

July 2006

## Assessment of Corruption in Cambodia's Private Sector

The private sector is the engine for economic growth, and plays a major role in creating employment for new entrants into the labor force. To promote the private sector, a conducive and enabling environment is needed. Currently, the Cambodian private sector encounters various constraints. Corruption is one of the private sector's major constraints.

To promote the private sector, the problem of corruption needs to be successfully tackled. To contribute to curbing corruption in the private sector, the Economic Institute of Cambodia with the support of USAID, Pact, and PADCO/AECOM conducted a study on corruption assessment in the private sector (CAPS).

This policy brief is a summary of the above CAPS study. The study uses a wide range of methodologies that include: literature review, quantitative and qualitative surveys, modeling system to assess the impact of corruption on the private sector, and an advisory team. In April 2006, the study was conducted with a sample of about 1,200 enterprises in nine major municipalities and provinces of Cambodia. Furthermore, a total of 20 focus group discussions (FGDs) of micro, small and medium enterprises (MSMEs) as well as personal interviews with public officials were conducted.

With the aim to raise the private sector's awareness of corruption,

this policy brief will shed light on the nature, causes and extent of corruption. It will also provide a set of practical recommendations on how to reduce corruption in the private sector.

### Nature of Corruption

Corruption may happen anywhere and at any time. In the private sector, corruption often arises during inspections by public officials. In Cambodia, there are no clear inspection policies regarding the number, time and purpose of inspections. In general, inspections are just pretexts to ask for money by different agencies. Small and medium size businesses face several kinds of inspections for their day-to-day operations.

The most frequent public institutions that inspect enterprises include tax authorities, police, local authorities, fire & building safety, environment, standard inspection, labor and social security, etc. Tax inspections appear to be the most frequent because it is part of the Tax Department's obligations to ensure that enterprises declare their tax obligations correctly. The proportion of enterprises inspected by other agencies increases with the size of the enterprise.

Inspections by public officials raise some gender issues as well. Normally, women-headed households who run businesses face more burden-

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some inspections by public officials. Therefore, they need to pay more unofficial fees to maintain good relations with the authorities. These women often lack education and information regarding business regulations and law, and end up paying more unofficial fees. In addition, women are at risk of being verbally and sexually harassed by public officials during the course of inspections.

Inspections and unofficial fees are a burden on the private sector. Yet, micro-enterprises tend to consider this a rather small problem, since they often know in advance the amount that they have to pay for inspections. This is because paying unofficial fees is part of the everyday life of micro-entrepreneurs. However, SMEs and large enterprises are less likely to know in advance the amount of unofficial payments. This is because SMEs and large enterprises have more complicated businesses. Therefore, the amount of unofficial fees for SMEs and large enterprises is on a case-by-case basis.

The process of acquiring unofficial fees varies according to the type of business. In general, public officials come to the enterprise's premises and demand bribes. But there are also cases where enterprises contact public officials directly or bribe public officials through middlemen. Contacting public officials and the use of middlemen is more frequent among more formal enterprises, particularly SMEs and large enterprises. When enterprises are more formal, they face more bureaucracy. To receive efficient and rapid public services, the use of middlemen and directly contacting public officials becomes a necessity. In general, once the unofficial fees are paid, enterprises receive efficient services from public officials.

### Causes of Corruption

Both the private sector and public officials have various views

on why corruption occurs. Entrepreneurs offer diverse reasons why they pay unofficial fees to public officials. In general, micro-enterprises pay unofficial fees to maintain good relations. SMEs and large enterprises pay unofficial fees primarily to receive public services and secondly to maintain good relations with public officials.

The private sector believes that there are five main causes of corruption: 'Low salary of public officials', 'lack of an effective anti-corruption mechanism', 'culture of corruption', 'lack of an independent & effective judiciary', and 'poor law enforcement'.

Public officials also agree with the reasons raised by the private sector. However, public officials highlighted their 'small salaries' as the primary cause for them to solicit bribes.

### Extent of Corruption

Overall, unofficial payments in Cambodia's private sector are relatively high. This varies across provinces, depending on the local public administration with which businesses deal with and the specific economic activities of each area.

For small individual firms, unofficial payments are not so serious because they can afford it. If an enter-

prise is more formal, then unofficial fees become more serious. Manufacturing enterprises seem to pay more unofficial fees since they need to deal with different public officials for different production stages.

On average, the private sector pays unofficial fees of about 2.8 percent of their total annual turnover, amounting to US\$330 million in 2005. This amount does not include unofficial fees paid by import-export companies to custom officers, port and other public officials during goods clearance, nor by companies who have received government contracts.

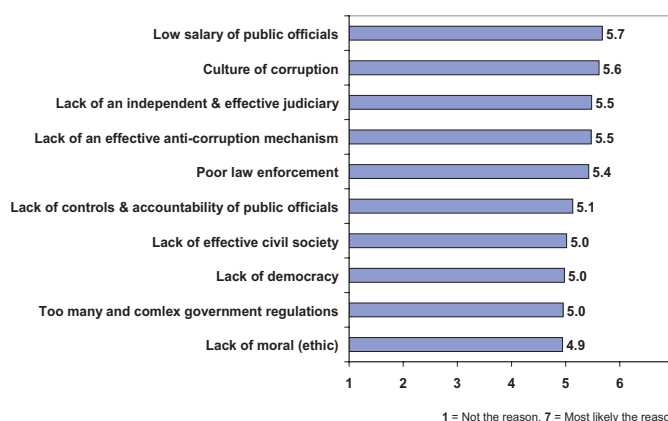
More specifically, micro-enterprises, SMEs and large enterprises pay unofficial fees of about 1.8 percent, 2.5 percent, and 4.1 percent of their annual sale, respectively.

The figures above suggest that the extent of corruption in the private sector seems to have been significantly reduced compared to the World Bank survey undertaken in 2004, which put unofficial fees at about 5 to 7 percent of sale.

### Impact on the National Budget

Even though the amount of corruption in the private sector is perceived to be reduced in percentage, compared to previous years, the total amount of money lost to cor-

#### Perception of SMEs on Reasons for Unofficial Fees



Source: EIC, CAPS Survey, April 2006

ruption is still high. Unofficial fees paid by the private sector reach US\$330 million. This amount represented about 50 percent of the total Government budget revenue in 2005, or about 6 percent of GDP.

The high level of unofficial fees seems to have an impact on the effectiveness of tax collection. The official tax rate on the private sector is much higher than the effective rate actually paid. In spite of the significant progress in collecting domestic tax revenue made by the Tax Department, only about 25 percent of the potential tax was collected from the private sector in 2005. The potential loss in government revenue could reach US\$400 million.

The private sector thus benefits from not fully paying tax, even though businesses have to pay different types of unofficial fees to various public officials. This is a likely consequence from the perceived complex and non-transparent tax system currently in place in Cambodia.

### How to Curb Corruption?

Curbing corruption is difficult, but possible. According to the entrepreneurs and government officials interviewed, there is no absolute way to curb corruption. Different strategies and action plans should be enforced in tandem to reduce corruption as much as possible. This policy brief attempts to offer various useful recommendations provided by the private sector and public officials.

#### *Adopting a 'Good' Anti-corruption Legislation*

Presently, Cambodia still does not have an anti-corruption law. The enactment of an anti-corruption legislation is needed. The Government has failed in its commitment to adopt the anti-corruption law by the end of June 2006 as pledged during the 8th Consultative Group meeting between donors and the Govern-

ment in March 2006.

There is also controversy over the draft law's compliance with international standards. These issues concern the operational independence and autonomous budget of the anti-corruption secretariat and the adequate independence of an investigation authority. The draft law also fails to allow the Secretary General of the Anti-corruption Council to access asset declarations - including those of officials' spouses and children - during investigations. The draft law also lacks provisions regarding the confidentiality to protect victims and witnesses and special penalties for breaking confidentiality.

In order to fight corruption in the private sector, the very first step to take is to adopt a 'good' anti-corruption law. The Government has revealed its strong will in the fight against corruption through various government policies. To make this will a reality, efforts should be to adopt a high standard anti-corruption law so that Cambodia has a strong and reliable legal basis to combat corruption.

#### *Effective Enforcement of Anti-corruption Legislation*

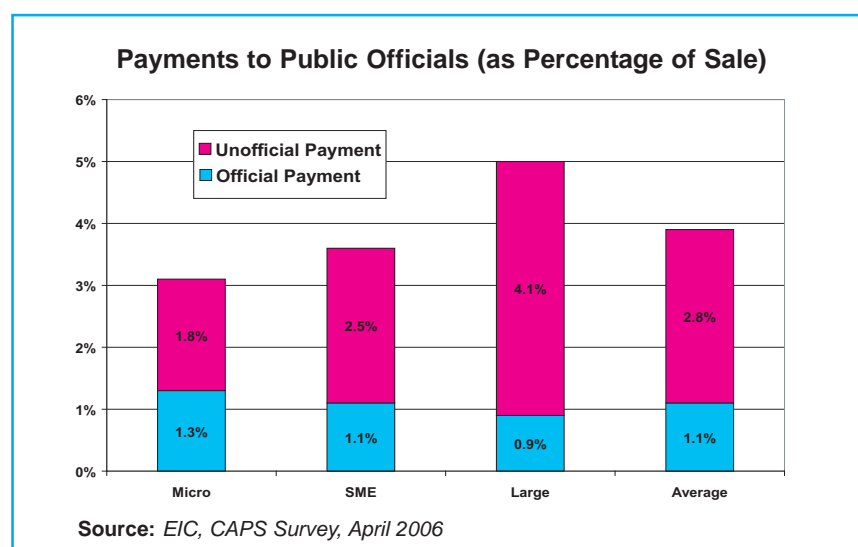
The adopted anti-corruption law should not only be on paper. In addition, the enforcement of the law

should equally be applied regardless of who and what the person does. Anti-corruption campaigns should be top-down rather than bottom up.

#### *Raising Salaries of Civil Servants*

To effectively enforce the anti-corruption law the issues of the public officials' salaries must be considered. Without an adequate salary, civil servants cannot survive and are thus corrupt and solicit bribes from the private sector. If salaries were high enough to meet the basic needs of public officials, who are involved in petty corruption for survival, their corrupt behavior would be drastically curbed. Therefore, increasing the salaries of public officials can be an effective way to reduce corruption.

In order to increase salaries one must define how much is considered 'enough' for public officials. Ordinary public officials surveyed by EIC in the provinces believe that a salary between US\$100 to US\$150 per month is enough for them to survive and meet their basic family needs. The Government has pledged, in its Rectangular Strategy, to raise the salary of civil servants by 10 to 15 percent to improve their living standards to an appropriate and dignified level. The gradual raise of civil servants' salaries has been put



into action, but there are still complaints that these increased salaries are inadequate.

It is important to note that research in other countries has shown that raising salaries alone without other reforms does not automatically reduce corruption.

### *Promoting Good Governance and Ethics*

Good governance plays a very important role in curbing corruption. Having a 'One-window-service' also reduces corruption by speeding up the public administration process.

More importantly, regulations, procedures and information concerning business should be simple, easy for the private sector to comply with and accessible to entrepreneurs at a low cost. All official business fees should be published and disseminated.

An additional measure to strengthen good governance is the rotation of public officials. Doing this will prevent public officials from strengthening their network and creating channels of corruption.

Moreover, strict control and monitoring of subordinates by high ranking officials is necessary. Officials in high positions should have a clear policy, strong direction and control over their subordinates and should be held accountable.

It is equally important to promote efficiency of the public administration by ensuring the fair recruitment and promotion of public officials. The capacity of public officials should be strengthened to perform their duties effectively. Doing all this is important to dispense with networking and the patronage system.

Public administration needs to provide a system that allows citizens to report corruption. A complaint should be confidential and reporters should be protected. Citizens' complaints should be acted upon seriously. This would create an

incentive for them to report corruption in the future.

Last but not least, ethics are an important tool for everybody to be honest. Ethics should be promoted and strengthened through education. The private sector and public officials should be taught honesty, to have patriotic wisdom, a nationalistic spirit and national conscience.

### *Participating in the Fight against Corruption by the Private Sector*

The private sector could take part in the fight against corruption in two different ways. First, the private sector itself needs to be honest. Every single member of the private sector should refrain from bribing public officials.

Second, the private sector can form or participate in counter-corruption communities and associations. A business, acting as a single voice, does not have the required strength to effectively influence public authorities to consider either problems or interests. Associations are more effective in voicing concerns to policymakers.

These associations will be successful with the full support of the Government. A conducive environment is needed, where they can freely exercise their rights to bargain and associate without fear.

## Concluding Remarks

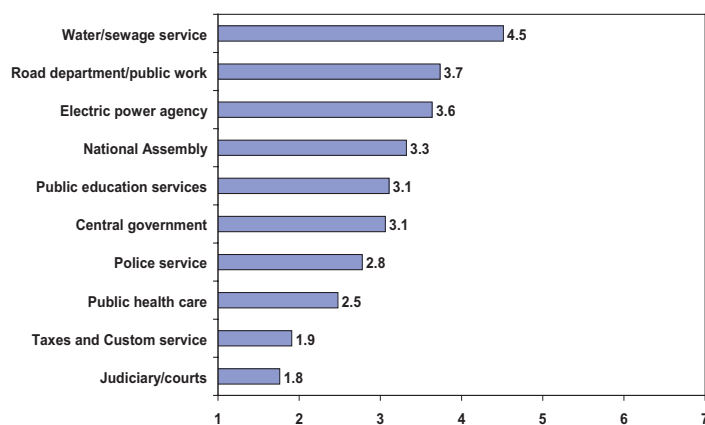
Corruption in Cambodia's private sector is complicated in nature. Both businesses and public officials are involved in corruption which is imbedded within the country due to the system of patronage and networking.

Although the extent of corruption in the private sector seems to be reduced, compared with the World Bank assessment in 2004, its extent actually remains high. To curb corruption, the reasons behind corruption must be addressed.

If corruption in the private sector were to be dispensed with, the amount lost to unofficial fees could be used in a more productive way. This amount (US\$330 million in 2005) could be more than enough to raise the salaries of civil servants to a decent level of US\$100 to US\$150 per month. Corruption in the private sector can be reduced in tandem with efficient public administration.

More interestingly, partly due to corruption, the Government collects only about 25 percent of the total estimated potential tax revenue. The Government's efforts to collect more tax revenue should concentrate on simplifying the tax system and improving transparency in tax collection.

### Honesty and Integrity of Officials in Public Services



Source: EIC, CAPS Survey, April 2006

1 = Not honest at all, 7 = Very honest