Cambodia’s WTO Agreements: a Review of Legislative Commitments

One of the main reasons Cambodia joined the World Trade Organization (WTO) was to use its membership as a springboard for promoting a credible, open and fair business environment. In joining the WTO, the government of Cambodia promised to enact a total of 47 regulations and laws that, if properly enforced, would foster investment and accelerate economic growth.¹

The government agreed to a “Work Program” through which most of these laws would be completed by 2006; however, as of July 2006, only 19 laws and regulations have been adopted. The business community in Cambodia, particularly foreign companies, is paying close attention to whether or not the government delivers on these commitments. The slow pace at which the necessary laws have been developed could negatively impact Cambodia’s efforts to attract foreign investment, and therefore to provide some of the jobs required by the 230,000-plus entrants to the labor market each year.²


Even though many other business-related laws are part of Cambodia’s WTO commitments need to be enacted, this Bulletin highlights the seven laws listed above because their passage and proper implementation is likely to have the most immediate impact on the country’s private sector. Enactment of the first four laws in particular (Secured Transactions, Commercial Leasing, Issuance and Trade of Non-Government Securities, Insolvency) is expected to increase businesses’ access to finance, the lack of which is a key constraint to private sector growth. The passage and fair enforcement of the remaining three laws (Commercial Contracts, Competition and Commercial Court) can instill confidence in businesses and consumers about the economy and rule of law in the country. This can motivate existing businesses to expand and encourage potential entrepreneurs to start new ventures, which in turn can create new jobs, foster economic growth and reduce poverty. The importance of each law and its current status is described below.

The passage of these business laws will encourage private sector growth as they set out frameworks for more equitable business transactions. Their passage have been delayed for two main reasons. First, there has been a lack of cooperation between the legal experts contracted by development partners and the MOC legal team to help with drafting the various laws. Often the draft laws, which are given to the MOC in Khmer, are translated incorrectly by people who lack the appropriate legal expertise. As a result, the MOC legal team sometimes needs to rewrite the laws. Also, there was a year of political stagnation after the 2003 national election, so every law that was supposed to have been passed by Parliament had to be rescheduled.

In order to speed up the passage of the laws we need both human and financial resources. We are working on restructuring the MOC’s Legal Department so that it consists of staff who are qualified to work on drafting the various commercial laws. We also need financial support to increase the effectiveness of our work. I envision establishing a Center of Laws within the MOC so that our staff can conduct research and draft laws.

H.E. Mao Thora, Undersecretary of State, Ministry of Commerce

¹ Sok Hach (2003), WTO Accession for Cambodia: Opportunities and Challenges, Economic Review, Economic Institute of Cambodia, Page 3.
² Sok Hach (2005), Cambodia Economic Watch, page 34.
Secured Transactions Law

In economies where credit histories do not exist or are unreliable, a sensible course of action for lenders is to lend money only against collateral – i.e., land, houses, and movable assets.

Although financing secured against personal property is allowed under Cambodia’s Contract Law of 1988, the current legal system does not provide any method for registering movable assets. Consequently, the majority of Cambodian banks only accept fixed property as collateral. For many companies that have significant capital invested in movable assets, this limits their access to credit, which in turn hinders their ability to improve or expand their operations.

A Secured Transactions Law would establish a framework under which lending institutions could secure their loans against movable property. Specifically, it would provide for a system through which property could be registered, evaluated, and secured. It would also establish priority for secured lenders over property used as collateral. By minimizing the risks for lenders, borrowers’ opportunities to access credit would likely increase.

The Secured Transactions Law was scheduled for adoption by the National Assembly in February 2004. Its passage was rescheduled to 2005. At present, a draft of this law is being reviewed by the Second Commission of the National Assembly on Finance and Banking. It is not known when this draft law will be passed.

Commercial Leasing Law

The leasing of equipment and/or machinery was put into practice in the early 1950s; by 2005, it had become a world US$500 billion and accounts for approximately 20% of the world’s capital formation.\(^3\) The reason for the phenomenal growth in leasing over the past 50 years is clear. For small and medium sized companies, accessing sizeable, long term credit for the purchase of new equipment to expand their businesses is very difficult; it is even more so in Cambodia, where currently banks accept only fixed property as collateral.

Leasing will address this shortcoming because, in essence, it offers businesses the equivalent of long-term loans for equipment. A leasing company (the “lessor”) buys equipment and leases it to a business (the “lessee”) who uses the equipment in its operations. Depending on the nature of a lease contract, a lessee may have the right to buy the leased equipment at the conclusion of the lease agreement; alternatively, the lessor may be able to recover the equipment and sell it in a secondary market.

Currently Cambodia does not have a modern Commercial Leasing Law. Though leasing is allowed under the Banking Law of Cambodia, only banks are allowed to engage in leasing. The Commercial Leasing Law was slated to be passed in January 2005 and has since been rescheduled for 2006. This law has been drafted under the leadership of the National Bank of Cambodia, which plans to hold public hearings before sending it to the Council of Ministers for further discussion.

Access to finance, especially long-term finance, is a key to private sector development. But the private sector has limited access to long term finance as banks are reluctant to lend due to high risks. This deprives private enterprises of the funds they need to acquire equipment to expand their businesses. The Commercial Leasing Law that Cambodia is going to pass will address this issue.

It is slightly delayed because we have a big working group, and it takes a lot of time and coordination to ensure that the law is relevant to everyone.

H.E. Dr. Sum Sannisith, Secretary General, National Bank of Cambodia

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Law on the Issuance and Trade of Non-Government Securities

While the existence of the Secured Transactions and Leasing Laws can allow businesses to receive financing from institutions such as banks and leasing companies, the Law on Issuance and Trade of Non-Government Securities would set up the legal framework for enterprises to obtain capital directly from investors. Passage of this law, along with the establishment of effective capital markets, would enable Cambodian companies to raise funds by selling stocks and/or bonds to the public.

For a company, financing through the capital markets can yield a number of advantages over financing through banks. In the capital markets, a company is evaluated not only on its current business performance and on the current value of its assets, but also on its future earning prospects. Also, the capital markets offer companies access to a broader and larger source of funds, as anyone in the general public can purchase shares (i.e., make equity investments) in a company or lend a company money (e.g., through purchasing bonds) in the hopes of reaping returns on their investments. Moreover, a company can establish a stronger commercial presence and brand name when its stocks are traded publicly in the capital markets.

Cambodia currently does not have an Insolvency Law. Originally, under the government’s “Work Program” that followed WTO accession, this law was expected to come into effect in January 2004; that date was later revised to 2005. As of now, however, it is still in draft form and under discussion by the Council of Ministers at the Inter-Ministerial level. It is not known when this draft law will be passed.

Commercial Contracts Law

To foster trade, countries need sound contract laws and effective enforcement. The Cambodian Contract Law that is currently in effect dates back to 1988, when the country was under a socialist regime and followed economic principles based on central planning; it is therefore not in line with the needs of a market-oriented economy.

The passage of a Commercial Contracts Law that guarantees fair enforcement of the rights and duties of parties engaged in a contract could significantly impact the conduct of business. If businesses had confidence that the courts would honor and enforce contracts, entrepreneurs would more likely be willing to conduct business with people beyond their own circle of friends, family, and trusted partners. Such new opportunities could help them gain access to more markets, increase profits, and expand their businesses.

According to Cambodia’s legislative agenda under its WTO Agreement, the new Commercial Contracts Law was supposed to be passed by the National Assembly in February 2004. It was later rescheduled for passage in 2005. As of now, however, it has not yet been drafted. The Ministry of Commerce plans to start drafting this law sometime between 2008 and 2010.

Insolvency Law

Establishing a business through the official registration process is often considered complicated, costly and time consuming. Experience from other countries reveals that closing a business is no less of a cumbersome task. Bankruptcy proceedings can take as long as 10 years in Brazil and India and can cost as much as 76% of the value of a business estate in the Central African Republic and Lao PDR.4

Such long and costly procedures for closing businesses can affect a country’s economy in at least three different ways:

1. The total value of proceeds received by creditors, shareholders, employees, and other stakeholders in the businesses is diminished. For example, if it takes 10 years to close a business before the court decides that the company’s assets must be auctioned off to pay debts, the value of the assets will probably shrink over this period (e.g., due to depreciation and/or misappropriation). As a result, the overall monetary value generated from the liquidation of assets is likely to be much lower than if they were sold during the first year of bankruptcy proceedings.

2. The chances of rehabilitating viable businesses are hurt. In many cases, companies may have a good chance of operational success but find themselves financially distressed due to cash flow problems. In most advanced economies, bankruptcy proceedings allow a distressed company to continue operating while its business and finances are being restructured. From a social welfare perspective, it is more beneficial for society if a company going through hardship continues operating rather than closing down completely; a distressed company can still provide some jobs, whereas a dissolved company would employ no one.

3. Businesses’ access to finance is limited. Insolvency legislation ensures that secured lenders have a higher priority to claims against a company’s assets than other stakeholders. This is crucial because unless lenders feel confident about recouping their investments, they are unlikely to take on the risk of lending to potentially profitable businesses. For this reason, such legislation ultimately allows companies to have more access to finance.

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Establishing a Commercial Court would put commercial disputes fully under the complex nature of many commercial cases. Edge and understanding of business issues. Such a court could significantly improve the handling of commercial disputes. As companies become more confident that their commercial disputes will be dealt with fairly by judges who understand the complexities of business, they are likely to more willingly engage in business transactions that expand their operations and create more jobs.

However, competition must be fair. The passage and effective enforcement of a Competition Law would help to limit abuses of market, economic, or political power, such as price-fixing and the creation of monopolies by those with connections. Such a law would force companies to compete through means such as product differentiation, improved quality and lower prices, which would in turn translate into benefits for consumers and foster economic growth.

Commercial laws are important because they create conducive conditions for business. In addition to passing these laws, we need good and effective law enforcement to increase investor confidence. At present, some Cambodian businesses engage in somewhat monopolistic activities that hinder fair competition and hurt consumers. We do not have a sufficient basis for resolving these problems because we do not yet have a Competition Law.

The drafting and passage of these laws have been delayed for two reasons, in my opinion. First, the Ministries responsible for drafting the various laws lack legal expertise. Second, each Ministry tries to have its own interests incorporated or protected in the laws. To accelerate the passage of the draft laws, we need greater political will from the ministries who draft the laws, lawmakers, and those who implement them.

H.E. Ky Lum Ang, Chairperson of 9th Commission, National Assembly

Law Establishing a Commercial Court

It is well-known that resolving disputes through the Cambodian court system can be expensive and time-consuming. There are two main reasons for the slow speed of the courts – there are too few of them, and also, the number and the capacity of the judges and judicial staff are low.

There are a total of 130 judges working in 21 provincial/municipal courts and in the Court of Appeal and the Supreme Court (both in Phnom Penh). This is approximately equivalent to one judge for every 100,000 inhabitants. Compared to that of other post-conflict countries, this ratio is very low. Data for 2000 shows approximately 9 judges in Lebanon and 6 judges in Nicaragua, for every 100,000 inhabitants; both countries experienced years of civil war in the 1980s. In addition, many judges lack a strong knowledge of business issues and are therefore unable to understand fully the complex nature of many commercial cases.

Establishing a Commercial Court would put commercial cases under the jurisdiction of a single institution; this specialized court could be staffed by judges with a strong knowledge and understanding of business issues. Such a court could significantly improve the handling of commercial disputes. As companies become more confident that their commercial disputes will be dealt with fairly by judges who understand the complexities of business, they are likely to more willingly engage in business transactions that expand their operations and create more jobs.

By providing loans to private enterprises, banks play an important role in fostering economic growth. The banking industry can fulfill this role more meaningfully if the legal and judicial frameworks in Cambodia protect the interests of lenders. Banks, however, are not sure that they can recover their loans because they are not confident that the courts can effectively enforce contracts. Business laws that are being developed are crucial to the banking industry because they will instill more confidence in dispute resolution.

However, it is more important that these laws are implemented properly. The court plays a critical role in law enforcement, especially in enforcing contracts. The court should be transparent when resolving disputes that result from breaches of contracts.

Mr. Andy Kun, Chairperson of the Association of Banks in Cambodia

Conclusion

Cambodia is clearly behind on the legislative commitments it made when joining WTO. Policy and legal reform is a daunting process that requires time, significant human resources and political will from all of the government institutions involved and affected. As prolonged wars have significantly deprived Cambodia of human capital, the delay in reforming and adopting these complex pieces of legislation is understandable.

Notwithstanding these delays, as a key stakeholder in this process, the business community has continuously requested that the government provide it with regular updates on the status of each law. With such information, its members can not only provide the government with useful inputs and feedback on legislation, but also ensure that they comply properly with the laws.

The Cambodian government promised its citizens and the world that it would take on the challenges of economic integration and turn them into opportunities. Passing and enforcing key laws that improve the business environment and facilitate the growth of private enterprises is a necessary step. Speedy adoption and fair implementation of these laws can unleash capital and promote entrepreneurial activities that, in turn, stimulate economic growth and create jobs for thousands of Cambodians.