ways: from the bottom up, from the top down, and by expanding linkages horizontally.

Working From the Bottom Up. The value chain approach utilized by Cambodia MSME, and described in the Cambodia Development Partner Value Chain Activity and Coordination study, has had a great deal of success in building coordination between private sector actors, raising value chain priorities to the provincial and national levels of government, and directing reform initiatives. The value chains create a central focus around which incremental local reforms can be made and larger reforms related to international agreements can be measured. This approach has been fully integrated into the Trade SWAp as part of pillar 2, Products and Services. Through the value chain assessment workshop and through the G-PSF, the Cambodia MSME project has successfully lifted local issues specific to the project's three value chains to the national level, including issues of importance to the broader community of development partners implementing value chain projects throughout the country. Referred to by a UNDP consultant to the MoC as his "new bible," the value chain report produced by USAID and the workshop that led to it have begun to build awareness of the impact of regulatory issues and implementation challenges across diverse value chains while engaging MSMEs in the process of reform and heightening a shared national awareness of local economic development needs.

Another bottom-up approach is to assist provincial managers and staff to advocate for more responsibility and requisite authority for implementing reforms. The Cambodia MSME project began working on this initiative intensely as of October 1, 2007, and will continue to assist provincial staff to advocate for their interests with national ministries and governors. The model for this advocacy is similar in theory and practice to the model Cambodia MSME uses for the private sector MSMEs. We believe this is a critical missing link in the policy reform and implementation chain.

Working From the Top Down. The bottom-up approach currently in use by the Cambodia MSME project will be matched with a top-down approach in which support is provided to the implementation of legal and regulatory priorities related to WTO accession and other trade agreements. This will involve capacity building at the national level for clear information dissemination and administrative implementation guidance to the provincial level. The specifics of capacity building will be elaborated during the early days of the activities below through a demand-driven approach in which consultants assist the government to prioritize reforms and respond to requests for assistance and services, an approach that has worked successfully for many years under the Vietnam Support for Trade Acceleration project.

From the top down, the Trade SWAp and DTIS 2007 are organizing trade-related reform priorities based on WTO and bilateral free trade agreements and areas that Cambodia plans to pursue. As mentioned, the second pillar in particular provides a framework for linking activities at the national level to specific value chains at the local level.

Improving Horizontal Linkages. A third level of activity in the expanded BEE strategy will be to strengthen horizontal linkages and communication across provinces, ministries, and donors engaged in value chain initiatives. In the long term, building connections between provincial leaders will assist them to better advocate for their needs—in many cases, a budget with which they can fund activities in the provinces—and will enable progressive provinces to share information with those that are more remote or disengaged. Among ministries, a similar process will be supported. At the donor level, there are many activities in value chain-related policy reform, but no mechanism for the activities to build on one another to obtain a higher level of impact.

Assumptions and Risks. The Cambodia MSME project is making a number of basic assumptions in proposing the strategy described in detail below. Chief among these are the expectations of continued ability to engage directly with the RGC and, therefore, continued USAID funding in the area of business enabling environment. The project also assumes that macroeconomic and political stability in Cambodia will enable reform efforts to continue to move forward.

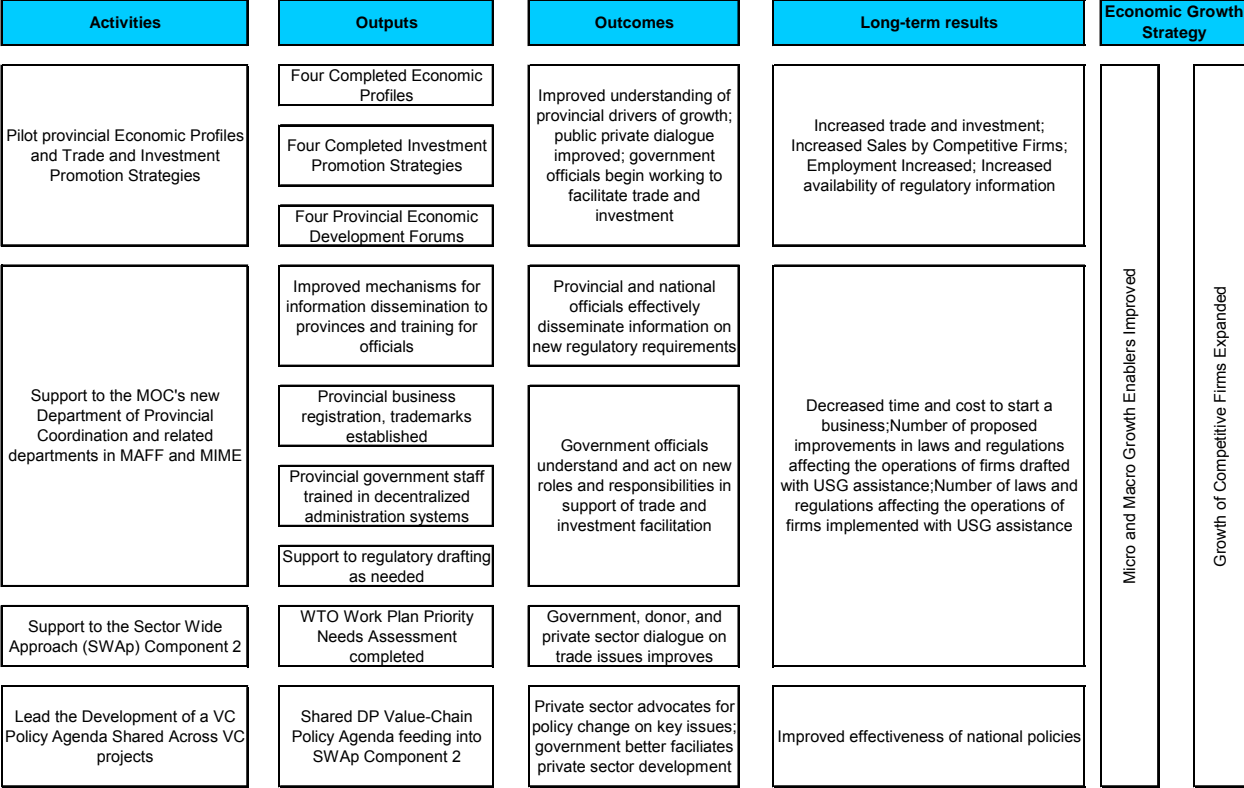
The expanded BEE strategy does not address all of the potential areas for assistance to the business enabling environment. Among the areas not covered explicitly are some of the most often cited constraints to investment in Cambodia: lack of access to credit, the high cost of individual collateralized loans, and corruption in many areas, including the high cost of land registration. While access to credit is a fundamental aspect of the BEE, it is already being addressed directly through Cambodia MSME's component 3, Improved MSME Access to Finance. Meanwhile, corruption will be addressed indirectly through nearly all project activities. The activities described in this strategy will have a direct impact on improved legal and regulatory transparency and improved accountability of the government to the private sector. The success of these initiatives will reduce opportunities for informal payments and, it is hoped, result in a new relationship between the government and firms that prioritizes support to competitiveness rather than individual interests.

Each activity described in this strategy requires a great deal of cooperation and coordination with government officials as well as a dramatic increase in the availability of information on processes, procedures, and official fees. The project expects a certain amount of resistance to change and the timeline of activities is designed with this challenge in mind. However, the risk of delays or the need to alter expectations of results as the project progresses remains.

D. DETAILED STRATEGY

The activities included in the expanded BEE strategy address critical deficiencies in information between the public and private sectors and between and among levels of government. The activities are designed both to improve access to provincial-level information and to develop mechanisms for communication between the groups listed in order to build trust and strengthen support for reform in order to improve the environment for doing business and, ultimately, increase firms’ ability to be competitive in the domestic and international markets. The strategy is illustrated in Figure 5.

FIGURE 5: EXPANDED BEE STRATEGY MONITORING AND EVALUATION CAUSAL MODEL



D1. PILOT PROVINCIAL ECONOMIC PROFILES AND TRADE AND INVESTMENT PROMOTION STRATEGIES

In 2004, the Cambodian government issued a subdecree delegating direct facilitation of investments of \$2 million or less to provincial governors, without the need for Cambodia Development Council oversight. The governor's office in each province receives proposals for investment and is responsible for processing applications, researching proposals, and working with investors to meet necessary requirements. As a result, governors now have an important role to play in drawing and enabling investment within their borders and are linked into the process of economic development at the provincial level in a serious way.

The Cambodia MSME project, under the expanded BEE strategy, will complete pilot provincial economic profiles and investment promotion strategies in each of the four project-assisted provinces. The long-term results of the profiles and strategies will be increased trade and investment, increased sales by competitive firms in the provinces, and stimulated local employment, as well as increased availability of regulatory information. These results will be obtained by improving access to information at all levels of private sector and government, identifying opportunities to build consensus for provincial policy reform and improved implementation, and attracting greater levels of foreign and domestic investment to the provinces.

Each economic profile will consist of an analytic piece for use by the governor's office, departments, and ministries, and each strategy will be a short marketing document that will be readily accessible to investors. The analytic document will introduce the concept of the BEE and will be modeled in part on the 2007 update of the World Bank's Investment Climate Assessment for Cambodia and the International Trade Centre's export potential assessment. These documents present analyses at the national level but use frameworks that are useful to this provincial effort in terms of the types of information they collect and their analyses of domestic and international conditions and markets.

The provincial economic profiles will also incorporate data from the IFC-MPDF- and AusAID-funded Provincial Business Environment Scorecard (PBES) implemented by The Asia Foundation. This measure tracks provincial performance on a number of BEE indicators: entry costs, property rights, transparency, costs of regulatory compliance, informal charges, participation, crime prevention, tax burdens, and proactivity of provincial leadership. In 2007, the PBES covered 10 provinces, only two of which overlap with Cambodia MSME project provinces (Kampong Cham and Svey Rieng); therefore, these data will only be available for these two profiles in the first year.

The profiles and strategies are distinguished from existing analytic work in that they use a range of measures of interest to policy makers and investors to present concrete investment promotion strategies. Further, they are meant to serve as central points around which the discussion of reform can be held in a positive context of economic opportunities. The Cambodia MSME team has worked closely with provincial leaders on issues important to the project value chains and has identified a number of reform champions in departments of commerce and agriculture who are eager for information and recommendations in this area.

A combination of local and international consultants and members of the Cambodia MSME team will complete the design of the profiles in early 2008. A short-term economic analyst will lead the development of the analytic framework and survey instrument, direct the collection of any secondary data

available, and oversee the completion of the profiles and strategies in conjunction with a Cambodia MSME project counterpart. A local survey firm will contribute to the development and will lead administration of the survey. Preliminary research suggests that reliable secondary information will be difficult to obtain, so efforts will be concentrated on developing a survey that is extensive enough to provide an accurate picture of provincial conditions while remaining accessible and placing a minimal burden on respondents. Surveys may include provincial data on drivers of economic growth, investment, production structure, infrastructure, trade, and a variety of indicators related to the BEE and governance.

Successful preparation of the economic profiles will require extensive advocacy with provincial and national government leaders. During the initial design phase, Cambodia MSME staff will present the proposal to the departments of commerce, agriculture, and industry and the governors in each province, and will then lead discussions during survey implementation and when draft analytic results are available.

D2. ORGANIZE PROVINCIAL ECONOMIC DEVELOPMENT FORUMS

Cambodia MSME is increasingly providing opportunities for provincial leaders to engage with one another around reform issues. The project will formalize this process under its expanded BEE strategy through provincial economic development forums to be held in each of the pilot provinces. The public-private economic development forums will further provincial-level strategies on improving the business environment and result in increased sales, exports, and employment as well as decreased time and cost to start a business.

Upon completion of the draft profile and strategy, pilot provincial diagnostic discussions will be held with the public and private sectors in each of the provinces to review the results and address any questions that arise. Kampong Cham is a likely candidate for the first of the four provincial forums because of the proactive role of the Department of Commerce in that province. In fact, the Department prepared a basic Commerce Profile in 2006 for use with potential investors and has expressed eagerness to support an expanded initiative. Similar presentations would then be made in the other three provinces—Svey Rieng, Prey Veng, and Kratie—should time and resources allow.

The provincial economic development forums will be an opportunity to discuss the provincial-level information being developed through the 2008 PBES, the economic profile/investment promotion strategy, and the national-level approach taken by the World Bank's Investment Climate Assessment. Cambodia MSME will work to coordinate with other donors working in each of the provinces on this activity, obtaining their buy-in and leveraging provincial relationships and activities, especially in other value chain and economic development initiatives.

Building Support for a Provincial Economic Development Forum Held at the National Level. Based on the pilot provincial economic development forums, a national governors economic development forum may also be organized in late 2008 or early 2009. The forum should access the experience of other countries in the region, such as Vietnam, in more effectively spreading the results of economic growth across provinces.

There are a number of challenges in organizing a governors economic development forum in Cambodia. Chief among them are the fact that cross-provincial dialogue is minimal, governors have varying degrees of interest in addressing the BEE, and many have vested interests in maintaining the status quo. However, even in the face of these challenges, The Asia Foundation found strong support on a smaller scale for the

launch of the first PBES in 2007. Five governors and a number of other department leaders attended, including several from provinces that were not ranked in the PBES that year.

Cambodia MSME plans to address these constraints by establishing and building a relationship with the Ministry of Interior to build support for the governors forum early in the year and taking advantage of any mechanisms for working with the Ministry of Interior already under way. By the time the event is held in late 2008 or early 2009, both The Asia Foundation and Cambodia MSME will have engaged extensively with governors and other provincial department leaders around the development of the PBES and economic profile and strategy. However, Cambodia MSME staff will continue to gauge the feasibility of this forum within the first few months of the expanded strategy and decide at that point if it is attainable in 2008.

D3. SET THE STAGE FOR PROVINCIAL INVESTOR ROADMAPS

Provinces face differing investment opportunities and avenues for economic growth. The most obvious cases are those of Siem Reap, which draws an enormous amount of tourism-related investment, and Sihanoukville, home to Cambodia's main port. However, other provinces may have opportunities based on their proximity to neighboring Vietnam and Thailand or their location along the Tonle Sap or Mekong Rivers. Still others are becoming known for a relatively better business environment that will be attractive to investors.

There are some efforts to capitalize on geographic and other strengths at the national level, such as the location of Special Economic Zones along the borders with Vietnam and Thailand, as well as in other areas of the country. However, a comprehensive roadmap for investors does not exist at the provincial level, and there is evidence that differences in legal and regulatory implementation across provinces have important implications for investment facilitation. Research conducted for the BEE strategy suggests that provincial investor roadmaps would serve several USAID goals in Cambodia, including improving transparency, increasing investment and sales, improving growth enablers, and improving growth of competitive firms.

During 2008, the Cambodia MSME project will work to build interest in provincial investor roadmaps, although the actual development of provincial investor roadmaps is a longer-term activity recommended for a future project. The project will raise the benefits of such a document with ministries, departments, and governors and coordinate with the Council for the Development of Cambodia, which already has a simplified national-level investor roadmap available on its website. This high degree of coordination to make business information available to the public is essential because the provincial investor roadmaps will be demand-driven.

D4. SUPPORT TO THE MOC'S NEW DEPARTMENT OF PROVINCIAL COORDINATION

The Ministry of Commerce is in the process of a complete institutional reorganization with assistance from the European Commission. Two new departments at the national level are being created that will be critical to WTO implementation, the Trade SWAp, and policy implementation in the provinces. The first is the Department of International Cooperation, which will work to coordinate donor assistance under the Trade SWAp and in the area of trade and investment facilitation; the second is the Department of

Provincial Coordination, which will be responsible for disseminating policy implementation guidelines and overseeing decentralized MoC functions.

A wide range of donor assistance is already planned for the Department of International Cooperation, but the MoC has requested USAID/Cambodia MSME project assistance to develop the capacity of the Department of Provincial Coordination to oversee and implement decentralized business environment regulatory processes including business registration and parts of trademark registration.

The MoC recently completed a first round of capacity development training for all of its provincial departments. As part of the Ministry's reorganization, it is now in the process of developing capacity development plans that will identify staffing needs, set provincial budgets, and match Ministry job descriptions with the actual skill sets of staff in the positions. A gap analysis will be conducted to identify and address gaps between actual skills of the MoC staff and the requirements of each position. Within the context of these broader capacity development efforts, the Cambodia MSME project will focus on supporting the decentralization of business registration, as well as information dissemination that most affects value chain implementation and economic development at the provincial level.

Under this expanded BEE strategy, the Cambodia MSME project will field a Senior Better Regulation Advisor from January through September 2008 to support the decentralization and related capacity development and information dissemination requirements of the MoC's new Department of Provincial Coordination. The consultant will work closely with counterparts in the Cambodia MSME project. By March 2008, the advisor and the MoC's new department will jointly develop a six-month workplan through the end of the Cambodia MSME project. This workplan will likely include adapting existing registration forms and procedures to the provinces, establishing a system for provinces to report on provincial registration, conducting training workshops for provincial staff in the new procedures, and possibly providing some legislative drafting assistance related to the prakas required to provide the implementing guidelines to Ministry staff on decentralized functions.

Through activity D5 below, the Better Regulation Advisor will also support Trade SWAp pillar 2, Products and Services, which will include trade facilitation assistance for priority value chains to MAFF and MIME. Ideally, counterpart departments or individuals with functions similar to the MoC's Department of Provincial Coordination will be identified and linked to the Trade SWAp interministerial pillar design team composition and plans for implementation. While the MoC will be key counterpart, the Better Regulation Advisor will be based with the Cambodia MSME project in order to provide support to other ministries as needed.

D5. SUPPORT SWAP PILLAR 2

In addition to assisting in regulatory decentralization, the Better Regulation Advisor will support the design and implementation of the Trade SWAp pillar 2, Products and Services. A design team is being set up for pillar 2 and will be composed of representative development partners active in value chain development and representatives from the MoC, MAFF, and MIME, as well as the private sector. The Better Regulation Advisor included in activity D4 will represent Cambodia MSME and USAID on the Trade SWAp design team. The Advisor will offer expertise in the BEE issues affecting value chain implementation, as well as better regulation and policy reform related to decentralized policy administration.

The members of the design teams (one team for each of the three pillars) and their scopes of work will be vetted and approved by the Sub-Steering Committee on Trade and Trade-Related Investment at a meeting to be held on January 21, 2008. The design process will then be undertaken through March 2008, and the design team will prioritize three to five products (value chains) and design a cross-ministerial action plan with donors supporting different pieces of one cohesive framework to trade facilitation and value chain development. Activities in other value chains will also be integrated into the pillar 2 design and resulting action plan. Once the pillar 2 action plan is finalized, the Cambodia MSME project and the Better Regulation Advisor can provide ongoing support and targeted assistance for the implementation of the action plan.

Two additional inputs will be integrated into the Cambodia MSME project's support to Trade SWAp pillar 2 implementation:

WTO WORKPLAN IMPLEMENTATION DIAGNOSTIC NEEDS ASSESSMENT

The updated WTO workplan completed by the MoC for its meeting with the U.S. Trade Representative in Siem Reap on November 21, 2007, as well as the SEA-CLIR report produced for USAID by Booz Allen Hamilton, provide excellent roadmaps for the work that remains for Cambodia to achieve compliance with WTO requirements. However, once WTO-related legislation has been passed at the national level, there has been little or no follow-up or tracking of actual implementation of the new regulatory regime.

As a starting point in addressing this issue, a senior trade expert (perhaps with assistance from a local law firm) will conduct a diagnostic needs assessment focused on the implementation status of WTO-related laws and regulations *that are already passed and in force*. The diagnostic will identify the specific supporting subdecrees and prakas that must be formulated and issued; the ministries and departments responsible for their implementation; next steps and what technical assistance would be needed to support WTO *implementation*, with special attention to decentralized implementation in the provinces; and the status of any current or completed donor support to policy implementation.

Once the comprehensive diagnostic on the status of WTO policy is completed, the Better Regulation Advisor will work with the MoC and other ministries to disseminate the findings. The Advisor will also present the diagnostic to the Trade SWAp pillar 2 design and implementation team. Interventions from the diagnostic that support the successful implementation of the value chain approach central to pillar 2 will be identified, prioritized, and integrated into the Trade SWAp implementation design.

VALUE CHAIN POLICY AGENDA

As detailed in activity D6 below, a value chain enabling environment policy agenda will be developed through a participatory approach with the development partners active in value chains in Cambodia. The Better Regulation Advisor will integrate the enabling environment policy priorities into the Trade SWAp design and implementation plan. With USAID approval, the Advisor and the Cambodia MSME project will then support the targeted implementation of key activities under Trade SWAp pillar 2 through September 2008.

D6. LEAD THE DEVELOPMENT OF A VALUE CHAIN POLICY AGENDA SHARED ACROSS VALUE CHAIN PROJECTS

Building on the USAID-funded value chain workshop held in September 2007, the Cambodia MSME project will lead the development of a policy agenda shared across value chain projects in-country. Through a participatory consultative process, and within the Trade SWAp pillar 2 framework, Cambodia MSME will lead the identification and coordination of cross-sectoral product strategies and BEE issues among the multiple development partners involved in value chain activities. Cambodia MSME can collect information on industry-specific BEE constraints and identify shared constraints across sectors and value chains, as well as increase communication among value chain implementers in order to maximize impact and achieve scale.

As a starting point, Cambodia MSME will hold a second value chain workshop focused on BEE issues. The workshop will deepen typical foreign project team leader involvement in such workshops by inviting the Cambodian field coordinators and implementers and holding the event in Khmer. As an expansion of the core project value chain work from the provincial to the national level, the value chain policy agenda initiative will be led by the Cambodia MSME project's Business Enabling Environment Field Activities Team Leader and the Value Chain Field Coordinator, both Cambodians.

The findings from the workshop and follow-up consultations can be incorporated into the Trade SWAp pillar 2 implementation strategy. Once finalized, the agenda can be forwarded as a shared value chain development policy reform agenda to the G-PSF, the G-PSF working groups, relevant line ministries, and the provincial authorities that are often on the front line of policy implementation.

An illustrative timeline showing each of the activities and tasks in the expanded BEE strategy for the Cambodia MSME project is shown in Figure 6.

FIGURE 6: EXPANDED BEE STRATEGY TIMELINE, 2008

Activity	January	February	March	April	May	June	July	August	September
D1. Pilot Provincial Economic Profiles and Trade and Investment Promotion Strategies									
Finalize design of economic profiles	=====								
Hire local consulting firms for the profile and survey administration	=====								
Design survey and gather secondary data		=====							
Implement surveys in four project-assisted provinces			=====						
Perform data analysis and complete profiles					=====				
Complete marketing piece for each of four provinces					=====				
Conduct economic development forum in one pilot province							■		
D2. Organize Provincial Economic Development Forums									
Plan and hold provincial pilot forum			=====				■		
Plan and hold 3 additional provincial forums if time and resources allow					=====		=====	■ ■ ■	
Build support and consensus for a national governors forum			=====						
Hold an annual governors forum								▶
D3. Develop Pilot Provincial Investor Roadmap (long-term implementation)									
Work with provincial/private sector leaders to determine interest in a provincial investor roadmap			=====						
Develop pilot provincial investor roadmap								▶
Launch provincial investor roadmap								▶
D4. Support the MoC's New Department of Provincial Coordination									
Identify consultant	=====								
Develop strategy and outcomes for support		=====							
Provide ongoing support			=====						
D5. Support SWAp Pillar 2: Products and Services									
Conduct implementation needs assessment of WTO work program	=====								
Set priority work program activities for SWAp pillar 2				=====					
Integrate value chain policy agenda priorities into SWAp pillar 2				=====					
Assist MoC and other ministries to implement priority work program					=====				
D6. Lead the Development of a Value Chain Policy Agenda Shared Across Value Chain Projects									
Lead value chain policy agenda workshop with DPs		=====							
Present value chain policy issues to G-PSF working groups			=====						
Coordinate policy reform activities among DPs				=====					

E. RECOMMENDATIONS FOR FUTURE SUPPORT TO IMPROVED BUSINESS ENABLING ENVIRONMENT

Each of the activities in the expanded BEE strategy is intended to lay the groundwork for future USAID support in this area or to pilot activities that could provide new platforms to engage the national government and provinces on policy reform related to increased trade and investment. This section provides broad-brush recommendations for future activities that would be natural next steps for USAID to build on work completed in the expanded BEE strategy.

E1. EXPAND ECONOMIC PROFILING AND TRADE AND INVESTMENT PROMOTION TO ALL PROVINCES

Reform agendas will be well served by obtaining up-to-date information on the status of economic indicators at the provincial level, tracking progress over time, and including economic data and analysis in the policy development and reform process. The provincial economic profile and investment promotion strategies that will gather and disseminate these data will initially cover the four project-assisted provinces, building information in areas where Cambodia MSME has already developed a constituency. It is recommended that future programming expand this initiative to include all provinces, leveraging the PBES, which will also be updated for all provinces in 2008 and again in 2010. This document has already begun to improve provincial awareness and, in this next year, may spark a measure of competition among provinces that will spur their interest in additional tools to improve their rankings.

The economic profiles will feed information to policy makers at the national level to improve the linkage between policy decisions and needs of citizens, as well as provide information at the provincial level that investors can understand and capitalize upon. Further, the profiles could provide a countrywide platform that stimulates public-private dialogue on policy reform priorities.

E2. HOLD A GOVERNORS FORUM AND FOLLOW UP ON RECOMMENDATIONS

The expanded BEE activities under the MSME project will set the stage for an annual governors forum. This forum will flow directly from the information gathered by the economic profiles and the PBES and over time, it is expected that support for this meeting will grow as leaders become increasingly involved in the economic performance of their provinces. Should the timeframe of Year 3 of the Cambodia MSME project prove too short to effectively develop the forum, the first forum would take place during future programming efforts.

In addition to supporting an annual governors forum, USAID should support follow-up on targeted recommendations developed at these meetings. USAID should work with the Ministry of Interior,

provincial governors, and relevant line ministry and department officials to fulfill requests to develop provincial investor roadmaps, as described in E3. Further, additional recommendations for cross-provincial coordination and provincial engagement in the trade agenda will be gathered. The policy agenda that develops could then be integrated into national-level frameworks and presented in forums such as the G-PSF and its working groups.

E3. DEVELOP A PROVINCIAL INVESTOR ROADMAP

The Cambodia MSME team recommends that a future USAID-funded program include the development of demand-driven provincial investor roadmaps. By clarifying and publishing information on official processes and procedures, these roadmaps will both dramatically increase transparency in the area of doing business and bring in additional investment. The roadmaps will also serve as another vehicle around which USAID can offer assistance through a joint value chain and policy reform program, working to further simplify and clarify procedures and responding to private sector requests for support.

Because of the highly transparent nature of the investor roadmaps, gaining support from provincial governors in tandem with national-level approval will be the primary challenge. The gradual work of building demand among provincial leaders will begin in Cambodia MSME's Year 3 and continue into a new program.

While the development of investor roadmaps will directly improve transparency, they will not contribute extensively to increased investment on their own. The varying levels of capacity among governors suggest that simply providing this tool without additional support will have a limited impact on growth. The governors—who must take ownership of the roadmaps—should receive training to effectively implement them, learning how to use these tools to market their provinces domestically and abroad, draw investment, and link policy implementation to economic growth.

E4. CONTINUE VALUE CHAIN WORK AND EXPAND NATIONALLY AS A PLATFORM FOR POLICY DIALOGUE AT ALL LEVELS

The Cambodia MSME project approach has proven highly effective in demonstrating the benefits of reform directly to beneficiaries, without subsidies, and to a much wider group of firms and people through its policy advocacy and work in fostering public-private dialogue. To maintain this positive momentum, it is highly recommended that the value chain demonstration work be continued in the long term to maintain USAID's leadership position in showing how bottom-up private sector development can improve the competitiveness of whole sectors of firms through the value chain approach and that this success can be leveraged for lasting policy reform and improvements in the BEE. Maintaining the value chain activities can further ensure that policy recommendations and activities are based on existing needs and can develop the support of Cambodians at all levels. For a long-term program, future value chain efforts could be expanded to more provinces to expand national reach and to strengthen relationships among and influence other value chain programs across the country by anchoring the work in Trade SWAp pillar 2.

Finally, because most Cambodian value chains are in the agricultural sector, end-market regulations and requirements such as sanitary and phytosanitary standards will become increasingly important. An expanded project component in this area could be added, working in conjunction with MAFF and other donors active in the agricultural sector such as AusAID. Activities could include supporting international

accreditation and certification initiatives, with links to other countries in the region such as Vietnam and Thailand.

E5. SUPPORT PRIORITIZED WTO IMPLEMENTATION ACTIVITIES

Based on the diagnostic assessment of WTO implementation needs conducted in activity D5, a long-term project could prioritize assistance to the government at the national and provincial levels to implement the reforms that have already passed. Any such work will need to be closely coordinated with other donors because many of the WTO-related regulatory reform efforts are already supported in some way. Of the reforms most needed, a few were mentioned repeatedly during the preparation of this strategy for the Cambodia MSME project: the corruption surrounding the high cost of obtaining a land title and the related constraint this puts on the ability of firms to access credit, as well as the difficulty in enforcing contracts through the existing judicial system. Specific areas for potential intervention in the area of legal and institutional reform, such as court system reform and the establishment of a commercial court under the MoC, may be explored by USAID as part of a longer-term project.