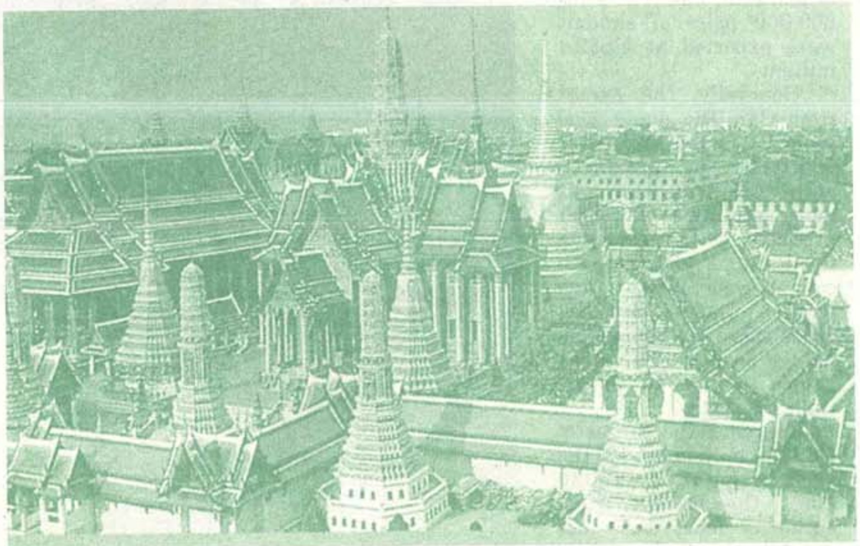
1. A competitive business climate



Better Business Climate in Cambodia for More Foreign Investment

by MEcon. LORS PINIT

Business climate involves many factors directly relevant to investment and business. An open and favorable climate will attract investors, thereby creating relations and affecting favorably development of the foreign sector. A good investment climate not only helps boost both local and foreign investment, but also taps domestic potentials.

In the keen competition of the globalized economy, constantly improving the business climate in order to attract more foreign investment has become a big worry for governments, especially in developing countries at their first stages of development and integration.

Cambodia is a purely-agricultural and poor country. Its domestic sources of capital couldn't meet the demand for investment of the economy. The international integration requires incessant increases in the investment, therefore, a good and healthy business climate will help mobilize both domestic and foreign sources of capital.

A favorable investment climate is a combination of various factors: geographical position, natural resources, legal and social infrastructure, political situation, and technical infrastructure as well. A favorable climate doesn't mean that it is competitive, because a country could build a favorable climate but it is still less favorable than ones found in other countries, therefore it becomes less competitive. That is, a competitive climate is the one that always become more favorable and attractive in comparison with ones offered by other countries.

Foreign experience shows that countries with better business climate always attract more foreign direct investment. Under current conditions of the global economy, the competition for foreign investment is keener and keener. A favorable business climate is not enough to make it more competitive in comparison with surrounding countries, because when one country improves its business climate, others also make a lot of changes. That is why the business climate must be improved incessantly.

In recent years, Cambodia has tried its best to improve its business climate:

- Allowing foreigners to own and run companies for at least 70 years.
- Cambodian nationals who control 51% of equity of a company could be granted land as requested.

- The corporate tax rate is fixed at 9% only, much lower than rates in neighboring countries. The sales tax could stay unchanged for at least eight years. Transfer of profit by foreign investors to their home countries is exempt from taxes.

2. How to improve the business climate in Cambodia

The flow of foreign investment to a country depends on various factors involving both investing and recipient countries.

Foreign investors want to find new markets and sources of raw materials, improve their business performance and make use of incentives offered by recipient countries. As for recipient countries, they are always in need of foreign investment, therefore they try their best to attract it by improving the business climate year after year.

Of factors of the business climate, the most important are: legal, financial, physical and technical infrastructure.

- Legal infrastructure: this infrastructure consists of the law system that provides a channel for the flow of foreign capital. This system includes laws and the bulk of subordinate legislature that regulate the realization of foreign investment, from fulfilling administrative procedures, making plans for the foreign sector, directing it towards prioritized zones and industries, and controlling the realization of foreign-invested projects. The law system is implemented by the administrative machinery organized according to regulations set by the law system. As for foreign investors, to ensure safety and efficiency for their investments, they always try to master the law system of the recipient countries.

A perfect legal infrastructure is an environment in which the law system is clear, stable, consistent and comprehensive that provides various incentives and encouragement for the foreign sector. The more detailed and transparent the law system is, the more favorable the business climate becomes. In other words, a complicated and inconsistent law system will discourage foreign investors.

- The physical environment includes natural and geographical factors that affect the foreign sector. Abundant natural resources and favorable geographical position are always important to investors' decision making process. Most multinationals have their headquarters situated in developed countries. That is why the natural resources there are exhausted. And they realized that producing goods with raw materials imported from other countries is less profitable than making overseas investment. In looking for sites for their investment projects, they always consider local natural resources and geographical position as decisive factors.

- The economic environment includes the average growth rate, inflation rate, stability of the domestic currency, development of the structure of industry, technical infrastructure, and macroeconomic policies. Reality shows that countries with open economic policies and incentive schemes for investment will attract more foreign capital than restrained economies do. In addition, well-developed technical infrastructure will facilitate transport of factor inputs and output and be taken into consideration by foreign investors although it is not the decisive reason for their decisions.

- Political and cultural environment: The political stability is the first consideration for investors to decide on their overseas projects because it ensures stable economic policies. The second consideration is the quality and organization of labor force, and cultural differences that could lead to obstacles to cooperation between local and foreign partners. Abundant and cheap labor is always a factor that attracts foreign investors. With recent technological advances, however, many investors started to consider other labor factors such as technical and managerial skills. That is why the competitiveness of a labor force is more and more dependent on the education system and general level of public knowledge, especially among the youth.

- Financial environment and tax system: A favorable financial environment includes a convertible domestic currency, modern banking services, existence of a capital market and effective mechanism for controlling the financial sector. Because this environment has close relations with the efficiency of the foreign sector, it becomes a decisive factor in attracting foreign investment and ensuring good performance for investment projects.

The tax system, convertibility of the domestic currency and government's control over macroeconomic matters will affect directly the performance of the foreign sector because they decide profitability of the projects. Foreign investors usually compare tax systems and financial policies of different countries before determining where to start their investment projects. In addition, operations of stock exchanges and banking system could hinder or smooth the performance of the foreign sector. As for recipient countries, their mechanisms for supervising the foreign sector could help limit unfair practices from foreign-invested companies.

In short, after considering factors affecting the flow of foreign investment in developing countries, including Cambodia, we could affirm that an open, healthy and transparent business climate is the decisive factor in attracting and improving the efficiency of foreign investment projects.■